I petition this Court to adopt the proposed Rule changes included in Supreme Court No. R020-0034. I will specifically focus my comments on the Task Forces recommendation that the Court eliminate Ethical Rule 5.4 of the Arizona Rules of Professional Conduct, Rule 42, Ariz. R. Sup.Ct. I believe that the proposed amendments are regarding ER 5.4 are needed in order to modernize ER 5.4 in accordance with current conditions and issues facing Arizona lawyers by allowing limited ownership and management of law firms while including extensive provisions designed to maintain and foster the protection of lawyers' professional independence of judgment.

The Current Version of ER 5.4

The current version of ER 5.4 imposes an absolute ban on nonlawyer ownership and/or management of law partnerships, professional corporations, and associations. The Comment to ER 5.4 notes that the limitations in the Rule regarding sharing fees "are to protect the lawyer's professional independence of justice." As shown below, the proposed amendment is designed to allow lawyers and law firms greatly needed increased flexibility in their modes of organization and operation while protecting lawyers' professional independence of judgment.

The Potential Benefits of the Proposed Amendment

A. Enhanced financial flexibility

Alternative Business Structure (ABS) may provide law firms with such significant benefits as asset protection, greater flexibility and lower costs in raising and retaining capital (including but not limited to the avoidance of high interest rates on loans), greater flexibility for remunerating employees, possible tax advantages, and opportunities to introduce more effective management and decision-making arrangements. In contrast, one proponent of ABS believes that the traditional law firm's reliance solely on partners and banks for funding can be a great disadvantage:

> This is a rather primitive, pre-industrial model of financing the firm . . . The owners bear significant risk, which effectively increases their cost of capital and restricts available funding. Part of the risk is from a mismatch of revenues and expenses. Even a fundamentally viable firm may face a liquidity crunch when its bank loans come due and its only assets are accounts receivable and pending cases.

Larry E. RIBSTEIN, REGULATING THE EVOLVING LAW FIRM, p. 9 (2008).

The traditional financial model "potentially prevents law firms from expanding their scale and scope to engage in risky but potentially lucrative businesses." *Id.*

One obvious and specific benefit of allowing that nonlawyer investment would be the ability to provide financing on contingency-fee cases. While the working capital requirements of most law firms can be covered by a bank's line of credit, contingency-fee cases have significant up-front costs that include attorney salary, firm overhead, and court costs. Covering these costs by nonlawyer investment would allow firms to take on cases that may be riskier at the outset.

"Funding more contingency-fee cases would have the added benefit of providing more access to justice for the public because risk-averse firms, who would normally reject possibly meritorious claims and leave these potential clients without representation, could offer representation knowing that non-lawyer equity would act as a buffer if the case was unsuccessful." Thomas Markle, A CALL TO PARTNER WITH OUTSIDE CAPITAL: *The Non-Lawyer Investment Approach Must Be Updated*, 45 Ariz. St. L. J 1251, 1263-64 (Fall 2013).

B. Enhanced operational flexibility

ABS offer firms flexibility in how they structure and run their businesses. ABS may permit firms to strengthen their management teams through the increased use of nonlawyers. Some firms already employ nonlawyers in leadership roles; however, it may be easier for firms to attract and keep talented nonlawyers to help in firm management if firms can offer them a share of the firm's ownership. Those nonlawyer professionals may be able to offer firms distinct insight that can improve those firms' delivery of legal services to their clients.

C. Cost Effectiveness/Quality of Services

Law firms that specialize in a particular area of law will be better equipped to provide high quality legal services by having nonlawyer managers on staff whose business or professional experience gives them expertise in a particular subject. The following are a few examples in which allowing nonlawyers to participate in the

ownership and/or management of firms may result in greater cost effectiveness and quality of services: engineers and architects with law firms that focus their practice on land use; scientists and engineers with law firms that have intellectual property practices; social workers and financial planners on the client service teams of family law firms; and nurses and investigators participating in the evaluation of cases and assisting in the evaluation of evidence and development of strategy for personal injury law firms.

