AN ECONOMIC CRISIS IS A TERRIBLE THING TO WASTE: REFORMING THE BUSINESS OF LAW FOR A SUSTAINABLE AND COMPETITIVE FUTURE

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In this Comment, I analyze how the current economic crisis has exposed many of the vulnerabilities of the conventional business model for law firms. After years of unprecedented but unsustainable growth, large law firms are stagnating, shrinking, or even disappearing entirely. Many law firms flourished amidst a frenzy of cheap and easy debt, high leverage, and inexhaustible billable hours—but were left without a net when work and collections rates dried up with the credit markets. Law firms are now left with only a few unpalatable options to raise working capital.

I aim to link the crippled state of the legal profession with the traditional prohibition on external investment in law firms. Cut off from investor capital, law firms are forced to rely on perilous amounts of debt and inefficient business practices in order to simply survive.

Contrary to the conventional justification for prohibiting outside investment, regulating the business structure of law firms is neither necessary nor sufficient to ensure ethical lawyering. Without access to modern capital structures, U.S. law firms are handicapped in building transnational legal presences and remain trapped in a failing business model. I propose a system in which law firms can access an outside pool of capital as publicly traded partnerships, while adopting more formal ethical structures that protect professional standards and prevent possible conflicts of interest.

The U.S. legal profession should take advantage of an ongoing paradigm shift to emerge from the crisis with liberalized business structures that allow firms to build sustainable, competitive practices that deliver more efficient services to their clients. I hope my discussion of these issues adds a new perspective to the debate concerning outside investment in U.S. law firms, and strikes a balance between ethical considerations and the evolving market for legal services.

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Introduction

The current economic crisis has infected nearly every industry, and even law firms have lost their fabled immunity to recession. After years of unprecedented growth, the vast majority of large law firms are now paring their ranks, and a few venerable firms have collapsed completely.[1] More than 40,000 legal services jobs have vanished since the official start of the recession in December 2007;[2] 2,500 jobs were lost during a brutal ten-day stretch in February

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

2. *Compare* BUREAU OF LABOR STATISTICS, U.S. DEP'T OF LABOR, THE EMPLOYMENT SITUATION: OCTOBER 2009 tbl.B-1 (Nov. 6, 2009), *available at* http://www.bls.gov/news.release/archives/empsit_11062009.pdf (providing data on the number of non-seasonally adjusted legal services jobs in October 2009), *with* BUREAU OF LABOR STATISTICS, U.S. DEP'T OF LABOR, THE EMPLOYMENT SITUATION: JANUARY 2008 tbl.B-1 (Feb. 6, 2009), *available at* http://www.bls.gov/news.release/archives/empsit_02062009.pdf (providing data on the number of non-seasonally adjusted legal services jobs in December 2007). For appraisal of the state of the profession at the close of March 2009, see Nate Raymond, *Job Losses in Legal Sector Continue*, AM L. DAILY, Apr. 3, 2009,

2009.[3] As the recession became more aggressive, so too did the measures to trim fat: large firms imposed pay freezes and salary cuts, deferred start dates for incoming associates, rescinded offers to graduates, curtailed or cancelled summer associate programs, fired scores of highly compensated associates, cut underperforming practices and partners, and slashed annual payouts to the partners that remained.[4]

The downturn exposed many liabilities masked by flush times, when law firms successfully raised per-partner earnings by increasing billable rates and adopting a highly leveraged structure, in terms of both debt and human capital.[5] However, many of the recent failings of law firms can be traced, in part, to those highly leveraged debt positions. Firms that find themselves teetering on a financial precipice as a result of aggressive leverage positions are easily nudged over by an unexpected exodus of key partners. The crisis revealed the vulnerabilities of the conventional business model for large law firms and unraveled confidence in the future of this system.[6] As it becomes clear that the economic crisis will be extended, law firms are scrutinizing their business models and experimenting with ways to build a more secure capital base.

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http://amlawdaily.typepad.com/amlawdaily/2009/04/job-losses-in-legal-sector-continue.html. Six months later, the tenor remained unchanged: In September 2009 the U.S. unemployment rate reached its highest in twenty-six years and the legal sector shed 13,600 jobs. Even when this figure is seasonally adjusted to account for the return of summer associates to fall classes, 2,000 jobs were lost. *See* Brian Baxter, *Legal Sector Loses 2,000 Jobs in September*, AM L. DAILY, Oct. 3, 2009, http://amlawdaily.typepad.com/amlawdaily/2009/10/jobs-report.html.

3. Martha Neil, *731 Lawyers and Staff Laid Off Monday at Morgan Lewis, K&L Gates and White & Case*, A.B.A. J., Mar. 9, 2009, http://www.abajournal.com/news/kl_gates_axes_115_sends_memo_good_people_will_be_looking_for_jobs.

4. *See, e.g.*, Bloomberg News, *No Arguing With These Figures: Recession Slamming Law Firms*, CHI. SUN TIMES, Apr. 7, 2009, at 7; Michael J. de la Merced, *The Legal Profession Feels the Pain of the Recession*, N.Y. TIMES, Mar. 26, 2009, at F2; Carol J. Williams, *New Lawyers Turn to Public Interest*, L.A. TIMES, Apr. 6, 2009, at A6.

5. *See, e.g.*, Susan Beck, *Past the Tipping Point*, AM. LAW., Jan. 2009, at 16, 16–17; Kellie Schmitt, *Could Higher Leverage Mean Lower Profits?*, RECORDER (S.F.), Nov. 22, 2005, at 1 ("Law firm leaders throughout California identify increasing leverage as a key strategy in their business model.").

In the legal services industry, "leverage" is used in two distinct, yet often related, contexts. A firm's leverage position may properly refer to either its degree of indebtedness, or the ratio of equity partners to nonequity (though highly compensated) associates.

6. *See, e.g.*, Paul Lippe, *Law Firms' 2011 Scenario and the End of Leverage*, AM. LAW., Feb. 11, 2009, http://www.law.com/jsp/article.jsp?id=1202428174244 (offering prognostications on the fundamental transformations of law firms as the markets recover); Bruce MacEwen, *The Great De-Leveraging*, ADAM SMITH ESQ., Mar. 8, 2009, http://www.adamsmithesq.com/archives/2009/03/the-great-de-leveraging.html (noting the myriad ways in which "the whole world is now aware of the perils of leverage"); Larry E. Ribstein, *The Over-Leveraging and Over-Regulation of the Legal Profession*, IDEOBLOG, Mar. 6, 2009, http://busmovie.typepad.com/ideoblog/2009/03/the-overleveraging-and-overregulation-of-the-legal-profession.html (drawing lessons from the ways in which lawyers are like "crashing investment banks").

This introspection hints at the opportunity hidden in the grim and ever more redundant headlines. While individual law firms scramble for working capital but balk at assuming additional debt, the legal profession as a whole should take a moment to rethink the conventional wisdom that led firms to build empires on unstable financial structures.[7] Law firms' dependence on debt should be unsurprising in light of rules that prohibit them from accepting outside investment. Yet the fear that outside investment from nonlawyers will transform the noble legal profession into a business draws an unsupportable distinction; the provision of legal services *is* a business, and large law firms must exercise business savvy to maintain a competitive edge. Governments overseas have already arrived at this conclusion. Australia debuted the world's first publicly traded law firm in 2007.[8] That same year, the United Kingdom passed legislation allowing its law firms to likewise seek outside investment.[9] Several other countries appear poised to follow suit.[10]

The prohibition on nonlawyer investment in U.S. law firms is predicated on the potentiality of conflicts of interest and undue influence from investors.[11] Yet other countries have overcome these perceived risks through regulation and mandatory ethical infrastructures imposed on firms that accept outside investment. Without access to modern capital structures, U.S. law firms are handicapped in building transnational legal presences. Firms with access to large pools of capital have a competitive advantage in expanding their practices globally and delivering efficient services to their clients.[12] Furthermore, outside investment would enable law firms to build sustainable

7. According to a survey of nearly 2,000 lawyers in the United Kingdom conducted earlier this year, 69 percent of managing and senior partners believed that "the current economic turmoil will force law firms to radically change their business models . . . ." Steve Hoare, *Senior Lawyers Question Law Firm Business Model*, LAW. (London), Jan. 5, 2009, at 1.

8. Jason Krause, *Selling Law on an Open Market*, A.B.A. J., July 2007, at 34.

9. *See* News Release, U.K. Ministry of Justice, Legal Services Act Given Royal Assent (Oct. 30, 2007), *available at* http://www.justice.gov.uk/news/newsrelease301007a.htm.

10. For a discussion of similar proposals currently under consideration in Spain, France, and Scotland, see *infra* Part III.C. *See also* HILDEBRANDT, THE LEGAL SERVICES ACT: INVESTING IN THE LAW 13–14 (2008).

11. Rule 5.4(d) of the ABA Model Rules of Professional Conduct provides that "[a] lawyer shall not practice with or in [an entity] authorized to practice law for a profit, if: (1) a nonlawyer owns any interest therein . . . ; (2) a nonlawyer is a corporate director or officer thereof . . . ; or (3) a nonlawyer has the right to direct or control the professional judgment of a lawyer." MODEL RULES OF PROF'L CONDUCT R. 5.4(d) (2003).

12. Opening satellite offices overseas is clearly a capital-intensive enterprise. For those firms with international clientele, a transnational legal practice also facilitates "assembling collaborative work teams across international borders, reducing the costs of supply and logistics through global supply chains, [and] achieving compliance with [foreign] regulatory regimes . . . ." Gillian K. Hadfield, *Legal Barriers to Innovation: The Growing Economic Cost of Professional Control Over Corporate Legal Markets*, 60 STAN. L. REV. 1689, 1719–20 (2008).

practices that can thrive independent of the sometimes questionable loyalty of a few rainmaker partners. Given that much of the value of a law firm stems from social capital and perceived legitimacy, both contingent upon ethical lawyering, "practicing to the share price" may actually encourage more robust adherence to ethical standards.

Law firms that recognize the double-edged sword of leverage are now loathe to take on more debt and hesitant to exact the necessary working capital from the pockets of partners. Seizing on opportunity, a few keen hedge funds have stepped in to fill the demand for capital, funding large-scale commercial litigation as an investment.[13] The hedge funds have thus far been successful in choosing strong cases—and exacting a hefty percentage of recoveries. Yet this arrangement seems unnecessarily costly and inefficient; the hedge fund essentially acts as a middleman between investors' capital and the recipient law firm. Allowing law firms direct access to that capital would better serve the client and the law firm, and is certainly no more problematic from a conflict standpoint than having a hedge fund as benefactor and beneficiary on a case-by-case basis.

Just as the Obama administration has recognized the crumbling of the economy as an opportunity for regulatory reform,[14] the legal profession should not let this crisis go to waste. The U.S. legal profession is in the midst of a paradigm shift, and many firms that survive the recession will have a radically different business outlook. A few pioneering firms have already begun to develop alternative methods of recruitment, billing, and compensation to adapt to the changing landscape. The legal profession as a whole should likewise take advantage of the urgency for reform to emerge from this economic crisis with liberalized business structures that allow firms to build sustainable, competitive practices that deliver more efficient services to their clients.[15]

This Comment begins in Part I with an overview of the modern U.S. legal profession, from the rise of large international law firms to the crippling effects of the current economic downturn, acutely illustrated by the recent

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13. Alison Frankel, *U.K. Litigation Financing Firm Now Has $100 Million to Invest in U.S. Cases*, AM. LAW. LITIG. DAILY, Apr. 10, 2009, http://www.law.com/jsp/law/international/LawArticle Intl.jsp ?id=1202429816146.

14. As Rahm Emanuel, President Obama's chief of staff, told a Wall Street Journal conference of CEOs: "You never want a serious crisis to go to waste," and continued to explain that "[t]hings that we had postponed for too long, that were long-term, are now immediate and must be dealt with. This crisis provides the opportunity for us to do things you could not do before." Gerald F. Seib, *In Crisis, Opportunity for Obama*, WALL ST. J., Nov. 21, 2008, at A2 (quoting Rahm Emanuel).

15. A paradigm shift would be a welcomed benefit of the financial meltdown. The New York Times comments that "[t]he silver lining, if there is one, is that the legal world may be inspired to draw blueprints for the 21st century." Adam Cohen, Editorial Observer, *With the Downturn, It's Time to Rethink the Legal Profession*, N.Y. TIMES, Apr. 2, 2009, at A26.

collapses of Heller Ehrman LLP, Thacher Proffitt & Wood LLP, and Thelen LLP. The woes of these failed firms, and those still in distress, can be traced to their high-risk leverage positions, a business strategy that for years has been touted as a recipe for profitability. Yet the traditional prohibition on external investment in the United States forces law firms to rely on debt; this rule and the rationale fueling it are described in Part II.

