DON'T JUST CHECK "YES" OR "NO": THE NEED FOR BROADER CONSIDERATION OF OUTSIDE INVESTMENT IN THE LAW

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This Note analyzes the controversial issue of outside investment in law firms. Motivated by concerns of promoting professionalism and independent judgment within the legal community, the ABA Model Rules of Professional Conduct currently prohibit nonlawyer investment, effectively preserving the traditional partnership model of ownership. As increasing competition, explosive global growth, and technological advances have challenged the demand for client-driven relationships in the delivery of legal services, and in light of recent legislation in Australia and the United Kingdom allowing outside investment in law firms, the author determines that the time has come to take another look at the prohibition in the United States.

Recognizing that outside investment has potential benefits and consequences, this Note argues that determining whether to allow outside investment is more than a simple "yes" or "no" question. To this end, the author analyzes five investment models, which represent the spectrum of possible vehicles. The first is the traditional ownership model, illustrated by publicly traded Australian law firm Slater & Gordon. A second possibility is a holding company, which the Note explores through the experiences of another Australian firm, Integrated Legal Holdings Limited. More moderate proposals include a minority ownership model and the creation of a legally related derivative security. Finally, the Note considers an alternative to outside investment in law firms—outside investment in individual lawsuits. Against the backdrop of these different models, the author urges the legal community to embrace a broader perspective in further investigating and evaluating the opportunities of outside capital. The author concludes by recommending that the ABA commission an independent study to analyze whether and, if so, how to modify the Model Rules to capture the benefit of outside investment while minimizing ethical concerns.

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I. INTRODUCTION

Lawyers have always worked in sole proprietorship or partnership structures with no outside investment.[1] Academics and practitioners alike, however, have debated the idea of nonlawyer investment in law firms. In the United States, the ABA Model Rules of Professional Conduct (Model Rules) prohibit nonlawyer investment in, or ownership of, law firms.[2] The Model Rules indicate that the underlying purpose of these prohibitions is to "protect the lawyer's professional independence of judgment."[3] Despite attempts[4] and arguments[5] to modify the Model Rules to allow for nonlawyer investment, the restrictions have prevailed.

Changes in the legal profession as well as changes in international investment in the law, however, have rekindled the debate. The legal profession today is much more competitive for both clients and attorneys, and law firms increasingly resemble conventional businesses.[6] Global growth and technology have significantly impacted the delivery of legal services. Internationally, Australia and the United Kingdom now allow for nonlawyer equity ownership in law firms.[7] In May 2007, Australian firm Slater & Gordon, Ltd. (Slater) became the world's first publicly traded law firm.[8] In light of these changes, outside investment in the law deserves further consideration in the United States.

The majority of the outside investment debate centers around the ethical implications of allowing nonlegal investment and ownership, including the impact on lawyers' judgment and the loss of professionalism.[9]

1. S. S. Samuelson, *The Organizational Structure of Law Firms: Lessons from Management Theory*, 51 OHIO ST. L.J. 645, 650 (1990).

2. MODEL RULES OF PROF'L CONDUCT R. 5.4 (2008).

3. *Id.* R. 5.4 cmt. 1.

4. *See infra* notes 16–18 and accompanying text.

5. *See, e.g.*, 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, 1–3 (1998); Thomas R. Andrews, *Nonlawyers in the Business of Law: Does the One Who Has the Gold Really Make the Rules?*, 40 HASTINGS L.J. 577, 578–79 (1989); Bernard Sharfman, Note, *Modifying Model Rule 5.4 to Allow for Minority Ownership of Law Firms by Nonlawyers*, 13 GEO. J. LEGAL ETHICS 477, 479–80 (2000).

6. Bruce MacEwen, Milton C. Regan, Jr. & Larry Ribstein, *Law Firms, Ethics, and Equity Capital*, 21 GEO. J. LEGAL ETHICS 61, 62 (2008); *see also* Marc Galanter & William Henderson, *The Elastic Tournament: A Second Transformation of the Big Law Firm*, 60 STAN. L. REV. 1867, 1910 (2008); SEAN WILLIAMS & DAVID NERSESSIAN, OVERVIEW OF THE PROFESSIONAL SERVICES INDUSTRY AND THE LEGAL PROFESSION 7–8, http://www.law.harvard.edu/programs/plp/pdf/Industry_Report_2007.pdf.

7. *See infra* Part II.B.2.

8. Martha Neil, *1st Birthday of 1st Publicly Owned Law Firm, Slater & Gordon*, A.B.A. J., May 21, 2008, http://abajournal.com/news/1st_birthday_of_1st_publicly_owned_law_firm_slater_gordon/; Slater & Gordon Ltd., History, http://www.slatergordon.com.au/pages/history.aspx (last visited Dec. 15, 2009).

9. *See infra* Part II.A. Much of the debate focuses on nonlawyer ownership. As Parts III.D and III.E illustrate, however, outside investment is possible without necessarily having direct ownership of the law firm. Further, this Note discusses only nonlawyer ownership and investment in the context of nonlawyers who do not participate in the business of serving clients (i.e., not a multidisciplinary firm). Nonlawyer investors or owners who participate in client service raise the additional concern of nonlawyers providing legal advice. *See* Paul R. Koppel, *Under Siege from Within and Without: Why Model*

Many in the legal community respond to the outside ownership question with a strong "yes or no" answer.[10] But even first year law students quickly learn that rarely is any answer purely black and white and even then, rarely is there one "right" answer. Further, those who respond with a quick "No!" often equate nonlawyer investment with the outer extremes; for example, they argue that allowing outside investment in law firms will lead to large retail institutions like Sears selling legal services next to the washing machines.[11] Using the idea that there is a spectrum of possibilities for allowing outside investment—from complete prohibition to complete investment freedom—this Note takes a closer look at potential investment models and how these models respond to the arguments for and against allowing such investment.[12]

Part II of this Note provides an overview of the current Model Rule 5.4, its restrictions on nonlawyer investment, and the arguments offered for and against allowing such investment. It also discusses current changes in both the legal profession and international law and explains why these changes are important to the outside investment debate domestically. Part III analyzes potential investment models along the spectrum of outside investment in the legal industry. The traditional ownership model and the holding company model are based on the structures of the two publicly traded law firms in Australia. More moderate proposals from the legal community include a minority ownership model and the creation of a legally related derivative security. Finally, this Note considers a proposed alternative to outside investment in law firms—outside investment in lawsuits. Based on the analysis of potential investment models, Part IV recommends that legal professionals and, in particular, the ABA reconsider the broad opportunities that public investment in the legal industry could provide. With Australia and the United Kingdom providing examples of direct ownership models and regulatory structures, the U.S. legal community, led by the ABA, can more closely analyze how to address the ethical concerns of nonlawyer investment while maximizing the benefit of such outside capital. No one

Rule 5.4 Is Vital to the Continued Existence of the American Legal Profession, 14 GEO. J. LEGAL ETHICS 687, 703 (2001) ("It is also entirely possible that non-lawyer partners in [multidisciplinary practices] will inadvertently give legal advice to clients in violation of the *Model Rules*.").

10. *See* Susan Gilbert & Larry Lempert, *The Nonlawyer Partner: Moderate Proposals Deserve a Chance*, 2 GEO. J. LEGAL ETHICS 383, 409 (1988).

11. *See* Adams & Matheson, *supra* note 5, at 3 n.9; Sharfman, *supra* note 5, at 481–82; *see also infra* notes 41–44 and accompanying text. Similarly, the new regulations in the United Kingdom have been called the "Tesco reforms," referring to a large U.K. supermarket chain. Steven Mark & Tahlia Gordon, *Innovations in Regulation—Responding to a Changing Legal Services Market*, 22 GEO. J. LEGAL ETHICS 501, 519 (2009) (internal quotation marks omitted).

12. This Note expands on Susan Gilbert and Larry Lempert's suggestion that we consider the spectrum of options possible with nonlawyer investment. *See* Gilbert & Lempert, *supra* note 10, at 409 ("Whether to allow lawyer-nonlawyer ventures is not a simple yes or no question. Rather, jurisdictions willing to give this issue the consideration it deserves would be well advised to consider the spectrum of possibilities.").

knows what the optimal investment or ownership models would be for U.S. firms, but the very concept that firms could develop models that best meet their needs deserves broader consideration.

II. BACKGROUND

The outside investment debate in the United States begins with Model Rule 5.4. The rule states that "[a] lawyer or law firm shall not share legal fees with a nonlawyer" and "shall not form a partnership with a nonlawyer if any of the activities of the partnership consist of the practice of law."[13] Further, "[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 nonlawyer owns any interest therein" or "a nonlawyer is a corporate director or officer."[14] The comments to Model Rule 5.4 indicate that these restrictions on fee sharing and third party investment serve to limit potential interference with lawyers' professional judgment.[15] In 1981, the ABA Commission on Evaluation of Professional Standards, known as the Kutak Commission, proposed changes to allow nonlawyer investment under certain conditions,[16] but this proposal was ultimately rejected by the House of Delegates.[17] Thus Model Rule 5.4 remained unchanged in its prohibition of outside investment,[18] and the debate on nonlawyer outside investment has continued.

13. MODEL RULES OF PROF'L CONDUCT R. 5.4(a), (b) (2008).

14. *Id.* R. 5.4(d)(1), (d)(2).

15. *Id.* R. 5.4 cmt. 1.

16. The restrictions proposed were:

(a) there is no interference with the lawyer's independence of professional judgment or with the client-lawyer relationship;

(b) information relating to representation of a client is protected as required by Rule 1.6;

(c) the organization does not engage in advertising or personal contact with prospective clients if a lawyer employed by the organization would be prohibited from doing so by Rule 7.2 or Rule 7.3; and

(d) the arrangement does not result in charging a fee that violates Rule 1.5.

ABA CTR. FOR PROF'L. RESPONSIBILITY, A LEGISLATIVE HISTORY: THE DEVELOPMENT OF THE ABA MODEL RULES OF PROFESSIONAL CONDUCT, 1982–2005, at 580 (2006).

17. Andrews, *supra* note 5, at 595–96. Professor Andrews provides a helpful history of the ethical restrictions on nonlegal ownership and Model Rule 5.4. *See id*. at 579–99.

18. Actual authority over the ethical rules rests with the state court systems and legislatures. *Id.* at 596. States, however, have almost uniformly adopted the Model Rules, and therefore they are extremely influential in ethics regulation. *Id.* at 596–97. The District of Columbia is a notable exception because its rules allow a nonlawyer to hold a financial interest or exercise managerial authority if the nonlawyer is "perform[ing] professional services which assist the organization in providing legal services to clients." D.C. RULES OF PROF'L CONDUCT R. 5.4(b) (2007). The rules allow for "collaborative services" but do not permit any ownership of a law practice for "investment or other purposes." *Id.* R. 5.4 cmts. 4, 8.

A. The Outside Investment Debate

The outside investment debate has traditionally focused on the ethical implications of allowing outside investment in the legal profession. Critics of outside investment are fearful of the potential negative effects, including the loss of independent judgment, the effect on client confidentiality, and the loss of professionalism. Proponents of outside investment, on the other hand, dispute that outside investment will lead to greater ethical dilemmas than those that already exist in the modern law firm. Proponents focus on the benefits outside capital could provide firms, including encouraging capital investment in intangibles, promoting the collective interest of the firm, and easing the pressures of the current alternative financing. Critics counter that the outside capital will be used merely to cash out partners' interests and question whether investors would actually invest in a law firm. This Section further explains the arguments against outside investment, as well as the potential benefits of allowing such investment.

1. Arguments Against Outside Investment in the Law

Critics of outside investment argue that breaking the traditional barrier against nonlawyer investment will lead to a flood of undesirable results. Among the most cited reasons are the loss of independent judgment, the effect on client confidentiality, and the loss of professionalism.

Critics concerned about the loss of independent judgment fear that nonlawyer investment will influence attorneys' client decisions.[19] Loss of independent judgment specifically underlies the Model Rules' prohibition on nonlawyer investment.[20] Critics argue that nonlawyer owners are not subject to, and would not understand, attorneys' ethical obligations[21] and that lawyers will try to "practice to the share price" instead of to the client's needs.[22] Proponents of outside investment counterargue that the interests of nonlawyer owners are no more powerful than the current interests of equity partners who receive 100% of profits at each year-end.[23] Further, proponents argue that practicing to a share price is not a prob-

19. Andrews, *supra* note 5, at 600.

20. MODEL RULES OF PROF'L CONDUCT R. 5.4 cmt. 1.

21. *See* Cindy Alberts Carson, *Under New Mismanagement: The Problem of Non-Lawyer Equity Partnership in Law Firms*, 7 GEO. J. LEGAL ETHICS 593, 612 (1994). There are other remedies against nonlawyers who have comparable duties. Andrews, *supra* note 5, at 600, 603–04. Critics, however, discount the adequacy of these enforcement devices. *See* Carson, *supra*, at 613–15.

22. MacEwen, Regan & Ribstein, *supra* note 6, at 63, 70; *see also* Andrews, *supra* note 5, at 600–01; L. Harold Levinson, *Independent Law Firms that Practice Law Only: Society's Need, the Legal Profession's Responsibility*, 51 OHIO ST. L.J. 229, 248 (1990).

23. Larry E. Ribstein, *Want to Own a Law Firm?*, AMERICAN, May 30, 2007, http://www.american.com/archive/2007/may-0507/want-to-own-a-law-firm [hereinafter Ribstein, *Want to Own a Law Firm?*]; *see also* Andrews, *supra* note 5, at 602.

lem in conventional corporations[24] and that putting other interests above the client would be economic suicide for a law firm in the long run.[25]

Critics also argue that nonlawyer investment will negatively affect client confidentiality and the attorney-client privilege. Nonlawyer involvement in client matters is currently dealt with under existing professional and ethics rules as well as agency duties.[26] Critics, however, distinguish nonlawyer employees from nonlawyer owners under Model Rule 5.1, which addresses the responsibilities of partners and other supervisory lawyers.[27] Public investment presents additional client confidentiality issues because of securities disclosure requirements. The disclosure requirements would have to be reconciled with confidentiality obligations to clients.[28] Compliance with securities regulations, however, could be cost prohibitive.[29]

Finally, critics fear that nonlawyer investment will lead to a loss of professionalism and the profession's social responsibility. Traditionally, the law has been thought of as a profession, not a business.[30] Other professional service industries have evolved to include both private and public company investment, while law has remained in the traditional partnership model.[31] Critics of outside investment argue that "the public perception of lawyers will decrease if law firms go public because society will see lawyers as just another group of businessmen and businesswomen who want to make as much money as possible."[32] Any already negative public views of law firms would be only further cemented by public

24. MacEwen, Regan & Ribstein, *supra* note 6, at 90. *See generally* Larry E. Ribstein, *Accountability and Responsibility in Corporate Governance*, 81 NOTRE DAME L. REV. 1431 (2006) [hereinafter Ribstein, *Accountability*].

25. MacEwen, Regan & Ribstein, *supra* note 6, at 70; Bruce MacEwen, A Talk with Andrew Grech, Managing Partner of the World's First Publicly Traded Law Firm 2 (August 2007), http://www.bmacewen.com/blog/pdf/ConversationWithAndrewGrech2007August.pdf ("From the firm's perspective, 'there was no uncertainty for us as lawyers which came first [clients or investors], but we needed to convince institutional investors that their best long-run interest would be served if we continued to put clients first.'" (alteration in original) (quoting Slater Managing Director Andrew Grech)); *see also* Ribstein, *Accountability*, *supra* note 24, at 1444, 1459.

26. Andrews, *supra* note 5, at 614–16.

27. *See* Carson, *supra* note 21, at 621–22 ("If a temporary lawyer or non-lawyer employee violates a client confidence, the employing lawyer will be held to be responsible as well. However, the same degree of oversight is not required with regard to partners." (footnotes omitted)); *see also* MODEL RULES OF PROF'L CONDUCT R. 5.1 (2008).

28. Ribstein, *Want to Own a Law Firm?*, *supra* note 23.

29. *See* 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, 337, 345 (2008).

30. *See, e.g.*, State *ex rel.* Fla. Bar v. Murrell, 74 So. 2d 221, 226 (Fla. 1954) ("[L]aw is not a business,—it is a profession, a noble one, with standards in certain respects different from those applicable to business . . . .").

31. Laura Empson, *Surviving and Thriving in a Changing World: The Special Nature of Partnership*, *in* MANAGING THE MODERN LAW FIRM: NEW CHALLENGES, NEW PERSPECTIVES 11, 11–12 (Laura Empson ed., 2007). The consulting and accounting industries both have firms with public ownership. *Id.* at 11.

32. *See* DeBuse, *supra* note 29, at 345.

investment.[33] Proponents of change argue that law firms cannot deny that firms are becoming just like any other business[34] and that regulatory transparency will benefit the law profession, which is traditionally self-regulated.[35]

Law is unique, however, in that "lawyers help make 'law' in their work" and are therefore thought to engage in the production of both private and public goods.[36] The other side of the "practicing to the share price" concern is that lawyers will become too attentive to their clients' interests and will seek to improve profits and share price at the expense of their duties to the court and the public.[37]

Critics also argue that "practicing to the share price" would result in a decrease in pro bono or other public work that does not contribute to the firms' bottom line.[38] Proponents, however, respond that because a law firm's most important asset is its people, attorney-employees can compel the firm to continue its public service.[39] Additionally, today's

33. *See id.* Negative public perception of law firms and lawyers are well documented. *See, e.g.*, Michael Asimow, *Embodiment of Evil: Law Firms in the Movies*, 48 UCLA L. REV. 1339, 1371–73 (2001) (analyzing the portrayal of law firms in films and noting that recent Harris Polls have found that public attitudes toward lawyers have worsened); LEO J. SHAPIRO & ASSOCS., ABA SECTION OF LITIG., PUBLIC PERCEPTIONS OF LAWYERS: CONSUMER RESEARCH FINDINGS 4 (2002), http://www.abanet.org/litigation/lawyers/publicperceptions.pdf ("Americans say that lawyers are greedy, manipulative, and corrupt.").

34. *See* Ribstein, *Want to Own a Law Firm?*, *supra* note 23 ("One benefit of law firms being publicly traded is that this would make it harder for lawyers and law firms to deny that they really are businesses."). On the other hand, Professor Mitt Regan has expressed hesitancy in fully equating law firms with conventional businesses. *See* MacEwen, Regan & Ribstein, *supra* note 6, at 77 ("I don't think that law firms should be assimilated completely into the category of just another form of business enterprise.").

35. *See* MacEwen, Regan & Ribstein, *supra* note 6, at 82 ("[T]o the extent having outside investors might increase a firm's 'transparency,' there may be at least some reason for optimism that lawyers would be less, not more, inclined to deviate from the highest professional standards for fear of being exposed."); MacEwen, *supra* note 25, at 4 ("One reason the standing of the legal profession has diminished in the public's eyes is that conflicts have not been dealt with openly. Where lawyers regulate themselves, it's an environment that invites suspicion." (quoting Slater Managing Director Andrew Grech)). Americans tend to believe that lawyers are not effective self-regulators. *See* LEO J. SHAPIRO & ASSOCS., *supra* note 33, at 4. On the other hand, outside regulation may prove to be incompatible with the profession's historically independent culture. *See* MacEwen, Regan & Ribstein, *supra* note 6, at 74; *see also* James R. Faulconbridge & Daniel Muzio, *Reinserting the Professional into the Study of Globalizing Professional Service Firms: The Case of Law*, 7 GLOBAL NETWORKS 249, 251 (2007) ("[L]awyers, as professionals, demand autonomy in their work and input into the strategic direction of the firm.").