D. Increased access to justice

There are several ways in which allowing a degree of nonlawyer funding of law firms may positively impact access to justice. First, lifting constraints on the supply of capital for firms will decrease the cost that firms pay for such capital, thereby tending to decrease the cost of legal services to consumers. Second, competition may be increased because more lawyers might be willing to start their own firms if they do not see large, high interest bank loans as their only funding option.

At the same time, larger law firms might provide better access to justice, due to risk-spreading opportunities and economies of scale and scope. While individual clients must currently rely on small partnerships and solo practitioners, allowing non-lawyer capital and management into the market might facilitate the emergence of large consumer law firms. It is plausible that such firms would find it easier than

small ones to expand access through flat rate billing, reputational branding, and investment in technology. Lastly, ending the rigid insulation of lawyers from non-lawyers allows potentially innovative inter-professional collaborations, which might bring the benefits of legal services to more people even if firms stay small. In summary, ABS may improve consumer choice and value because additional sources of capital may encourage legal service providers to take greater risks in improving their services, and that innovation in turn, may allow lawyers to deliver better services at lower prices.

E. Increased access to law practice-related technology

State of the art technology in various aspects of legal practice, particularly research and administration, can be prohibitively expensive for small and medium-sized firms. The funds generated by nonlawyer participation in law firms can be used to make long term investments in law practice related technology and delivering legal services to clients in new ways. Firms can also offer more attractive terms regarding participation in the firm to professionals specializing in information technology. As observed by Professors George C. Harris & Derek F. Foran:

> Current advances in Internet and computer software technology would seem to provide unprecedented opportunities for efficient and affordable delivery of needed services and effective collaboration among professionals serving clients' related needs. Without lifting the current prohibitions on capital investment from outside the profession and resulting structural innovations, those opportunities will likely remain unfulfilled—at least as they might benefit middle- and lower-income consumers.

Harris & Foran, *The Ethics of Middle-Class Access to Legal Services and What We Can Learn From the Medical Profession's Shift to a Corporate Paradigm*, 70 FORDHAM L. REV. 775, 835 (2001).

F. Increased ability to function in a globalized market

As summarized by one commentator:

> Today the idea that lawyers serve only clients in their locality is unrealistic due to continuous increases in national and global commerce. In fact, most of the leading law firms have both a national and global presence. Further, with the increasing mobility of our population and the ease of information sharing throughout the world, the reality is that lawyers will find it increasingly appealing to be licensed in multiple states and to practice with law firms throughout the country and the world. These realities become extremely relevant when considering the current restrictions imposed by Model Rule 5.4.

(footnotes omitted). Justin Schiff, *The Changing Nature of the Law Firm* etc. 42 Capital Univ. L. Rev. 1009, 1036 (2014).

There is no Evidence Supporting the Concern that the Proposed Amendment Would Threaten Lawyers' Independence of Judgment.

As noted above, the Comment to ER 5.4 states that the limitations in the Rule regarding sharing fees "are to protect the lawyer's professional independence of justice" The ABA Commission on the Future of Legal Services, created in 2014, framed the issue as follows:

> The primary argument against ABS is that any form of nonlawyer ownership or management threatens lawyers' "core values," particularly, professional independent judgment and loyalty to clients. Specifically, opponents of ABS fear that lawyers will act in the financial interests of the firm's nonlawyer owners rather than in the best interests of their clients. Even if measures are put in place to ensure that nonlawyer owners will obey the rules of professional conduct, critics of ABS point out that this is insufficient: after all, lawyers must demonstrate their understanding of the rules by graduating from law school and passing the bar examination and the multistate professional responsibility examination. Relatedly, nonlawyer ownership could pose a threat to the quality of legal services, particularly if lawyers feel beholden to investors rather than their clients.

(footnotes omitted). ABA Commission on the Future of Legal Services, For Comment: Issues Paper Regarding Alternative Business Structure, April 8, 2016, went on to find that there was no evidence from either U.S. or foreign jurisdictions that ABS has caused the anticipated harm.