In the nearly three decades since the American Bar Association last considered the prospect of external investment, the legal profession has undergone dramatic changes. Part II assesses the continuing validity of the prohibition in light of these changes. Many of the concerns underlying the prohibition on outside investment are either contrary to the modern conception of the law firm, which increasingly resembles a corporate entity in all but name, or are adequately addressed by ethics rules that regulate individual lawyer conduct.[16] In the last few decades other professional service industries, such as finance and marketing, have successfully liberalized access to capital through public listings without sacrificing professional ethical standards. The legal profession remains unique among these service providers only by virtue of the enduring prohibition on alternative business forms. As a contrast to such formalistic regulation, Part III details the emergence of publicly traded law firms overseas, and the shift in perspective in the face of changing business needs.

Part IV presents the benefits of accepting external investment. Aside from the competitive pressures that make such a move necessary for the continued viability of large U.S.-based firms in the global marketplace, access to outside pools of capital will encourage firms to become more efficient, innovative, and ethical. Capital lock-in also facilitates the recruitment and retention of talent, geographic expansion, technological development, diversification of practice areas, and assures financial stability that is not defined by the presence of individual partners.

The Comment concludes in Part V by offering a balance between commercial and ethical considerations. Law firms need not incorporate to reap the benefits of outside investment. Publicly traded partnerships, such as The

16. *See* Milton C. Regan, Jr., *Lawyers, Symbols, and Money: Outside Investment in Law Firms*, 27 PENN ST. INT'L L. REV. 407, 420–23 (2008) (detailing how the current reality of law firms has departed from a classic partnership model and moved towards a corporate model). For examples of some of the ethics rules that directly address the general concerns regarding an individual lawyer's independent professional judgment, see MODEL RULES OF PROF'L CONDUCT R. 1.6 (client confidentiality), R. 1.7 (conflicts of interest), R. 1.8(f) (permitting a lawyer to accept compensation from a third party so long as there is no interference with the lawyer's professional independent judgment, the client gives consent, and that information relating to the representation stays confidential according to rule 1.6), and R. 5.2(a) (a subordinate lawyer is responsible for compliance with ethical rules even when acting under the direction of another person).

Blackstone Group, sell units to limited partners with no voting rights. Such partnerships would be well advised to adopt a more robust internal management of conflicts of interest, which would in turn facilitate the development of a culture of ethics within the firm. The modern large law firm can no longer rely solely on collegial self-regulation among the firm's attorneys. More formal regulation of professional ethics, spurred by changes in law firm structure and market forces, would be more responsive to the ethical pressures currently faced by the legal profession.

I. IN ECONOMIC CRISES, LEVERAGE PROVES A LIABILITY, NOT AN ASSET

A. Recession Decimates Law Firms

Few, if any, law firms will emerge from the financial crisis unscathed. Since the official start of the recession in December 2007, the legal services sector has shed more than 40,000 jobs.[17] 5,500 legal jobs—including both lawyers and staff—were eliminated during January and February of 2009.[18] Many firms evaluate compensation in January, and perhaps waited to see if the economic stimulus package would ameliorate the pain.[19] The stimulus package was not the panacea many had hoped for. Another 2,700 legal jobs were lost in March,[20] 1,300 in May,[21] 2,700 in July,[22] and 2,000 in September.[23] As the recession grew more entrenched, many firms conducted rounds of layoffs. For instance, Latham & Watkins LLP, a prestigious law firm and among the largest in the country, was recently forced to lay off 12 percent of its

17. *See supra* note 2 (providing data on the number of non-seasonally adjusted legal services jobs in September 2009); *see also* Jeff Jeffrey, *Pink Slips by the Hundreds in a Dark Week for Law Firms*, RECORDER (S.F.), Feb. 17, 2009, at 3.

18. De la Merced, *supra* note 4.

19. One of the theories accounting for the surge in layoffs early in the year was that "the rocky reception by the markets and Congress to the Obama stimulus package convinced several firm leaders that the downturn wasn't ending any time soon." Jeff Jeffrey, *Brutal Week of Law Firm Cuts*, LEGAL TIMES, Feb. 16, 2009, at 1.

20. BUREAU OF LABOR STATISTICS, U.S. DEP'T OF LABOR, THE EMPLOYMENT SITUATION: MARCH 2009 tbl.B-1 (Apr. 3, 2009), *available at* http://www.bls.gov/news.release/archives/empsit_04032009.pdf.

21. BUREAU OF LABOR STATISTICS, U.S. DEP'T OF LABOR, THE EMPLOYMENT SITUATION: MAY 2009 tbl.B-1 (June 5, 2009), *available at* http://www.bls.gov/news.release/archives/empsit_06052009.pdf.

22. BUREAU OF LABOR STATISTICS, U.S. DEP'T OF LABOR, THE EMPLOYMENT SITUATION: JULY 2009 tbl.B-1 (Aug. 7, 2009), *available at* http://www.bls.gov/news.release/archives/empsit_08072009.pdf.

23. *See* Baxter, *supra* note 2.

associates and 10 percent of its paralegals, eliminating a total of 440 jobs.[24] The firm evaluated its overcapacity in personnel following several years of increased hiring on pace with growing revenue, and took action after determining that the recession would "be longer lasting and [with] a slower recovery" than originally anticipated.[25]

Latham & Watkins's decision to downsize, far from an isolated example, represents a general trend among law firms to purge excesses from their workforces and balance sheets.[26] Of course, some firms' shrinking pains are more acute than others; among the recession's casualties are several large firms that have collapsed entirely. The economic climate has revealed the conventional business structure of law firms to be imprudent at best. Specifically, the traditional reliance on debt as leverage can no longer remain an unscrutinized practice. Large law firms, far from impervious to the downturn, are actually "immensely fragile institutions," and their highly leveraged debt positions and decline in revenue per lawyer a "combustible combination."[27]

B. Rise of the Modern Large Law Firm

As more law firms succumb to imprudent leverage positions, it seems imperative that other beleaguered firms take a closer look at their own capital structure. Law firms' previously sanguine attitude towards leverage was fueled by a thriving economy. During the peak of the credit markets, debt was cheap, readily available, and more palatable than siphoning funds from equity partners. Law firms became increasingly dependent on bank financing for working capital.[28] Indeed, law firms were viewed as a conservative investment and enjoyed privileged status in a lender's portfolio, creating an environment that "encouraged law firms to indulge in over-generous drawings policies, since the sole result of continuing to increase drawings to partners, whether or not

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24. V. Dion Haynes, *Latham & Watkins Cuts 190 Lawyers; Huge Global Firm Lays Off 250 Others*, WASH. POST, Feb. 28, 2009, at D1.

25. *Id.*

26. Chicago's marquee law firm, Sidley Austin LLP, laid off eighty-nine lawyers in a single day in March. Ameet Sachdev, *Sidley Austin Lays Off Dozens*, CHI. TRIB., Mar. 13, 2009, at C50. Morgan Lewis cut almost 4 percent of its lawyers in March. Chris Mondics, *Morgan Lewis Lays Off Lawyers, Staff*, PHILA. INQUIRER, Mar. 10, 2009, at C01.

27. These observations were made by law professor William Henderson. *See* Posting of William D. Henderson to Legal Profession Blog, *Selling BigLaw Short*, http://lawprofessors.typepad.com/legal_profession/2008/12/selling-biglaw.html (Dec. 16, 2008); Ameet Sachdev, *Law Firms' Woes Likely to Last: More Layoffs, Fewer Bonuses May Persist With Economic Slump*, CHI. TRIB., Jan. 1, 2009, at C28.

28. *See* Tina Williams, *Partnerships: Prudent Lenders*, LEGAL WK., Aug. 4, 2009, http://www.legalweek.com/legal-week/analysis/1496256/partnerships-prudent-lenders (noting that firms' reliance on bank financing contributed to lax management of finances, including debt collection from clients).

the firm's cash position justified it, was an increase in the firm's overdraft, to which partners individually paid scant regard."[29]

Leverage in terms of the ratio of associates to equity partners has also traditionally been viewed as a sound practice, increasing profitability.[30] "Firms calculate how to get maximum leverage from associates, figuring out how many associates they can hire without making the chances of making partner so slim that the firm can no longer compete for the brightest young graduates."[31] A standard recruitment tool is also the lock-step pay structure: Graduates expect a high base salary, with a guaranteed pay increase for each year they've been out of law school—irrespective of job performance. The lock-step system reduces competition among new associates, and pacifies those more senior associates who have little hope of making partner.

The race to maximize earnings per partner, the ubiquitous metric for general profitability, has led many firms to shy away from building a base of equity partners. Many firms have established a second class of nonequity partners who are paid a salary instead of sharing in the firm's profits in order to increase the appearance of high profitability. Indeed, surging profits-per-partner among the hundred largest law firms ranked by the *American Lawyer*—an average of $1.3 million in 2007—can largely be attributed to decreasing the number of equity partners in a firm.[32]

At many firms, a small number of indispensible partners serve as liaisons to the firm's clients. These rainmakers, with their books of business, essentially control the fate of the firm. Placating these partners is an imperative, leading firms to distribute nearly all profits to equity partners at the year's end, with little cash held in reserve. The collegial partnerships of yesteryear have been replaced by a two-tier system, in which nonequity partners now

29. *Id.*

30. Andrew Bruck & Andrew Canter, *Supply, Demand, and the Changing Economics of Large Law Firms*, 60 STAN. L. REV. 2087, 2093 (2008) ("The ratio of associates to partners, or 'leverage,' became an important predictor of a firm's profitability, as increasing the number of salaried associates often resulted in greater returns for the partners.").

31. Derek C. Bok, *Markets and Mindwork*, 10 WASH. U. J.L. & POL'Y 1, 4–5 (2002); *see also* Peter D. Sherer, *Leveraging Human Assets in Law Firms: Human Capital Structures and Organizational Capabilities*, 48 INDUS. & LAB. REL. REV. 671 (1995).

32. Martha Neil, *AmLaw 100 Profits Up, Partners Down*, A.B.A. J., Apr. 29, 2008, http://www.abajournal.com/news/amlaw_100_profits_up_partners_down.

By far the most transformative change to the traditional partnership model of law firms is the widespread adoption of the limited liability partnership form. Limited liability is one of the cherished advantages of the incorporated entity, insulating directors and officers from liability in their personal capacities. In the context of law firms, limited liability diminishes incentives for partners to informally monitor the conduct of their colleagues—a hallmark of the ethical infrastructure of traditional partnerships.

account for 35 percent of all partners.[33] At the current rate, nonequity partners will outnumber equity partners by 2015.[34]

Unfortunately, the firm structure that has developed over the past few decades lends itself to a feast or famine dynamic.

C. Case Studies in Law Firm Economics

High leverage provides a thin buffer for firms when fortunes turn. When revenue shrinks and demand for legal services drops, a firm still must cover loan payments and the lock-step salaries of its highly compensated associates. Firms felt the burden of carrying the overhead when, in the second half of 2008, historically low collection rates for accounts receivable were exacerbated by the collapse of the credit market; large clients who were themselves desperate for liquid capital deferred payments. Of the top five most highly leveraged firms in terms of associate/partner ratio, three—Cadwalader, Wickersham & Taft LLP, White & Case LLP, and Orrick, Herrington & Sutfcliffe LLP—have announced cutbacks, and one, Thelen, is in dissolution.[35] In the face of general economic turmoil, "the whole pyramid model is looking fragile."[36]

The final chapters of three firms that closed their doors in December 2008, and their debt-laden balance sheets, offer a cautionary tale to firms that continue to subscribe to the traditional business model. The infirmities in the failed firms' business practices are by no means unique to these firms, or this recession. The once immensely profitable and prestigious San Francisco-based firm of Brobeck, Phleger & Harrison LLP, with a thriving portfolio of dot-com and Silicon Valley clients, imploded along with the Internet bubble earlier this decade.[37] The firm's surprising collapse in 2003 was due, in part, to excessive reliance on debt—$90 million at its zenith.[38]

33. Aric Press & John O'Connor, *Lessons of the Am Law 100 2008*, AM. LAW., May 2008, at 131.
34. *Id.*
35. Beck, *supra* note 5.
36. *Id.*
37. Todd Wallack & Harriet Chiang, *Top S.F. Dot-Com Law Firm to Close*, S.F. CHRON., Jan. 31, 2003, at A1.
38. *See* Susan Beck, *Brobeck's Final Days*, AM. LAW., Mar. 2003, at 13. According to a former partner at Brobeck, the firm had entered "a death spiral, where you couldn't cut expenses fast enough as attorneys were leaving and taking business with them . . . . And because Brobeck had a lot of debt, the banks took control of the money and Brobeck had no choice but to fail." Petra Pasternak, *Upfront Scrutiny: Lateral Partners Anxious for Details on Borrowing, Equity*, RECORDER (S.F.), Nov. 24, 2008, at 1.

