By Electronic Mail and First Class Mail

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RE: Comments of the U.S. Chamber Institute for Legal Reform on the Issues Paper Concerning Alternative Business Structures

Dear Commission Members:

I am writing to offer comments on behalf of the U.S. Chamber Institute for Legal Reform ("ILR") on the Issues Paper Concerning Alternative Business Structures of the American Bar Association Commission on Ethics 20/20 Working Group on Alternative Business Structures (the "Issues Paper").

I. INTRODUCTION

ILR is a not-for-profit public advocacy organization affiliated with the U.S. Chamber of Commerce, the world’s largest business federation, representing the interests of more than three million businesses of all sizes and sectors, as well as state and local chambers and industry associations. ILR’s mission is to ensure a simple, efficient and fair legal system. Since ILR’s founding in 1998, it has worked diligently to limit the incidence of litigation abuse in U.S. courts and has participated actively in legal reform efforts in the United States and abroad.
ILR writes to express its strong opposition to any loosening of Model Rule 5.4’s restrictions on non-attorney investments in law firms. As set forth below, nobody has identified a distinct problem that would be solved by revisiting the restrictions in Rule 5.4. Moreover, allowing alternative business structures (even with the limitations proposed in the Issues Paper) would undermine core values of the U.S. legal system, transforming law from a profession into a business, and threaten to compromise the attorney-client relationship.

II. MODEL RULE 5.4 SHOULDN'T BE LOOSERED.


Model Rule 5.4 serves important public-policy interests. Most importantly, the rule ensures that law firms are organized and managed in a manner that will protect client interests and uphold the principles of the profession.¹ These core values, which are critical to the functioning of our legal system, are already threatened by the prospect that attorneys will put their own pecuniary interests ahead of their clients’ legal interests. Loosening Rule 5.4’s restraints on lawyer-nonlawyer partnerships would enhance that risk and thereby undermine the fundamental goals of the Model Rules.

There is no legitimate reason to take that dangerous step. The Issues Paper suggests that alternative business structures “might serve to enhance access to legal services for those otherwise unable to afford them, and to provide new and varied opportunities for lawyers and firms domestically to better serve clients.” But the Paper never explains why that would be the case. Nor does it offer any evidence that U.S. law firms are hampered in serving their clients because they are prohibited from organizing as alternative business structures.

Law firms already are able to employ (as non-partners) diverse professional service providers, including jury consultants, accountants and physicians. Thus, the only reason to permit any of these professionals to partner with lawyers is to increase the partnership’s capital. But notwithstanding some firms’ complaints about their

¹ Notably, the House of Delegates “overwhelmingly” rejected the Kutak Commission’s recommended changes to Model Rule 5.4 on a number of grounds, including that the existing Model Rules strike the appropriate balance among protecting clients’ interests, ensuring that lawyers comply with their ethical obligations, and permitting law firms to experiment with different methods of delivering legal services. See Matthew Bish, Revising Model Rule 5.4: Adopting a Regulatory Scheme that Permits Nonlawyer Ownership and Management of Law Firms, 48 Washburn L.J. 669, 675, 679 (Spring 2009).
ability to raise money,\textsuperscript{2} there is no evidence that U.S. law firms lack sufficient capital to serve their clients.

In reality, alternative business structures would likely hurt client interests – not help them – because lawyers would be focused on attracting and retaining nonlawyer investors, rather than providing top-notch legal services. This threatens to harm clients in at least three ways:

- First, there is a substantial risk that nonlawyer investors will focus only on their own profit and not on client interests or the advancement of the legal profession (of which they are not a part).

- Second, for similar reasons, nonlawyer involvement in law firm management would threaten to further dilute the already-diminishing role of the client in the U.S. legal system because lawyers may feel pulled by the interests of influential investors more so than the interests of their clients.

- Third, alternative business structures are likely to increase the cost of legal services and diminish access to justice because investors will expect substantial profits without adding much, if any, value to the quality (or efficiency) of the legal services being provided.

In this respect, alternative business structures are similar to third-party litigation financing and present the same dangers.\textsuperscript{3} Both practices increase the amount of money in the litigation system, and both serve to convert lawsuits from a mechanism to vindicate clients’ rights into investment vehicles al for non-lawyers with disposable capital.\textsuperscript{4} Moreover, other countries’ experiences with third-party litigation financing have demonstrated that once the genie is let out of the bottle, it is

\textsuperscript{2} See Jacoby & Meyers Law Offices, LLP v. The Presiding Justices of the First, Second, Third and Fourth Departments, Appellate Division of the Supreme Court of the State of New York, Civil Action No. 11-CV-3387 (S.D.N.Y. May 18, 2011).

\textsuperscript{3} "Third-party litigation financing" is the practice of providing financing to a person who is or may become involved in a civil action in return for an interest in any positive recovery or settlement in the case. ILR has previously submitted comments to the Commission on the inherent ethical problems with third-party litigation financing. \textit{See} J. Beisner to ABA Comm’n on Ethics 20/20, Feb. 15, 2011.

difficult to put back, and there is no reason to believe that alternative business structures would have dissimilar consequences.

Particularly instructive is Australia’s experience with third-party financing. Third-party funding was initially adopted in Australia for limited use in insolvency litigation. In the two decades since its introduction, third-party financing has spread throughout Australia’s civil-litigation system to the point where the line between law as a profession and as an investment-generating business is completely blurred. A recent legal challenge to this state of affairs led to a High Court decision affirming that law in Australia is a business like any other—and that there is no public-policy basis for limiting the spread or influence of third-party funders. The same dangers exist in the United States with respect to alternative business structures for law firms: once the bright-line rule against such partnerships is crossed, passive equity interests in law firms could become the norm—and the principles underlying Rule 5.4 would be permanently compromised.