A. Evidence from U.S. jurisdictions

1. District of Columbia

In 1988, D.C. adopted a version of MR 5.4 that allows nonlawyer ownership or management. D.C. Rule 5.4(b) provides:

> (b) A lawyer may practice law in a partnership or other form of organization in which a financial interest is held or managerial authority is exercised by an individual nonlawyer who performs professional services which assist the organization in providing legal services to clients, but only if:
>
> (1) The partnership or organization has as its sole purpose providing legal services to clients;
>
> (2) All persons having such managerial authority or holding a

financial interest undertake to abide by these Rules of Professional Conduct;

(3) The lawyers who have a financial interest or managerial authority in the partnership or organization undertake to be responsible for the nonlawyer participants to the same extent as if nonlawyer participants were lawyers under Rule 5.1;

(4) The foregoing conditions are set forth in writing.

Unlike the proposed amendment, this Rule does not contain a cap on the percentage of nonlawyer ownership.

As of 2012, with the Rule having been in effect for over twenty-four years, no disciplinary action concerning nonlawyers' interference with the professional judgment of lawyers has ever been filed against a D.C. law firm with nonlawyer partners. Schiff, *supra* at 1020 (2014). As stated in the December 2, 2011, ABA Comm'n on Ethics 20/20 Discussion Paper, "[t]here is simply no evidence that the perceived risk of interference [with lawyers' professional independence] has materialized." Jamie S. Gorelick & Michael Traynor, *For Comment: Discussion Paper on Alternative Law Practice Structures,* p. 6 (Dec. 2, 2011), available at http://www.americanbar.org/content/dam/aba/administrative/ethics_2020/20111202-ethics2020-discussion_draft-alps.authcheckdam.pdf.

To the contrary, the Commission's outreach and research revealed the following affirmative results:

• Small firms that have nonlawyer partners found the opportunity to hold out the prospect of partnership helpful in recruiting and retaining nonlawyers;

• While large law firms can often recruit and retain key nonlawyers as employees rather than as partners by providing salaries and bonuses comparable to the total compensation received by law partners, providing guaranteed compensation of that magnitude to nonlawyer partners or owners was not feasible for many smaller firms;

• Some plaintiff personal injury firms working on a contingent fee basis view fee-sharing with nonlawyer partners as a more equitable distribution of firm income given the value of the support nonlawyer partners provide in developing their firm's cases;

• Some firms reported that taking on nonlawyer partners has allowed for greater innovation and efficiency than segregating nonlawyers in a related ancillary business of the sort permitted under Rule 5.7 of the Model Rules of Professional Conduct. This applied even for firms that focus on lobbying; a

• Transaction costs borne by clients to deploy law firms and other professional service providers to work together on projects can be eliminated by firms that have nonlawyer partners.

• Many law firms in the District of Columbia are multijurisdictional firms, an appreciable number of which would like to add nonlawyer partners in their District of Columbia offices but for the continuing prohibition on nonlawyer partners in other U.S. jurisdictions.

Id., p.7. Despite this evidence, the ABA Commission on Ethics 20/20 decided not to propose changes to the ABA policy prohibiting nonlawyer ownership of law firms. Ted Schneyer, *"Professionalism" as Pathology: The ABA's Latest Policy Debate on Nonlawyer Ownership of Law Practice Entities*, 40 Fordham Urban L. J. 74, 82 (Issue 1, Article 15, 2013)

2. Washington State

The Washington Supreme Court has created an independent paraprofessional that is licensed to give legal advice, the Limited License Legal Technician (LLLT). In 2015, the Court issued a new rule permitting LLLTs to own a minority interest in law firms. See, Wash. Rules of Professional Conduct R 5.9. To date, counsel is not aware of any disciplinary complaints arising out of this Rule.

3. North Carolina

Since 2003, the North Carolina version of MR 5.4 has omitted the provision of 5.4(d) that prohibits a lawyer from practicing law in a professional corporation or association if a nonlawyer is a corporate director or officer thereof. Rule 5.4, 27 N.C.A.C. Chapter 2. Thus, a lawyer in North Carolina may practice law in a firm which is managed by a nonlawyer. Once again, counsel is not aware of any disciplinary complaints arising out of this Rule.