Heller Ehrman, another large San Francisco law firm, was forced to file for Chapter 11 bankruptcy in December 2008.[39] The firm had seen its capital base shrink as partners peeled away throughout 2008, including the firm's high-grossing intellectual property group.[40] A series of settlements stymied the firm's revenue from litigation, as well as its ability to make loan payments. By September the firm's debt was in the range of $30 million.[41] Heller's bank accounts were frozen after a succession of partner departures violated bank covenants governing its debt, forcing the firm to close its doors at the end of 2008.[42]

Thacher Proffitt & Wood also dissolved at the close of 2008 after a prestigious 160-year history. In the years preceding its collapse, Thacher had striven to keep pace with the surge in securitization work, financing a massive expansion effort with $30 million in debt.[43] The decision to essentially mortgage the future of the firm on the success of a narrow industry was likely hailed as propitious, even if a bit imprudent. However, the firm suffered a major blow with the collapse of the credit markets, which "left a once fiercely independent firm at the mercy of its creditors."[44] The situation forced Thacher management to scramble "to inject some much-needed capital into the firm," according to a former Thacher partner.[45] Rumors concerning the health of the firm abounded, and in early 2008 there was talk of the firm relying on credit for 2007 partner payouts and bonuses.[46] Partners were asked to supply astonishing amounts of capital—half a million dollars for some—to keep the firm afloat.[47] The firm also began to aggressively hold back partner profits—as much as $250,000 per partner.[48] However, these measures were insufficient to overcome the firm's accumulated losses.[49]

Lastly, Thelen, one of the nation's hundred highest-grossing corporate law firms in 2007,[50] dissolved in December 2008.[51] "[T]he firm encountered trouble when revenue didn't keep pace with costly expansion efforts," and an

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39. Amanda Royal, *Heller Laterals Took $7 Million: List Names Partners Who May Be Asked to Give Back Capital*, RECORDER (S.F.), Feb. 25, 2009, at 1.
40. Koppel, *supra* note 1.
41. *Id.*
42. *See* Royal, *supra* note 39.
43. David Bario, *A Really Bad Bet*, AM. LAW., Mar. 2009, at 84.
44. *Id.*
45. Matt Byrne, *Thacher Proffitt & Wood: Bitter End*, LAW. (London), Jan. 19, 2009, at 14.
46. *Id.*
47. *Id.*
48. *Id.*
49. *Id.*
50. Nathan Koppel, *Thelen Law Firm Faces Threat of Closing*, WALL ST. J., Oct. 29, 2008, at B8.
51. *See* Nate Raymond, *Thelen Settles Lawsuit With Schiff Hardin Over Sublease*, N.Y.L.J., Aug. 24, 2009, at 1.

exodus of partners caused the firm to breach a bank covenant that capped the number of partners who could leave the firm in any twelve month period.[52] The breach caused the firm to default on its primary credit agreement, and as a result the bank gained control over the firm's expenditures.[53] Nearly a year after the firm closed its doors, Thelen filed for Chapter 7 bankruptcy in September 2009.[54] Thelen's bankruptcy petition revealed that its assets, between $10 million and $50 million, were eclipsed by liabilities totaling between $50 million and $100 million.[55]

Amidst the turmoil of the law firm dissolutions late last year, Hildebrandt International, a consulting service that advises the legal industry, issued a white paper analyzing the fundamental causes of law firm failure.[56] Hildebrandt studied circumstances surrounding the recent law firm dissolutions and those of eighty law firms that failed between 1998 and 2004 in an attempt to identify commonalities that precipitated the collapses.[57] Three common fundamental flaws were identified; not surprisingly, the most salient proved to be a firm's poor financial health.[58] Excessive leverage in terms of debt was the most debilitating factor.

> Many of the failed firms that [Hildebrandt] examined borrowed substantial amounts of money to fuel growth as well as to pay partners during periods of cash shortfalls. Many of these firms were thinly capitalized—some almost as a matter of philosophical principle—a condition that drove an increased need for debt financing. High debt levels put these firms at particular risk when external economic conditions turned against them.[59]

Firms with high fixed costs in the form of loan payments and steep associate salaries are more susceptible to a triggering event, such as the defection of key partners to rival firms.[60] The ensuing downward spiral of financial turmoil and further departures becomes almost self-perpetuating, and difficult to reverse.

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52. Koppel, *supra* note 50.
53. *Id.*
54. *Thelen Law Firm Files Chapter 7 After Citi Cutoff*, REUTERS, Sept. 18, 2009, http://www.reuters.com/article/bankruptcyNews/idUSN18260720090918.
55. *Id.*
56. HILDEBRANDT INT'L, THE ANATOMY OF LAW FIRM FAILURES (2008), *available at* http://www.hildebrandt.com/PublicDocs/Doc_ID_1739_492004850218.pdf.
57. *Id.*
58. *Id.* at 2.
59. *Id.* at 3.
60. *See id.* at 2.

D. Distressed Law Firms Adapt

With the collapse of Heller, Thacher, and Thelen as a distressing reminder of the vulnerabilities of law firm balance sheets, the financial (in)stability of a firm, and its structure of capital and debt, is becoming much more influential in how potential laterals discriminate between firms.[61] Hiring partners and recruiters have noticed that, in contrast to flush times when candidates are chiefly concerned about personal fit and compensation, they now ask "more specific questions about the financial history, equity levels, borrowing habits and financing plans of the firms they are considering."[62] Consider Jones Day, which added thirty-five laterals in 2008: The firm uniquely boasts "zero debt . . . and no credit line."[63] Of course, there is a trade-off to reliance on liquid capital. As one Jones Day partner characterizes it, partners "take home less money than they would if we were more leveraged, but we also have the comfort of not having to answer to any outside lenders"; the partner added that this last point is "very attractive" to candidates.[64]

The current recession provides the legal profession the opportunity to reevaluate the conventional business practices of law firms. Some large law firms are now attempting to forestall their own demise by turning to partners to raise capital, and avoid debt. For instance, DLA Piper announced that it would reduce some partner payouts and convert more than 200 nonequity partners into equity partners—requiring each to provide more than $100,000 to the firm for the privilege.[65] Through these initiatives the firm expects to reduce its debt by a third.[66] McDermott Will & Emery LLP has created a separate track of staff lawyers who are paid less than regular associates to reduce its ratio of high-salaried lawyers to equity partners.[67] Dewey & LeBoeuf LLP announced it would withhold certain monthly distributions from its partners to build up its capital base.[68] Clifford Chance LLP asked all of its partners to contribute as much as $150,000 each to build the firm's capital base.[69]

This deleveraging trend parallels that of Wall Street investment firms, which frantically tried to reduce steep leverage positions in the face of economic

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61. Pasternak, *supra* note 38.
62. *Id.*
63. *Id.*
64. *Id.*
65. Ashby Jones, *Some Top Law Firms Tap Partners for Cash*, WALL ST. J., Jan. 29, 2009, at B1.
66. *Id.*
67. Debra Cassens Weiss, *How McDermott Tackled Its Leverage Problem*, A.B.A. J., Jan. 6, 2009, http://abajournal.com/news/how_mcdermott_tackled_its_leverage_problem.
68. Jones, *supra* note 65.
69. *Id.*

crisis.[70] As the economy has worsened, the two main lenders to firms—units of Citigroup Inc. and the bank formerly known as Wachovia—have started attaching more stringent terms to loans, further eroding the desirability of debt.[71] Firms seeking to extend credit lines must now comply with detailed disclosures, and institute a litany of changes demanded by lenders who have been burned by law firms now in default. Citigroup, for instance, now insists that indebted law firms "plac[e] strict internal controls on discretionary spending, cut[ ] bonuses, freez[e] associate salaries, postpon[e] new hires or initiatives, lay[ ] off professional and administrative staff, and revamp[ ] partner compensation schedules to slow distributions and improve cash positions."[72]

E. Litigation Ripe for Investment

With debt in disfavor, cash is once again king, as are those who can supply it. Some litigation practices have already turned to alternate funding schemes offered by shrewd investors with coffers of cash and a tolerance for calculated risk. For instance, Juridica Investments Ltd., a publicly traded U.K. hedge fund, is now in the business of funding plaintiff commercial litigation in the United States—as an investment.[73] Working with general counsel of Fortune 500 companies, and lawyers from top firms, Juridica has taken an equity interest in seventeen large commercial cases since its initial public offering in December 2007.[74] The recession has spurred interest in "spreading risk" associated with litigation, and lawyers directly proposition the company with opportunities to invest its $100 million.[75] The investments have paid off for Juridica shareholders; the company recently issued a 4.6 percent dividend with the repayment of a law firm loan.[76] Third-party litigation funding of this ilk has been popular in the United Kingdom for the last few years, and some pioneering companies are attempting to expand its use to

70. For example, early in 2008 Lehman Bros. raised $4 billion in new capital to bring its leverage ratio down to 27.3 from 31.7. Merrill Lynch had a leverage ratio of 27.8 in mid-2007, as compared to 17.9 at the close of 2003. The leverage ratio, a measure of the level of borrowing, is total assets divided by total shareholder equity. Peter Eavis & David Reilly, *Losing Leverage: Some Firms Cut Debt in This Uncertain Era*, WALL ST. J., Apr. 7, 2008, at C1.

71. *See* Nate Raymond, *Banks Keeping Law Firm Clients on Shorter Leash*, AM. LAW., Jan. 5, 2009, *available at* http://www.law.com/jsp/article.jsp?id=1202427211781 ("Law firms, typically considered good credit risks, are now experiencing the toughest and most expensive lending conditions in years."); David Enrich, *Lending Drops at Big U.S. Banks*, WALL ST. J., Jan. 26, 2009, at A1.

72. Susan A. Berson, *Loans and Moans: Past Firm Failures Mean Tougher Credit Rules*, A.B.A. J., Sept. 2009.

73. Frankel, *supra* note 13.

74. *Id.*

75. *Id.*

76. *Id.*

third-party funding for high-stakes defense work.[77] The drawback to law firms and their clients in accepting the bankroll, of course, is having to part with between 25 and 40 percent of total recoveries.[78]

The business potential in third-party litigation funding is tremendous. Because "[i]t's an unsophisticated and relatively naïve market . . . there should be a chance for some good returns," noted the head of investment for another hedge fund interested in funding litigation for profit.[79] Despite the risk inherent in any litigation, many cases present fairly low-risk investment scenarios. It's also an unsaturated market: the U.S. litigation market, worth roughly $33 billion, has only $4 billion invested in it.[80] Various other hedge funds are perking to high returns on sound economic prospects, and have made statements indicating an interest in raising capital "to take advantage of a wave of corporate litigation cases expected to arise from the credit crunch."[81]

The continued interest of hedge funds in litigation funding attests to the demand for capital on the part of some of the foremost litigation practices in the nation. The option surely has allure as an alternative to squeezing capital from frozen credit markets, but the margin is incredibly high. The hedge fund is essentially acting as a middleman, funneling capital from its own individual shareholders to the law firm, and then reaping an outsized reward from the success of the attorneys at trial. Removing the middleman, and giving the law firm direct access to the capital of investors, would certainly be a more efficient arrangement. The notion of a law firm IPO in the United States has been bandied about,[82] but bringing the idea to fruition would be in direct contravention of ethical rules. Seemingly, the arrangement would not pose a greater risk to ethical rules than does the equity investment of a hedge fund on a case-by-case basis, which is permitted. Logic notwithstanding, law firms must now resign to finance litigation through one of two evils, creditors or hedge funds.

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77. Claire Ruckin, *U.K. Third-Party Litigation Funding Rules in Final Stages*, LEGAL WK., July 31, 2008, http://www.law.com/jsp/article.jsp?id=1202423414109.

78. Sofia Lind & Claire Ruckin, *External Funding Booms as Litigators Plot Upturn*, LEGAL WK., Mar. 20, 2008, http://www.legalweek.com/legal-week/news/1145812/external-funding-booms-litigators-plot-upturn.

79. Sophia Grene, *Rich Pickings From Legal Cases*, FIN. TIMES (London), Jan. 26, 2009, at 10.

80. *Id.*

81. *Id.*

82. *See, e.g.*, 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 (1989); Bruce MacEwen, Milton C. Regan, Jr., & Larry Ribstein, *Law Firms, Ethics, and Equity Capital*, 21 GEO. J. LEGAL ETHICS 61, 76 (2008).

II. CAN MERE BUSINESS STRUCTURE ENSURE ETHICAL LAWYERING?

Despite the appeal of accessing a pool of capital from outside investment, ethical rules prohibit such an endeavor. The ABA Model Rule of Professional Conduct 5.4(d),[83] implemented through state-promulgated rules, provides that a "lawyer shall not practice with or in [an entity] authorized to practice law for a profit, if: (1) a nonlawyer owns any interest therein . . . ; (2) a nonlawyer is a corporate director or officer thereof . . . ; or (3) a nonlawyer has the right to direct or control the professional judgment of a lawyer."[84] However, in light of the realities of the modern law firm, this strict prohibition on outside investment in law firms should be reexamined.