B. All Three Proposals Set Forth In The Issues Paper Threaten To Hurt The Practice Of Law In The U.S.

ILR applauds the Commission for recognizing that nonlawyer passive investment in law firms “would not be appropriate to recommend for implementation in the United States at this time.” ILR is concerned, however, that the three potential approaches for consideration set forth in the Issues Paper would put the U.S. on a direct path to such passive investments. The Issues Paper states that the three posited options “assume that the nonlawyer is partnered with and is an active member of the firm.” But as proposed in the Issues Paper, there is no standard for

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5 In addition to third-party financing, Australia also permits law firms to raise capital by organizing as alternative business structures, as the Issues Paper notes. See Issues Paper at 7–10.


7 Issues Paper at 2 (emphasis added).
defining an “active member of the firm” under any of the three options; nor is there any means of ensuring that the real intent of such partnerships would be to participate actively in the firm – rather than simply to provide more capital sources for law firms (the very result that the Commission seeks to avoid).

ILR is thus opposed to all three options.

1. **Option 1: Limited Lawyer/Nonlawyer Partnerships With A Cap On Nonlawyer Ownership**

Under Option 1, lawyers would be permitted to partner (and share fees) with nonlawyers subject to certain, specified limitations. In particular: (1) the firm could engage only in the practice of law; (2) the nonlawyers could not own more than a certain percentage (e.g., 25%) of the firm; and (3) the nonlawyers would be required to pass a “fit to own” test. ILR commends the Commission for proposing these safeguards but nevertheless urges the Commission to reject Option 1.

As a threshold matter – and as noted above – ILR does not believe there is any demonstrated need for vitiating Rule 5.4’s protections. But even if some changes were called for, Option 1 does not adequately protect against the dangers of passive investment in law firms by nonlawyers. In particular, ILR believes that any rule that permits a law firm to organize as an alternative business structure must also require that the non-lawyer partners *actively* and *materially* assist the lawyers in providing legal services to clients *by bringing some valuable non-legal professional service to the table*, not merely by raising capital or assessing the likely profitability of any case for the partnership. Such direct professional involvement is critical to ensure that non-lawyer partners do not simply become involved in the law firm as a conduit for a passive equity investment. Such involvement also must encompass more than merely assessing the firm’s likely return on a case, because such a service does nothing to benefit the client. Indeed, without “active participant” and “benefit to the client” requirements, this option poses all the same risks as allowing passive investments. And even if investments were capped at 25 percent, that is a sufficiently large share to give a non-lawyer considerable influence over the law firm’s operations.

ILR appreciates that the District of Columbia’s Rule of Professional Conduct 5.4 permits alternative business structures without this suggested safeguard. ILR believes, however, that Washington, DC, is a unique legal environment – and its experience cannot serve as a model for other states. First, the District of Columbia’s rule primarily allows local law firms to provide legal services that involve lobbying the United States government. Washington, DC, is, of course, the seat of the federal government, the location of all foreign nations’ embassies to the United States, and
the location of numerous non-governmental organizations. Thus, any benefits that are realized from permitting lobbyists to partner with lawyers are unique to the practice of law in Washington, DC, and would not be exported to other states adopting similar rules. Indeed, ILR is hard-pressed to think of any other professional service that is so tied to any particular location in the United States. Second, because Washington, DC, is the only U.S. jurisdiction that permits alternative business structures, any law firms that wish to partner with nonlawyers may only practice in Washington, DC, and cannot export their services to other states. This provides a natural check against law firms abusing the District of Columbia’s rule as a means to generate capital. If other states adopted similar rules, however, this natural check would disappear.

2. **Option 2: Limited Lawyer/Nonlawyer Partnerships With No Cap On Nonlawyer Ownership**

Like Option 1, Option 2 would allow lawyer-nonlawyer partnerships; the key difference is that Option 2 would not place a cap on nonlawyer ownership. In this respect, Option 2 is more like the District of Columbia rule, which also does not cap nonlawyer ownership.

To the extent any changes are made to Rule 5.4’s restrictions on lawyer-nonlawyer partnerships – and ILR believes that none are needed – Option 2 is even more problematic than Option 1. After all, absent a cap on nonlawyer ownership, lawyers could find themselves in the minority of their own law firm management structure. This would mean that nonlawyers would have the power to make strategic and other decisions for the firm – without the experience and professional responsibility of attorneys.

3. **Option 3: Permitting Alternative Business Structures To Offer Both Legal And Non-Legal Services**

Option 3 is the most radical – and dangerous – of the three options set forth in the Issues Paper because it would allow alternative business structures to offer both legal and non-legal services, and thus turning the practice of law from a profession into a business. If a law firm that is organized as an alternative business structure were permitted to engage in businesses other than the practice of law, there is a distinct risk that it would sacrifice its clients’ interest for the sake of other business interests. This is particularly true because the firm’s non-lawyer partners would not have fiduciary obligations to the firm’s legal clients – or the professional duties that come with being a lawyer. As such, if a legal representation were going poorly, they would likely pressure the lawyer partners to support other, more successful business lines. This is exactly the risk that Model Rule 5.4 seeks to