B. Evidence from foreign jurisdictions

Many foreign jurisdictions allow some form of ABS. These jurisdictions include Australia, Belgium, various Canadian provinces, Denmark, England, German, Italy, the Netherlands, New Zealand, Poland, Scotland, Quebec, Singapore, Spain, and Wales. The forms of ABS permitted in these jurisdictions vary with

respect to such dimensions as percentage of nonlawyer ownership allowed; degree and type of regulation designed to ensure professional independence of judgment; and whether services offered are limited to legal services.

Whereas most prior arguments regarding the potential ethical issues raised by ABS were based on speculative predictions, the Commission on the Future of Legal Services had the benefit of a resource that was unavailable to bodies which had previously investigated these issues- formal empirical studies. These studies primarily involved ABS in Australia, England and Wales, and most were completed after the ABA Commission on Ethics decided it would not propose any policy changes regarding ABS. 2016 Issues Paper, p. 11. According to the 2016 Issues Paper:

> There is currently no evidence that the introduction of ABS has resulted in a deterioration of the legal profession's "core values." In its 2014 Consumer Impact Report, the UK Legal Consumer Panel concluded that "the dire predictions about a collapse in ethics and reduction in access to justice as a result of ABS have not materialised." Despite the creation of hundreds of ABS firms in recent years, the UK report found that "[t]here have been no major disciplinary failings by ABS firms or unusual levels of complaints in the Legal Ombudsman's published data." Moreover, "overall consumer confidence in the quality of work and professionalism of lawyers has held steady since 2011."Australia also has not experienced an increase in complaints against lawyers . . . In sum, the Commission found no studies indicating the erosion of core values or harm to clients in jurisdictions that permit ABS.

(footnotes omitted). 2016 Issues Paper, p. 12.

The 2016 Issues Paper cites two additional arguments supporting its finding that ABS have been positive: increased funding for innovation and jurisdictions have stayed with ABS. *Id.*, pp. 14 -15.

C. Analogous models

1. In-house counsel

The 2016 Issues Paper also found that in the U.S., experience with in-house counsel supported the conclusion that ABS did not pose a threat to lawyers' professional independence of judgment or other core values. Noting that since the late 19th century, it has been common practice for corporations to employ lawyers in-house, the Commission stated:

> Working in-house for a client in some circumstances may place pressure on a lawyer's ability to exercise independent professional judgment. After all, within some corporations, in-house lawyers are "business employees, report to corporate officers who are agents of the client but not the client itself, and are often thought to be more beholden to those officers than are the company's outside counsel...." Although this relationship in some circumstances arguably poses the same threat as ABS to the lawyer's exercise of independent professional judgment-- indeed, the ABA once espoused this view – the practice of lawyers working in-house is not only well accepted but in-house counsel time and time again have demonstrated their ability to exercise independent professional judgment.

(footnotes omitted). 2016 Issues Paper, p.13.

2. The medical model

Commentators have noted that the liberalization of the rules of medical ethics pertaining to ownership or management of medical business entities by non-

physicians has not been problematic: "'[T]he medical profession went through a similar marketplace liberalization and has not faced the ethical issues feared by many. Instead, it has found stability and innovation through corporate structures.'" Markle, *supra* at 1265, quoting Harris & Foran, *supra* at 812, 815.

V. The Arizona Supreme Court Should Adopt the Proposed Amendment to ER 5.4.

On June 17, 2014, this Court established the Committee on the Review of Supreme Court Rules Governing Professional Conduct and the Practice of Law. The Committee was created "in recognition that the changing practice of law in the last decade poses new ethical questions that necessitate review of certain court Rules governing the practice of law." Committee on the Review of Supreme Court Rules Governing Professional Conduct and the Practice of Law, Final Report, January 9, 2015, p.1. The Committee considered the possibility of recommending changes to the Rules that would permit nonlawyer ownership or management of law firms. Nonetheless,

> [t]he Committee did not believe that taking the . . . step permitting nonlawyers to own or manage firms was necessary. In addition, the Committee understands that this issue is the subject of current study by the American Bar Association; the Committee therefore recommends awaiting the development of further information through that effort prior to making any change in Arizona Rules regarding nonlawyer ownership.