A. Rationale Behind the Traditional Prohibition on Outside Investment

As the comments following Rule 5.4 explain, the regulations concerning a law firm's business structure and source of financing were established "to protect the lawyer's professional independence of judgment."[85] The limitations found in this rule reflect the traditional view of law as an insular profession, and can be traced to 1908 when the ABA first crafted the Canons of Professional Ethics.[86] The Canons effectively prohibited a law firm from accepting investment from, or sharing fees with, nonlawyers.[87] When the ABA adopted the Model Code of Professional Responsibility in 1969, it maintained the traditional restrictions on permissible business associations, and explicitly prohibited a lawyer from practicing law in an entity if a nonlawyer "owns any interest therein" or "is a corporate director or officer thereof"[88]—language that persists to this day.

There has not been a consensus on the advisability of a wholesale ban on outside ownership of law firms, even among the rules' drafters. In the late 1970s, the ABA established a commission, led by Robert Kutak, to develop

83. MODEL RULES OF PROF'L CONDUCT R. 5.4(d) (2003).
84. *Id.*
85. *Id.* R. 5.4 cmt. 1.
86. *See* CANONS OF PROF'L ETHICS (1908), *available at* http://www.abanet.org/cpr/mrpc/Canons_Ethics.pdf.
87. *Id.* Canon 33 ("Partnerships between lawyers and members of other professions or nonprofessional persons should not be formed or permitted where any part of the partnership's employment consists of the practice of law."); *id.* Canon 34 ("No division of fees for legal services is proper, except with another lawyer . . . ."); *id.* Canon 35 ("A lawyer's responsibilities and qualifications are individual. He should avoid all relations which direct the performance of his duties by or in the interest of such intermediary.").
88. MODEL CODE OF PROF'L RESPONSIBILITY DR 5-107(c)(1) (1980).

new rules to replace the Model Code of Professional Responsibility.[89] The Kutak Commission reexamined the advisability of the prohibition on lawyers entering into business associations with nonlawyers, and concluded that the rules should be revised to permit outside investment in law firms, subject to certain limitations.[90] The commission's proposed version of Rule 5.4 would permit a lawyer to practice in an organization in which a nonlawyer held a financial interest, provided that the arrangement did not interfere with the lawyer's independent professional judgment or with the client-lawyer relationship, including the preservation of client confidentiality, and did not violate any rules concerning advertising or fees.[91]

The commission's support for such a dramatic departure from tradition was rooted in its doubt that restrictions on business structure were either necessary or sufficient to ensure ethical lawyering. The commentary accompanying the proposed rule noted that "[g]iven the complex variety of modern legal services," all of which "raise problems concerning the client-lawyer relationship . . . it is impractical to define organizational forms that uniquely can guarantee compliance with the Rules of Professional Conduct."[92] The "Legal Background" section of the commission's alternative circulated draft explicitly juxtaposed the realities of the legal profession to the antiquated logic of the Model Code:

> To prohibit all intermediary arrangements is to assume that the lawyer's professional judgment is impeded by the fact of being employed by a lay organization. The assumed equivalence between employment and interference with the lawyer's professional judgment is at best tenuous. Applications of unauthorized practice principles, only tenuously related to substantial ethical concerns raised by intermediary relationships, may be viewed as economic protectionism for traditional legal service organizations.
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> The exceptions to per se prohibitions on legal service arrangements involving nonlawyers have substantially eroded the general rule, leading to inconsistent treatment of various methods of organization on the basis of

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

90. *Id.*

91. AM. BAR ASS'N, 107 ANNUAL REPORT OF THE AMERICAN BAR ASSOCIATION 886–87 (1985) (Report of the Commission on Evaluation of Professional Standards); Adams & Matheson, *supra* note 89, at 8.

92. AM. BAR ASS'N, *supra* note 91, at 887; *see also* Andrews, *supra* note 82, at 594.

> form or sponsorship. Adherence to the traditional prohibitions has impeded development of new methods of providing legal services.[93]

Despite the commission's persuasive critique of a prohibition premised on archaic norms and permeated by contradictory logic, the ABA House of Delegates roundly rejected the proposed change. The ABA floor debates revealed that the delegates' chief concern lay not with the independence of a lawyer's professional judgment, but with the threat of competition from large corporations or other professional service providers that could open their own law firms. A delegate asked, "Does this rule mean Sears & Roebuck will be able to open a law office?" The fate of the proposed rule was promptly resolved after the answer given was "Yes."[94]

The ABA instead adopted an amended rule largely identical to that of the original Model Code.[95] The blanket prohibition on ownership by nonlawyers in the amended rule essentially embraced the economic protectionism that the Kutak commission had cautioned against. Though the ABA was concerned that such a watershed change "would have a fundamental but unknown effect on the legal profession,"[96] it seems clear that adherence to an outdated and unnecessary rule smothers innovation in the legal profession.[97]

Of course, with external capital comes external influence, and the concern that individual lawyers may defer to the interests of shareholders, to the detriment of their clients, is a reasonable one. However, arguments against external investment on such grounds have less traction in situations where a firm permits only minority equity ownership by outsiders, or withholds voting rights altogether. Nor is it clear that a share price has more potential to meddle with a lawyer's judgment than profits-per-partner. In any event, as the recent economic crisis shows, the current model built on protectionism, albeit well-intentioned, actually harms lawyers and law firms by forcing them to rely on shaky business models to expand and thrive.

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93. MODEL RULES OF PROF'L CONDUCT 78–80 (Alternative Draft 1981) (citations omitted).

94. RONALD D. ROTUNDA & JOHN S. DZIENKOWSKI, LEGAL ETHICS: THE LAWYER'S DESKBOOK ON PROFESSIONAL RESPONSIBILITY § 5.4-3(a) (2009). The House of Delegates asserted that "(1) the Commission proposal would permit Sears, Montgomery Ward, H & R Block, or the Big Eight accounting firms, to open law offices in competition with traditional law firms; (2) nonlawyer ownership of law firms would interfere with the lawyer's professional independence; (3) nonlawyer ownership would destroy the lawyer's ability to be a 'professional' regardless of the economic cost; and (4) the proposed change would have a fundamental but unknown effect on the legal profession." Andrews, *supra* note 82, at 595–96.

95. Andrews, *supra* note 82, at 596.

96. *Id.* at 595–96.

97. *See generally* Hadfield, *supra* note 12, at 1695 (detailing the various ways in which "[t]he current regulatory model stands as a tremendous barrier to innovation in legal markets and thus as a severe obstacle to the effort to meet the needs of a rapidly transforming globally competitive economy").

B. The Continuing Vitality of the Prohibition on Outside Investment in the Modern Law Firm

The initial resistance of the ABA to mounting a paradigm shift in legal structures is understandable, given the traditional view that nonlawyer involvement in the management of lawyers presents an ethical quagmire, and that self-regulation is itself a virtue.[98] The ABA's commitment to self-regulation by the legal profession perpetuates the classic partnership model for law firms, wherein there is "a voluntary association of partners who share equally in the outcomes of a common venture, who participate as equals in self-governance through consensus, and who owe distinctive responsibilities to one another."[99] However, the ABA last evaluated the feasibility of liberalizing legal business structures nearly thirty years ago; much has changed in the legal services landscape, and professional service industries generally, during this period.

Even though unique treatment of legal business forms remains, the organization and functioning of the large modern law firm bears striking resemblance to the corporate model in many important respects.[100] "[T]oday's large firm has many more formal organizational controls, such as hierarchical chain of command, more professional managers in positions of authority, distinct practice departments, and detailed financial management and reporting systems."[101] Law firms have also evolved towards an employment structure marked by several tiers of associates and partners without equity status and who are less personally invested in the firm as an entity.[102]

The classic partnership model dramatically changed with the rise of the limited liability partnership, a transformative development that seriously

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98. *See* MODEL RULES OF PROF'L CONDUCT pmbl. ¶ 11 (2003) ("To the extent that lawyers meet the obligations of their professional calling, the occasion for government regulation is obviated. Self-regulation also helps maintain the legal profession's independence from government domination. An independent legal profession is an important force in preserving government under law, for abuse of legal authority is more readily challenged by a profession whose members are not dependent on government for the right to practice.").

99. Regan, *supra* note 16, at 417.

100. *Id.* at 420–23. Regan notes that "firms no longer are able to rely on informal social norms to regulate behavior." MILTON C. REGAN, JR., EAT WHAT YOU KILL: THE FALL OF A WALL STREET LAWYER 37 (2004) [hereinafter REGAN, EAT WHAT YOU KILL].

101. REGAN, EAT WHAT YOU KILL, *supra* note 100; *see also* Marc Galanter & William Henderson, *The Elastic Tournament: A Second Transformation of the Big Law Firm*, 60 STAN. L. REV. 1867, 1876 (2008) (noting recent trend of "[m]anagement becoming a separate function performed by specialists; there are nonlawyer management auxiliaries like marketing director, public relations, technology, etc.").

102. *See* Galanter & Henderson, *supra* note 101, at 1882–98 (detailing evidence of the transformation of the promotion-to-partnership tournament into an "elastic tournament" where "the prize of equity partnership, which includes the traditional prerogatives of ownership, is increasingly rare").

undercuts the argument for self-regulation by law firms. The limited liability partnership form does away with joint and several liability among partners in a law firm, using the general partnership to shield individual partners in the same way the corporate entity functions to insulate directors and executives from personal responsibility for corporate liabilities.[103] Most firms in the U.S. have undertaken this organizational form, which directly erodes incentive for lawyers within a firm to police their colleagues' ethical conduct.[104] The ubiquity of LLPs in the legal marketplace evidences "the increasing scale of the modern law firm, acknowledgment of diminishing ability to rely on informal collegial controls on behavior, and, with a highly active lateral market, probably less commitment to the firm as an institution for sharing risks and rewards."[105]

The heavy-handed regulation of legal business forms embraced by the ABA Model Rules is not warranted by some intrinsically unique aspect of the practice of law. Indeed, lawyers are increasingly being treated and regulated like service providers in other areas, such as finance. "[T]he service providers paradigm makes it much more likely that lawyer regulations will be the subject of benchmarking not only across national borders, but across professions."[106] Other professional service industries like investment banking, management consulting, and advertising were at one time organized around partnerships, much like the legal profession today. However, over the past several decades regulatory bans on external investments in these industries have been lifted, leading to a deluge of private and public investment in professional service companies.[107]

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103. *See generally* LARRY E. RIBSTEIN & PETER V. LETSOU, BUSINESS ASSOCIATIONS § 6.05, at 239 (4th ed.) (Anderson Publ'g Co. 2003) ("All LLP statutes provide that LLP partners are not personally liable for the negligence or other misconduct of other partners or employees unless the partner participated in or supervised the wrongdoing . . . . Most recently enacted LLP statutes limit the liability of LLP partners for both contract-type and tort-type liabilities.").

104. *See* Jerry Crimmins, *Safety in Saying, 'Later, Law Partners'*, CHI. DAILY L. BULL., Dec. 26, 2008, at 3 ("Thacher is an LLP. This means that, like most law firms these days, its partners have limited liability. If Thacher had been an old-style general partnership, its partners would have vicarious liability for the firm's debts, and those liabilities would follow the individual partners to their new firm or firms."); Robert W. Hillman, *Organizational Choices of Professional Service Firms: An Empirical Study*, 58 BUS. LAW. 1387, 1401 (2003) (finding, for example, that in Texas virtually all firms with more than fifty lawyers are organized as LLPs rather than as traditional partnerships). For a general background on how the availability of limited liability is transforming the modern law firm, see ALAN R. BROMBERG & LARRY E. RIBSTEIN, BROMBERG AND RIBSTEIN ON LIMITED LIABILITY PARTNERSHIP, THE REVISED PARTNERSHIP ACT, AND THE UNIFORM LIMITED PARTNERSHIP ACT (2009).

105. Regan, *supra* note 16, at 423.

106. Laurel S. Terry, *The Future Regulation of the Legal Profession: The Impact of Treating the Legal Profession as "Service Providers*,*"* 2008 J. PROF. LAW. 189, 189, 206 (emphasis omitted) (providing evidence that "the legal profession is not viewed as a separate, unique profession entitled to its own individual regulations, but is included in a broader group of 'service providers,' all of whom can be regulated together").