36. MacEwen, Regan & Ribstein, *supra* note 6, at 70; *see also* Levinson, *supra* note 22, at 235.

37. MacEwen, Regan & Ribstein, *supra* note 6, at 71–72. The preamble to the Model Rules states that "[a] lawyer, as a member of the legal profession, is a representative of clients, an officer of the legal system and a public citizen having special responsibility for the quality of justice." MODEL RULES OF PROF'L CONDUCT pmbl. (1) (2008).

38. *See* Carson, *supra* note 21, at 630–32; DeBuse, *supra* note 29, at 336.

39. *See* Ribstein, *Accountability*, *supra* note 24, at 1451; Arthur T. Farrell, Current Development, *Public Interest Meets Public Ownership: Pro Bono and the Publicly Traded Law Firm*, 21 GEO. J. LEGAL ETHICS 729, 731–32 (2008).

corporate philanthropy efforts demonstrate that social responsibility and profit maximization are not necessarily mutually exclusive.[40]

The loss-of-professionalism argument also encompasses the fear that allowing nonlawyer investment and ownership will lead to megafirms owned by large retail or accounting firms.[41] These "corporate giants" would purchase law firms and compete with the traditional law firms.[42] According to this argument, the megafirms would put the smaller, traditional law firms out of business. Proponents of nonlawyer investment view this argument as simply promoting illegal and inefficient economic protectionism of smaller law firms.[43] Proponents further argue that conflict of interest rules will limit firm size: the potential for conflicts of interest among clients increase as the firm size increases, and therefore firms will limit their expansion as fewer unconflicted client opportunities are available.[44]

Fear of the loss of independent judgment, the effect on client confidentiality, and the loss of professionalism are powerful concerns that have kept skeptics from considering any changes to the investment prohibition.

2. Potential Benefits of Capital Raised from Outside Investors

On the other hand, proponents of nonlawyer investment focus on the potential benefits that outside capital could bring to law firms. The three main benefits of outside capital investment include encouraging capital investment in intangibles, promoting the collective interest of the firm, and easing the pressures of the current financing methods.

First, proponents argue that raising outside capital will encourage firms to use this capital for long-term investment on items such as information technology and professional development.[45] Under the current partnership structure, in which partners receive 100% of the profits at year-end, firms are less likely to spend money in the present if the investment has only intangible future benefits.[46] Investment in information technology improves the efficiency of a firm's delivery of legal services.[47] Associate training and mentoring is a long-term investment that may or may not pay off depending on how long the associate remains at the

40. Farrell, *supra* note 39, at 734–37.

41. *See* Sharfman, *supra* note 5, at 479, 481.

42. *See* Adams & Matheson, *supra* note 5, at 10; Sharfman, *supra* note 5, at 479, 481.

43. Andrews, *supra* note 5, at 616–21.

44. Adams & Matheson, *supra* note 5, at 14–15; *see* MODEL RULES OF PROF'L CONDUCT R. 1.7, 1.9–1.11 (2008).

45. *See* MacEwen, Regan & Ribstein, *supra* note 6, at 84.

46. *Id.* MacEwen notes that "[l]aw firms notoriously under-invest in: information technology, knowledge management systems, long-run commitments to professional development, retention, and training, and a host of other intangible assets which have real costs today but only unquantifiable benefits in the future." *Id.*

47. *See infra* notes 96–97 (discussing the impact of technology on the delivery of legal services).

firm.[48] Offering greater professional development could help firms recruit and retain talented associates in the increasingly competitive legal environment, but firms are not incentivized to make such investments under the current year-end draw partnership structure.[49]

Next, proponents argue that nonlawyer investment and ownership would emphasize the collective interests of the firm and minimize the incentives to act only for individual interests.[50] The incentive to work collectively as a firm results from investors' preference for stability.[51] Investors would not be as comfortable with many firms' current "eat-what-you-kill" structure, as opposed to lock-step or seniority-based compensation structures.[52] Rather, individuals, and practice groups, would be incentivized to work together for the collective interests of the firm.[53]

Finally, nonlawyer investment could ease the pressures presented by the current alternative financing options of contingency fee litigation and bank borrowings. Contingency fee financing can be a significant burden on a firm when litigation lasts over a long period of time.[54] Outside capital could relieve the difficulty of being able to support a contingency case until completion of the litigation.[55] The attorney, proponents argue, would be able to make better decisions for the client because the outside capital would reduce the pressure of self-financing.[56]

Outside capital can also reduce a firm's need for bank borrowings.[57] In 2006, firm liability for bank borrowings accounted for 14.1% of net income.[58] For example, 518-lawyer San Francisco firm Brobeck, Phleger & Harrison had close to $90 million in debt when it collapsed in late 2002.[59] When Heller Ehrman dissolved in September 2008, it had close to $30 million of debt.[60] Increasingly, firms are requiring additional partner con-

48. *See* MacEwen, Regan & Ribstein, *supra* note 6, at 84.

49. *See infra* Part II.B.1. Slater has used the capital raised from public ownership to invest in professional development: "With a public listing . . . we were able to obtain access to the capital we need for long-term growth, which provides a credible and rewarding future for professional staff . . . ." MacEwen, *supra* note 25, at 2.

50. *See* MacEwen, Regan & Ribstein, *supra* note 6, at 73.

51. *Id.* at 84.

52. *See id.* at 73. The "eat-what-you-kill" structure bases partner compensation on each individual partner's contribution to the firm's revenue. Sung Hui Kim, *Gatekeepers Inside Out*, 21 GEO. J. LEGAL ETHICS 411, 432–33 (2008).

53. *See* MacEwen, *supra* note 25, at 4.

54. *See* Sharfman, *supra* note 5, at 485–86.

55. *See id.*

56. *See id.*

57. *See id.* at 486.

58. Leigh Jones, *Firms Ask Partners to Pony Up*, NAT'L L.J., July 8, 2008, http://www.law.com/jsp/article.jsp?id=1202422803643.

59. Brenda Sandburg, *Brobeck Falls*, RECORDER, Jan. 31, 2003, http://www.law.com/jsp/PubArticle.jsp?id=900005380125.

60. Nathan Koppel, *Recession Batters Law Firms, Triggering Layoffs, Closings*, WALL ST. J., Jan. 26, 2009, at A1.

tributions to manage or reduce debt exposure.[61] Critics, however, argue that debt financing, although admittedly a potential influence on attorneys' judgment, is the lesser of the two evils because of the ability to refinance debt and the smaller likelihood that debt holders will participate in management.[62] Nevertheless, financial pressure from either contingency fee caseloads or significant bank borrowings can affect independent judgment.

On the whole, critics are skeptical that these potential benefits truly motivate the push for outside capital investment and argue instead that partners seek merely to cash out on the potential millions that could be raised from outside investors.[63] Further, critics question whether investors will accept the risk of investment in a law firm.[64]

B. How the Debate Has Changed

Since the Kutak Commission's proposal for change in the early 1980s, the legal community has continued to debate the outside investment question with no clear resolution.[65] Changes in both the legal environment and international law, however, have added new considerations to the traditional debate.

1. The Modern Legal Environment

The traditional partnership model has been successful for law firms because the legal profession has historically depended on expert-based work product and client-driven relationships.[66] But, changes in the legal environment challenge the ability of the traditional partnership model to remain most effective.[67] Increasing competition, explosive growth, and technological advances have significantly influenced the practice of law.

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61. *See* Jones, *supra* note 58. In late 2008, DLA Piper asked its income partners to contribute capital in an attempt, in part, to reduce its credit exposure. Lynne Marek, *DLA Piper, for First Time, to Ask Income Partners to Contribute Capital to Firm*, NAT'L L.J., Nov. 20, 2008, http://www.law.com/jsp/nlj/PubArticleNLJ.jsp?id=1202426158853.

62. Levinson, *supra* note 22, at 248.

63. *See* DeBuse, *supra* note 29, at 334 & n.166, 337; Bruce MacEwen, Publicly Traded Law Firms: The Starter's Pistol Has Fired, Adam Smith, Esq., http://www.bmacewen.com/blog/archives/2005/06/publicly_traded.html (June 19, 2005, 14:07).

64. DeBuse, *supra* note 29, at 345. The argument that investors may not accept the risk of investment in a law firm seems to be rebutted by the substantial interest generated subsequent to the enactment of the U.K. Act. *See infra* note 166 and accompanying text.

65. For a sample of the literature debating the ownership question since the rejection of the Kutak Commission's proposal, compare Adams & Matheson, *supra* note 5, Andrews, *supra* note 5, and Gary A. Munneke, *Dances with Nonlawyers: A New Perspective on Law Firm Diversification*, 61 FORDHAM L. REV. 559 (1992), with Carson, *supra* note 21, and Levinson, *supra* note 22.

66. John J. Gabarro, *Prologue* to MANAGING THE MODERN LAW FIRM: NEW CHALLENGES, NEW PERSPECTIVES, *supra* note 31, at xvii, xxii.

67. *Id.* For a more detailed analysis of the traditional partnership model and how firms have departed from this traditional model in response to the changing legal environment, see Milton C. Re-

a. The Competition for Clients and Attorneys

Over the last two decades, the legal profession has become much more competitive for both clients and attorneys. The competition for clients has led to a "climate of insecurity,"[68] as "a competitor [firm] is always working to lure the client away."[69] General counsel of large corporations are powerful in the attorney-client relationship because they can take their companies' business elsewhere.[70] Further, cost is increasingly becoming an important factor for hiring outside counsel.[71] The focus on corporate legal cost has become especially sharp during the current economic crisis.[72] The rise in flat fee billing demonstrates how law firms are considering new business models in response to competition for clients.[73] Document review work is increasingly being outsourced overseas because of the significant cost savings: $25 an hour for a lawyer in India versus $150 to $300 an hour for a paralegal or associate in the United States.[74] Virtual law firms—those without a traditional brick-and-mortar office—have developed in response to attorneys' frustration with the traditional law firm business model and to clients' demands for lower

gan, Jr., *Lawyers, Symbols, and Money: Outside Investment in Law Firms*, 27 PENN ST. INT'L L. REV. 407, 416–23 (2008).

68. Galanter & Henderson, *supra* note 6, at 1910; *see also* SLATER & GORDON LTD., PROSPECTUS 83 (2007) (indicating that competition for market share is a risk factor for investors to consider).

69. Galanter & Henderson, *supra* note 6, at 1910.

70. *See* Andrew Bruck & Andrew Canter, Note, *Supply, Demand, and the Changing Economics of Large Law Firms*, 60 STAN. L. REV. 2087, 2088–89 (2008).

71. *See* RICHARD SUSSKIND, THE END OF LAWYERS? RETHINKING THE NATURE OF LEGAL SERVICES 11 (2008); Leonard Bierman & Michael A. Hitt, *The Globalization of Legal Practice in the Internet Age*, 14 IND. J. GLOBAL LEGAL STUD. 29, 32–33 (2007). General Electric, for example, has a competitive bidding process for legal services over the Internet. *Id.* at 33.

72. *See, e.g.*, Brian Zabcik, *How They're Cutting Back: Law Departments Look for Savings Wherever They Can Find Them*, CORP. COUNS., Feb. 2009, at 20. To reduce costs, general counsel will look to bring more work in-house, use lower-priced outside counsel, and use more alternative fee arrangements. *Id.*; *see also* Debra Cassens Weiss, *Citigroup GC Has No Sympathy for Law Firms Seeking Premium Fees*, A.B.A. J., Sept. 28, 2009, http://www.abajournal.com/news/citigroup_gc_has_no_sympathy_for_law_firms_seeking_premium_fees.

73. *See* David Gialanella, *The Skinny on Flat Fees: 'Value Pricing' Requires Managing a New Way*, A.B.A. J., July 2008, at 26, 26 ("The secret [of flat fee billing] lies in vastly improved work efficiency that helps siphon business away from other firms."); Nathan Koppel & Ashby Jones, *'Billable Hour' Under Attack*, WALL ST. J., Aug. 24, 2009, at A1. The debate over moving from a billable hour structure to a flat fee structure has generated significant commentary. *See, e.g.*, Evan R. Chesler, *Kill the Billable Hour*, FORBES, Jan. 12, 2009, at 26, 26 (Presiding Partner at Cravath, Swaine & Moore LLP).

74. V. Dion Haynes, *Recession Sends Lawyers Home: Firms Trade Brick-and-Mortar Prestige for a Better Business Model*, WASH. POST, Mar. 9, 2009, at D1. The ABA issued an ethics opinion allowing outsourcing of legal work given that the outsourcing "lawyer remains ultimately responsible for rendering competent legal services to the client." ABA Comm. on Ethics and Prof'l Responsibility, Formal Op. 451 (2008) (outlining in further detail the outsourcing attorney's responsibilities in accordance with the Model Rules). Public accounting firms already outsource work to India. Paul Lippe, *Welcome to the Future: An Interview with the Futurist*, AMLAW DAILY, Nov. 10, 2008, http://amlawdaily.typepad.com/amlawdaily/2008/11/welcome-to-th-1.html.

rates.[75] Without the overhead of maintaining a physical office and employing associates, partners in a virtual law firm can decrease their rates by 25% and therefore have a "Wal-Mart effect of discounting" the price of legal services.[76]

In addition to competition for clients, the competition for attracting and retaining top talent is also a concern for law firms.[77] The competition for talent is critical because the firms' attorneys are its most important asset. Law firms compete for talent not only with each other but also with finance firms and banks, consulting firms, private equity, and in-house law departments.[78] Compensation skyrocketed over the past decade because of the competitive environment.[79] The competition for attorneys is best exhibited by the escalation of starting salaries of associates at large law firms upon graduation.[80] Starting salaries at New York firms doubled over two decades, increasing from $71,000 in 1988 to $160,000 in 2008.[81]

Once recruited, associates have little loyalty to their current firm, and firms must continually manage the lateral market.[82] Firms have ex-

75. Haynes, *supra* note 74. The traditional business model requires "increas[ing] rates and billable hours to finance ballooning profits and overhead." *Id.* Technology enables virtual law firms to do business and deliver legal services without traditional offices. *See infra* Part II.B.1.c.

76. Haynes, *supra* note 74.

77. *See* Elizabeth Goldberg, *The Annual Mad Dash for Fresh Talent Is Under Way Again—Is This Any Way to Recruit Associates?*, AM. LAW., Aug. 2007, at 93, 93. The cost of recruiting is significant, estimated to be up to $250,000 per summer associate, and firms face high turnover after associates' third and fourth year (40% and 62%, respectively). *Id.* The prospectuses for both Slater and Integrated Legal Holdings Limited (the second Australian law firm to go public) indicate that competition for employees and employee retention are top issues that the firms face. INTEGRATED LEGAL HOLDINGS LTD., PROSPECTUS 2, 19 (2007); SLATER & GORDON LTD., *supra* note 68, at 83.

78. MacEwen, Regan & Ribstein, *supra* note 6, at 65.

79. *See* Gabarro, *supra* note 66, at xviii. The current economic recession has caused firms to re-evaluate their ability to continue escalating lock-step salaries and bonuses, even forcing some firms to cut associate pay. *See, e.g.*, Carlyn Kolker, *'Medieval' U.S. Law Firm Pay Structure Buckles*, BLOOMBERG, Mar. 16, 2009, http://www.bloomberg.com/apps/news?pid=20601109&sid=atnsq9FCtNiA&refer=news; Molly McDonough, *LA Firm Cuts Associate Pay, an Indication of Cracks in the Lockstep Model?*, A.B.A. J., Apr. 1, 2009, http://www.abajournal.com/news/l.a._firm_cuts_associate_pay_an_indication_of_cracks_in_lockstep_pay_model.

80. *See* Bruck & Canter, *supra* note 70, at 2088–89, 2096–97; Ameet Sachdev, *Raising the Bar for Legal Salaries: Experts Argue Higher Wage Bad for Industry*, CHI. TRIB., Jan. 27, 2007, at 1, *available at* http://archives.chicagotribune.com/2007/jan/27/image/chi-0701270101jan27 ("Firms in New York, Chicago and other large markets stick remarkably close together in salary moves because of market pressure and as a matter of reputation. No firm wants to look cheap in trying to recruit top students.").

81. Bruck & Canter, *supra* note 70, at 2096–97. Many doubt whether starting salaries will remain at $160,000, with some indicating that starting salaries could fall to $100,000. Adam Cohen, Editorial, *With the Downturn, It's Time to Rethink the Legal Profession*, N.Y. TIMES, Apr. 2, 2009, at A26.

82. *See* Galanter & Henderson, *supra* note 6, at 1879; Martha Neil, *Survey: Associate Loyalty at All-Time Low*, A.B.A. J., Nov. 5, 2007, http://www.abajournal.com/news/survey_associate_loyalty_at_all_time_low/. The dynamics of the competitive market have shifted in the current economic crisis as the lateral market has essentially dried up. *See* Zach Lowe, *Headhunters Have Layoffs, Too*, AMLAW DAILY, Mar. 11, 2009, http://amlawdaily.typepad.com/amlawdaily/2009/03/headhunters-have-layoffs-too.html. In addition to affecting salaries, the economic recession has also forced layoffs at many large firms. *See, e.g.*, Cohen, *supra* note 81; Koppel, *supra* note 60.

panded from the simple associate and partner roles to include a variety of attorney positions to meet the growing demands of its employees: "non-equity partners, permanent associates, of-counsel and de-equitized partners."[83] It is not clear how the current financial crisis will affect the competitive market for attorneys in the long-run, but the competitive environment of the past two decades has significantly changed the legal industry.

b. Explosive Global Growth

The current legal environment has also been influenced by explosive global growth. Modern law firms have grown in size, location, and client service. "Global mega firm[s]"[84] employ thousands of lawyers in offices throughout the globe. The largest global firm, DLA Piper, for example, employed over 3600 attorneys in 2007, and is currently located in sixty-seven offices across twenty-nine countries.[85] Firms looking to expand into new domestic and international legal markets have led to a trend of firm mergers and consolidation.[86] Despite the high level of merger and consolidation activity, however, the legal industry is much less consolidated than other professional service firms,[87] such as accounting,[88] investment banking,[89] and consulting.[90] Client service has reached across

83. Galanter & Henderson, *supra* note 6, at 1877; Regan, *supra* note 67, at 422.

84. Gabarro, *supra* note 66, at xvii.

85. Leigh Jones, *Another Growth Spurt for Firms*, NAT'L L.J., Nov. 12, 2007, at S3; DLA Piper, Facts and Figures, http://www.dlapiper.com/global/about/facts/ (last visited Dec. 15, 2009).

86. Elizabeth Chambliss, *New Sources of Managerial Authority in Large Law Firms*, 22 GEO. J. LEGAL ETHICS 63, 81 (2009); Jones, *supra* note 85.

87. Jones, *supra* note 85. The downturn in the economy starting in late 2008 has prompted further consolidation in the legal industry. *See* Debra Cassens Weiss, *For Many Law Firms, It's 'Eat or Be Eaten,'* A.B.A. J., Jan. 20, 2009, http://www.abajournal.com/news/for_many_law_firms_its_eat_or_be_eaten.

88. The public accounting industry is dominated by the "Big Four" firms of PricewaterhouseCoopers LLP, Deloitte LLP, Ernst & Young LLP, and KPMG LLP. U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-08-163, AUDITS OF PUBLIC COMPANIES: CONTINUED CONCENTRATION IN AUDIT MARKET FOR LARGE PUBLIC COMPANIES DOES NOT CALL FOR IMMEDIATE ACTION 1, 9 (2008) [hereinafter GAO REPORT]; *see also* Jeremy Newman, *Wanted: Real Competition*, ACCOUNTANCY, July 2008, at 22, 22 (discussing the dominance of the "Big Four" in the United Kingdom). In the 1980s, the industry had eight major firms, but only these four remain after mergers and the dissolution of Arthur Anderson following the Enron scandal. GAO REPORT, *supra*, at 1, 9. These firms audit 98% of the public companies with annual revenues greater than $1 billion. *Id.* at 4.