Id. at p. 8. The study referred to by the Court was the one being undertaken by the Commission on the Future of Legal Services.

In 2016, that Commission published its final Report. Its recommendation was that "[c]ontinued exploration of alternative business structures (ABS) a will be useful, and where ABS is allowed, evidence and data regarding the risks and benefits associated with these entities should be developed and assessed." *Report on Future of Legal Services in the United States* (2016), p. 42. The Commission noted that its "views were informed by the emerging empirical studies of ABS" which revealed "no evidence that the introduction of ABS has resulted in a deterioration of lawyers' ethics or professional independence or caused harm to clients and consumers." *Id.* However, the Commission stated that the majority of comments that it received in response to its 2016 Issues Paper expressed strong opposition to ABS, and in particular "many of the comments opposing ABS focused on the belief that ABS posts a threat to the legal profession's 'core values', particularly to the lawyer's ability to exercise independent professional judgment and remain loyal to the client." *Id.* Thus, in making its recommendation, the Commission gave more weight to subjective, speculative and unfounded "belief" than to empirical evidence.

The same process occurred when the Commission on Ethics 20/20 decided in 2011 not to propose amendments to MR 5.4 that would have allowed ABS. Ted Schneyer, professor of law at the University of Arizona James E. Rogers College of Law, served as commission member of the ABA Commission on Ethics 20/20 and

co-chaired the ALPS (ABS) Working Group. In addition, he co-authored the draft amendment to MR 5.4 that was submitted for comment and consideration.

After analyzing the input regarding the proposed amendment, which was for the most part extremely negative, Prof. Schneyer concluded that the arguments against the amendment were based on rhetorical tools developed over time in the legal community in connection with the potential of any sort of "business entanglements" between lawyers and nonlawyers. Prof. Schneyer further argued that the use of this "idiom of professionalism" did not "promote sound and stable policies on issues concerning lawyers' 'business entanglements with nonlawyers.'" Thus, individuals who opposed the amendment of MR 5.4 relied on rhetoric rather than empirical evidence.

The 2016 Issues Paper points out that the dangers which the current restrictive version of MR 5.4 is designed to protect against are not in kind different from the financial pressures lawyers experience in firms in which nonlawyers exercise no ownership or management:

> [a]lthough critics of ABS express concern that nonlawyer ownership will place excessive financial pressure on lawyers to act for the benefit of nonlawyer owners rather than the client, it is undeniable that U.S. lawyers already face significant financial pressures. As one commentator described those tensions during the ABA's debate over MDP in 1999: "Any and all forms of professional practice are subject to pressures, constraints and temptations – pressures from hierarchical superiors or peers, payment systems or fee arrangements, incentives to career advancement or financial reward inside firms or in the profession generally – that may to a greater or lesser extent compromise the

> exercise of a lawyer's independent judgment." The question is whether ABS would pose a greater threat to the professional independence of lawyers than "those that currently exist in the everyday practices of lawyers in law firms, corporate law departments, government agencies, and nonprofit organizations.

This observation cuts against the assumption that allowing ABS will result in new and unique temptations for lawyers to violate their duties of professional independence of judgment and loyalty to their clients.

CONCLUSION

As one commentator has pointed out, the ABA has abdicated its leadership role on this issue, and "[t]herefore, as the ultimate enforcer and creator of ethical guidelines, American states must take their self-directed control over their legal markets and open them to non-lawyer investment, as the District of Columbia has already done." Markle, *supra* at 1253.

Amending ER 5.4 to allow for limited nonlawyer ownership and management will result in law firms having enhanced financial and operational flexibility; offering increased access to justice; having greater cost effectiveness and better quality of services; being able to better access law-related technology; and gaining increased ability to function in the global market. Empirical evidence over many years from the U.S. and abroad shows that the ethical issues that opponents believe would inevitably arise from the use of ABS simply have not materialized. The ownership and management by nonlawyers of law firms provided for in the proposed

amendment to ER 5.4 is quite limited and has adequate safeguards against any threat to the legal profession's "core values" including that of maintaining lawyers' professional independence of judgment. The Court should adopt the proposed amendment to ER 5.4.

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