107. HILDEBRANDT, *supra* note 10, at 18.

Investment banks were the first professional service providers to utilize the IPO as a source of funding to improve business technology, expand operations, and supply working capital. Each of the top twenty-five investment banks is now publicly listed.[108] When these financial service providers began to publicly incorporate, the ethical standards of the profession were maintained. The experiences of those professional service industries that have embraced external investment support the idea that (1) the shift from purely private partnerships to public incorporation becomes an industry-wide trend once permitted; and (2) professional ethical standards regarding conflicts of interest and client confidentiality are not sacrificed as a consequence.[109]

The ethical risks associated with outside investment in law firms already pervade the legal industry. The ABA Model Rules provide the most direct evidence of this, as most of the concerns justifying the prohibition in Rule 5.4 are dealt with in other disciplinary provisions, such as rules against conflicts of interest (Rule 1.7) and breaching client confidences (Rule 1.6).[110] Rule 1.8(f) allows a lawyer to accept compensation from a third party as long as there is no interference with the lawyer's independent professional judgment and the client gives informed consent. Most relevant to the concerns of independence of professional judgment is Rule 5.2(a), which provides that "[a subordinate] lawyer is bound by the rules of professional conduct notwithstanding that the lawyer acted at the direction of another person." These rules provide a more direct and efficient method of monitoring lawyers' behavior than broad regulations on legal business forms.

The concern that lawyers might tailor their professional judgment to most benefit the firm's share price, rather than the firm's clients, merely highlights an already existing problem. Top firms are already fastidiously ranked by legal publications like *American Lawyer* according to financial metrics such as profits per partner and revenue per lawyer.[111] As a result, law firms are increasingly relying on a base of nonequity partners to boost profits per equity partner.[112] Law firm partners and commentators have noted that using per-partner earnings, or revenue per lawyer, as "the sole measure of success" is flawed in its simplicity and "pays no heed to corporate responsibility."[113] In contrast, a share

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108. *Id.* at 19.

109. *See id.* at 20.

110. Larry Ribstein, who blogs on the economics of law firms, has incisively noted that "we generally address firms' social costs by regulating their conduct rather than their internal structure." MacEwen, Regan & Ribstein, *supra* note 82, at 79.

111. *See The Am Law 100 2009*, AM. LAW., May 2009, at 143 (ranking the nation's 100 highest-grossing firms according to gross revenue, revenue per lawyer, profits per partner, and compensation).

112. *See* Neil, *supra* note 32.

113. *See* MacEwen, Regan & Ribstein, *supra* note 82, at 76.

price, calibrated on more than mere size of revenue, might encompass a firm's perceived value in terms of quality, ethical lawyering. At base, clients are purchasing a product, and the quality of that product will drive sales. The profitability of a law firm is dependent upon attracting potential clients to its services and building a loyal client base. Shareholders will directly benefit from a law firm that earns a reputation for quality and efficiency among clientele.

The influence of a more holistic metric of a law firm's value could actually bolster the force of ethical rules regulating individual lawyer conduct. "[T]he dynamics of the marketplace actually militate against the notion that nonlawyer investors would interfere with the lawyer's professional independence and judgment,"[114] and provide the firm, as an entity, a direct financial incentive to monitor the professionalism of its lawyers. Ironically, practicing in the shadow of the share price could give teeth to the slew of ethical rules that are precisely aimed at preventing the feared effect of outside investment.

Regulating business structure is neither necessary nor sufficient to ensure ethical lawyering; the Model Rules presume lawyers are capable of conforming their individual conduct to ethical standards. There are myriad circumstances in which lawyers practice law under the supervision of nonlawyers in accordance with ethics rules. For instance, the concern that external investment would cause lawyers to practice to the share price seems equally applicable to in-house counsel of public companies. In this context, the lawyer is expected to maintain his independent professional judgment notwithstanding the fact that he answers to a nonlawyer, and is ultimately responsible to shareholders.

Certainly, the prospect of minority equity ownership in a firm does not present more potential for conflict than majority equity ownership in a particular case by a hedge fund. Investors will not have a direct influence on a lawyer's decisions during the course of litigation. Yet, "[l]imiting ownership of law firms to nonlawyers . . . permits the pretense that self-regulation by lawyers is a viable strategy that distinguishes law firms from other economic enterprises."[115] To conclude that lawyers are different from otherwise similar service providers merely because they continue to receive special treatment relies on circular justification. Drawing distinctions between law as profession and law as business not only perpetuates a misleading dichotomy,[116] but also mistakenly implies that a lawyer's independent professional judgment and business judgment cannot be aligned.

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114. Adams & Matheson, *supra* note 89, at 17.

115. Regan, *supra* note 16, at 432.

116. *See generally* Christopher J. Whelan, *The Paradox of Professionalism: Global Law Practice Means Business*, 27 PENN. ST. INT'L L. REV. 465 (2008) (presenting the tension between commercialism and professionalism in the legal industry).

III. FOREIGN JURISDICTIONS EXPERIMENT WITH INNOVATIVE BUSINESS STRUCTURES

Other nations have liberalized their rules regarding outside investment in law firms, recognizing that economic protectionism of traditional law firms impedes innovation and stunts the market for legal services. These countries have adapted to the realities of a changing legal world while maintaining fidelity to professional values. After considered debate, both Australia and the United Kingdom passed laws allowing outside investment,[117] confident that adherence to professional values would not be sacrificed in turn. Numerous other countries are poised to follow suit.[118] Governments are increasingly viewing archaic restrictions as a handicap to a strong and competitive global presence. Such speculation will soon become reality for those countries that do not modernize their views.

A. Australia

Slater & Gordon, an Australian personal injury law firm, debuted as the world's first publicly traded law firm in 2007.[119] The firm made use of legislation that radically liberalized legal business forms to raise Au$35 million in its IPO on the Australian Securities Exchange (ASX).[120] Shares rose 40 percent on first day of trading.[121] The *Legal Profession Act 2004* had authorized law firms to incorporate and seek external investment after recommendation by Australia's National Competition Policy Review Process.[122] The move

117. Legal Profession Act, 2004, § 136 (N.S.W., Austl.); Legal Services Act, 2007, c. 29, § 89, sched. 13 (Eng. & Wales), *available at* http://www.opsi.gov.uk/acts/acts2007/pdf/ukpga_ 20070029_en.pdf.

118. As discussed in Part III.C, *infra*, similar initiatives are under consideration in France, Spain, and Scotland, which regulates its legal profession independently of England and Wales. HILDEBRANDT, *supra* note 10, at 13–14.

119. Krause, *supra* note 8.

120. *See* Kwabena Appenteng, *An International Perspective: The Publicly Traded Law Firm*, CHI. LAW., Feb. 2009, at 24; Richard Lloyd, *The Change Agenda: Market* Force, AM. LAW., Dec. 2008, at 100.

121. Alex Spence & James Rossiter, *Investors Give Thumbs-up to World's First Law Firm Flotation*, TIMES LONDON, May 21, 2007, *available at* http://business.timesonline.co.uk/tol/business/law/article1818722.ece.

122. Steven Mark & Georgina Cowdroy, *Incorporated Legal Practices—A New Era in the Provision of Legal Services in the State of New South Wales*, 22 PENN ST. INT'L L. REV. 671 (2004) (explaining initial effect on New South Wales's rules of a 1998 National Competition Policy Review report supporting liberalization of rules governing multidisciplinary practices).

was viewed as "a key means of enabling legal practices to raise capital for expansion to facilitate competition in domestic and international markets."[123]

Slater & Gordon's watershed decision to go public was an auspicious one. When the firm listed on the ASX, it was carrying at least Au$15 million in short-term debt. As a plaintiff firm dealing in personal injury and class action suits, Slater & Gordon provides services on a contingency fee basis. This model requires substantial capital outlay during the course of litigation, without a guarantee of recovery. According to the prospectus issued in connection with the float, Au$15 million of the capital raised was to be used to "reduce" existing debt.[124]

The prospectus also noted that Slater & Gordon did not wish to rely on debt to fund growth, and wanted to secure the future of the firm even if the current partners left—taking their capital with them.[125] Within a year of its IPO, the firm went on to use the remaining capital from the float to acquire a half dozen of its rivals.[126] As the firm continues to assimilate smaller firms and diversify geographically, it has been able to post strong numbers, even in the midst of a global recession. In April 2008, Slater & Gordon's stock was billed by Australia's national newspaper as one of ten "survival shares for investors marooned in a sea of trouble."[127] The tip was a good one: In the last half of 2008, total revenue was up 35 percent to Au$50.5 million, and profits rose 22.5 percent in the same period, to nearly Au$8.5 million.[128] The firm expects profits to continue to rise in the future, and is watching the market for further acquisition opportunities.[129]

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123. *See* Christine Parker, *Peering Over the Ethical Precipice: Incorporation, Listing, and the Ethical Responsibilities of Law Firms* 13 (Melbourne Law Sch., Legal Studies Research Paper No. 339, 2008) (working draft for discussion at "The Future of the Global Law Firm Symposium," Georgetown Law Center, Center for the Study of the Legal Profession, Apr. 17–18, 2008), *available at* http://ssrn.com/abstract=1132926 (quoting Victorian Attorney General Robert Hull).

124. SLATER & GORDON LTD., PROSPECTUS 44 (Apr. 13 2007), *available at* http://svc015.wic046p.server-web.com/docs/prospectus/Prospectus.pdf.

125. *See* Parker, *supra* note 123, at 5–6. According to the managing director at Slater & Gordon, the move to incorporate was motivated by the concern "that a partnership was an inefficient way of investing. . . . You distribute all the profits in a partnership, whereas in a corporate structure you can retain earnings at a much more preferential tax rate." Lloyd, *supra* note 120, at 99.

126. *Legal Advice: Should You Buy Shares in a Law Firm?*, ECONOMIST (London), Aug. 21, 2008, at 55, *available at* http://www.economist.com/business/displaystory.cfm?story_id=11967043.

127. Lloyd, *supra* note 120.

128. *Slater & Gordon Hits Year-High First Time in Three Months*, AUSTL. CO. NEWS BITES–STOCK REPORT, Apr. 3, 2009.

129. Brian Baxter, *Dow Might Be Down, but Stock of One Law Firm Is Up*, AM. LAW., Feb. 27, 2009, http://www.law.com/jsp/law/international/LawArticleIntl.jsp?id=1202428622111. Following Slater & Gordon, Integrated Legal Holdings (IHL) listed on the ASX in August 2007. The IPO was not phenomenal, due to the largest drop in the history of the ASX the day before, but the firm has

Cognizant of the tension between the firm's role as a public corporation and as a professional service provider, Slater & Gordon's prospectus noted its overriding ethical obligations in the face of a conflict of interests:

> Lawyers have a primary duty to the courts and a secondary duty to their clients. These duties—including the attendant responsibilities such as client confidentiality and the rules relating to legal professional privilege—are paramount given the nature of the Company's business as an Incorporated Legal Practice. There could be circumstances in which the lawyers of Slater & Gordon are required to act in accordance with these duties and contrary to other corporate responsibilities and against the interests of Shareholders and the short-term profitability of the Company.[130]

With less than one third of its shares offered on the open market, Slater & Gordon's move to become public did not entail a risk of majority shareholder conflicts. Australian law also requires that all incorporated legal practices have formal management systems to ensure that the firm (including directors and employees) complies with ethical obligations.[131]

B. United Kingdom

The United Kingdom's *Legal Services Act 2007* permits nonlawyers to invest in law firms, though the regulations enabling these investments are not expected to be in place until 2011 or 2012.[132] The reforms instituted by the *Legal Services Act* developed from the findings of a report commissioned by the Lord Chancellor in 2003, and mark a dramatic departure from traditional

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regained most of the lost share price. IHL's model is to purchase and merge law firms into its existing structure. *Id.*

130. SLATER & GORDON LTD., *supra* note 124, at 84.

131. According to the Legal Profession Act 2004, the legal practitioner director:

> must ensure that appropriate management systems are implemented and maintained to enable the provision of legal services by the incorporated legal practice:
>
> > (a) in accordance with the professional obligations of Australian legal practitioners and other obligations imposed by or under [the legal profession legislation and regulation], and
> >
> > (b) so that those obligations of the Australian legal practitioners who are officers or employees of the practice are not affected by other officers or employees of the practice.

Legal Profession Act 2004 § 140(3) (N.S.W., Austl.). Likewise, under sections 2.7.9–.10 of the National Model Bill on the Legal Profession, the "legal practitioner director" is responsible for the introduction, supervision, and monitoring of the firm's ethical systems. NAT'L MODEL BILL ON THE LEGAL PROFESSION §§ 2.7.9–.10 (2006), *available at* http://www.lawcouncil.asn.au/library/policies-$-guidelines/national-profession/model-bill.cfm.