89. Goldman Sachs, Morgan Stanley, Lehman Brothers, and Merrill Lynch were the largest U.S. independent investment banks, dominating the market; however, the failure of Lehman Brothers and the takeover of Merrill Lynch left the investment banking industry in flux. *See* Olesya Dmitracova & Steve Slater, *Analysis: Investment Banking Evolves into New Model*, USA TODAY, Sept. 23, 2008, http://www.usatoday.com/money/industries/banking/2008-09-22-analysis-banks_N.htm. In addition, Goldman Sachs and Morgan Stanley have converted to traditional bank holding companies, essentially collapsing the investment banking industry. Jon Hilsenrath et al., *Goldman, Morgan Scrap Wall Street Model, Become Banks in Bid to Ride Out Crisis*, WALL ST. J., Sept. 22, 2008, at A1. Opponents of nonlegal ownership may point to this collapse of the investment banking industry as evidence of why law firms should not be publicly owned. For an insightful comparison of the collapse of the investment banking industry to the potential impact of law firms going public, see Bruce MacEwen, Pretend Your

borders as firms broaden their services to parallel their clients' global expansion.[91] These global firms market their services to clients just as any other business[92] and often hire nonlawyer specialists for business development and marketing.[93] Firms also employ a substantial number of nonlawyers in executive and managerial positions to help manage this explosive growth.[94] The partnership model—originally intended for smaller, intimate organizations—now must stretch to accommodate megafirms with partners and associates across the globe.[95]

c. Technology

Technology has also significantly influenced legal work from both the client's and attorney's perspective. The work product itself and the delivery of such product have changed. Technology has enhanced firms' efficiency and standardized many areas of work, such as automated document assembly.[96] Computers and the Internet have made research and document drafting much less complex and time-consuming.[97] The increasing commoditization of legal work diminishes the value of a part-

Firm Is an Investment Bank, Adam Smith, Esq., http://www.adamsmithesq.com/archives/2008/10/pretend_your_firm_were_an.html (Oct. 1, 2008, 13:07).

90. The top three management consulting firms are McKinsey & Company (owned by its partners), the Boston Consulting Group (owned by its employees), and Bain & Company (owned by its partners). Careers-in-Consulting, Top Ten Firms in Management Consulting, http://www.careers-in-business.com/consulting/topfirms.htm (last visited Dec. 15, 2009); Vault, Management & Strategy Consulting Firms Rankings: Top 50 Consulting Firms, http://www.vault.com (follow "Industries" hyperlink; then follow "Top 50 Consulting Firms" hyperlink) (last visited Dec. 15, 2009). Accenture is the largest management consulting firm and also is a public company. Careers-in-Consulting, *supra.* Other management consulting firms that are public companies include Huron Consulting and FTI Consulting. FTI, Investor Relations, http://ir.fticonsulting.com/phoenix.zhtml?c=82634&p=irol-IRHome (last visited Dec. 15, 2009); Huron Consulting Group, Investor Relations Home, http://ir.huronconsultinggroup.com/phoenix.zhtml?c=180006&p=irol-irhome (last visited Dec. 15, 2009).

91. *See* Gabarro, *supra* note 66, at xvii. DLA Piper joint chief executive Frank Burch stated that the firm's strategy has been "to mirror its own clients' consolidation and globalization." Jones, *supra* note 85; *see also* Faulconbridge & Muzio, *supra* note 35, at 250 ("[T]hese global professional service firms (PSFs) are now involved in all the major cross-border corporate deals and operations that dominate discussions in publications such as *The Financial Times*.").

92. *See Hot Management Trends to Watch & Emulate in '08*, LAW OFF. MGMT. & ADMIN. REP., Mar. 2008, at 1, 11 ("Marketing budgets continue to increase as a percentage of firm revenues at both large and midsize firms, with many now going beyond 2%.").

93. *See* Gabarro, *supra* note 66, at xviii.

94. *See id.*; *Hot Management Trends to Watch & Emulate in '08*, *supra* note 92, at 14 (reporting that midsize and large firms continue to designate managing partners as CEOs because "a law firm also is a business"); *see also* Chambliss, *supra* note 86, at 65.

95. Gabarro, *supra* note 66, at xxii.

96. *See id.* at xviii; SUSSKIND, *supra* note 71, at 36 (discussing, for example, the potential benefits of "automatic document assembly technology").

97. ANDREW L. KAUFMAN & DAVID B. WILKINS, PROBLEMS IN PROFESSIONAL RESPONSIBILITY FOR A CHANGING PROFESSION 671 (4th ed. 2002); SUSSKIND, *supra* note 71, at 100–05 (discussing "automated document assembly"); Bierman & Hitt, *supra* note 71, at 32–33. One company now offers "Do-It-Yourself Legal Forms Software" for pro se drafting of wills, rental agreements, promissory notes, partnership agreements, and more. Standard Legal, Do-It-Yourself Legal Forms Software, http://www.standardlegal.com/legal-forms-software.html (last visited Dec. 15, 2009).

nership or apprenticeship model because that model most effectively supports professional development and individual client-driven relationships and work product.[98]

The trend that legal work is becoming more like a commodity only reinforces the competitive environment. The more standardized the work product, the more likely it is that the client will base firm retention on price rather than relationships, as it traditionally has been done.[99] General counsel may feel more comfortable outsourcing commodity work as opposed to specialized work.[100] But even "high-end," or "bet the company," work is influenced by the advances in information technology.[101]

Furthermore, technology has greatly changed the dissemination of legal information. Attorneys may no longer be the sole gatekeepers to such information. The Internet increasingly provides greater public access to the law.[102] Although technology may not, and unquestionably should not, completely replace the attorney's role, the greater availability of public legal information certainly influences the attorney-client relationship.[103] A more informed client has more control in the relationship.[104]

98. *See* Gabarro, *supra* note 66, at xviii, xxii; *see also* Lippe, *supra* note 74. Cisco's director of legal technology solutions, Steve Harmon, has conceptualized the commoditization of legal services as "a type of focusing and unbundling," in that technology will streamline other tasks so that attorneys can "spend more effective time thinking, and solving complex problems." Paul Lippe, *Welcome to the Future: Revolutions and Other Models of Change*, AMLAW DAILY, July 6, 2009, http://amlawdaily.typepad.com/amlawdaily/2009/07/welcome-to-the-future-revolutions-and-other-models-of-change.html.

99. *See supra* notes 68–72 and accompanying text.

100. *See* David Hechler, *Passage to India*, CORP. COUNS., Jan. 2009, at 70, 70–71 (discussing "offshoring" legal work).

101. *See* RICHARD SUSSKIND, THE FUTURE OF LAW: FACING THE CHALLENGES OF INFORMATION TECHNOLOGY xlvi–xlvii, li (1998). Commodity work is increasingly distinguished from sophisticated "high-end" work, which will likely account for the majority of big law firms' business in the future. *See* Jonathan D. Glater, *Even Law Firms Join the Trend to Outsourcing*, N.Y. TIMES, Jan. 13, 2006, at C7. The question, then, becomes whether firms can "survive on high-end work alone." SUSSKIND, *supra* note 71, at l–li; *see also* Glater, *supra* ("[A]ny time work that could be completed by [a] firm was [outsourced], it became 'a lost opportunity.'").

102. *See* SUSSKIND, *supra* note 71, at 242. For example, Cornell University Law School provides a significant amount of legal information, including codes and case law, free to the public through its Legal Information Institute. *See* Cornell University Law School, Legal Information Institute, http://www.law.cornell.edu/ (last visited Dec. 15, 2009).

103. KAUFMAN & WILKINS, *supra* note 97, at 671. Many argue that "[t]here is no substitute . . . for seeing an experienced lawyer face-to-face." SUSSKIND, *supra* note 71, at 244. The accuracy and reliability of legal information on the Internet is a valid concern. *Id.* at 243.

104. The influence of the "informed consumer" has also changed the medical field. *See* Anna Quindlen, *In a Peaceful Frame of Mind*, NEWSWEEK, Feb. 4, 2002, at 64, 64 ("Americans have increasingly demanded more information and more control. People who once took orders from their physicians are now willing only to take advice."); *see also* SUSSKIND, *supra* note 71, at 244 (analogizing improved access to legal information to the increased medical information now available online).

But although the legal profession has changed considerably, the partnership structure has remained the same.[105] Critics have questioned whether the traditional partnership model can successfully adapt to the increases in competition, growth, and technology in the modern legal environment.[106] Corporations, in fact, were developed in response to the changes in size, scale, and complexity of organizations during the Industrial Revolution.[107] The economic crisis of 2008–2009 has further exposed the weaknesses of the traditional law partnership structure, which may influence those who previously had an "if it's not broken, don't fix it" attitude about law firm structure.[108]

Proponents of nonlawyer investment point to the corporate characteristics of the modern law firm described above to question whether the "loss of professionalism" argument truly holds weight today.[109] But client service still drives the day-to-day activities of legal professionals.[110] The question then becomes whether a law firm can balance the day-to-day client service while adapting to the changing environment.[111]

2. International Changes in Australia and the United Kingdom

While changes in the legal environment have been occurring over time and with much discussion in the legal community,[112] recent changes in Australia and the United Kingdom have provided the major spark in

105. *See* SIR DAVID CLEMENTI, REVIEW OF THE REGULATORY FRAMEWORK FOR LEGAL SERVICES IN ENGLAND AND WALES 2–3 (2004) ("[B]usiness structures through which legal services are delivered to the public have changed little over a considerable period. . . . But business practices have changed.").

106. *See* Gabarro, *supra* note 66, at xviii–iv; Kolker, *supra* note 79 ("In the current economic crisis, we see the final demise of the medieval guild in the American legal profession." (citation omitted)). Commentators argue that the traditional law firm organization is "creaking and groaning at the seams." Gabarro, *supra* note 66, at xviii. Supporters of the traditional law firm, however, view the "corporatism" of firms as having a negative effect on the profession. *Id.*

107. Gabarro, *supra* note 66, at xxii.

108. One commentator has noted that "until large-scale problems are identified with the legal-services industry in the United States, support for reform will be lacking." Justin D. Petzold, Comment, *Firm Offers: Are Publicly Traded Law Firms Abroad Indicative of the Future of the United States Legal Sector?*, 2009 WIS. L. REV. 67, 99. Though the problems with Big Law firm structure in the United States exposed in the financial downturn can be addressed without major changes to the partnership structure, the recent events at a minimum highlight how the competitive environment has reshaped the profession and potentially provide the catalyst necessary to open the public's mind to a major change in firm structures.

109. *See supra* note 34 and accompanying text. For example, law firms, like conventional businesses, pay close attention to the financial performance of the firm and its attorneys. The metrics of profits per equity partner (PEP) and revenue per lawyer (RPL) are analogous to conventional internal metrics used by business organizations. *See* MacEwen, Regan & Ribstein, *supra* note 6, at 72. Law firm leaders recognize that the modern practice of law requires just as much business sense as legal skill. *See* Gialanella, *supra* note 73, at 26 ("[L]aw is a business more than anything . . . .").

110. *See* Gabarro, *supra* note 66, at xxiii.

111. *See id.* at xxii–xxiv; SUSSKIND, *supra* note 71, at 247 ("Survival will also rest to some degree, therefore, on whether law firms can reinvent themselves, embrace new skills, and so provide newly competitive legal services.").

112. *See, e.g.*, Munneke, *supra* note 65, at 563–64 (discussing competitive changes in the 1980s).

renewing the legal investment debate. Between 2003 and 2007, the Australian states of New South Wales, Victoria, Tasmania, Western Australia, and Queensland, as well as the Australian Capital Territory and the Northern Territory, passed legislation allowing nonlawyer investment in law firms.[113] South Australia, the only Australian state or territory currently without such legislation, is considering a bill that would allow nonlawyer investment.[114] The United Kingdom followed in 2007 with its own legislation legalizing nonlawyer investment.[115] Because of the increased international competition among law firms, U.S. firms are competing with international firms that can raise outside equity capital. The potential disadvantage to U.S. firms as well as the potentially problematic regulatory uncertainty has resurrected the debate domestically.

a. Australia

In Australia, New South Wales, Victoria, Western Australia, Tasmania, Queensland, the Australian Capital Territory, and the Northern Territory currently allow nonlawyer investment and profit sharing.[116] Although the legislation differs in some respects, the material aspects of each state's and territory's act are similar in the regulation of nonlawyer investment.[117] The acts specifically allow incorporated legal practices.[118] At least one director must be a lawyer who is responsible for the management of legal services and ensures that appropriate management systems are implemented and maintained to enable the provision of legal

113. Legal Profession Act, No. 24 (2007) (Tas. Sess. Stat.), *available at* http://www.austlii.edu.au/au/legis/tas/num_act/lpa200724o2007225/; Legal Profession Act 2007 (Queensl. Stat.), http://www.legislation.qld.gov.au/LEGISLTN/CURRENT/L/LegalProA07.pdf; Legal Profession Act, No. 38 (2006) (N. Terr. Austl. Laws), *available at* http://www.austlii.edu.au/au/legis/nt/consol_act/lpa179/; Legal Profession Act (2006) (Austl. Cap. Terr. Laws), *available at* http://www.austlii.edu.au/au/legis/act/consol_act/lpa2006179/; Legal Profession Act, No. 112 (2004) (N.S.W. Stat.), *available at* http://www.austlii.edu.au/au/legis/nsw/consol_act/lpa2004179/; Legal Profession Act, No. 99 (2004) (Vict. Acts), *available at* http://www.austlii.edu.au/au/legis/vic/consol_act/lpa2004179/; Legal Practice Act, 2003 (W. Austl. Stat.), *repealed by* Legal Profession Act (2008) (W. Austl. Stat.), *available at* http://www.austlii.edu.au/au/legis/wa/consol_act/lpa2008179/. Western Australia repealed its original legislation and enacted the Legal Profession Act in 2008 to be more in line with a model bill designed to harmonize legal regulation across the Australian states and territories. *See infra* note 117.

114. Legal Profession Bill, No. 54 (2007) (S. Austl.), http://www.lawsocietysa.asn.au/pdf/Legal_Profession_Bill_2007.pdf.

115. Legal Services Act, 2007, c. 29 (Eng.).

116. *See* sources cited *supra* note 113. Australian regulation of legal services differs across states and territories, similar to the state-based regulatory structure of the United States.

117. The acts are based, in part, on a Legal Profession Model Bill, drafted as part of a national project by the Law Council of Australia to standardize the legal profession regulations. *See* LEGAL PROFESSION—MODEL LAWS PROJECT, MODEL BILL (MODEL PROVISIONS) (2006), http://www.department.dotag.wa.gov.au/_files/model_bill.pdf; Law Council of Australia, The Model Legal Profession Bill, http://www.lawcouncil.asn.au/programs/national_practice.model-bill.cfm (last visited Dec. 15, 2009). Because the acts are substantially similar, the following analysis uses the New South Wales, Victoria, and Western Australia acts as examples.

118. Legal Profession Act, § 100 (2008) (W. Austl. Stat.); Legal Profession Act, No. 112, c.2, § 135 (2004) (N.S.W. Stat.); Legal Profession Act, No. 99, c.2, § 2.7.5 (2004) (Vict. Acts).

service in accordance with the standard of professional obligations of legal practitioners.[119] The legal practitioner director must also ensure that the obligations of legal practitioners are not affected by other officers or employees.[120]

All legal employees remain subject to professional obligations and rules.[121] Furthermore, the acts have "undue influence" provisions stating that no one shall cause or induce an attorney or director to "contravene this Act, the regulations, the legal professional rules or his or her professional obligations . . . ."[122] The acts set up a scheme headed by a Legal Services Commissioner and Board for reporting complaints and conducting the resulting mediation, investigation, and discipline.[123] The acts also indicate that a firm's pro bono services do not constitute a director's breach of fiduciary duty.[124]

In response to the fears concerning client confidentiality, the laws state that the attorney-client privilege is not affected when an attorney acts as an officer or employee of an incorporated legal practice.[125] Regulators, however, may disclose information to the Australian Securities and Investments Commission (ASIC) despite confidentiality laws.[126] Privilege or duty of confidentiality also does not excuse compliance with requirements such as providing information in a disciplinary investigation.[127]

Since the passing of the respective states' and territories' legislation, two legal-related corporations have listed and sold shares on the Australian Securities Exchange (ASX). Slater became the first publicly owned law firm in May 2007.[128] Primarily a plaintiff's firm, the firm structure is

119. Legal Profession Act, § 105 (2008) (W. Austl. Stat.); Legal Profession Act, No. 112, c.2, § 140 (2004) (N.S.W. Stat.); Legal Profession Act, No. 99, c.2, § 2.7.10 (2004) (Vict. Acts).

120. Legal Profession Act, § 105(3) (2008) (W. Austl. Stat.); Legal Profession Act, No. 112, c.2, § 140(3) (2004) (N.S.W. Stat.); Legal Profession Act, No. 99, c.2, § 2.7.10(3) (2004) (Vict. Acts).

121. Legal Profession Act, §§ 108, 113, 147 (2008) (W. Austl. Stat.); Legal Profession Act, No. 112, c.2, 7, §§ 143(1), 148, 181, 711 (2004) (N.S.W. Stat.); Legal Profession Act, No. 99, c.2, § 2.7.17 (2004) (Vict. Acts).

122. Legal Profession Act, § 130 (2008) (W. Austl. Stat.); Legal Profession Act, No. 112, c.2, § 164 (2004) (N.S.W. Stat.); *see also* Legal Profession Act, No. 99, c.2, § 2.7.35 (2004) (Vict. Acts).

123. Legal Profession Act, §§ 534–542 (2008) (W. Austl. Stat.); Legal Profession Act, No. 112, c.7, §§ 679–681, 686–693 (2004) (N.S.W. Stat.); Legal Profession Act, No. 99, c.6, pts. 6.2–.3 (2004) (Vict. Acts). Western Australia entitles the regulatory body and its head officer the "Legal Profession Complaints Committee" and the "Law Complaints Officer," respectively. Legal Profession Act, §§ 555, 572 (2008) (W. Austl. Stat.).

124. Legal Profession Act, § 108(4) (2008) (W. Austl. Stat.); Legal Profession Act, No. 112, c.2, § 143(4) (2004) (N.S.W. Stat.); Legal Profession Act, No. 99, c.2, § 2.7.13(4) (2004) (Vict. Acts).

125. Legal Profession Act, § 108(3) (2008) (W. Austl. Stat.); Legal Profession Act, No. 112, c.2, § 143(3) (2004) (N.S.W. Stat.); Legal Profession Act, No. 99, c.2, § 2.7.13(3) (2004) (Vict. Acts).

126. Legal Profession Act, § 121 (2008) (W. Austl. Stat.); Legal Profession Act, No. 112, c.2, § 155 (2004) (N.S.W. Stat.); Legal Profession Act, No. 99, c.2, § 2.7.26 (2004) (Vict. Acts).

127. Legal Profession Act, § 588 (2008) (W. Austl. Stat.); Legal Profession Act, No. 112, c.8, § 724 (2004) (N.S.W. Stat.); Legal Profession Act, No. 99, c.3, § 3.3.46 (2004) (Vict. Acts).

