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Private Equity Investments in Law Firms Have arrived in the UK and Have Largely Ignored BigLaw; What Will Happen as This Phenomenon Arrives in the United States?

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After so much anticipation, the law permitting nonlawyer equity investment in law firms ("Alternative Business Structures" or "Tesco" laws) took effect in England in November and for BigLaw, it is much more of a yawn than a yowl. I can't say I am very much surprised. I previously predicted this result.

As some have noted, the proceeds of capital infusions by outside investors in large law firms will likely be applied to technology and most particularly knowledge management systems, all with a view of lowering costs to consumers of legal services. The result would be increased commoditization and reduced revenues per lawyer. Thus, the consequence of such investments may well be that unless one creates a Goldman Sachs-type leverage ratio (10,000 to 1?), an extremely unlikely result for any law firm; the investor will simply not get the anticipated return.

and second year associates and the profession continues to move to an inverted pyramid model, that kind of leverage just won't happen.

The practice areas which yield the highest return still remain in the plaintiffs' class action bar and in big stakes high end plaintiffs' contingency cases. The recent acquisition by Australian based, publicly held Slater & Gordon of Liverpool personal injury firm Russell, Jones & Walker for £58 Million serves to prove that point. Similarly, just yesterday, private equity firm Duke Street announced an LBO for insurance litigation firms Cogent Law and Plexus Law. Massive class actions and other high end cases chew up enormous amounts of capital. Law firms which have been active in this world have already amassed substantial capital and have the internal resources to fund these cases. Some still utilize traditional institutional lending from banks at favorable rates. Others utilize litigation funding companies which do tend to charge exorbitant interest rates; but, then again, these funding companies accept all of the risk in making non-recourse loans and at the end of the day, they do not remain partners of the law firm.

Others have noted that outside investors in a firms would exert some degree of control

within a law firm and the danger they highlight is that such investors will impair the independence of the lawyers' judgments in directing that efficiency, rather than the clients' best interests will be a driver in handling a client engagement, all in violation of Rule 1.1 of the Model Rules of Professional Conduct.

An added impediment is the preservation of client secrets and confidences. Non lawyer investor participation in law firm management necessarily makes non-lawyers privy to such secrets and confidences, with no mechanism to police the maintenance of such confidentiality by these non-lawyers.

Ultimately, the killer ethical rule in the United States that dooms private equity investment is not the confidentiality provisions or the requirement that lawyers act with independence. Rather, it's one never mentioned in the discourse on this subject: The prohibition that bars lawyers from entering into agreements that limit their ability to practice law. Thus, equity investors in law firms could never have any assurance that a law firm's most valuable assets -- its partners-- would exercise their free agency rights and ride down the elevator one day, never to return.

As the ABA agonizes over whether US law firms should permit nonlawyer employees of a law firm to hold an equity investment in law firms, the real question concerns the underlying issue of adoption of Tesco laws in the United States. The New York State Bar Association announced just a few days ago that it would create a committee, under the capable leadership of immediate past NYSBA president Stephen Younger to study the issue. But, even as he seated this committee, current NYSBA President Vincent Doyle proclaimed that the Association "remains opposed to nonlawyer ownership of law firms." Sounds like a fair unbiased hearing on the subject won't be very likely here.

The reality is that bar associations and government regulators were and continue to be asleep at the switch as nonlawyer owned and unlicensed LPO's moved and continue to move to openly practice law in the United States and nonlawyer owned and unlicensed Internet providers of legal services do the same, These phenomena were the result of market forces and a bit of ingenuity and brazenness by these entities and the sloth of the regulators. The fact is that we do have a model under which non lawyers can effectively invest in law firms (yes, even commercial law firms), earn a solid return and even exercise some degree of control in what we believe to be an ethically compliant fashion. Interested, call me and ask about it.

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