132. The "alternative business structures" first require the establishment of a new regulator, the Legal Services Board.

restrictions on legal business forms and external investment. Sir David Clementi, a former deputy governor of the Bank of England, was tasked to

> consider what regulatory framework would best promote competition, innovation and the public and consumer interest in an efficient, effective and independent legal sector [and to] recommend a framework which will be independent in representing the public and consumer interest, comprehensive, accountable, consistent, flexible, transparent, and no more restrictive or burdensome than is clearly justified.[133]

An impetus of the Clementi Report was "a concern about the restrictive nature of current regulatory structures," in recognition of the fact that business structures have changed little while business practices have changed considerably.[134]

The Clementi Report includes a detailed discussion of alternative business practices, including outside ownership. The report identified key objectives for a regulator of legal services,[135] and noted that any regulatory framework would need to ensure that professional standards were consistent with the legal principles of independence, integrity, confidentiality, and the duty to act in the best interests of the client.[136] With these objectives and principles guiding its analysis, the report determined that

> [t]here would be considerable benefit in permitting outside owners of legal practices. In general economic terms, new capital from outside the industry would be permitted which should increase capacity and exert a downward pressure on prices. In a business sense, new investors might bring not just new investment but also fresh ideas about how legal services might be provided in consumer friendly ways.[137]

The *Legal Services Act 2007* implements the reforms envisioned by the Clementi committee by allowing firms to adopt Alternative Business Structures (ABS).[138] A firm utilizing an ABS may seek external investment, including full ownership of the firm, either through private equity or by publicly listing shares on an exchange. A firm may apply for a license to become an ABS through a (yet to be established) licensing board.[139] If an outside investor

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133. SIR DAVID CLEMENTI, REVIEW OF THE REGULATORY FRAMEWORK FOR LEGAL SERVICES IN ENGLAND AND WALES: FINAL REPORT 1 (2004), *available at* http://www.legal-services-review.org.uk/content/report/report-chap.pdf.

134. *Id.* at 2–3.

135. *Id.* at 15–17.

136. *Id.* at 21.

137. *Id.* at 115. The report proceeded to address, and dismiss, the traditional concerns regarding outside ownership, including inappropriate owners, unreasonable commercial pressures that conflict with professional duties, and cherry picking of business.

138. Legal Services Act, 2007, c. 29, § 89, sched. 13 (Eng. & Wales), *available at* http://www.opsi.gov.uk/acts/acts2007/pdf/ukpga_20070029_en.pdf.

139. *Id.*

seeks to own more than a 10 percent equity stake in an ABS, the arrangement is conditioned on approval of the investor's "probity and financial position," as determined by the licensing authority.[140] An ABS with less than 10 percent of equity owned by nonlawyers is considered a "low risk" entity and qualifies for loosened licensing rules.[141] A firm licensed as an ABS must ensure that lawyers maintain "professional principles," acting with independence and integrity, in the best interests of their clients and justice, and maintain client confidentiality and standards of work.[142] A person who would compromise these principles may not hold any interest in the entity.

Irwin Mitchell LLP, the fourth largest law firm in the United Kingdom, has expressed its intention to embrace external investment.[143] Fearful that the legal profession in England and Wales risks being outpaced by foreign competition, the firm has even urged the government to move more quickly in establishing the regulatory mechanisms to enable the change.[144]

C. And Beyond . . .

Initiatives similar to those taken in Australia and the United Kingdom are likely to expand to the legal profession elsewhere, as the globalization of legal services likewise entails the globalization of regulatory reform. In 2005, the findings of the Clementi committee led the European Commission, the executive branch of the European Union, to support reform for legal business structures.[145] The Organization of Economic Cooperation and Development, of which the EU is a member, also maintains a progressive stance on this issue, releasing a report in 2008 that cast doubt on the benefit of traditionally

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140. *Id.* (For those with at least 10 percent interest in an ABS, "[t]he licensing authority must in particular have regard to . . . the person's probity and financial position.").

141. *Id.* §§ 106–108.

142. The professional principles are laid out in Section 1 of the Act as part of the regulatory objectives. *Id.* § 1. In order for a person holding a restricted interest to meet the approval requirements, the holding of that interest must not compromise the regulatory objectives (*i.e.*, professional principles). *Id.* § 89, sched. 13, para. 6.

143. Press Release, Irwin Mitchell, Irwin Mitchell Welcomes Legal Services Act (Oct. 31, 2007), *available at* http://www.irwinmitchell.com/PressOffice/PressReleases/IrwinMitchellWelcomesLegalServicesAct.htm.

144. *Id.*

145. COMM'N OF THE EUROPEAN CMTIES., PROFESSIONAL SERVICES—SCOPE FOR MORE REFORM (2005), *available at* http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2005:0405:FIN:EN:PDF. For an in depth discussion of developments in EU policy in this arena, see Laurel S. Terry, *The European Commission Project Regarding Competition in Professional Services*, 29 NW. J. INT'L L. & BUS. 1 (2009).

heavy regulations on the legal profession.[146] The report urged member countries to "identify and remove the restrictions which are unnecessary or disproportionate to achieve public interest goals."[147] A study conducted by a Dutch economics institute in June 2008 reached similar conclusions. The study indicated that high levels of regulation do not "improve access to law," and accordingly governments should justify the high level of regulation by showing that the social benefits of such regulation outweigh its social costs.[148]

Individual countries are indeed taking pause to reconsider the restrictions that hinder the transnational viability of their respective legal professions. In June 2008, President Nicolas Sarkozy of France appointed a commission to review the French legal profession, including its business structures.[149] The commission is charged with "suggest[ing] to the Government new structures enabling law firms to compete better with international firms," "to increase the quality of service for consumers," and "to improve competition within the profession."[150] The year prior, Spain introduced a new law allowing external investment comprising up to 25 percent of total equity in professional service companies, conceivably including law firms.[151]

The Scottish Parliament, partially in response to the changes effected in England and Wales through the *Legal Services Act*, has undertaken consultation regarding the prospect of similar reforms to the Scottish legal profession. One representative response to the consultation framed the issue as one of survival:

> The requirements of legal firms to operate for major business clients are very different from what they were even ten years ago. Very substantial investment in technology, disaster recovery, business continuity, finance and human resources is now required . . . . External capital is required simply to allow Scottish firms to compete . . . . Expansion by Scottish firms into international markets, on any scale, will remain more or less impossible unless a shareholding model is permitted.[152]

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146. ORG. FOR ECON. COOPERATION AND DEV., COMPETITIVE RESTRICTIONS IN LEGAL PROFESSIONS (2007), *available at* http://www.oecd.org/dataoecd/12/38/40080343.pdf.

147. *Id.* at 10.

148. BARBARA BAARSMA, FLÓRA FELSÖ & KIEJA JANSSEN, SEO ECON. RESEARCH, REGULATION OF THE LEGAL PROFESSION AND ACCESS TO LAW (2008), *available at* http://www.seo.nl/binaries/publicaties/rapporten/2008/2008_1.pdf.

149. *See* CCBE, CCBE-INFO 4 (Oct. 2008), *available at* http://www.ccbe.eu/fileadmin/user_upload/NTCdocument/newsletter_21_enpdf1_1225364394.pdf.

150. HILDEBRANDT, *supra* note 10, at 15.

151. *Id.* at 13–14.

152. *See* LAW SOC'Y OF SCOT., THE PUBLIC INTEREST: DELIVERING SCOTTISH LEGAL SERVICES: POLICY PAPER ON ALTERNATIVE BUSINESS STRUCTURES 11 (2009) (internal quotation marks omitted).

In April 2009, the Law Society of Scotland urged the government to remove restrictions on outside investment and generally support a modernization of the Scottish legal profession.[153] The Scottish Parliament introduced a Legal Services Bill on September 30, 2009, designed to allow attorneys to secure external investment, form business relationships with nonlaywers, and enable innovation within the provision of legal services.[154]

IV. REINVENTING THE LEGAL PROFESSION THROUGH OUTSIDE INVESTMENT

By disallowing novel business structures, the U.S. legal profession is effectively cut off from pioneering developments in the provision of legal services. Everything from a law firm's management practices to client services, delivery process, associate compensation, and billing schemes is homogenized across firms as the "partnership straightjacket" restricts both the pursuit of and reward from innovative thinking.

A. Globalized Practices

The innovation in business structures overseas may provide the most compelling reason to similarly liberalize regulation in the United States. The *American Lawyer* Global 100 law firms includes twelve U.S.-based law firms that have a quarter or more of their lawyers stationed in foreign offices; two of these firms have more than half of their lawyers overseas.[155] Just ten years

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Of course, this may be merely a matter of opinion. Holding a contrary view is the CCBE, an organization that officially represents the legal profession in the European Union. In its most recent comment on this matter, the CCBE noted "investor ownership will not likely entail significant efficiency gains for the law firms. This is because law firms are not heavily capital dependent and because the general advantages of investor owned companies are not fully applicable to the legal law firms." CCBE, ECONOMIC SUBMISSION TO COMMISSION PROGRESS REPORT ON COMPETITION IN PROFESSIONAL SERVICES 6–7 (2006), *available at* http://www.ccbe.eu/fileadmin/user_upload/NTC document/ccbe_economic_submis1_1182239202.pdf.

153. The policy paper submitted by the Law Society of Scotland states that "the Council believes that the legal profession in Scotland should be able to offer its services through structures which best meet the demands of modern society and a global economy. Practitioners should be free to retain the traditional business model but that should not be their only choice." LAW SOC'Y OF SCOT., *supra* note 152, at 13.

154. Legal Services (Scotland) Bill Explanatory Notes 2, 2009, Bill [30] *available at* http://www.scottish.parliament.uk/s3/bills/30-legalServices/b30s3-introd-en.pdf. The text of the bill, as introduced, is available at http://www.scottish.parliament.uk/s3/bills/30-legalServices/b30s3-introd.pdf.

155. White & Case and Baker & McKenzie have 65 percent and 82 percent of their lawyers outside of the United States, respectively. Firms with between 30 percent and 45 percent of lawyers overseas include Cleary Gottlieb, Dewey & LeBoeuf, Mayer Brown, Orrick, Reed Smith, Shearman & Sterling, and Squire Sanders & Dempsey. Debevoise & Plimpton, Jones Day, and Latham &

ago, however, U.K. firms dominated the market for international legal services. For instance, in 1999 Latham & Watkins had only forty lawyers stationed outside of the U.S., as compared to the more than 600 lawyers Allen & Overy and Linklaters each had outside of Britain, or the more than 1,300 from Clifford Chance.[156] Currently New York and London are the epicenters for global legal practice, a duopoly leading a network of more than a hundred cities housing global law firms.[157] Geographic diversification blunted the effect of the economic crisis on international firms, since even a recession of global proportions is experienced differently in different regions, and across industries.[158] This presents something of a catch-22, since firms that wish to expand the size of offices or diversify geographically require large upfront capital that partners may be either unable or unwilling to provide themselves.

A rising concern among U.S. law firms is that they will lose relevance in the global arena when forced to compete with the liberalized business structures available to foreign firms.[159] Given the increasingly transnational practices of many law firms, U.S.-based firms will find themselves at a competitive disadvantage in a globalized marketplace for legal services if they fail to embrace modern practices.[160] In many respects, the regulatory regime that American lawyers must abide by is simply incompatible with the reforms soon to be implemented in the United Kingdom, and hinder American firms' ability to associate with foreign lawyers. There is concern that, by operation of Model Rule 5.4, "a U.S. firm likely would have to withdraw from business arrangements with a foreign firm that has nonlawyer managers or owners, and the U.S. firm could not share fees with that foreign firm."[161] Others suggest that, so long as the American firm bills a separate flat fee for its work, such conflict can be avoided.[162] In any event, the incongruent regulatory schemes will inevitably give rise to logistical problems in transcontinental collaboration efforts.

The pressure for reform has prompted the American Bar Association to revisit the issue of regulating the U.S. legal profession in the context of globalization.[163] An ABA commission, newly minted in August 2009, will

Watkins each have just over a quarter of their lawyers in international offices. *See The Global 100: Most Lawyers 2009*, AM. LAW., Oct. 2009, at 191.

156. *See* Richard Lloyd, *The Great Game*, AM. LAW., Oct. 2009, at 134.

157. James R. Faulconbridge et al., *Global Law Firms: Globalization and Organizational Spaces of Cross-Border Legal Work*, 28 NW. J. INT'L L. & BUS. 455, 460 (2008).

158. *See* Lloyd, *supra* note 156.

159. James Podgers, *Off the Mat: After a Beat-Down Nine Years Ago, Multidisciplinary Practice May Get Another Look From the ABA*, A.B.A. J., Aug. 2009, at 65.

160. *See* MacEwen, Regan & Ribstein, *supra* note 82.

161. *See* Podgers, *supra* note 159.