128. Slater & Gordon Ltd., *supra* note 8. For an overview of Slater's listing process from the perspective of its Managing Director and General Counsel, see Andrew Grech & Kirsten Morrison, *Slater & Gordon: The Listing Experience*, 22 GEO. J. LEGAL ETHICS 535 (2009).

similar to the traditional partnership model, except that ownership is in the hands of shareholders.[129] Slater has enjoyed success since its initial public offering in 2007.[130] The firm has acquired twelve practices from different regions of the country and across varying practice groups.[131] The firm has also opened a new office in Ipswich and announced agreements to acquire two additional firms.[132] The acquisitions expanded Slater's geographical presence to areas identified for growth potential and cross-practice opportunities.[133]

Slater's shares opened on May 22, 2007, at A$1.50 and have since fluctuated between A$1.25 and A$1.98, with the stock closing at A$1.70 on November 13, 2009.[134] The firm has retained nearly all of its Board of Directors and management personnel since the public offering.[135] At its year-end June 2008, revenue increased by 26.7%, and net profit after taxes increased by 41.8% over the previous fiscal year-end.[136] The firm's profit margin increased slightly from 16.9% at fiscal year-end 2007 to

129. SLATER & GORDON LTD., *supra* note 68, at 15.

130. *See* Neil, *supra* note 8.

131. During fiscal year-end June 2008, Slater acquired eight law firms: D'Arcys Solicitors (Brisbane, military compensation), McClellands (Sydney, personal injury), Edwin Abdo and Associates (Bunbury, commercial law), Nagle & McGuire (Nowra, personal injury), Crane Butcher McKinnon (Croffs Harbour, family and commercial law), Blessington Judd (Sydney, commercial law), Secombs (Footscray, full service practice), and Rugendyke Lawyers (Newcaste, family law). SLATER & GORDON LTD., ANNUAL REPORT 2007–2008, at 33–34. In addition, Slater acquired the personal injury and professional negligence practices of Quinn & Scattini, a Queensland firm. *Id.* at 34. Slater issued roughly 1.4 million ordinary shares as consideration for the acquisitions. *Id.* at 61. Since then, Slater has acquired three additional practices. Press Release, Slater & Gordon Ltd., McGlades Practice Joins Slater & Gordon in Ballarat (Oct. 21, 2009); Press Release, Slater & Gordon Ltd., Slater & Gordon Join Forces with Leading Rural Legal Firm (Aug. 5, 2009); Press Release, Slater & Gordon Ltd., Slater & Gordon to Merge with the Personal Injuries Practice of Queensland Firm (Oct. 7, 2008). Slater press releases are available at the firm's Web site. Slater & Gordon Ltd., News & Publications, http://www.slatergordon.com.au/pages/news_publications.aspx (last visited Dec. 15, 2009).

132. Press Release, Slater & Gordon Ltd., National Law Firm Opens Ipswich Office (Oct. 1, 2009); Press Release, Slater & Gordon Ltd., Slater & Gordon to Acquire Adams Leyland Lawyers (Nov. 12, 2009); Press Release, Slater & Gordon Ltd., Slater & Gordon to Acquire Kenyons Lawyers (Nov. 12, 2009).

133. Press Release, Slater & Gordon Ltd., Slater & Gordon to Acquire Three Regional Practices (Nov. 20, 2007), http://www.slatergordon.com.au/docs/MediaReleases/Slater%20&%20Gordon%20to%20Acquire%20Three%20Regional%20Practices.pdf. For example, the acquisition of personal injury firm Nagle & McGuire in the Nowra region expanded Slater's presence in an area with a strong military presence, capitalizing on the acquisition of D'Arcys Solicitors, a military compensation practice. *Id.*

134. Daily historical stock prices are in Australian dollars and can be retrieved on the Reuters Finance website, http://www.reuters.com/finance/stocks, using Slater's stock symbol (SGH.AX). The low of A$1.25 was on October 13, 2008, and the high of A$1.98 was on September 11, 2007. Slater's stock fell 17.6% in 2008, which is modest in comparison to the rest of the global markets. The Dow Jones Industrial Average, for example, fell 33.8% in 2008. Vikas Bajaj, *Markets Limp into 2009 After a Bruising Year*, N.Y. TIMES, Jan. 1, 2009, at A1.

135. *Compare* SLATER & GORDON LTD., *supra* note 68, at 33–35, *with* Slater & Gordon Ltd., Board & Management, http://www.slatergordon.com.au/pages/investors_boardmanagement.aspx (last visited Dec. 15, 2009).

136. SLATER & GORDON LTD., *supra* note 131, at 1. Slater had revenue of $62.9 million and $79.7 million in fiscal year-end June 2007 and June 2008, respectively. *Id.* Net profit after tax was $10.7 million and $15.1 million in fiscal year-end June 2007 and June 2008, respectively. *Id.*

19.0% at fiscal year-end 2008.[137] Even during the financial downturn of late 2008, Slater reported a 35.0% increase in revenue and 22.4% increase in net profit after taxes for the six months ending December 31, 2008, over the previous corresponding period.[138]

Integrated Legal Holdings Limited (Integrated) was the second Australian law firm to go public after the regulatory changes.[139] As its name suggests, Integrated is a holding company that does not itself provide legal services but rather acquires independent firms and provides a national support network.[140] Integrated's public debut has not been as smooth as Slater's experience. The ASIC issued stop orders on Integrated's prospectus,[141] which forced extended negotiations over disclosure in the prospectus.[142] Further, the Legal Practice Board of Western Australia (LPBWA) issued a statement raising "serious concerns" about the firm's issuance.[143] The concerns related to the firm's calculation of goodwill and the total consideration received by Foundation Partners and related entities.[144] The share price closed at A$0.14 per share on November 6, 2009, a sharp decline from its issue price of A$0.50 per share in August 2007.[145] The company replaced its chief executive in April 2008 and remains confident in its business model.[146] The legal community is

137. *See id.* Profit margin is calculated as net profit after taxes divided by revenue.

138. SLATER & GORDON LTD., PRESENTATION FOR RELEASE TO MARKET ON HALF YEAR RESULTS 3–4 (2009), http://www.slatergordon.com.au/docs/Governance%20docs/2009/SGH%20FY%2009%20Half%20Year%20Presentation%20(FINAL)%20(2).pdf; Brian Baxter, *Dow Might Be Down, but Stock of One Law Firm Is Up*, AMLAW DAILY, Feb. 26, 2009, http://amlawdaily.typepad.com/amlawdaily/2009/02/dow-might-be-down-but-stock-up-for-one-law-firm.html.

139. Integrated was incorporated in June 2006 and went public in August 2007. INTEGRATED LEGAL HOLDINGS LTD., *supra* note 77, at 23, 91; *see also* INTEGRATED LEGAL HOLDINGS LTD., ANNUAL REPORT FOR THE YEAR ENDED JUNE 30, 2008, at 1 (2008).

140. INTEGRATED LEGAL HOLDINGS LTD., *supra* note 77, at 12.

141. The ASIC issues a stop order on disclosure documents, like a prospectus, if "some information that would affect an investor's decision is misleading or missing from the document or there are new circumstances that an investor needs to know about." Austl. Sec. & Inv. Comm'n, Stop Orders on Offer Documents, http://www.asic.gov.au/fido/fido.nsf/byheadline/Stop+orders+on+offer+documents?openDocument (last visited Dec. 15, 2009).

142. Carolyn Batt, *Watchdog Puts Stop on Law Float*, W. AUSTRALIAN, May 18, 2007, at 49.

143. *Id.*; *see also* INTEGRATED LEGAL HOLDINGS LTD., *supra* note 77, at 3. For a timeline of events concerning the ASIC and LPBWA leading up to Integrated's public offering, see Christine Parker, *Peering Over the Ethical Precipice: Incorporation, Listing, and the Ethical Responsibilities of Law Firms* 50–51 (Univ. of Melbourne Legal Studies, Research Paper No. 339, 2008), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1132926#.

144. INTEGRATED LEGAL HOLDINGS LTD., *supra* note 77, at 3.

145. *Id.* at 4. Integrated's daily historical stock price can also be found on the Reuter's Finance website, http://www.reuters.com/finance/stocks, using Integrated's stock symbol (IAW.AX).

146. Press Release, Integrated Legal Holdings Ltd., 2008 Full Year Result and Dividend Announcement 2, 5 (Aug. 28, 2008), *available at* http://www.ilh.com.au/MediaCentre.asp (follow "2008 Full Year Result and Dividend Announcement" hyperlink); Press Release, Integrated Legal Holdings Ltd., ASX/Media Announcement: Managing Director/Chief Executive Officer (Apr. 21, 2008), *available at* http://www.ilh.com.au/MediaCentre.asp (follow "Appointment of MD/CEO" hyperlink).

watching these trail blazers to see how they navigate nonlegal investment.[147]

b. The United Kingdom

In October 2007, the United Kingdom passed the Legal Services Act of 2007 (U.K. Act) in response to concerns about its overly complex regulatory structure, its complaint systems, and the restrictive nature of existing firm structures.[148] The legislation was the result of over three years of independent and government study of the country's legal regulatory framework.[149] The U.K. Act first set forth regulatory objectives to guide the governing bodies[150] and professional principles to guide attorneys.[151]

The U.K. Act created a two-tiered regulatory structure. First, it created the Legal Services Board (LSB) as the oversight regulator "to promote the regulatory objectives."[152] The U.K. Act then created a second tier of "approved regulators" that will provide day-to-day regulation.[153] It also created two new forms of practice: Alternative Business Structures (ABS)[154] and Legal Services Bodies (LSB).[155] ABS regulation

147. *See, e.g.*, Jason Krause, *Selling Law on an Open Market*, A.B.A. J., July 2007, at 34, 35 ("The U.S. legal community may be in a fortunate position as a follower and not a leader on this issue. Observers say it's better to let Australia and the U.K. experiment before the U.S. considers any changes."); Richard Lloyd, *A Public Debut*, AM. LAW., June 2007, at 79, 79. Indeed, the results from Australia have been positive. There has been no ethical apocalypse, as was predicted. Mark & Gordon, *supra* note 11, at 532–33. Rather, New South Wales regulatory officials have found that the regulatory system has been adequate to manage the challenges, and that despite the challenges, the benefits have been even greater. *Id.*

148. *See* CLEMENTI, *supra* note 105, at 1. The Clementi Report presents the results of a government-ordered independent analysis of the U.K. legal regulatory structure. DeBuse, *supra* note 29, at 331–33.

149. DeBuse, *supra* note 29, at 332–33. The Clementi Report was followed by a government review before the eventual introduction of the U.K. Act. *Id.*

150. Legal Services Act, 2007, c. 29, § 1(1) (Eng.).

151. *Id.* § 1(3). The professional principles specifically address many of the criticisms of outside ownership. The professional principles set forth are:

> (a) that authorised persons should act with independence and integrity,
>
> (b) that authorised persons should maintain proper standards of work,
>
> (c) that authorised persons should act in the best interests of their clients,
>
> (d) that persons who exercise before any court a right of audience, or conduct litigation in relation to proceedings in any court, by virtue of being authorised persons should comply with their duty to the court to act with independence in the interests of justice, and
>
> (e) that the affairs of clients should be kept confidential.

Id.

152. *Id.* § 3; *see also id.* sched. 1 (providing additional detail regarding membership and other provisions of the LSB).

153. *Id.* § 20 (definition of "approved regulators"); *id.* § 21 (list of "regulatory arrangements," or duties of the approved regulators); *see also id.* sched. 4 (listing the eight statutorily approved regulators, such as the Law Society and the General Council of the Bar).

154. *Id.* pt. 5.

includes both multidisciplinary practices and external nonlawyer investment.[156] Nonauthorized persons with a 10% or greater interest or ability to exercise "significant influence over the management" of an ABS are subject to approval by the relevant licensing authority.[157] Regulators, however, may modify the licensing terms of certain "low-risk bod[ies]" to allow for an ABS with minority—less than 10%—management and ownership by nonlawyers.[158]

Due to the time necessary to develop the required regulatory bodies for the ABS,[159] the U.K. Act created LSBs, monitored by existing regulatory bodies such as the Solicitors Regulatory Authority, to allow some nonlawyer investment during the transition period.[160] LSBs must have management composed of at least 75% lawyers.[161] Once the licensing scheme for the ABS is in place, any firm with nonlawyer management must become a licensed ABS.[162] Therefore, the LSBs are merely vehicles for helping smooth the transition to nonlawyer outside investment.

The U.K. Act also created an Office for Legal Complaints (OLC) to quickly and independently handle complaints regarding services regulated by the U.K. Act.[163] The OLC can investigate claims and provide redress for the complainant,[164] as well as report misconduct to approved regulators for potential disciplinary action.[165]

The questions of whether and how overseas firms will utilize the U.K. Act to implement investment and management changes remain uncertain because the regulatory structure is not yet fully in place. Early

155. *Id.* sched. 16 para. 82. These bodies are also known as Legal Disciplinary Practices. *See* SOLICITORS REGULATION AUTH., LEGAL SERVICES ACT: NEW FORMS OF PRACTICE AND REGULATION 3 (2007).

156. Legal Services Act, 2007, c. 29, § 72(1) ("A body ('B') is a[n] [ABS] if a non-authorised person—(a) is a manager of B, or (b) has an interest in B."); *id.* § 72(2) ("A body ('B') is also a[n] [ABS] if—(a) another body ('A') is a manager of B, or has an interest in B, and (b) non-authorised persons are entitled to exercise, or control the exercise of, at least 10% of the voting rights in A."). A "non-authorised person" is essentially a nonlawyer or an entity with 10% or more of its voting rights controlled by nonlawyers. *See id.* § 111.

157. *Id.* sched. 13 paras. 1–3. Approval requires that the person or entity's interest does not compromise the regulatory objectives nor the ability of a licensed person's section 176 duties. *Id.* sched. 13 para. 6. The nonauthorized owner may also be subject to a fitness test. *Id.* The licensing authority can impose further conditions on a restricted interest or require a divesture of ownership. *Id.* sched. 13 paras. 33, 38, 41–43.

158. *Id.* §§ 106–108.

159. The Solicitors Regulation Authority indicated that the regulatory framework for the ABS likely will not be in place until at least late 2011. SOLICITORS REGULATION AUTH., *supra* note 155, at 3; *see also* Solicitors Regulation Authority, Legal Services Act FAQs, http://www.sra.org.uk/sra/legal-services-act/lsa-questions-faqs.page (listing anticipated dates for implementation of the regulations) (last visited Dec. 15, 2009).

160. Legal Services Act, 2007, c. 29, sched. 16 para. 82 (Eng.); SOLICITORS REGULATION AUTH., *supra* note 155, at 3.

161. Legal Services Act, 2007, c. 29, sched. 16 para. 82 (Eng.).

162. SOLICITORS REGULATION AUTH., *supra* note 155, at 4.

163. Legal Services Act, 2007, c. 29, §§ 113–114 (Eng.); *see also id.* sched. 15.

164. *Id.* §§ 113(1)–(2), 137.

165. *Id.* §§ 113(4)–(5), 143.

indications show that the U.K. Act has generated interest in the investment community; it is less clear how interested the law firms would be in the outside capital.[166] One estimate, however, indicates that over the next five years, a quarter of U.K. firms could raise outside capital.[167] These international changes will significantly impact how the United States views its investment restrictions.

3. The Importance of Changes in the Legal and International Environment for Future Law Firm Investment

The immediate changes in international investment rules and the increasingly competitive and business-like legal environment have raised the question of how U.S. firms will react. The ability of U.K. firms to raise outside capital could threaten U.S. firms' competiveness.[168] The United States and United Kingdom dominate the world's legal markets.[169] U.S. firms, particularly in the New York market, that compete directly with large U.K. firms will want the same ability to raise public capital as their British competitors.[170] New York firms are already behind their British Magic Circle counterparts in terms of international

166. SOLICITORS REGULATION AUTH., *supra* note 155, at 11 ("It is clear that the Act is of interest to many commercial organisations and investment groups who would want to own or invest in law firms. Some are making preliminary soundings of existing firms, and others are, we believe, making firm proposals."); Lloyd, *supra* note 147, at 80. *But see* Christopher J. Whelan, *The Paradox of Professionalism: Global Law Practice Means Business*, 27 PENN ST. INT'L L. REV. 465, 484–85 (2008) (indicating that law firms may prefer to remain as traditional partnerships); Lindsay Fortado, *Private Equity Considers Investing in U.K. Law Firms*, BLOOMBERG, Aug. 3, 2009, http://www.bloomberg.com/apps/news?pid=20601085&sid=asso5puZd5fA; Michael Herman, *Legal Services Set for 'Big Bang' as Buyout Fund Targets Law Firms*, TIMES ONLINE (London), Mar. 6, 2008, http://business.timesonline.co.uk/tol/business/law/article3497281.ece.

167. Herman, *supra* note 166.

168. Anthony E. Davis, The Future of the Global Law Firm, Remarks at the Georgetown Symposium on the Future of the Global Law Firm (Apr. 17, 2008) (transcript available at http://www.law.georgetown.edu/LegalProfession/Papers.html; then follow "Comments of Anthony E. Davis" hyperlink) ("[T]he Legal Services Act will in fact provide a launching pad for the Magic Circle (and other English based) firms to *eat our lunch*."); *see also* Martha Neil, *British Law Firms May Go Public, Too*, A.B.A. J., June 12, 2007, http://www.abajournal.com/news/british_law_firms_may_go_public_too/ ("If the English firms can sell stakes in their law firms publicly, that will then give them an advantage. . . . If the rules were to change, we would then examine what's in our best interest to do." (quoting the CEO of a San Francisco law firm)).

169. D. Daniel Sokol, *Globalization of Law Firms: A Survey of the Literature and a Research Agenda for Further Study*, 14 IND. J. GLOBAL LEGAL STUD. 5, 9–11 (2007).

170. Martha Neil, *Egads! Will US Law Firms Go Public?*, A.B.A. J., Aug. 13, 2007, http://www.abajournal.com/news/egads_will_us_law_firms_go_public (quoting Bruce MacEwen that "[i]f a magic-circle firm were to . . . go public and have access to the deep pool of capital, they could use it to build their practices in New York, and the first thing you would hear out of the mouths of managing partners is 'we need a level playing field'" (alteration in original)). "Magic Circle" refers to the top five U.K. law firms: Allen & Overy, Clifford Chance, Freshfields Bruckhaus Deringer, Linklaters, and Slaughter and May. Law Britannica.co.uk, Glossary of Legal Terms, Magic Circle, http://www.lawbritannia.co.uk/Reference.htm#magic (last visited Dec. 15, 2009).

growth.[171] The ability to raise public capital could provide the Magic Circle firms even more international growth opportunity.

Furthermore, nonlawyer investment and management could change a firm's approach to delivering legal services and lead to innovation with nontraditional methods of service.[172] A fresh perspective from outside the legal community would bring innovation and insight that those inside the community cannot or are not willing to envision.[173] The innovation in delivery of service, in addition to the already significant impact of developing technology,[174] will increase efficiency and lower the cost of legal services.[175] U.S. firms competing with U.K. firms will be disadvantaged if they do not develop and offer more cost-effective and efficient services. Economic pressure has brought change in the past;[176] economic pressure from international competition could persuade a change in the investment rules.[177]

In addition to creating economic pressures, the U.K. Act creates uncertainty as to what multinational firms can do in the differing regulatory environments of the United States and the United Kingdom.[178] Cross-border development has become an important facet of current legal practice.[179] The regulatory conflict created by the U.K. Act could inhibit or threaten cross-border practice.[180] The U.K. Act does include a

171. *See* E. Leigh Dance, Think Again About Globalization—A Guest Column, Adam Smith, Esq., http://www.adamsmithesq.com/blog/archives/2008/10/think_again_about_globali.html (Oct. 28, 2008, 11:42).

