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The Newest Big Issue: Non-Lawyer Ownership or Investment in Firms

By Robert Denney

Alternate Fee Arrangements (AFAs), non-lawyer service providers and, more recently, non-lawyers as firm CEOs have been among the most discussed – and sometimes debated – developments in the legal profession the last few years. Now another issue is producing increasing discussion and debate: non-lawyer ownership of, or at least investment in, law firms.

Background

This all began 22 years ago in the U.K. when the Courts and Legal Services Act 1990 (CLSA) broke the monopoly that solicitors, barristers and licensed conveyancers had over the provision of certain legal services known as "reserved activities". This act also permitted non-lawyers to enter the legal market by the creation of Alternate Business Structures (ABS's) which allowed lawyers and non-lawyers to work together to deliver legal and other services and also solicit outside investments.

Then five years ago Slater & Gordon, a major personal injury firm in Australia, filed a public stock offering and, in the U.K., the Legal Services Act 2007 was passed, succeeding the 1990 act. The motive behind these developments was to increase consumers' access to legal services and to increase competition in the legal profession. This has been happening.

The first ABS, Premier Property Lawyers, began operating in October, 2011, the earliest date allowed by the LSA. Others ABSs have followed. Early this year, in what is probably the first purchase of a law firm by a publicly traded U.K. company, Quindell Portfolio announced it was acquiring personal injury firm, Silverbeck Rymer, to expand its claims-management services.

The next development occurred last March when British regulators allowed the Co-operative Group, a member organization that runs grocery stores and also offers banking and insurance services, to provide legal advice on divorce and other family-law matters to its seven million members.

The Issue Arises in the U.S.

It wasn't until the passage of the Legal Services Act 2007, as well as the filing by Slater & Gordon, that the issue of non-lawyers owning firms or entities that provide legal services attracted anything more than a casual glance from the U.S. legal profession. Ironically however, although barred by state bar associations, this structure has existed since 1980 when the District of Columbia Bar Association voted to allow non-lawyers to hold a financial interest in law firms. There is still little information on how many Washington firms have taken this step except for the now-defunct Howrey & Simon which had made its top financial officer a partner back in 1990.

Now ownership, or at least the related issue of non-lawyer investment in law firms, has increasingly become the subject of debate by both supporters and opponents – as well as the basis for three federal law suits. These were filed last year in New York, New Jersey and Connecticut by Jacoby & Meyers which challenged the states' rules prohibiting outside investment in law firms. Although the New York suit was dismissed last month, the firm has challenged the ruling. The case is expected to be referred back to the district court for further proceedings.

Although previous proposals to expand law firm ownership have been repeatedly defeated, the developments in Australia and the U.K. have caused the American Bar Association to consider presenting a less extreme option for consideration by its House of Delegates next year at the earliest.

The proposal – if the ABA decides to present it – would allow non-lawyers working at a law firm to own as much as 25% of the firm. It would also include certain requirements to guard against unethical conduct. Non-lawyer partners would have to agree to abide by the same rules of professional conduct as lawyers. They would also not have control or authority over a lawyer's professional judgment.

The Debate Has Heated Up

As you would expect regarding any change involving lawyers, the intensity of the arguments both for and against the issue, has increased.

For example, opponent Lawrence J. Fox, a partner in the Philadelphia-based firm Drinker Biddle & Reath, stated, "Let's keep remembering the story of Arthur Andersen and Enron – how great firms can lose their way by chasing monetary gain." Another opponent, David J. Carr, a partner at Ice Miller in Indianapolis, who wrote one of the comments opposing the proposal, has been even more outspoken. He said, "I can't think of anything more pernicious or ill-considered. You are diluting the essence of what it means to be a lawyer."

And Robert Weber, I.B.M. General Counsel, says firms are only looking for interest-free capital. "I don't know if I'd call it greed, but it's in the greed ball park."

On the other hand, Tony Williams, former managing partner of the global U.K. firm Clifford Chance, has said, "I've been party to this sometimes rather sterile debate – are you a profession or a business? I don't see a contradiction between the two." And Thomas Gordon emphasizes the original intent of the changes in the U.K. Gordon is the legal and policy director for Consumers for a Responsive Legal System, a group that wants to make legal services more accessible. "It's the people who can't pay $500 an hour but could pay a $500 flat fee for a divorce who would benefit."

Just an Issue for Small Firms?

Developments in both Australia and the U.K. would seem to indicate that non-lawyer ownership or investment is an issue that would only be of benefit to small firms that provide legal services to individuals such as divorce, wills and personal injury suits. In the U.K. most large corporate firms have not yet addressed these options because, in their opinion, they would create more problems.

For example, according to an ethics opinion issued by the New York State Bar Association earlier this year, if they are part of a U.K. firm that has non-lawyer partners, New York lawyers can't practice in the state.

However, faced with continually increasing expenses in a flat or even shrinking U.S. legal market, many BigLaw firms are implementing aggressive growth strategies which include recruiting lateral entries that have large books of business and opening offices in foreign countries or forming alliances with foreign firms. These strategies can require considerable capital. Historically, law firms have needed relatively little working capital which they have been able to obtain through lines of credit, off-balance sheet leases or partner contributions. In the current global economy, these traditional sources may not be available or sufficient.

Meanwhile Jacoby & Meyers continues to pursue its case and has already formed a limited liability company with the expectation it will be allowed to accept outside investments. And other types of operations, many of which are not lawyer-owned, continue to provide an increasing range of services.

It is not surprising that many lawyers oppose outside investment in law firms. However, a large number of legal services providers that are not law firms have already evolved in the U.S. In a recently published article, Tony Williams may have summed up the entire issue best. "If external funding permits lawyers to do more for their clients and build services the market wants, then as long as safeguards are in place, external investment could have a positive impact."

Stay tuned.

***Robert Denney**, a member of this newsletter's Board of editors, is President of Robert Denney Associates, Inc., a firm that provides strategic management and marketing counsel to law firms throughout the United States and parts of Canada. The firm's website is www.robertdenney.com. Mr. Denney can be reached at 610-644-7020 or bob@robertdenney.com.*