162. *Id.*

163. *Id.*

specifically consider the possibility of allowing alternative business structures under the Model Rules as a means of enabling U.S. firms "to compete with legal providers in other countries while continuing to protect the public and the core values of the profession."[164]

B. Capital Lock-In and Sustainability

A law firm IPO promises the security of capital lock-in for law firms. Capital lock-in for the incorporated entity "ma[kes] it possible to build lasting institutions. Investments [can] be made in long-lived and specialized physical assets, in information and control systems, in specialized knowledge and routines, and in reputation and relationships, all of which [can] be sustained even as individual participants in the enterprise" come and go.[165] Such assurances would be a boon to law firms in the current economic climate. Capital raised from a float, as opposed to a creditor, does not need to be paid back. This virtue of capital lock-in can combat the "decline in law firm stability as 'star' attorneys increasingly practice in a free agent market"[166] by ensuring continuity of the firm notwithstanding the presence of individual partners. As we have seen, the exodus of a few high-powered partners can be contagious and lethal to a firm.[167]

A publicly listed firm can also use stock options as a recruitment and retention tool for associates, one that is disconnected from the consuming pursuit of partner status.[168] Currently, the trajectory of a "successful" law firm career is singularly defined by making partner. Providing associates an alternate means of attaining success could deemphasize the competition to make partner and dampen the disappointment felt by those who are simply not destined for partnership. The cannibalizing effect of the "elastic tournament" to partnership has been extensively documented, and works to further privilege a small cadre of reputed rainmakers. With power centralized in the practices of a few key partners, the success of the firm is contingent on the continued loyalty of these partners. However, sustainability would be paramount to investors valuing a

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164. *Id.*

165. Margaret M. Blair, *Locking in Capital: What Corporate Law Achieved for Business Organizers in the Nineteenth Century*, 51 UCLA L. REV. 387, 387 (2003).

166. JOHN C. COFFEE, JR., GATEKEEPERS: THE PROFESSIONS AND CORPORATE GOVERNANCE 227 (2006).

167. *See* Galanter & Henderson, *supra* note 102, at 1872 ("[T]he locus of firm control has shifted to an inner core of 'partners with power' who may or may not be strongly wedded to the firm. Large law firms that refuse to privilege these partners inevitably run the risk of large-scale defection and implosion." (footnotes omitted)).

168. *See* Richard Lloyd, *British Firms Watch Australia's Law Firm IPOs With Interest*, AM. LAW., June 6, 2007, http://www.law.com/jsp/article.jsp?id=1181034331105.

publicly traded law firm. The firm would have more incentive to build organizational capital rather than focusing solely on placating rainmakers to prevent lateral departure.[169] "What matters is the extent to which a law firm is more than the sum of its parts—whether it can be seen as a separate, continuing entity with its own income independent of the individuals who currently constitute it."[170]

Focusing on the success of the firm as an entity may lessen individualistic tendencies among lawyers, who would have increased incentives to build the social capital of the firm as a whole. This would translate into actively fostering skills of younger associates, since mentoring produces strength across a firm. Currently, associates that do not win the favor of key partners are isolated from the demanding yet stimulating work assignments necessary to build skills and experience.[171] Promoting the welfare of individual lawyers early in their careers is essential to developing job satisfaction and firm loyalty, effects that feed back into the stability of the firm.

Indeed, some of the qualities that define the most elite law firms are, according to *American Lawyer*'s annual A-List, associate training and satisfaction.[172] By measuring qualities that look beyond profits, the A-List provides a multi-dimensional assessment of a firm's value—something that profits-per-partner and revenue-per-lawyer rankings miss. These metrics would become even more influential in a publicly traded firm. Munger, Tolles & Olson LLP's position at the top of the A-List for the past two years is at least partly attributable to the fact that "Munger isn't highly leveraged with associates, which tends to make for more satisfied young lawyers."[173] Rewarding staff with shares in the firm would likewise frustrate defection, since it correlates directly to an economic interest in the success of the practice as a whole.

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169. *See* Regan, *supra* note 16, at 428 ("In order to serve as an attractive investment, a firm will need to rely less on individual rainmakers and more on the performance of the firm as a whole. It will need to devote resources to building organizational capital rather than stockpiling a stable of profitable but mobile rainmakers.").

170. Stephen Mayson, *Building Sustainable Value: A Capital Idea*, *in* MANAGING THE MODERN LAW FIRM 141, 145 (Laura Empson ed., 2007).

171. *See* Galanter & Henderson, *supra* note 102, at 1914–16 ("[O]ne of the key analytical insights of the elastic tournament is that 'the firm' has precious little bargaining leverage with partners who preside over the best training opportunities . . . . Because no one's standing in the firm is secure or permanent, powerful partners have strong incentives to hoard associates with the most impressive credentials, the most tireless work ethic, and the most undivided loyalty to the individual partner.").

172. *See* Susan Beck, *Power Shift: Four New York Firms Slide off the A-List*, AM. LAW., July 2009, at 48, 48.

173. *Id.* at 49.

C. Merit-Based Compensation

Law firms deal in human capital, selling the expertise and skill of their lawyers. Not surprising, then, is the fact that the largest single expense for a law firm is the salaries of its lawyers. However, the traditional lock-step compensation structure bloats associate compensation and leads to inflated salaries tied to seniority, not performance. Compensating classes of attorneys identically, irrespective of merit, has been variously described as a "medieval" and "ridiculous" aspect of the profession.[174] Such claims are at least circumstantially supported by the fact that the practice is unique among professional service industries.

In response to the recession, some firms have attempted to stop the hemorrhaging of scarce resources by freezing associate salaries, or reducing the salaries for first-year associates.[175] Clearly such measures are transitional, and portend more fundamental changes to the associate compensation structure of law firms. The U.S. legal community is entrenched in the archaic lock-step system, and has bristled at previous endeavors by individual players to adopt a more progressive pay structure. For example, when Howrey LLP announced plans to switch to a merit-based compensation system in 2007, "the firm was seen as 'committing suicide' because it wouldn't be able to compete for personnel."[176] But if firms wish to outwear the current recession and build durable business models for the future, they should embrace, rather than shun, more flexible compensation structures that logically reward a lawyer for exemplary expertise and skill. Hildebrandt International advocates competency-based models of compensation also as a response "to client concerns—particularly acute in the present economic environment—that they not be 'over charged' for younger or less experienced lawyers."[177]

In May 2009 DLA Piper, the world's second largest law firm, announced its decision to retire the outmoded model of seniority for one of merit. The firm released a memo explaining that its decision was made in light of the fact that "the business environment in the next few years will be fundamentally different, and our clients have taken dramatic action to reshape their businesses

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174. According to Joel Henning, a consultant at Hildebrandt International, "[i]n the current economic crisis, we see the final demise of the medieval guild in the American legal profession." Carlyn Kolker, *'Medieval' U.S. Law Firm Pay Structure Buckles*, BLOOMBERG NEWS, Mar. 16, 2009.

175. DLA Piper, for instance, has announced that salaries for all incoming first-year associates will be slashed by $15,000. Leigh Jones, *DLA Piper Announces Pay Cuts, New Compensation Model*, NAT'L L.J., May 15, 2009, *available at* http://www.law.com/jsp/article.jsp?id=1202430749367.

176. Kolker, *supra* note 174.

177. HILDEBRANDT INT'L & CITI PRIVATE BANK, CLIENT ADVISORY 15 (2009).

to fit this new reality."[178] Other law firms, including Orrick, Shearman & Sterling LLP and Bingham McCutchen have also adopted compensation structures that reward performance.[179] The flexibility of compensating associates based on performance would likely be imposed upon a publicly traded law firm—the blindly egalitarian compensation structure would not be well tolerated by the market. Merit-based pay is a direct response to clients' frustration with rising costs, and will be key to attracting and retaining clients. Firms with merit-based compensation can credibly reassure clients that their rates represent the quality of lawyering, and not merely an aggregation of six-minute time blocks.

D. Alternative Billing Schemes

The economic crisis has made clients more cost conscious and demanding of efficiency. In fact, the steep cost of outside counsel due to billable hours has forced a move among many large corporate clients to instead rely on their in-house counsel. A publicly traded law firm would be free to adopt more efficient alternate fee arrangements to match the changing expectations of clients. In this way, a publicly traded law firm would be better structured to withstand a recession of billable hours. With the availability of cost-effective services from public firms, corporate clients may be more willing to wean themselves from overdependence on their in-house legal departments. This would have the ancillary effect of promoting independent professional judgment across the profession, as in-house lawyers might be more susceptible to pressure to sacrifice judgment to the demands of an employer.

For a firm with a corporate client base, access to outside investment would enable the firm to respond to clients' calls for a change to the billable hour.[180] Plaintiff firms routinely litigate on a contingency fee basis; firms rely on their own capital reserves to fund litigation costs in exchange for a sizable percentage of any amount awarded to the client, but risk losing these sunk costs if the suit is not successful. With a larger capital base, corporate defense firms could adopt a similar strategy by fronting the costs of representing their clients and forgoing a billable hour fee schedule. Under an adaptation of reverse contingent fee litigation, the firm would instead receive a specified sum in

178. Jones, *supra* note 175.

179. *Id.*; Amanda Royal, *Bingham Adds Merit Piece to Associate Pay*, RECORDER (S.F.), Oct. 6, 2009, at 1.

180. *See* Caryn Tamber, *Law Firms Looking for Alternatives to the Billable Hour*, DAILY REC. (Baltimore), Dec. 15, 2008.

the event of a favorable settlement.[181] The presiding partner at Cravath, Swain & Moore LLP is a proponent of such alternate billing schemes, and has unreservedly remarked that "[t]his is the time to get rid of the billable hour."[182] He recently noted that "more clients are paying Cravath flat fees for handling transactions and success fees for positive outcomes, as well as payments for meeting other benchmarks."[183] Barring a change to the billable hour, publicly traded firms would still have increased ability to take on cases requiring upfront investment of large amounts of capital, such as complex litigation or, as in the case of Slater & Gordon, personal injury litigation.[184]

A publicly traded law firm would likely eliminate the billable hour, given its inherent inefficiencies. When fees are detached from aggregate hours worked, incentives to prolong litigation simply to rack up fees are nullified. The result can appease both the lawyers and the clients. Consider efficiencies gained by Morrison & Foerster LLP when it "negotiated a fixed fee for defending a company in court, covering work up to the point of a motion for summary judgment."[185] According to a former Morrison partner, now a senior consultant at Hildebrandt International, the agreement provided the firm a percentage of the amount saved by the client "if the case settled for less than what the company feared having to pay if it lost in court."[186] The goal of the arrangement was thus "to resolve the dispute quickly."[187] When lawyers expeditiously reached an appealing settlement number, the client was happy and the effective hourly rate received by the firm was nearly 50 percent more than the firm's standard billable hour.[188]

In an illustrative contrast, Heller Ehrman's profits, scaled to billables, were hurt when a number of cases settled early.[189] In the first few months of 2007, Heller "lost about one-quarter of its litigation business due to settlements, including its defense of Microsoft in the antitrust litigation and Ernst & Young LLP in securities litigation."[190] The decrease in revenue further undermined

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181. *See id*.

182. Jonathan D. Glater, *Billable Hours Giving Ground at Law Firms*, N.Y. TIMES, Jan. 30, 2009, at A1.

183. *Id*.

184. *See* Lloyd, *supra* note 168 ("The most likely U.K. candidates for an IPO are firms with high-volume, commoditized practices, such as debt recovery, real estate, and personal injury work. Other possibilities are firms that are in markets ripe for consolidation, that must support a large amount of work in progress, or that depend on a significant technology investment.").

185. Glater, *supra* note 182.

186. *Id*.

187. *Id*.

188. *Id*.

189. *Id*.

190. Koppel, *supra* note 1.

the firm's fragile finances, leading to its dissolution. Had Heller negotiated fixed fee arrangements with those clients, it would have been rewarded for the savings accrued to the client with substantially higher fees and possibly avoided the indebtedness that ultimately led to its demise.

In some cases, the switch to alternative fee arrangements may be a matter of necessity, since the current scarcity of billable hours is unlikely to sustain a firm's profitability. O'Melveny & Myers, for example, has disclosed its intent to adopt a single rate card by 2012 with the hope of becoming the industry "leader in providing high-end legal services on a fixed fee bases, reducing costs to clients and achieving superior economic performance through practice management oriented toward cost-effective client service."[191] The proposed business model was outlined in a five-year strategic plan distributed internally at O'Melveny; the firm confirmed its long-term plan after it was leaked to the legal blog Above the Law.[192] Years of financial stagnation under the billable hours model, the standard fare for litigation shops like O'Melveny, provided the impetus for change.[193] The decision to break free from billing practices that are unsatisfying to both the firm and clientele, though newsworthy, is also logical and will likely prove mutually beneficial.[194]

E. Investing in Efficiency

With an increased pool of capital distinct from the excess profits that are typically distributed to equity partners at the end of the year, firms could substantially increase investment in infrastructure and technology. Limited access to liquid capital "stymie[s] the potential for substantial innovation by ruling out innovations that require more sophisticated forms of financing."[195] Furthermore, restrictions on financing legal innovation curbs any "incentive for analysts to develop expertise in spotting important developments in legal products or business strategies, or for business schools to produce expertise in

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191. *See* Debra Cassens Weiss, *O'Melveny Aims to Become Fixed-Fee Leader, Leaked Plan Says*, A.B.A. J., Sept. 17, 2009, http://www.abajournal.com/news/omelveny_aims_to_become_fixed-fee_leader_leaked_plan_says/.