172. SUSSKIND, *supra* note 71, at 10 ("[T]he delivery of legal services will be a very different business when financed and managed by non-lawyers." (emphasis omitted)); Lippe, *supra* note 74.

173. SUSSKIND, *supra* note 71, at 254 ("Just as librarians did not invent Google, lawyers may not create tomorrow's innovations in legal practice.").

174. See the discussion of technological changes in the modern legal environment, *supra* Part II.B.1.c.

175. SUSSKIND, *supra* note 71, at 11 ("The new wave of [public] investors and managers will surely find that individual law firms and the legal profession are inefficiently resourced and often overresourced."); Lippe, *supra* note 74.

176. Krause, *supra* note 147, at 34. Pressure from the economic downturn is already prompting innovation in the delivery of legal services within the current Model Rules. *See supra* notes 73–76 and accompanying text.

177. MacEwen, Regan & Ribstein, *supra* note 6, at 91 ("[I]nternational competition could break down the resistance of tradition and history."); James Podgers, *Work in Progress:* Change *Is Becoming the Byword that Characterizes the Legal Ethics Field*, A.B.A. J., Oct. 2008, at 25, 25 ("If we cannot develop a system [of regulation] that will bend under the pressure of the international economy, we will break." (citation omitted)).

178. *See* Sydney M. Cone, III, *International Legal Practice Involving England and New York Following Adoption of the United Kingdom Legal Services Act 2007*, 28 NW. J. INT'L L. & BUS. 415, 431–32 (2008); Posting of Jeff Jeffrey to The Blog of Legal Times, Changes in Regulations of U.K., Australian Lawyers Could Affect U.S., http://legaltimes.typepad.com/blt/2009/04/changes-in-regulations-of-uk-australian-lawyers-could-impact-us.html (Apr. 21, 2009, 13:04). Domestic firms with offices abroad and foreign firms with domestic offices face uncertainty as to how to develop cross-border practice.

179. *See supra* Part II.B.1.b.

180. Cone, *supra* note 178, at 435 ("When two international legal centers as important as England and New York become mutually 'problematic' with respect to recent regulatory developments, the cross-border practice of law can be seriously inhibited or threatened.").

provision for modification of the regulations for foreign firms,[181] but the provision provides no substantive guidance for foreign-based firms practicing in the United Kingdom. Leaving questions of how to apply the differing regulations to cross-border practice in the hands of public enforcement and private litigation will be costly.[182] The economic pressures and regulatory uncertainty in the global legal environment not only renew the debate of nonlawyer investment domestically, but also raise the stakes in how we will react to these internal and international developments.

III. ANALYSIS

If the restrictions on investment in Model Rule 5.4 were modified, many possible investment models could evolve in the United States based on models already being used overseas and creative models adapted to the unique needs of the legal industry. The complexity and variety of modern legal practices suggest that allowing multiple investment models would benefit the profession. Given the wide range of investment and direct ownership structures, the next step in the outside investment debate is to carefully analyze these models and how they respond to the arguments for and against allowing such investment. A better understanding of the potential investment and ownership models is necessary to fully understand the ethical effects and long-term benefits of allowing law firms to raise outside capital. This analysis and understanding will then provide the building blocks for further study of how to responsibly modify, if at all, Model Rule 5.4 to allow for beneficial outside investment without compromising professional ethics.

This Note analyzes five potential investment models. Slater and Integrated present two very different direct ownership models: traditional outside ownership and holding company models, respectively. U.S. firms can use the experience of these publicly owned firms to gain perspective in how to structure domestic firms.[183] These models, however, would require the most significant changes in the Model Rules. Legal scholars and commentators have proposed more moderate models, such as allowing minority direct ownership or creating legal-related derivative security investments. Lastly, the concept of investment in lawsuits—rather than in law firms—is an alternative that should be considered as well.

181. Legal Services Act, 2007, c. 29, § 109 (Eng.) ("The Lord Chancellor may by order make provision for the modification of any provision of this Part in its application to a body of persons formed under, or in so far as the body is recognised by, law having effect outside England and Wales.").

182. Cone, *supra* note 178, at 435.

183. *See supra* note 147 and accompanying text. For an analysis of the regulatory regime in New South Wales since it started allowing incorporated law firms in 2001, see Mark & Gordon, *supra* note 11.

A. Slater & Gordon: Traditional Direct Ownership Model

Slater has a traditional corporate ownership model with two classes of shareholders. Because of temporary share transfer restrictions, the Slater model is currently similar to the minority ownership model, but Slater could be controlled by outsiders in the near future. Slater has addressed many of the criticisms of public investment and has effectively leveraged its outside capital to benefit the firm in the long-run. Because of differences in the practice of law in the United States and Australia, however, the Slater model may not be as successful domestically.

1. Slater's Capital Structure

As in a traditional corporation, Slater's shareholders are the firm's owners. Its shareholders include board members and management, employees, and outside ownership.[184] The firm's capital structure has two classes of shares: ordinary shares and Vesting Convertible Redeemable (VCR) shares.[185] The ordinary shares consist of (1) shares owned by employees, including seven key individuals within the firm (Vendor Shareholders), (2) shares sold from Vendor Shareholders to the public, and (3) newly issued shares sold to the public.[186] Vendor Shareholders funded Slater's growth until the public offering and together still account for the majority of shares.[187] The public offering of shares was not actually open to the general public but rather was restricted to broker firms and institutional and professional investors.[188] About 80% of Slater's shares offered to outside investors are owned by fund managers.[189]

The Board offers VCR shares to the firms' employees.[190] These shares are not listed on the ASX, have no voting rights, and receive no dividends; however, the shares can be converted to ordinary shares upon vesting.[191] At the completion of the offering, Slater's capital structure

184. SLATER & GORDON LTD., *supra* note 68, at 15.

185. *Id.* at 15, 100.

186. *Id.* at 15. Vendor Shareholders and other employees held 77.6 million shares before the offering, with Vendor Shareholders accounting for 69.9 million of the shares (including "Shares converted from Foundation Shares"). *Id.* at 86. 17.3 million of the Vendor Shareholders' existing shares were sold to new shareholders under the Prospectus, and an additional 17.7 million shares were newly issued. *Id.*

187. *Id.* at 15. See also the discussion of the Vendor Shareholders as majority owners, *infra* notes 196–97 and accompanying text.

188. SLATER & GORDON LTD., *supra* note 68, at 17.

189. MacEwen, *supra* note 25, at 2. Outside shareholders include, for example, National Nominees Limited, RBC Dexia Investor Services Australia Nominess Pty Limited, Citicorp Nominees Pty Limited, HSBC Custody Nominees (Australia) Limited, and Craig Lee (Lee Super Fund). SLATER & GORDON LTD., *supra* note 131, at 81.

190. SLATER & GORDON LTD., *supra* note 68, at 15.

191. *Id.* at 15, 89. The Board sets vesting conditions, which "relate to the performance of the participant and the performance of the Company." *Id.* at 89. If the employee has met the vesting conditions and has not forfeited the shares through departure or other forfeiture conditions, the shares will vest and automatically convert to ordinary shares. *Id.* The converted shares can be forfeited or

was as follows: 55.9% ordinary shares held by existing shareholders, 32.5% ordinary shares held by the public, and 11.6% VCR shares.[192]

At the outset, the firm's ownership model is similar to a minority outside ownership model.[193] Outside owners initially accounted for only a minority, or 32.5%, of total shares and only 36.8% of voting shares.[194] Existing shareholders held the majority, or 63.2%, of the voting shares at the time of the public offering.[195] Not only is the nonlawyer ownership a minority, share ownership—and therefore control—was heavily concentrated in the top board members and management. Three of the five directors held a combined 28.4% of the voting shares.[196] The three board members and four other members of management accounted for 55.2% of the voting shares.[197] The concentration of ownership in the firm's attorneys, especially those in management positions, is consistent with the minority ownership model.

The Slater model, however, differs in that Slater does not restrict outside ownership and investment indefinitely. Slater imposed share transfer restrictions on both the Vendor Shareholder and current employees.[198] Vendor Shareholders entered into a Shareholders Agreement to restrict their sale of shares over a five year period.[199] The agreement restricts partners from selling greater than 20% of their shares per year.[200] The Shareholders Agreement also requires Vendor Shareholders to maintain a minimum amount of shares while employed at the firm and to transfer some or all shares back to the firm upon departure from the firm.[201] Employee shareholders other than Vendor Shareholders are also

bought back by Slater upon an employee's departure. *Id.* For three years after conversion, an employee cannot transfer converted VCR shares. *Id.* After those three years, the employee is subject to minimum holding requirements. *Id*. In fiscal year-end June 2008, over five million VCR shares vested and were converted into ordinary shares. SLATER & GORDON LTD., *supra* note 131, at 61.

192. SLATER & GORDON LTD., *supra* note 68, at 15.

193. *See infra* Part III.C.

194. SLATER & GORDON LTD., *supra* note 68, at 15, 86. Shares initially held by outside owners were those sold pursuant to the Prospectus; total shares include VCR Shares, whereas voting shares do not. *Id.* at 86. VCR shares held by employees have no voting rights. *See supra* notes 190–91 and accompanying text.

195. SLATER & GORDON LTD., *supra* note 68, at 86.

196. *Id.* at 83, 86, 94.

197. *Id.* at 15, 86.

198. *Id.* at 87–88.

199. *Id.* at 37–38, 88. After the offering, Vendor Shareholders held 52.6 million shares, which account for 48.8% of the total shares and 55.2% of the voting shares (excludes VCR shares).

200. *Id.* at 37–38, 88. The restriction, however, is through a Shareholder's Agreement, and thus the firm has no enforcement power over the agreement. *Id.* at 37, 88. Only the other Vendor Shareholders, who are parties to the agreement, can enforce compliance. *Id.*

201. *Id.* at 88. Vendor Shareholders employed at Slater must maintain a minimum of "the lower of 5 times their annual salary and 20% of their shareholding at the time of Listing." *Id.* Vendor Shareholders will determine the penalties of departure based on the circumstances of the departure. *Id.* Transfer of shares upon departure is for "nominal consideration." *Id.* Employees of acquired firms who own existing shares are also subject to similar provisions restricting the sale of shares over a five-year period, subject to minimum holding requirements and share transfers based on status of employment at Slater. *Id.* at 87.

required to hold a minimum share amount.[202] Therefore, the current composition of nonlawyer to lawyer owners may change over time so that nonlawyers could increasingly gain more control.

2. Slater and the Outside Investment Debate

Slater's experience going public illustrates various means to mitigate the ethical and professional concerns while also reaping the benefits of outside capital investment.

a. Slater's Response to Ethical and Professional Concerns

Slater has acted in response to many of the ethical and professional concerns critics voiced regarding public investment in law firms. The firm has addressed the potential conflict of interest between serving clients and serving the public and courts through disclosures that acknowledge the risk and explain the firm's risk-mitigating practices. Slater remains committed to its philanthropic and social causes, negating any inference that social utility will decrease if a law firm is publicly owned. The firm's share transfer and minimum holding restrictions, in part, limit the ability of partners to merely cash out the firm's value after the public offering and limit the influence of outside owners on a firm's professional judgment. Finally, Slater's public investor restrictions could be analogized to hedge fund investor restrictions in the United States, therefore reducing required regulatory disclosures and mitigating client confidentiality concerns.

Slater includes numerous risk disclosures in its prospectus to address concerns regarding the potential conflict of interest between serving a client and an attorneys' duty to the court and public. Its prospectus clearly discloses that the firm's foremost loyalties are to the court and its clients.[203] Slater negotiated with regulatory authorities to be able to unequivocally state that the client takes priority over the shareholder.[204] In addressing key risks, the firm indicates that duties to the court and clients may require the firm to act "contrary to other corporate responsibilities and against the interests of Shareholders and the short-term profitability of the Company."[205] Slater has chosen to address the conflict of interest risk through disclosure, and once the firm has disclosed its primary duties

202. *Id.* at 87, 89.

203. *Id.* at 36 ("To the extent that there is a conflict or potential conflict between those duties, that conflict shall be resolved as follows: the duty to the Court will prevail over all other duties; and the duty to the client will prevail over the Company's other corporate responsibilities and duty to shareholders."). The firm reinforces its priorities to the court and client in its Corporate Governance Policy. SLATER & GORDON LTD., CORPORATE GOVERNANCE STATEMENT 1 (Aug. 23, 2007), http://www.slatergordon.com.au/docs/Governance%20docs/Board%20Corporate%20Governance%20Policy%20final%20230807.pdf.

204. MacEwen, *supra* note 25, at 2.

205. SLATER & GORDON LTD., *supra* note 68, at 84.

to the client and courts, the investors and market can decide whether to take the risk of investment.[206]

To further address the conflict of interest risk, the firm has embraced the attitude that putting clients first will benefit investors in the long-run.[207] In recognizing and managing the risk of conflict, the firm requires its lawyers to sign its "National Practice Standards," which provide proper procedures for client service.[208] The National Practice Standards "assist in embedding a culture where the ethical and professional responsibilities of lawyers are given primacy."[209] The firm also has a Code of Conduct to regulate employee behavior and ensure that its lawyers comply with all obligations.[210] The firm's ethics code and compliance programs are relevant to an investor's risk assessment. Providing investors with full disclosure of the risk as well as the firm's risk-mitigating practices will help the market to make better investment decisions when considering whether to accept such risk.

In response to the argument of a decreasing social utility, Slater states in its prospectus that it will continue to be committed to public interest matters and reiterates this social commitment in its Corporate Governance policies.[211] The firm continues to offer its "No Win, No Fee" policy for personal injury cases, which improves public access to the legal system.[212] The firm also continues to fund two philanthropic causes, the Slater & Gordon Fund and the Asbestos Research Fund.[213] Thus, there is

206. *See supra* note 64; *see also* Regan, *supra* note 67, at 424 (indicating that the primary duty to clients over shareholders could be "taken into account in the price of the firm's shares in the market").

207. MacEwen, *supra* note 25, at 2 ("From the firm's perspective, 'there was no uncertainty for us as lawyers which came first [clients or investors], but we needed to convince institutional investors that their best long-run interest would be served if we continued to put clients first.'" (alteration in original) (quoting Slater Managing Director Andrew Grech)). Certainly a firm's culture towards addressing these conflicts of interest is important, but it is questionable whether culture alone can prevent conflicts from arising. A structural incentive, such as the level of separation in the holding company model, would be more effective. *See infra* Part III.B.2.a.

208. SLATER & GORDON LTD., *supra* note 68, at 28. Annual reviews of practice groups ensure compliance with these standards. *Id.*

209. *Id.*

210. SLATER & GORDON LTD., CODE OF CONDUCT (Aug. 23, 2007), http://www.slatergordon.com.au/docs/Governance%20docs/Board%20Code%20of%20Conduct%20Rules%20Final%20230807.pdf; SLATER & GORDON LTD., *supra* note 203, at 2.

211. SLATER & GORDON LTD., *supra* note 68, at 29; SLATER & GORDON LTD., *supra* note 203, at 4.

212. SLATER & GORDON LTD., *supra* note 68, at 29; Slater & Gordon Ltd., No Win—No Fee, http://www.slatergordon.com.au/pages/no_win_no_fee.aspx (last visited Dec. 15, 2009) (stating that the fee arrangement "was created in direct response to growing community concern that access to legal justice was beyond the reach of many"). In changing its laws to allow outside ownership of law firms, the United Kingdom also emphasized "improving access to justice" as a major objective. Legal Services Act, 2007, c. 29, § 1(c) (Eng.); s*ee also* Krause, *supra* note 147, at 35.

213. SLATER & GORDON LTD., *supra* note 131, at 16, 17. In line with the firm's stated interest in opening legal services to the public, the Fund focuses on "people who find themselves marginalised or vulnerable as a result of the catastrophic financial effects of injury." Slater & Gordon Ltd., Slater & Gordon Fund, http://www.slatergordon.com.au/pages/slater_gordon_fund.aspx (last visited Dec. 15, 2009). The firm's philanthropic activities are no different than any other corporate philanthropic endeavors. *See* Farrell, *supra* note 39, at 734–37 (discussing philanthropy in the corporate world).

no indication that Slater's public offering has made the firm any less socially conscious.

The share transfer and minimum holding restrictions imposed on Vendor Shareholders and employees address, at least in part, the concerns regarding partners' true motivations for raising outside capital and the influence of outsiders on professional judgment. These restrictions first mitigate concerns that partners would merely cash out and ride off into the sunset with the firm's value.[214] The restrictions also lessen the ability of outside owners to influence the firm's professional judgment because employee shareholders are more likely to hold a controlling interest. The transfer restrictions last only five years,[215] which allows for a significant change in control in a relatively short time period. Managing Director Andrew Grech "expect[s] that employee shareholders will retain a majority and if not a controlling interest for the foreseeable future . . . ."[216] Nevertheless, outside investors could control the firm in five years. Therefore, the transfer restrictions only in part address the partner motivation and professional judgment concerns.

Finally, restricting outside or public sales to broker firms and institutional and professional investors illustrates a potential means for limiting client confidentiality concerns in the United States. The restriction is similar in principle to the investor restrictions for hedge funds. Hedge fund investment is restricted to "accredited investor[s]"—mainly large institutions and high net worth individuals.[217] Because investment is limited to these accredited investors, hedge funds are not subject to many of the Securities and Exchange Commission (SEC) regulations that mutual funds and brokerage firms are.[218] "Hedge funds typically issue securities in 'private offerings' that are not registered with the SEC under the Securities Act of 1933," and the funds "are not required to make periodic reports under the Securities Exchange Act of 1934."[219] Hedge funds are not subject to the same level of disclosure requirements that securities regulations impose on registered securities.[220]

If the class of investors for legal-related securities is restricted to such accredited investors, the SEC may permit less rigorous disclosure

214. *See supra* note 63 and accompanying text. MacEwen proposed in 2005 that if firms were to go public, they should "put restrictions on capital extraction, as well as set the expectations of investors for fast-cash-out suitably underwater." MacEwen, *supra* note 63.

215. SLATER & GORDON LTD., *supra* note 68, at 37–38.

216. MacEwen, *supra* note 25, at 2 (quoting Slater Managing Director Andrew Grech).

217. 15 U.S.C. § 77b(a)(15) (2006); *see also* Houman B. Shadab, *The Challenge of Hedge Fund Regulation*, REGULATION, Spring 2007, at 36, 36.

218. *See* DANIEL R. SOLIN, THE SMARTEST INVESTMENT BOOK YOU'LL EVER READ 74 (2006).

219. U.S. Sec. & Exch. Comm'n, Hedging Your Bets: A Heads Up on Hedge Funds and Funds of Hedge Funds, http://www.sec.gov/answers/hedge.htm (last visited Dec. 15, 2009).

220. *Id.* The government, however, has considered increasing regulation of hedge funds in response to the financial collapse of late 2008. Joshua Boak, *Fund Managers Hedge on Possible Regulation*, CHI. TRIB., Nov. 14, 2008, at 25; Sharon Otterman, *Volcker Suggests Ways to Refine Bank Regulations*, N.Y. TIMES, Feb. 4, 2009, http://www.nytimes.com/2009/02/05/business/05bank.html.

regulations.[221] With less rigorous disclosure requirements, the concern for client confidentiality is reduced. The majority of hedge funds voluntarily choose to register and disclose additional information in response to investor demand for increased transparency.[222] Without mandatory disclosure requirements, however, hedge funds are able to weigh the costs and benefits of further disclosure.[223] Reducing mandatory disclosures for legal-related securities would allow a law firm seeking to raise outside capital to disclose as much as it is chooses without compromising client confidences; the investors can then decide whether to invest.[224]

b. The Benefits of Outside Capital

Slater has benefited from the outside capital investment through growth of the firm and reduced reliance on partners for funding conditional cases. The firm has focused on long-term capital investment in intangibles. Its employee share plan also provides Slater an advantage in the competition for attorney talent.