192. *See* Sara Randazzo, Brave New World of Alternative Fees, DAILY J., Oct. 21, 2009, at 11.

193. The leaked plan acknowledged that the firm's litigation model, "which depended heavily on high charge hours levels by associates, counsel and partners to offset the impact of discounted rates and increased write-offs of expenses and time, has been under pressure for at least three years . . . ." Weiss, *supra* note 191.

194. The law firms of Mayer Brown and Reed Smith have likewise announced plans to discard the traditional billable hour model for fixed or capped fees for transactional work. *See* Emma Sadowski, *Mayer Brown and Reed Smith Set to Champion Fixed Fees*, LEGAL WK., Sept. 16, 2009, http://www.legalweek.com/legal-week/news/1533830/mayer-brown-reed-smith-set-champion-fixed-fees.

195. Hadfield, *supra* note 12, at 1727.

law firm management."[196] A publicly traded law firm, especially one that has jettisoned the billable hour, would no doubt have greater incentives to encourage the development of technology that aids in the provision of its services. Under the current regime, ironically enough, the efficiencies gained through technology detract from billable hours and profits.

In contrast, technology would be a boon to the value of a firm on the market if it gained a reputation among clients for innovation and efficiency. Complex litigation routinely involves a morass of e-discovery; under new rules and federal case law, the cost burden of preserving, collecting, and producing e-discovery is the responsibility of the party being asked to produce the documents.[197] As e-discovery costs mount, clients will flock to firms with the most streamlined infrastructure for dealing with requests. As competition pressures increase, "[i]n many ways, innovation represents an untapped opportunity for law firms—the next great frontier for firms looking to expand their businesses and improve their competitive positions."[198]

V. BUILDING A CULTURE OF ETHICS IN PUBLICLY TRADED PARTNERSHIPS

Allowing the U.S. legal profession access to the same sources of external investment enjoyed by other professional service providers, and legal professions in other countries, is critical to rebuilding a more stable and competitive industry. In fact, allowing such outside investment would likely foster a culture of ethics if combined with other reforms in internal law firm structure. More formal ethical structures mark a departure from the traditional reliance on informal collegial ties between lawyers to monitor behavior, but are also better suited to protect professional standards from the pressures facing the modern law firm. Allowing outside investment in law firms would actually hasten these necessary reforms.

The most direct source of external influence on lawyers practicing in publicly listed companies might come from the board of directors, who owe shareholders a fiduciary duty. However, external investment need not entail

196. *Id.*

197. *See* FED. R. CIV. P. 26(b)(2)(B). There is a "presumption . . . that the responding party must bear the expense of complying with discovery requests . . . ." Oppenheimer Fund, Inc. v. Sanders, 437 U.S. 340, 358 (1978). However, given the high costs of retrieving electronic data, courts may shift the costs of e-discovery to the requesting party. *See, e.g.*, Zubulake v. UBS Warburg LLC, 217 F.R.D. 309, 317–18 (S.D.N.Y. 2003).

198. HILDEBRANDT, INNOVATION IN THE LAW FIRM WORLD: THE NEXT GREAT FRONTIER (2008), *available at* http://www.hildebrandt.com/Publications/Pages/PublicationDetail.aspx?PublicationGuid=d01c0f00-46b2-4bec-b6bd-00527b50ecc4.

incorporation, involving establishment of a board of directors and corporate officers. Instead, law firms could become publicly traded partnerships (PTPs). PTPs sell limited partnership interests (known as "units") that are traded on public exchanges, just like corporate stock. The limited partners, as distinct from the general partners, provide capital to the partnership but have no role in its management. This structure is similar to dual-class stock issued by companies such as Google or the New York Times. However, by going public as a partnership, rather than a corporation, a law firm would avoid, for example, the listing requirement on both the New York Stock Exchange and NASDAQ that corporations have a majority of independent directors.[199]

This form is now reserved for a select class of entities, usually energy companies under a rigid regulatory structure. However, The Blackstone Group LP, an investment firm, has creatively manipulated the system to be classified as a PTP.[200] "Blackstone's IPO, valuing the firm at about $34 billion, has reshaped the compensation and recruiting structures of the buyout world—helping the firm to lure talent needed to manage both its portfolio and subsidiary companies."[201] Mirroring a trend in the legal field where firms imitate the financial structure of their competitors, Blackstone's IPO has placed pressure on rival buyout firms to follow suit.[202] The decision to list publicly may be a necessary adaptation to the new "competitive landscape as the newly public buyout firms obtain access to more capital to make acquisitions" than that available to firms relying on private sources of funding.[203]

Law firms could preempt potential conflicts with shareholders by making clear that the priorities of the client come first, similar to the provision Slater & Gordon included in its prospectus.[204] Indeed, this type of quality service would build share price. Limiting external equity to a minority interest in the firm would also quell concerns of undue influence over the lawyers' independent professional judgment. The transparency that comes with requisite disclosures may actually strengthen a firm's commitment to ethical principles and improve client service through more direct market competition. For

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199. *See* NYSE, INC., CORPORATE GOVERNANCE RULES § 303A.01 (2004) ("Listed companies must have a majority of independent directors."); NASDAQ, INC., CORPORATE GOVERNANCE RULES § 5605(b)(1) (2009) ("A majority of the board of directors must be comprised of Independent Directors . . . .").

200. For a discussion of how the Blackstone IPO reinvents the public firm, see Larry E. Ribstein, *Going Privlic*, AM., Mar. 27, 2007, http://www.american.com/archive/2007/march-0307/going-privlic.

201. Henny Sender & Dennis K. Berman, *KKR Plans Its Own IPO; Blackstone Offering Pushes Equity Firms to Pursue Capital*, WALL ST. J., June 22, 2007, at C3.

202. *Id.*

203. *Id.*

204. *See* Regan, *supra* note 16, at 424.

instance, hedge fund executives have acknowledged that being a publicly listed company is not only a tool for expanding business and attracting talent; it also demands transparency, which "help[s] lend legitimacy to the fund in the eyes of investors."[205]

Regulatory reform that would allow outside investment may itself be an opportunity to develop more robust internal regulation of conflicts and ethics at law firms.[206] Balancing economic considerations and ethics is an extant problem within the industry, and is not adequately addressed by self-regulation of individual lawyers.[207] Regulation could mandate that firms build an ethical infrastructure, much like Australia's requirement that incorporated legal practices have formal management systems to ensure adherence to ethical standards by both lawyers and nonlawyer employees and directors.

However, Australia's model has its shortcomings: under the public model, (1) the firm is not responsible as an entity for ethics violations, as compliance with the rules "focus[es] too narrowly on individual responsibility at the expense of entity responsibility";[208] and (2) regulators lack expertise to adequately ensure that the requisite "appropriate management systems" are in place.[209] To improve upon Australia's model, firms accepting external investment could be required to retain an in-house compliance specialist to navigate ethical issues raised by public investment.[210] Such a change would make ethical compliance a firm-wide responsibility, a shift from the current regime that focuses on the responsibilities of the individual lawyer. The notion of holding the firm responsible for ethical conduct would entail further changes in ethics rules,[211] but this could bolster individual compliance efforts since firm policies and

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205. Cassell Bryan-Low, Peter Lattman, & Gregory Zuckerman, *KKR in Fishbowl, Swims With Sharks: IPO Will Bring a Capital Splash, but Other Investment Firms Find Disclosure Draws Unwanted Scrutiny*, WALL ST. J., July 29, 2008, at C1.

206. *See* Christine Parker, *Law Firms Incorporated: How Incorporation Could and Should Make Firms More Ethically Responsible*, 23 U. QUEENSL. L.J. 347 (2004), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1098095.

207. *See* John Cain, *Good Ethics Requires Constant Vigilance*, L. INST. J., Sept. 2002, at 4, 4 (encouraging voluntary ethics reform in Australia after scandals: "The [Law] Institute believes that each firm should appoint a partner or senior consultant to be the designated ethics practitioner. This practitioner would be the first contact when someone in the firm has an ethical question or problem. . . . [T]he Institute . . . will provide training, both formal and informal, to the various firms' ethics practitioners.").

208. Parker, *supra* note 206, at 373.

209. *Id.* at 376.

210. *See* Elizabeth Chambliss & David B. Wilkins, *A New Framework for Law Firm Discipline*, 16 GEO. J. LEGAL ETHICS 335, 346–49 (2003).

211. *Cf*. MODEL RULES OF PROF'L CONDUCT R. 5.1(a) (2003) (limiting responsibility for ethical violations to individual attorney and supervising attorney).

procedures "create economic and social incentives for individual conduct" that are "distinct from—and prior to—individual bad acts."[212]

Formal policies that promote the ethical obligations of a firm would edify a sense of core values among the firm's lawyers. Most law firms depend on earned reputation of quality ethical lawyering, regardless of the business structure of the firm.[213] Developing a strong firm culture would build brand reputation and client loyalty—both factors that would be a boon to share value.[214] In fact, societal considerations, such as a firm's culture or the institutional pressure of the legal services market, are more effective monitors of ethical behavior.[215] Any conflicts that arise in the natural course of business (and that are already rife in practice) could be managed by a rigorous adherence to the firm's sense of core values,[216] values that are strengthened by external scrutiny.

CONCLUSION

Leverage, once seen as the prescription for profitability, has proven to be the Achilles' heel of the U.S. legal profession. However, by exposing the vulnerabilities of the conventional law firm business model, the current economic crisis provides a valuable opportunity for the legal profession. Specifically, state bars should reevaluate the prudence of ethical rules that force firms to rely

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212. Chambliss & Wilkins, *supra* note 210, at 338.

213. *See* Larry E. Ribstein, *Ethical Rules, Agency Costs, and Law Firm Structure*, 84 VA. L. REV. 1707 (1998).

214. Hildebrandt International identified "unhealthy culture" as a fundamental flaw related to the internal dynamics of firms that fail:

> At their core, great law firms—however technically structured—are partnerships of fairly autonomous professionals that must be led more by persuasion and example than by fiat. As such, a healthy culture (or set of core values) that strikes the right balance between common commitment and autonomous action is essential for a successful firm. That balance is almost always missing in failed firms. Again, this is an issue that can (and should) be addressed before it becomes a real problem, but many firms lack the will or the leadership to tackle it until it is too late.

HILDEBRANDT INT'L, *supra* note 56, at 4–5.

215. *See* Elizabeth Chambliss, *MDPs: Toward an Institutional Strategy for Entity Regulation*, 4 LEGAL ETHICS 45, 48 (2001) ("[M]any of the ethical issues large firm lawyers face . . . are matters governed by firm-wide policy rather than individual decision-making."); Mark C. Suchman & Lauren B. Edelman, *Legal Rational Myths: The New Institutionalism and the Law and Society Tradition*, 21 LAW & SOC. INQUIRY 903, 922–23 (1996) (arguing that individual conduct is shaped by the social dynamics of an organization, and "compliant behavior is motivated more by cultural norms and accounts than by the imminent threat of legal sanctions").

216. *See* Susan Saab Fortney, *Are Law Firm Partners Islands Unto Themselves? An Empirical Study of Law Firm Peer Review and Culture*, 10 GEO. J. LEGAL ETHICS 271, 285 (1996) (reporting that 75 percent of 191 Texas law firms surveyed periodically monitor partners' compliance with conflicts procedures).

on debt for working capital and expansion efforts and assess the continuing validity of the rules' underlying concerns.

The traditional prohibition on outside investment in U.S. law firms stifles innovation, disrupts financial stability, and is neither necessary nor sufficient to maintain professional ethics. The initiatives passed by Australia and the United Kingdom to liberalize access to capital do not sacrifice ethical standards, but evince the belief that regulating the conduct of individual lawyers is more efficient than regulating the business form of the firm. If the U.S. legal industry wishes to maintain a global presence in the market for legal services, it must adapt to the changing demands of clients and the financial climate. Reform—reinvention even—is necessary to build sustainable, competitive practices that deliver efficient services to clients. This revitalized legal profession may even experience a more robust commitment to ethical standards, as a firm's value will be judged holistically based on its ability to provide quality, ethical lawyering. Whether the U.S. legal industry as a whole will successfully internalize the lessons from the crisis is uncertain. Nevertheless, individual law firms are in a unique position to experiment with timeworn business practices on a firm-wide level. Those firms that adapt to the evolving market for legal services will have a promising future that may pay dividends.