Previously, partners invested substantial personal capital and reduced year-end draws to fund conditional fee cases.[225] This led to a need for public capital in order to fund the firm's growth.[226] Slater indicated that public funds would "be used to pursue the Company's growth strategy, including an ongoing acquisition program and the acceleration of the organic growth of the business through national brand building initiatives."[227] The firm also wants to expand its presence outside its core personal injury practice.[228] As a plaintiff's firm, Slater has utilized equity

221. The outside investment debate lacks a detailed analysis of how a law firm security would be regulated under current securities law, as well as what regulatory changes might be appropriate for such specialized security, given the client confidentiality concerns. The securities regulation aspect is an important aspect of the public ownership debate and is one example of an area that should be given further consideration.

222. Shadab, *supra* note 217, at 41.

223. *See id.*

224. *See* Andrews, *supra* note 5, at 630–31; Lloyd, *supra* note 147, at 80 ("Once a firm lists, [the equity's value] becomes a question for the public markets to decide. Partners tend to have an understandable confidence in the value of their firms as business enterprises. It's not clear yet whether shareholders will agree."); *supra* note 64 and accompanying text.

225. *See* MacEwen, *supra* note 25, at 3. The firm has a "No Win-No Fee" policy for personal injury cases. *See supra* note 212 and accompanying text. Conditional fee arrangements are different from the contingency fee arrangements used in the United States. Under conditional fee arrangements, clients pay costs and legal fees plus an "uplift," calculated as a percentage of the total costs. AINSLIE LAMB & JOHN LITTRICH, LAWYERS IN AUSTRALIA 121 (2007); Slater & Gordon Ltd., *supra* note 212. Under a contingency fee arrangement, clients pay fees as a percentage of their award or settlement. Under either arrangement, however, the firm must bear significant costs for the duration of the litigation. Slater uses its public capital to ease the pressure of its "No Win-No Fee" program.

226. *See* MacEwen, *supra* note 25, at 3.

227. SLATER & GORDON LTD., *supra* note 68, at 10.

228. *Id.* Going public has allowed the firm to better align incentives to focus on the firm's collective performance rather than each individual practice. Practices now have the incentive to collaborate with other developing groups. *See* MacEwen, *supra* note 25, at 4.

capital as a means to expand its ability to finance litigation beyond partner contributions.

Slater also has utilized the outside capital to invest in many of the intangibles in which law firms typically underinvest. The firm has developed metrics for evaluating capital investment in areas that do not directly contribute revenue, such as professional development, marketing, human resources, and technology.[229] Providing capital for investment in these traditionally underfunded areas is one of the main benefits touted by proponents of outside investment.[230]

Slater's ownership model also includes an employee share plan.[231] The plan directly addresses the issue that firms face in recruiting and retaining top talent in the competitive legal market. The firm implemented the plan to give key employees "a personal stake in the Company's performance and success" and "to provide incentives to, and assist in retaining key employees."[232] The employee ownership plan allows Slater to give associates an ownership stake faster than the traditional partnership track. In current partnership models, the division between owners (partners) and nonowners (associates) is clear and difficult to hurdle. Associates must commit years of work for partnership consideration, with no guarantees of admittance.[233] The employee ownership plan addresses Slater's concern of recruiting and retaining quality attorneys by providing ownership prospects outside of the traditional partnership track.[234]

3. Why Slater's Model May Not Work in the United States

The Slater model, however, may not be as successful for U.S. firms.[235] To start, the firm enjoys a significant advantage from market recognition. Slater has an established brand name in Australia and operates throughout almost all of the country.[236] The firm has stated that this

229. *See* MacEwen, *supra* note 25, at 4.

230. *See supra* Part II.A.2.

231. SLATER & GORDON LTD., *supra* note 68, at 15, 88; *see also supra* Part III.A.1.

232. SLATER & GORDON LTD., *supra* note 68, at 15. At the time of its prospectus, thirty-two employees participated in the employee ownership plan. *Id.* at 89. The firm's 2007–2008 Annual Report indicates that the employee ownership plan had over forty participants at year-end June 2008. SLATER & GORDON LTD., *supra* note 131, at 7.

233. *See* Galanter & Henderson, *supra* note 6, at 1883 ("At the end of some predetermined time period (usually six to ten years), the prize of partnership was awarded to the associates who had performed the best in terms of high-quality legal work and the production of additional excess human capital." (footnote omitted)).

234. *See* MacEwen, *supra* note 25, at 2 ("Without access to a long-term equity asset, there was tremendous tension between senior partners with ownership interests and associates with no immediate ownership prospects.").

235. Slater itself has identified four qualities basic to its effectiveness as a business structure: (1) "a sustainable business model," (2) "management capacity to deal with the increased regulatory burden," (3) comfort with "the increased transparency," and (4) "a need for capital." Grech & Morrison, *supra* note 128, at 540.

236. SLATER & GORDON LTD., *supra* note 68, at 10. The firm reported that its name had general public awareness of 60% nationally and 83% in Melbourne. *Id.*

recognition allows the firm to attract clients institutionally instead of through the individual attorneys employed by the firm.[237] Reduced reliance on individual attorney-client relationships gives the firm more freedom to monitor its employees without the risk of the attorney, and therefore the client business, departing for another firm.[238]

U.S. firms rely much more on individual attorney-client relationships rather than on clients' relationship with the firm. Partners are valued by their current book of business, not their long-term value to the firm.[239] U.S. firms are much more vulnerable to partners picking up and moving their business to another firm that is willing to pay more right away.[240] "Restrictions on non-competition agreements prevent firms from giving their lawyers incentives to build firm capital, including the firm's reputation . . . ."[241] Without having a more long-term commitment from partners, investors may be weary of investing directly in any particular firm.[242] Outside investment, on the other hand, could help build firm capital and transition U.S. firms from partner-based to firm-based relationships.[243]

Further, Slater's culture traditionally has encouraged capital investment, albeit from partners and reduced year-end draws.[244] Firms that have a culture in which partners withdraw 100% of the profits at year-end for their own personal benefit—often referred to as strip-mining the firm—may resist the firm's change to focusing on long-term profitability.[245] Under the current partnership structure, "partners have every in-

237. *Id.* at 25 ("Most new clients come to the Company rather than through individual lawyers."). The firm also states: "[A] large percentage of new client enquiries come to Slater & Gordon because of its general reputation and brand awareness." *Id.*

238. *Id.* ("The power of the Slater & Gordon brand, can in certain practice areas, minimise the impact of the departure of individual lawyers.").

239. *See* Larry E. Ribstein, Law Firms as Firms 5 (Apr. 17, 2008) (unpublished manuscript), http://www.law.georgetown.edu/LegalProfession/documents/RibsteinWebsitePaper.pdf [hereinafter Ribstein, Law Firms as Firms].

240. *See* MacEwen, Regan & Ribstein, *supra* note 6, at 74 ("[F]irms have only limited ability to regulate the behavior of their lawyers, because they are keenly aware that rainmakers may decamp for other firms if there is any effort to encroach on their freedom of action."); Ribstein, Law Firms as Firms, *supra* note 239, at 5.

241. Ribstein, Law Firms as Firms, *supra* note 239, at 5; *see also* MacEwen, Regan & Ribstein, *supra* note 6, at 74 & n.18. Lawyers are prevented from entering noncompete agreements by Model Rule 5.6. MODEL RULES OF PROF'L CONDUCT R. 5.6 (2008).

242. One of the benefits of having an index-based derivative security, discussed *infra* Part III.D., is that the "index-based security would capture the lateral partners' revenue from both firms, resulting in an increase or decrease only if the lateral partner personally brings in more or less business." Tonio D. DeSorrento & Geoffrey R. Thompson, *Something Short of Selling Out: Derivatives-Based Innovation in the Legal Profession and Capital Markets*, 21 GEO. J. LEGAL ETHICS 577, 588 (2008).

243. *See* Regan, *supra* note 67, at 428–29.

244. MacEwen, *supra* note 25, at 3.

245. *See* Karen MacKay, *What Will Work to Motivate Tomorrow's Firm Leaders (and What Do Today's Leaders Think)?*, LEGAL MGMT., July–Aug. 2005, at 38, 44 ("One managing partner told me recently that one of his greatest challenges is to resolve the tension between partners who want to 'strip-mine the firm every year' and those who want to 'invest in the future.'").

centive to 'stripmine the firm' . . . at the end of every fiscal year."[246] Like building firm capital, transitioning a firm's culture from a year-end payout to a long-term perspective would be a significant undertaking with uncertain results. Proponents of outside investment cite the benefits that would flow from such a cultural transition as a reason to allow such investment.[247] Firm culture regarding long-term versus short-term goals would have to be addressed before a model like Slater's could be successful in the United States. On the other hand, a change in the ownership structure to one similar to Slater's structure, which better incentivizes adopting a long-term focus, could also be the catalyst for law firms and partners to embrace such a cultural transition.[248]

Regulation of the legal profession by each individual U.S. state also presents a problem for allowing direct ownership models like Slater. All Australian states and territories but one have adopted rules that allow for nonlawyer ownership and fee sharing.[249] Slater uses service agreements to accommodate practicing in South Australia, where such ownership and fee sharing is not allowed.[250] The general uniformity of regulation allows Slater to establish a national brand across Australia. In the United States, ethical rules are prescribed by the state courts and legislatures for their respective state bars.[251] The Model Rules currently have been adopted or heavily relied on by most states; however, if some states chose to adopt changes to allow for nonlawyer investment and other states do not, firms will face challenges in adhering to the different investment regulations across the fifty states.[252]

Current U.S. corporate law also presents a potential problem for direct ownership models. Slater negotiated with regulators to be able to unequivocally state that the shareholder is not the firm's top priority. U.S. corporate law, however, generally adheres to the shareholder wealth maximization principal.[253] U.S. regulators may not allow firms to

246. MacEwen, Regan & Ribstein, *supra* note 6, at 84.

247. *See supra* Part II.A.2.

248. One recent proposal is for law firms to "mimic going public" by "creat[ing] a new metric that accounts for organizational capital." DeBuse, *supra* note 29, at 344. The current partnership structure, however, provides little incentive for partners to have a long-term outlook. The ability of this intangible internal metric to change the "strip-mine" culture of partners and law firms is questionable. Many factors, including management support, impact firm culture, *see* Chambliss, *supra* note 86, at 92; however, providing incentives through the formal organizational structure would be much more effective than an intangible metric in changing the legal profession's culture from a short-term to a long-term investment focus.

249. *See supra* notes 113–14.

250. SLATER & GORDON LTD., *supra* note 68, at 93.

251. *See* Andrews, *supra* note 5, at 596–97.

252. *See* Larry E. Ribstein, *Ethical Rules, Law Firm Structure, and Choice of Law*, 69 U. CIN. L. REV. 1161, 1163 (2001). Firms will often adhere to the most restrictive rules, which in this situation would be to not allow any nonlawyer ownership. *See id.*

253. *See, e.g.*, Prod. Res. Group, L.L.C. v. NCT Group, Inc., 863 A.2d 772, 787 (Del. Ch. 2004) ("[Delaware] corporate law (and that of most of our nation) expects that the directors of a solvent firm will cause the firm to undertake economic activities that maximize the value of the firm's cash flows primarily for the benefit of the residual risk-bearers, the owners of the firm's equity capital."); Mark J.

make this type of statement in their offering materials. Even if regulators allow such disclosure, the introduction of duties to clients and the courts above the duty to shareholders would introduce great uncertainty into corporate law. Such a disclosure would be in clear contravention of Delaware corporate law requiring strict shareholder maximization.[254] It is not clear how courts—in particular the influential Delaware courts—would treat challenged board decisions of a public law firm.

Finally, the Australian and U.K. legal systems differ from the U.S. legal system in that the former countries take a "losers pay" approach to legal fees and restrict contingency fee agreements.[255] The burden of potentially paying legal costs for an unsuccessful suit makes it harder for plaintiffs in these jurisdictions to bring suit. Improving access to legal services was one of the main concerns in the Australian and U.K. changes.[256] Thus, the social value of public investment to fund plaintiff suits, such as Slater's "No Win, No Fee" conditional fee arrangement, may be of greater need overseas than domestically.

B. Integrated Legal Holdings Limited: Holding Company Model

Australian firm Integrated illustrates a second possible investment model: a holding company. A comparison of Slater and Integrated's business models and its uses of outside capital highlights how varying investment models may evolve to meet the needs, culture, and characteristics of individual law firms. Further, Integrated approaches the ethical and professional concerns of outside investment in much the same manner as Slater, but its holding company structure adds further protections against such concerns.

1. The Holding Company Model and Integrated's Business Strategy

As a holding company, Integrated itself does not provide legal services.[257] Contrary to Slater's model to acquire firms but operate under one national brand name, Integrated's business model brings together small- to medium-sized law firms and related practices that retain their

Roe, *The Shareholder Wealth Maximization Norm and Industrial Organization*, 149 U. PA. L. REV. 2063, 2065 (2001). Pennsylvania is the exception: directors can pick any group that they think should be the priority interest. *See* 15 PA. CONS. STAT. § 1715(b) (1995). The priority of clients and the courts above shareholders, therefore, would not be problematic under Pennsylvania corporate law.

254. *See, e.g.*, *Prod. Res. Group*, 863 A.2d at 787.

255. *See* Brian R. Cheffins & Bernard S. Black, *Outside Director Liability Across Countries*, 84 TEX. L. REV. 1385, 1405–06, 1434–35 (2006); *see also supra* note 225.

256. Legal Services Act, 2007, c. 29, § 1(c) (Eng.) (stating that one of the act's regulatory objectives is "improving access to justice"); Krause, *supra* note 147, at 35.

257. INTEGRATED LEGAL HOLDINGS LTD., *supra* note 77, at 8. The prospectus indicates that "Integrated's role will be to manage and oversee the Group's activities as a whole." *Id*. at 12.

existing names and day-to-day independence.[258] The business model is to selectively acquire legal firms and information technology organizations to provide a national network for client services, to promote cross servicing between firms of differing geographic and practice specialties, and to promote "sharing of best practice management techniques" between firms.[259] Integrated's business model aims to offer firms cost savings and enhanced recruitment and retention of employees.[260]

The company owned two incorporated law firms at the time of its public offering[261] and as of May 15, 2009, had acquired four additional firms.[262] In addition to law firms, the company also owns 90% of Law Central Co Pty Ltd (Law Central), "a business that provides access for lawyers and the public to legal information and documents."[263] The independent firms each manage their own day-to-day operations and the provision of legal services, led by Legal Practice Directors.[264] "The Legal Practice Directors are expected to concentrate on the legal obligations of their practice, delivering quality service to their clients, practice development and making profits."[265] Integrated itself is not involved in providing any legal advice or supervising legal services.[266] The independent

258. *Id.* at 2, 8. Allowing each firm to continue branding under its own name allows for "minimal disruption and fewer integration costs" and also "encourage[s] a focus . . . on the needs of clients and on providing a value-added service." *Id.* at 34–35.

259. *Id.* at 8. The firm indicated that its acquisition focus will be firms in New South Wales, Victoria, and Western Australia but that it will pursue acquisitions in other jurisdictions if and when those jurisdictions allow nonlawyer ownership and fee sharing. *Id.* at 12. Thus, Integrated seeks to avoid the potential problems that Slater encounters when using service agreements to operate in jurisdictions that do not allow nonlegal ownership. It is unclear whether Integrated's approach at targeting firms only in those jurisdictions that allow nonlawyer ownership and fee sharing would resolve the issue domestically, considering that many firms, even midsized firms, operate in more than one state.

260. *Id.* at 13, 23. Potential cost savings include "statutory insurances, discount group purchasing arrangements for printing, stationary and office equipment, some shared office space and marketing and accounting services, together with other synergies." *Id.* at 13. Employee programs include greater human resource services, structured reviews, and training. *Id.* at 23.

261. *Id.* at 8. The two firms are Brett Davies Lawyers and Talbot Olivier. The firms are "small to medium sized Perth based law firms" and are wholly owned subsidiaries of Integrated. *Id.* at 11, 23–25.

262. Acquisitions since its public offering include: Mda Lawyers (Sydney, tax law, March 2009), Argyle Partnership (Sydney/Melbourne, commercial law, November 2008), Shane Leslie law firm (Perth, commercial litigation, September 2007), and Peter Marks law firm (Perth, estate planning, September 2007). Press Release, Integrated Legal Holdings Ltd., Member Firm Tuck-in Acquisition (Mar. 9, 2009), http://www.ilh.com.au/Documents/Argyle-mda_ASX_Announcement_%20Tuck_in_Acquisition_of_mda_lawyers.pdf; Press Release, Integrated Legal Holdings Ltd., Significant East Coast Law Firm Acquisition (Nov. 4, 2008), http://www.ilh.com.au/Documents/ArgyleASXAnnouncement.pdf; Press Release, Integrated Legal Holdings Ltd., 2008 Full Year Result and Dividend Announcement (Aug. 28, 2008), http://www.ilh.com.au/Documents/2008%20Full%20Year%20Result%20and%20Dividend%20Announcement.pdf.

263. INTEGRATED LEGAL HOLDINGS LTD., *supra* note 77, at 2, 38. In acquiring Law Central, Integrated is responding to the trend of increasing delivery of legal services through the Internet. *See supra* Part II.B.1.c.

264. INTEGRATED LEGAL HOLDINGS LTD., *supra* note 77, at 13, 35.

265. *Id.* at 34.

266. *Id.* at 35.

firms do not have any overlapping directors with any other firm.[267] The Legal Practice Directors of each individual firm appoint a managing director who reports to the Integrated Managing Director.[268] The Integrated Managing Director reports to the Board of Directors, and together they monitor the individual firms' financial performance and oversee and control general business activities.[269] By allowing firms to keep their day-to-day independence while providing a national support network, Integrated hopes "to retain the best parts of the partnership model, but also gain access to the listed company environment."[270]

Sole practitioner and small- to medium-sized firms fit best in Integrated's model because of its more decentralized structure.[271] In contrast, the Slater model works well for a large, nationally established brand name firm. Slater's established culture of a large national practice fits the traditional direct ownership model. For Integrated, the traditionally independent culture of smaller firms is retained in the holding company model. This comparison illustrates that public ownership of law firms does not have to be limited to large firms or any particular type of firm. The model can develop based on firms' individual needs and cultures.

Similar to Slater's capital structure, Integrated also had previously existing shareholders, called Foundation Shareholders.[272] At the time of the public offering, these Foundation Shareholders held 37.4 million shares.[273] In addition, 24 million shares were offered to the public, and 1.3 million shares were offered to existing Law Central shareholders, for a total of 62.7 million shares after the public offering.[274] Thus the capital structure after the public offering was: 59.7% Foundation Shareholders, 38.3% public shareholders, and 2.0% Law Central shareholders.

2. Responses to the Outside Investment Debate

Integrated offers another illustration of how a law firm can address the ethical and professional concerns presented by outside investment

267. *Id.* at 36.

268. *Id.* at 35.

269. *Id.* General business activities include "employment issues, developing cross referral networks within the Integrated Legal Group, assisting with insurance needs, accounting and general administrative functions." *Id.*

270. Zoe Lyon, *Integrated Legal Holdings Appoints New Leader*, LAW. WKLY., May 5, 2008, http://www.lawyersweekly.com.au/blogs/top_stories/archive/2008/05/05/integrated-legal-holdings-appoints-new-leader.aspx (citation omitted).

271. *See* INTEGRATED LEGAL HOLDINGS LTD., *supra* note 77, at 26. The firm has outlined strict criteria for acquiring firms and has set out a due diligence process. *Id.* at 26, 37. Integrated's criteria is focused on "growth and strategic fit in terms of services, location and profitability." *Id.* at 26.

272. *Id.* at 6. Foundation Shareholders are Foundation Partners (now Legal Practice Directors) and their affiliates (Vendor Shareholders), as well as the Sponsor. *Id.* at 3–4, 6. There are seven Foundation Partners from Talbot Olivier and one from Brett Davies Lawyers. *Id.* at 27, 32. These Foundation Partners are each Legal Practice Directors. *Id.* at 27, 32, 34.

273. *Id.* at 6.

274. *Id.*

and also benefit from the raising of outside capital. The major benefit of the holding company structure is the additional layer of separation between the public owners and the attorneys servicing clients.

a. Integrated's Response to Ethical and Professional Concerns

Integrated addresses many of the ethical and professional concerns of outside investment in a manner similar to Slater, using share transfer restrictions and investor disclosures. The holding company structure, though, provides an additional safeguard against these concerns and client confidentiality concerns. On the other hand, the holding company structure introduces a new risk of conflicts of interest that may arise between clients of the independently operated yet wholly owned subsidiary law firms.

Integrated imposes share transfer restrictions on inside shareholders[275] to address the concern of partners selling out and leaving the firm and to minimize the risk of outside influence on independent judgment. Integrated, however, has less strict restrictions on the transfer of shares than Slater.[276] Foundation Shareholders are voluntarily restricted from selling shares for twenty-four months.[277] Vendor Shareholders are free to transfer shares up to an aggregate value A$500,000, and any shares retained above that amount are subject to voluntary escrow restrictions.[278] All retained shares must be held in escrow for twelve months, two-thirds must be held for thirty months, and one-third must be held for forty-eight months.[279] Law Central shareholders are subject to twenty-four-month restrictions on the sale of shares, but if the shareholder paid cash, the restriction on half the shares is released after three months.[280] Integrated also has two-year employment agreements with its Foundation Partners.[281] Similar to Slater, these share transfer restrictions, even with the addition of the employment agreements, only in part address the concerns of partner departures and outside influence on professional judgment. The Integrated shares are restricted for only a short period of time, and thus the amount of shares held by outside parties may increase significantly in the near future. Although the company believes it has incentives in place to keep its key directors from leaving, the risk remains an important consideration for investors.[282]

275. *Id.* at 6, 82–83.
276. *See id.* at 3.
277. *Id.* at 6.
278. *Id.* at 6, 10–11. Integrated has eight Vendor Shareholders; therefore, the maximum aggregate value of shares that can be freely transferred is $4 million. *Id.* at 11.
279. *Id.* at 6, 10–11.
280. *Id.* at 6.
281. *Id.* at 34–35.
282. See *id*. at 35, 73–74 for a discussion of the risks involved if Foundation Partners leave the firm.

Beyond share transfer restrictions, Integrated's structure provides an additional—and more effective—safeguard against professional judgment risks than just disclosure to investors. Integrated does disclose its primary duty to the client and court in its prospectus.[283] Integrated's structure, however, is a more concrete safeguard against conflicts of interest and professional judgment risks than a mere disclosure. The holding company structure inserts a level of separation between the client service activities of each individual law firm and the outside investors. In theory, this additional level of separation should reduce the potential for investors to influence the independent judgment of the attorneys at the individual firms. The holding company, led by the Managing Director and Board of Directors, is involved in the big-picture planning and not the delivery of client service.[284] The individual law firms and their attorneys will make the day-to-day decisions and will be able to balance their duties to the courts, the public, and the client.

The June 2007 public offering of the Blackstone Group limited partnership offers a useful example of how the holding company model could work for law firm investment.[285] Blackstone's public investors are limited partners in a complex holding company structure.[286] The offer did not transfer any real power or control to the public shareholders, and senior managers are the sole decision makers.[287] The public limited partners cannot replace management of the holding company or the lower-level holding companies.[288] Just as Blackstone's ownership model operates "as a holding company feeding money down to private equity firms," Integrated operates as a legal holding company feeding money down to independently operated law firms.[289] This concept of restricting the control of public owners limits concerns of attorney independence. Admittedly, Blackstone's new structure opens a range of potential risks and regulatory uncertainty.[290] Law firms, however, could utilize many of the

283. *Id.* at 8.

284. *Id.* at 35.

285. The Blackstone Group, Investor FAQs, http://ir.blackstone.com/faq.cfm (last visited Dec. 15, 2009); *see also* MacEwen, Regan & Ribstein, *supra* note 6, at 67.

286. Larry E. Ribstein, *Going Privlic*, AMERICAN, Mar. 27, 2007, http://www.american.com/archive/2007/march-0307/going-privlic [hereinafter Ribstein, *Going Privlic*]. For a more detailed discussion of the Blackstone Group's structure, see Larry E. Ribstein, *Uncorporating the Large Firm* 34–38 (Ill. Law & Econ. Research Papers Series, Research Paper No. LE08-016, 2008), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1003790 [hereinafter Ribstein, *Uncorporating the Large Firm*]. Professor Ribstein discusses the potential for law firms to become "publicly traded uncorporations." *Id.* at 37–39, 44. "Uncorporations" are limited partnerships and limited liability companies. Larry E. Ribstein, *The Uncorporation and Corporate Indeterminacy*, 2009 U. ILL. L. REV. 131, 132. A detailed analysis of law firms as "publicly traded uncorporations" is beyond the scope of this Note, but such a structure is another potential ownership model that deserves further analysis.

287. Ribstein, *Going Privlic*, *supra* note 286.

288. *Id.*

289. *Id.*

290. *Id.*

concepts of Blackstone's unique model when analyzing potential public ownership structures.

The holding company model also provides a level of separation for client confidentiality. Integrated requires its firms to include a provision in its client retainer agreements for limited disclosure of material matters, including the client's identity.[291] The firm will not disclose the nature of matters, only the work performed in relation to the fees generated.[292] Each firm provides "monthly, half yearly and annual financial reports, draft and final annual budgets and other financial reporting information to ensure that the businesses are meeting Integrated's financial expectations and to enable Integrated to satisfy its reporting obligations to the regulatory authorities."[293] The information requested would "relate to financial performance rather than day to day operations of a law firm."[294] Additionally, the incorporated firms, operating independently, will not exchange confidential information among each other without the express consent of the client.[295]

Aggregating financial results from the individual law firms allows for disclosure of financial and other general information without violating client confidences. The question that remains is whether the aggregate information is enough to satisfy disclosure requirements. Integrated notes that although it believes its proposal will satisfy the disclosure requirements of the ASIC, there is no guarantee that further disclosure will not be required.[296] Therefore, although the additional level of separation allows for some added comfort regarding client confidentiality, harmonizing disclosure requirements and client confidences remains an outstanding risk factor for investors.

Unlike Slater, however, the holding company structure presents the additional problem of conflicting client interests. Integrated states that one of its individual firms may provide services on matters that conflict with interests of another of its individual firm's clients.[297] Although Integrated purports that "the fact of common ownership of the Incorporated Law Firms does not, of itself, create a conflict of interest," the potential for client conflicts even among these independent firms is unsettling given the shared services between firms.[298] Integrated appears to wash its hands of potential conflicts and leave such situations to the Legal Practice Directors.[299] A company policy on how to handle such situations would help, at a minimum, guide the Legal Practice Directors in how to

291. INTEGRATED LEGAL HOLDINGS LTD., *supra* note 77, at 9.
292. *Id.*
293. *Id.* at 36.
294. *Id.*
295. *Id.* at 35.
296. *Id.* at 9.
297. *Id.* at 35.
298. *Id.* at 35–36; *see also supra* note 260 and accompanying text (discussing shared services).
299. INTEGRATED LEGAL HOLDINGS LTD., *supra* note 77, at 35.

handle client conflicts between wholly owned subsidiaries of a holding corporation.

b. The Benefits of Outside Capital

Integrated also presents a further example of the potential uses of outside capital. Integrated, like Slater, plans to utilize its outside capital to fund a growth strategy.[300] The firm plans to use $3.7 million of the $12 million total capital raised as working capital to fund its growth and acquisition strategy.[301] The firm also, however, plans to use $6.7 million—over half of the capital raised—to pay the vendors of the subsidiary law firms and the shareholders of Law Central.[302] The portion relating to payments to Law Central shareholders certainly is a long-term investment similar to what the proponents of outside investment envisioned. Although the capital raised is not being retained, the Law Central acquisition is an investment in technology that will bring long-term intangible benefits and will compliment the subsidiary law firms' delivery of legal services. The payment to vendors does not necessarily bring any long-term benefits but does illustrate how a law firm could use outside capital to reduce its bank borrowings. Integrated thus shows that firms may use the outside capital for a variety of benefits, depending on each individual firms' needs.

Integrated also further illustrates that firms can use their capital structure to incentivize employees. The firm has an employee equity participation program to "reinforce lawyer and employee loyalty."[303] The firm has both an employee share option plan and employee share plan.[304] The exercise price for the options and the issue price for the shares are determined by the Board.[305] Under the share plan, employees are restricted from disposing of shares: one-third of shares may be disposed of within one year of the issue date and two-thirds of shares may be disposed of within two years of the issue date.[306] Integrated views its employee share plan to offer its attorneys an alternative to the traditional "up-or-out" partnership model: "Many younger lawyers see partnership as a life sentence. The ILH business model offers these up-and-coming lawyers equity without having to take on partnership. That will allow a

300. *Id.* at 2, 4.

301. *Id.* For a discussion of the firm's acquisition strategy, see *supra* text accompanying note 271.

302. INTEGRATED LEGAL HOLDINGS LTD., *supra* note 77, at 4; *see also supra* text accompanying note 274.

303. INTEGRATED LEGAL HOLDINGS LTD., *supra* note 77, at 13. "The objective of the [Employee Share Option Plan] is to assist in the recruitment, reward, retention and motivation of employees of the Company and its subsidiaries." *Id.* at 83.

304. *Id.*

305. *Id.*

306. *Id.* at 84. After two years of the issue date, employees are free to dispose of shares. *Id.*

great opportunity for internal growth in our ILH law firms."[307] Both Integrated and Slater employee share plans are aimed at helping the firms to recruit and retain top talent through the offer of ownership.

C. Direct Minority Ownership Model

Given the concern in the United States for potential negative consequences of direct outside ownership, a more moderate proposal allowing only minority ownership[308] may be more appealing. Under a minority ownership model, lawyers maintain ownership and management control.[309] This restriction on control could be effected through share ownership restrictions, stock transfer restrictions, and share voting controls. Allowing only minority outside ownership would minimize the ethical and professional concerns while also allowing firms to gain some of the benefits of outside capital. Nevertheless, client confidentiality is a concern no matter what level of outside investment is allowed.

1. How to Restrict Ownership

The threshold question for minority ownership is how to restrict ownership to maintain control within the attorneys of the law firm. Firms could restrict control from outside investment in a number of ways, including share ownership restrictions, stock transfer restrictions, and share voting controls. Restrictions on share ownership reduce outside influence as the public owners would hold only a minority equity interest. The U.K. Act, for example, sets the applicable ownership threshold at 10% for those "low-risk bod[ies]" that are subject to less regulation than the ABS.[310] Delaware corporate law permits "[a] written restriction or restrictions on . . . the amount of the corporation's securities that may be owned by any person or group of persons."[311] Through the restrictions, the minority equity position allows control to remain in the hands of the attorneys.

Firms could also use stock transfer restrictions to restrict outside control. Delaware corporate law permits transfer restrictions such as granting the corporation a right of first refusal[312] and requiring shareholders to obtain the corporation's consent before transferring shares.[313]

307. Carolyn Batt, *Legal Float Gets Full Steam Up*, W. AUSTRALIAN, May 19, 2007, at 81 (quoting Brett Davies, Chief Executive of Brett Davies Lawyers). For a discussion of the traditional "up-or-out" partnership model in relation to today's legal profession, see Galanter & Henderson, *supra* note 6, at 1873–76.

308. For one such proposal for allowing minority ownership, see Sharfman, *supra* note 5.

309. *Id.* at 495.

310. Legal Services Act, 2007, c. 29, §§ 106–108 (Eng.).

311. DEL. CODE ANN. tit. 8, § 202(a) (2001). Such restriction must not be "manifestly unreasonable." *Id.* § 202(c)(5).

312. *Id.* § 202(c)(1).

313. *Id.* § 202(c)(3).

Slater and Integrated impose transfer restrictions on employees and inside owners only for a limited period of time.[314] Similar but permanent transfer restrictions upon majority shareholders who are key management figures would ensure minority ownership and control indefinitely. Slater also requires that shares be transferred back to the firm upon an employee leaving the firm so that the employee cannot transfer the stock to outsiders.[315] Although stock alienability can have legal restrictions and enforcement problems,[316] transfer restrictions are a mechanism that law firms could consider to maintain control amongst inside owners.

A third potential means to retain power is voting controls. Firms could issue separate classes of stock to lawyers and nonlawyers, with the lawyers' preferred stock class holding priority voting rights.[317] Dual class voting "gives one set of shareholders (usually managers or the founders) a class of votes with multiple votes per share, thereby permitting them to maintain control of the enterprise even though having only a minority of the equity interest."[318] Dual class share structure traditionally has been used in the media and automobile industries.[319]

Google, for example, has a dual class share structure that gives cofounders Larry Page and Sergey Brin almost all control and leaves "investors largely powerless."[320] The public holds Class A shares, each entitled to one vote per share.[321] Class B shares, which are not publicly traded, are entitled to ten votes per share.[322] As a result, Class B shareholders effectively hold approximately 75% of the voting power.[323] Law

314. *See supra* notes 199–202, 276–81 and accompanying text.

315. *See supra* notes 201–02 and accompanying text; *see also* Ian Ayres & Stephen Choi, *Internalizing Outsider Trading*, 101 MICH. L. REV. 313, 382 (2002) ("Even public corporations have placed restrictions on shares sold to employees allowing the corporation to repurchase the shares at the end of employment.").

316. For a discussion of legal restrictions on and enforcement problems with stock transfer restrictions, see Ayres & Choi, *supra* note 315, at 383–85.

317. Sharfman, *supra* note 5, at 495–96; Ribstein, *Uncorporating the Large Firm*, *supra* note 286, at 15.

318. Robert B. Thompson, *Corporate Federalism in the Administrative State: The SEC's Discretion to Move the Line Between the State and Federal Realms of Corporate Governance*, 82 NOTRE DAME L. REV. 1143, 1149 (2007).

319. Cally Jordan, *The Chameleon Effect: Beyond the Bonding Hypothesis for Cross-Listed Securities*, 3 N.Y.U. J. L. & BUS. 37, 41 n.13 (2006). The New York Times Company and The Wall Street Journal in the media industry and Ford and General Motors in the automobile industry have dual class share structures. *Id.*; *see also* Grant M. Hayden & Matthew T. Bodie, *One Share, One Vote and the False Promise of Shareholder Homogeneity*, 30 CARDOZO L. REV. 445, 480 (2008).

320. Lynn A. Stout, *The Mythical Benefits of Shareholder Control*, 93 VA. L. REV. 789, 802 (2007); *see also* Robert P. Bartlett III, *Taking Finance Seriously: How Debt Financing Distorts Bidding Outcomes in Corporate Takeovers*, 76 FORDHAM L. REV. 1975, 1999 n.81 (2008). Together Larry Page and Sergey Brin own approximately 58 of 70 million Class B shares, or 83%. As explained below, Class B shareholders together hold approximately 75% of the total voting power. *See infra* note 323.

321. Google Inc., 2008 Proxy Statement (Schedule 14A), at 4 (Mar. 25, 2008), *available at* http://investor.google.com/order.html (follow "2008 Proxy Statement" hyperlink).

322. *Id.*

323. *See id.* For Google's 2008 annual stockholder meeting, there were approximately 238 million Class A shares and 75.5 million Class B shares outstanding. *Id.* With ten votes per share, the Class B

firms could devise similar dual share structures to ensure that power remains with attorneys rather than with the public.

One potential problem with the dual-share structure is that institutional investors typically prefer not to invest in such structures due to the potential impact on corporate governance.[324] Thus, if a law firm were to limit outside ownership to sophisticated investors to alleviate disclosure requirements and therefore confidentiality concerns,[325] institutional investors may not be willing to invest in structures that severely limit outside shareholder control.

2. Benefits of Minority Ownership

Requiring firms to retain control and management by using the means described above minimizes ethics and professional concerns. Retaining control reduces the likelihood that the minority outside owners could greatly influence attorney judgment and client decisions. The loss of independent judgment, professionalism, and duties to society are not as great a concern. Any influence that the minority owners would exert may be no greater than what firms already face from current financing options.[326] The reduced risk inherent in allowing minority ownership is reflected in the U.K. Act's provision for less stringent regulation of "low-risk bod[ies]," or those with less than 10% management and ownership by nonlawyers.[327] Restricting ownership to a minority position also prevents the rise of corporate-owned megafirms feared by critics of outside ownership.[328] Restricting the allowed outside ownership reduces the associated concerns and potential problems.

On the other hand, scaling down the outside ownership also scales down the benefits achieved with the outside capital. A firm with minority ownership can use its outside capital for any of the same benefits that the outside ownership advocates propose and that Slater and Integrated currently enjoy, such as investing in technology and other intangibles, reducing bank borrowings, or funding growth and acquisition strategies. The benefits, however, will be on a smaller scale due to the proportional reduction in outside capital raised when ownership is limited to a minority stake.

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shareholders had approximately 755 million votes, in comparison to the 238 million votes of Class A shareholders.

324. *See* Hayden & Bodie, *supra* note 319, at 471 & n.113; *see also* MacEwen, Regan & Ribstein, *supra* note 6, at 69 (suggesting that "a publicly-traded law firm would be less problematic than one owned by private equity, since equity funds tend to want an active role in exerting influence over the companies in which they invest").

325. *See supra* notes 217–23 and accompanying text.

326. Regan, *supra* note 67, at 427; Sharfman, *supra* note 5, at 495.

327. Legal Services Act, 2007, c. 29, §§ 106–108 (Eng.).

328. Sharfman, *supra* note 5, at 495.

The minority ownership restriction does not, though, restrict the firms' ability to incentivize employees. Employee stock plans can still hurdle the equity barrier between partners and associates, as done under Slater and Integrated's full ownership model. Admittedly, the liquidity of such ownership would not be as great when restricted to minority outside ownership, but the liquidity issue would be no greater than partners currently face in the traditional model. Thus on the whole, minority ownership would reduce ethical concerns, yet provide reduced benefits as well.

3. The Lingering Problem of Client Confidentiality

A minority ownership model, however, would not address all potential ethical problems. Introducing any level of outside investment, even a minority, prompts critics' concerns about client confidentiality. Providing enough information to satisfy investors while not breaching client confidentiality is a delicate balance.

One possibility that a law firm could consider is the use of confidentiality agreements that restrict the rights of investors to confidential information.[329] Courts have upheld such confidentiality agreements in partnerships.[330] For example, in *Exxon Corp. v. Burglin*,[331] the limited partners in a partnership holding oil and gas leases sued the general partner Exxon, alleging it "breached its fiduciary duty by failing to disclose information necessary for the valuation of their interests."[332] The Fifth Circuit upheld a provision of the partnership agreement that restricts the limited partners' right to obtain confidential information regarding the oil and gas reserves.[333] The partnership agreement also addresses the general partner's duty to disclose, stating that the general partner is not obligated to disclose "any information . . . concerning the Leases which the General Partner believes would be in the best interest of the Partnership or the General Partner to be kept confidential."[334] Delaware partnership law also allows general partners to withhold confidential information from limited partners if "in the best interests of the limited partnership" or if the partnership "is required by law or by agreement with a third party to keep [the information] confidential."[335]

329. Confidentiality agreements could be considered under any ownership or investment model, not just when restricted to minority ownership.

330. *See, e.g.*, Exxon Corp. v. Burglin, 4 F.3d 1294, 1298–99 (5th Cir. 1993). *But see A*ppletree Square I Ltd. P'ship v. Investmark, Inc., 494 N.W.2d 889, 893 (Minn. Ct. App. 1993) (setting aside agreement that general partner will provide information only upon limited partners' request).

331. *Burglin*, 4 F.3d 1294.

332. *Id.* at 1297.

333. *Id.* at 1298–99. The partnership agreement stated that "no Limited Partner shall have the right to any confidential information concerning the Leases." *Id.* at 1298.

334. *Id.* at 1299.

335. DEL. CODE ANN. tit. 6, § 17-305(b) (2000).

Law firms with outside investment could structure similar limits on the investors' right to confidential information and the firms' duty to disclose confidential information. It is unclear whether courts would allow such an agreement in the context of a corporation. It should also be noted that in upholding the partnership agreement, the court in *Burglin* did consider that the parties were highly sophisticated.[336] Restricting investment to sophisticated investors may increase courts' willingness to uphold such a restriction on confidential information in a corporate context.[337]

D. Ditching Direct Ownership: A Derivative Security Model

Even if law firms maintain control through restrictions of minority ownership, some may fear that once starting down the road of outside ownership, we will not be able to turn back.[338] This Note therefore considers alternative investment models that could capture some of the same value of outside investment without allowing direct ownership. One investment proposal is creating a legal-related derivative security.[339]

Bruce MacEwen has proposed the idea of a "derivative financial instrument, tradable as if it were a stock, engineered to reflect the implicit value of the firm."[340] The derivative could be based on the performance of a single firm or an index of firms.[341] Arguably, a derivative security with only passive investment is within the spirit of Model Rule 5.4 because a passive investor, in theory, would have no ability to influence an attorneys' independent judgment.[342] It is unlikely, however, that state bars would agree with such an interpretation and allow the derivatives under the current rules.[343] Nevertheless, MacEwen and Professors Mitt Regan and Larry Ribstein have started a discussion on the pros and cons of a legal-related derivative instrument, considering both the current rules and anticipating potential changes to the rules.[344]

One response to MacEwen, Regan, and Ribstein's discussion is a proposal for "a tradable financial-derivative instrument reflecting the value of an *index* of law firms."[345] The index could include firms by any

336. *Burglin*, 4 F.3d at 1299.

337. *See supra* notes 217–23 and accompanying text.

338. Krause, *supra* note 147, at 35 ("You have to remember, once you let go of a rule, there's no turning back." (citation omitted)).

339. *See* DeSorrento & Thompson, *supra* note 242, at 587–88; MacEwen, Regan & Ribstein, *supra* note 6, at 65, 68–69. DeSorrento and Thompson provide a brief overview of derivatives in general. *See* DeSorrento & Thompson, *supra* note 242, at 588–91.

340. MacEwen, Regan & Ribstein, *supra* note 6, at 65 (emphasis omitted).

341. *See* DeSorrento & Thompson, *supra* note 242, at 586–87; MacEwen, Regan & Ribstein, *supra* note 6, at 65, 68–69.

342. MacEwen, Regan, & Ribstein, *supra* note 6, at 66, 69.

343. *Id.* at 69.

344. *See generally id.*

345. DeSorrento & Thompson, *supra* note 242, at 586.

number of categories, including size, revenue, geography, or practice area.[346] The proposal authors argue that this nonequity, index-based derivative would not violate the existing rules of professional conduct "[b]ecause the practitioners would be legally and financially insulated" from derivative security holders.[347]

Functionally, the derivative would trade on an independent exchange, and a third party would aggregate data from the individual firms.[348] By disclosing only aggregate data, client confidentiality is not breached.[349] The aggregation of individual firms also provides a much more robust and liquid market for the derivative securities than securities based on a single firm.[350] Investing in an aggregated index would be a more stable investment because the industry's greatest assets—human capital, meaning partners and to a much smaller extent associates—move freely between individual law firms but much less frequently leave the industry altogether.[351]

The authors admit that the index-based derivative security would not provide the same level of capital, outside-the-box ideas, and creative innovations in client service that the previously discussed direct ownership models would provide.[352] Nevertheless, the concept would allow firms to enjoy some benefit while being much less invasive to the legal profession. Whether tracking an individual firm or an index, the more moderate proposal of a derivative security should be considered further.

E. Investment in Lawsuits: An Alternative to Investment in Law Firms

Finally, an alternative to allowing equity investment in law *firms* is allowing investment in particular law*suits*.[353] Investors provide the capital for lawsuits in exchange for a share of the litigation proceeds or a return on the funding plus a fee.[354] The loans are nonrecourse, meaning that if the plaintiff loses the case, the investor gets nothing in return.[355] The industry is typically associated with poor personal injury plaintiffs, but businesses also use such arrangements for complex commercial and other

346. *Id.* at 586–87.
347. *Id.* at 588.
348. *Id.* at 587, 595.
349. *Id.* at 595.
350. *Id.* at 587, 592.
351. *Id.* at 587–88.
352. *Id.* at 587.
353. Like the derivative security analysis, the following analysis of lawsuit financing is greatly simplified for the purposes of this Note. The author raises the idea of lawsuit financing simply to highlight an alternative to direct investment in law firms.
354. Susan Lorde Martin, *Litigation Financing: Another Subprime Industry That Has a Place in the United States Market*, 53 VILL. L. REV. 83, 86, 109 (2008). For a detailed explanation of the lending process, see Courtney R. Barksdale, Note, *All That Glitters Isn't Gold: Analyzing the Costs and Benefits of Litigation Finance*, 26 REV. LITIG. 707, 710–16 (2007).
355. Martin, *supra* note 354, at 86.

claims.[356] Investments in lawsuits are more widely accepted internationally due to the differences in fee structure. There are also concerns that such financing violates state champerty and usury laws and presents professional judgment and confidentiality conflicts. The global financial crisis, however, may make lawsuit financing more attractive in the United States.

1. International Lawsuit Financing

In Australia, litigation financing is widely accepted, and there is an active financing market.[357] One Australian litigation financing company, IMF Ltd., has been listed on the ASX since 2001.[358] Litigation financing companies in Australia act similar to defendants' insurance companies in that they handle the legal claim and choose the attorneys.[359] Australian courts typically have upheld challenged financing agreements.[360]

In the wake of the legal changes in the United Kingdom, several investors, including hedge funds, are looking to invest money into the legal market, not only in the form of law firm investment but also litigation funding.[361] Several hedge funds are already investing, including MKM Longboat, Jupiter, Juridica, and Invesco Perpetual.[362] Juridica, for example, has raised $100 million to invest in primarily commercial litigation and international arbitrations.[363] In the second quarter of 2008, the company made a $5 million investment in a case that settled, giving the company a profit of $3.5 million.[364]

356. *Id.* at 88–89. The Australian litigation financing market in particular focuses on substantive commercial claims. *See id.* at 107. A newly formed British joint venture is also focusing on corporate litigation. *See infra* note 381 and accompanying text.

357. Martin, *supra* note 354, at 107, 113. The depth of the Australian financing market is a potential problem because there are few litigation financing companies. *Id.* at 108, 111.

358. *Id.* at 107.

359. *Id.* at 109.

360. *Id.* at 110.

361. Herman, *supra* note 166; Andrew Longstreth, *Third-Party Litigation Financing Gaining Momentum in U.K.*, AMLAW LITIG. DAILY, Apr. 16, 2009, http://www.law.com/jsp/tal/digestTAL.jsp?id=1202429961377.

362. Patrick Hosking, *The Law Is Now an Asset Class*, TIMES (London), Dec. 21, 2007, at 45.

363. Alison Frankel, *U.K. Litigation Financing Firm Raises Additional $50 Million, Now Has $100 Million to Invest in U.S. Cases*, AMLAW LITIG. DAILY, Apr. 9, 2009, http://www.law.com/jsp/tal/digestTAL.jsp?id=1202429792708; Juridica Investments Ltd., http://www.juridicainvestments.com/ (last visited Dec. 15, 2009). Juridica is one of only a handful of hedge funds that currently invests in U.S. litigation. Gerelyn Terzo, *Courting New Fees: Hedge Funds Find Opportunities Investing in Lawsuits*, IDD MAGAZINE.COM, Jan. 23, 2009, http://www.iddmagazine.com/issues/2009_4/189489-1.html?partner=dealbook.

364. Lauren Tara LaCapra, *Hedge Fund Hell: These Funds Sue You*, STREET.COM, Jan. 23, 2009, http://www.thestreet.com/story/10459369/2/hedge-fund-hell-these-funds-sue-you.html.

2. Lawsuit Financing in the United States

Lawsuit financing has been more acceptable in Australia and the United Kingdom than in the United States because of differences in their legal systems that present more "access to justice issues."[365] Plaintiffs in Australia and the United Kingdom pay for the defendant's legal expenses if their case is unsuccessful.[366] These countries also restrict contingency fee arrangements, which are allowed in all U.S. states.[367] Critics of lawsuit financing point to the large fees that the financing companies take from plaintiffs—typically poor personal injury plaintiffs—as reason to prohibit such financing arrangements.[368] Proponents, on the other hand, argue that plaintiffs need this financing "to level the playing field between wealthy corporate defendants and poor plaintiffs."[369] Despite its general negative reputation, litigation financing is widely available in the United States.[370]

The major issue surrounding these financing firms is whether they run afoul of state champerty and usury laws.[371] States vary in their treatment of champerty: "An agreement between an officious intermeddler in a lawsuit and a litigant by which the intermeddler helps pursue the litigant's claim as consideration for receiving part of any judgment proceeds."[372] Usury laws restrict the lawful interest rate for loans.[373] Many states have not directly addressed whether litigation financing violate these state laws.[374]

Additionally, investment in lawsuits rather than law firms does not solve the issues of attorney independent judgment and client confidentiality. In contrast to Australia, U.S. litigation financing firms do not par-

365. Martin, *supra* note 354, at 106 (citation omitted).

366. *See supra* note 255 and accompanying text. The concern of increasing frivolous lawsuits is less significant in Australia and the United Kingdom because the loser must pay legal fees. Martin, *supra* note 354, at 113. Arguably, however, the danger of increased frivolous lawsuits is unfounded because lenders will not finance frivolous lawsuits with nonrecourse loans and because courts can sanction parties who bring frivolous suits. *Id.* at 86–87.

367. *See supra* note 225 and accompanying text; *see also* Christy B. Bushnell, Comment, *Champerty Is Still No Excuse in Texas: Why Texas Courts (and the Legislature) Should Uphold Litigation Funding Agreements*, 7 HOUS. BUS. & TAX L.J. 358, 359 (2007).

368. Barksdale, *supra* note 354, at 726; *see also* Martin, *supra* note 354, at 84, 87. Martin compares litigation financing to other subprime lending industries, noting that "[i]t is the situation of the poor individual borrower, however, that creates antipathy toward the entire subprime industry." *Id.* at 95.

369. Martin, *supra* note 354, at 102. For an in-depth analysis of the pros and cons of lawsuit financing, see Mariel Rodak, Comment, *It's About Time: A Systems Thinking Analysis of the Litigation Finance Industry and Its Effect on Settlement*, 155 U. PA. L. REV. 503, 513–23 (2006).

370. *See* Barksdale, *supra* note 354, at 730; *see also* Martin, *supra* note 354, at 87. Martin notes that a Google search for "litigation financing" returns results for more than fifty such financing firms. *Id.* at 87 n.22.

371. Susan Lorde Martin, *The Litigation Financing Industry: The Wild West of Finance Should Be Tamed Not Outlawed*, 10 FORDHAM J. CORP. & FIN. L. 55, 55–56 (2004).

372. BLACK'S LAW DICTIONARY 246 (8th ed. 2004); Martin, *supra* note 354, at 86.

373. Martin, *supra* note 371, at 58.

374. *See* Barksdale, *supra* note 354, at 723.

ticipate in the handling of the lawsuit.[375] Nevertheless, critics point to outside investors' expectations of a return as a heavy influence on litigation strategy.[376] The client confidentiality question is also a problem as plaintiffs must disclose confidential information to these firms to obtain financing.[377] Clients must provide informed consent to disclose such information; however, the client is risking the attorney-client privilege by disclosing such information to finance the lawsuit.[378]

Despite the general misgivings about litigation financing in the United States, the industry may have even more explosive growth during the global financial crisis because litigation is generally countercyclical.[379] As the credit crunch squeezes law firms and businesses, those with a claim to pursue may look elsewhere for funding. In the months prior to January 2009, Juridica experienced a "30% to 40% increase in inquiries by law firms seeking outside funding for litigation."[380] British litigation insurance broker ILF Limited and alternative assets advisor IGS Group formed a joint venture called Independent Litigation Funding (ILF) to finance the securities litigation expected to explode due to the financial crisis.[381] ILF is looking "to raise $232 million to finance mid-sized corporate litigation cases in U.K. courts."[382] Thus, outside funding in lawsuits, rather than law firms, may be one alternative in response to today's legal and economic environment.

IV. RECOMMENDATION

Given the spectrum of potential investment models, the U.S. legal profession needs to adopt a broader perspective when considering the question of outside investment in the law. The debate is not simply a line drawn in the sand;[383] allowing outside investment in the law does not necessarily mean that Sears will soon be in the business of providing legal services. That fear represents the most extreme pole of the investment spectrum. Rather than focus on the benefits or shortcomings of the present partnership model, this Note adds to the outside investment debate by analyzing how different potential investment and direct ownership models along the investment spectrum could be used by the legal

375. Martin, *supra* note 354, at 109.

376. *See id.*; Julia H. McLaughlin, *Litigation Funding: Charting a Legal and Ethical Course*, 31 VT. L. REV. 615, 651 (2007).

377. *See* McLaughlin, *supra* note 376, at 649.

378. *See id.*

379. Lance Bachmeier, Patrick Gaughan & Norman R. Swanson, *The Volume of Federal Litigation and the Macroeconomy*, 24 INT'L REV. L. & ECON. 191, 205 (2004).

380. Terzo, *supra* note 363.

381. Andrew Longstreth, *U.K. Joint Venture Seeks to Raise $232 Million to Invest in Expected Corporate Litigation Boom*, AMLAW LITIG. DAILY, Jan. 15, 2009, http://www.law.com/jsp/tal/digestTAL.jsp?id=1202427480673.

382. *Id.*

383. *See* Regan, *supra* note 67, at 408.

profession in the future. The analysis illustrates the wide range of the spectrum and shows how the investment question is much more complex than a yes or no answer. The analysis also provides numerous examples of how a firm can address the ethical and professional concerns of outside investment while benefitting from the capital raised.

This Note, however, does not claim to address all aspects of the debate; it aims only to broaden the legal profession's perspective on outside investment. Much more careful consideration is necessary before the profession can make an informed and responsible decision of whether and, if so, how to modify the Model Rules to allow some level of outside investment. Therefore, this Note recommends that the ABA commission an independent study of the current regulatory structure and legal profession in the United States, similar to the United Kingdom's study and resulting Clementi Report, to provide a more comprehensive analysis of outside investment in the law.[384] Such study should consider the issue under the same basic framework used above: the modern legal environment, the regulatory changes internationally, the ethical and professional concerns of outside ownership, and the benefits outside capital would bring to the profession. The analysis above is merely a starting point, and there is much more that the commission should consider. This Note did not, for example, address the additional concerns of nonlawyer owners in multidisciplinary firms. There are also other models to consider beyond the five presented here.[385] Further, any complex financial security such as the derivative investment discussed above should be carefully scrutinized to ensure that investors and the market can understand the risk of the security.[386]

The biggest issue for the commission to consider is what the regulatory structure should be if the Model Rules are modified to allow some level of outside investment. The regulatory structure will depend in great part on how far along the investment spectrum the legal profession is willing to move from the currently prohibitive rules. Australia and the United Kingdom provide examples of regulatory safeguards that we could implement domestically. For example, we could consider the value of Australia's legal practitioner director, who is responsible for managing the legal services and ensuring that outsiders do not interfere with attor-

384. *See supra* note 148 and accompanying text. At a minimum, we need to explore how to address the current regulatory conflict created by the U.K. Act. *See supra* notes 180–82 and accompanying text. Other commentators have noted the lack of a comprehensive analysis of the legal profession in the United States. *See* Petzold, *supra* note 108, at 96.

385. One proposed model is the Swiss Verein structure, used by Big Four accounting firms Deloitte and KPMG. *See generally* Megan E. Vetula, Current Development 2008–2009, *From the Big Four to Big Law: The Swiss Verein and the Global Law Firm*, 22 GEO. J. LEGAL ETHICS 1177 (2009). Professor Ribstein's "uncorporation" model is yet another possible structure. *See supra* note 286 and accompanying text.

386. *See* David Brooks, Op-Ed., *Two Cheers for Wall St.*, N.Y. TIMES, Jan. 25, 2008, at A25. The 2008 sub-prime mortgage crisis illustrates the risk of creating complex financial instruments that investors do not understand and that the market cannot value. *See id.*

neys' professional obligations.[387] We could regulate firms with outside ownership through a licensing body, or implement a central complaint office similar to the U.K. regulatory scheme.[388] We could also draw from current domestic state and federal regulation of corporate behavior.[389] It is important to consider how the regulatory framework will impact management authority and accountability with the firm.[390] The regulatory framework and the safeguards it would provide are an important component of the ethical debate. A detailed study using the framework presented in this Note would provide a better discussion of the behavioral incentives and ethical concerns of allowing some degree of outside investment under a change in the Model Rules.

V. CONCLUSION

This Note illustrates the range of legal-related investment possibilities and urges that we take a broader approach in looking at how outside investment would impact the profession. Over the last two decades, the legal environment has changed significantly, yet the partnership structure remains the same. The regulatory changes to allow outside investment in Australia and the United Kingdom further push the outside investment question into the spotlight. The answer to outside investment, however, should not be a simple yes or no. The possible investment spectrum—from direct ownership, to a derivative security, to investment in lawsuits—demands a more nuanced analysis and response. Indeed much remains to be analyzed before we can decide how to respond to the outside investment question in the United States. Only by embracing a broader perspective, however, will we be able to give the question the consideration it deserves.

387. *See supra* notes 119–20 and accompanying text.

388. *See supra* notes 152–53, 163–64 and accompanying text.

389. *See* MacEwen, Regan & Ribstein, *supra* note 6, at 91 ("There is little mandatory regulation of corporate structure, yet corporate behavior itself is heavily regulated by federal and state law."). Professor Mitt Regan has discussed possible regulatory structures and professional values that should be considered in choosing a regulatory structure. *See* Regan, *supra* note 67, at 432–37.

390. *See* Chambliss, *supra* note 86, at 92–94.