



Who owns the firm



Law firm shares are traded on the stock market in Australia. UK law firms are seriously exploring their IPO options. A raft of legislative changes worldwide is shaking up the legal profession and challenging long-held beliefs about professionalism. Will North American law firms soon be controlled by non-lawyers?

By Scott Brede

It's one of the fundamental pillars of the legal profession that lawyers have never really doubted: law firms and law practices are operated and controlled by lawyers. Full stop, end of story. Right?

Well, maybe not for much longer. Professional codes that have kept the "effective control" of law firms out of the hands of non-lawyers are facing perhaps their greatest threat. But this time, the challenge isn't coming from accounting giants pushing for so-called multi-disciplinary practices, as was the case in the late 1990s.

Today, the charge is being led by an enterprising Australian law firm attempting to show lawyers around the world the growth potential of going public and selling shares, and by radical new legislation in the United Kingdom that could see supermarkets operating law firms. And in a larger sense, it's part of a worldwide modernization and re-examination of what the practice of law is all about.

Through rapid-fire acquisitions fueled by an influx of capital, Melbourne-based Slater & Gordon Ltd. has substantially expanded its footprint in Australia since becoming the first law firm to be listed on a stock exchange anywhere in the world in May 2007. This past February, the firm announced

its half-year profits were up a startling 56 percent since its initial public offering. (The results of its first full financial year were not available at press time.)

But Slater & Gordon's pioneering move pales in comparison to the real challenge to the *status quo*, set to take place around 2011, when a massive deregulation of the legal profession in the United Kingdom will open the door to public ownership of law firms there. Among many other effects, the *Legal Services Act* (LSA) will allow law firms to sell shares and even be sold to corporations, possibilities that U.K. firms are already actively pursuing.

Bruce MacEwen, a New York lawyer and consultant who discusses law firm management strategy at his website "Adam Smith, Esq." (www.bmacewen.com/blog), advises managing partners on this side of the Atlantic to closely watch these overseas changes and to start introducing their colleagues to the idea of some form of non-lawyer ownership. "Because when the lid comes off, things may start happening very quickly."

Ethical considerations

Hold on a second. Don't the ethics codes of lawyers' governing bodies throughout North America strictly forbid heresies like law firm IPOs? Steven Krane, chair of the American Bar Association's Standing Committee on Ethics and Professional Responsibility and a partner with Proskauer Rose in New York, certainly thinks so. And he doubts the near-term impact on this continent's legal industry of developments like the LSA.

An overwhelming majority of North American lawyers, Krane predicts, would rise up in opposition to

Illustration by Stephane Denis, Three in a Box

the idea that law firms should be allowed to sell ownership stakes. "You open the door a crack, and you're allowing for the possibility of non-lawyer control over the practice of law," he says.

But MacEwen thinks present-day ethics rules preventing law firms from turning over their reins to non-lawyers will begin to buckle once a publicly financed U.K. firm makes major inroads into North American legal markets. "It won't be a Magic Circle firm," says MacEwen, "but it may very well be a name-brand firm just below the Magic Circle...."

"All the ways of growing law firms are increasingly capital-intensive. I think it's a failure of imagination that law firms couldn't do more if they had real access to capital."

"One place they are going to look is New York." And once that happens, he says, "that will really put the screws on bar regulatory authorities to level the playing field" and allow North American law firms the same access to non-lawyer investments.

Whether current ethics rules would even allow a U.K.-based law firm operated by non-lawyers to open its doors in Canada or the United States remains a matter of debate. But MacEwen says any move to curb such expansion efforts would likely be miserably unsuccessful: "You can't stop the money from flowing to where it wants to be."

Investor interest

The LSA emerged from a groundbreaking report by Sir David Clementi into a U.K. legal profession that Clementi judged had fallen out of step with competition laws, consumer care and marketplace demands. The statute will, among many other things, enable British law firms to sell ownership stakes to private investors, or even to merge with banks and supermarkets. The effective date is 2011, although the necessary government machinery might take longer to set up.

In March, London-based Lyceum Capital moved quickly to become the first investment house to publicly announce its intention to target the U.K.'s legal sector. To buttress its credibility, Lyceum put together a senior advisory panel whose members include legal visionary Richard Susskind and former Clifford Chance managing partner Tony Williams, now a founder and principal of Jomati Consultants in London.

Williams, who has also served as worldwide managing partner of Andersen Legal, Arthur Andersen's associated global law network, has been surprised by the "willingness to learn" about Lyceum's proposition expressed by U.K. law firms. (Lyceum intends to focus on investment opportunities at firms with revenues between £20 million and £30 million, or \$40 million to \$60 million).

A "quite substantial" number of firms have inquired so far, he says, declining to be more specific or reveal any of those law firms by name. Most of those discussions have been exploratory in nature, with some rising to a more serious level.

Lyceum Capital, Williams says, initially expects to focus "much more on the retail end of the market," where law firms providing "process-driven" legal services could be made more efficient and profitable through investments in technology. But "it's wrong and naïve to think that [investors' interest in the legal sector] will begin and end there," he says.

At least in the near future, however, Williams doesn't anticipate any Magic Circle firms will seriously consider the possibility of selling shares. Those with sizeable operations in the U.S. and elsewhere where non-lawyer ownership is prohibited would likely have to undergo major restructurings in order to take that route.

Rising down under

Australia's Slater & Gordon is becoming a sizable operation of its own. Just months after its AU\$35 million IPO in 2007, the firm completed back-to-back acquisitions of Brisbane-based D'Arcys Solicitors and Sydney-based McClellands.

The firm has since announced the acquisition of four additional firms and the partial acquisition of a fifth, as part of its strategy of increasing its presence beyond its roots in Melbourne, Victoria, where it started out in 1935 primarily representing union workers in claims against railroad companies.

Slater & Gordon now operates in 27 locations in Australia, with 43 percent of its revenue coming from outside Victoria, up 9 percent from the first half of 2007, according to the report on its first half year since going public. Overall, its total income rose more than 25 percent to AU\$37.4 million during the first six months following its IPO.

Nor has Slater & Gordon been alone on this trail. In Western Australia, Perth-based Integrated Legal Holdings Ltd. also took advantage of a recently enacted law there allowing for the public issuance of law firm shares. Since raising AU\$12 million by going public in August of 2007, it has reported half-year profits of more than AU\$895,000 on revenues of AU\$4.5 million.

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Where is all this heading? In April, law firm leaders and legal scholars from around the world came together at the Georgetown University Law Center in Washington, D.C., to try to figure it all out. MacEwen, who helped arrange the event, reports that “the overall tone was one that change is coming, but it’s too soon to tell what it’s going to look like.”

New law firm governance models will emerge, he predicts. “It’s kind of like the dot-com era.... When the Internet came along, at first no one knew what kind of businesses would survive and be viable.” For every Google and Amazon, there were nearly countless Internet companies that called it quits. The legal profession is likely to experience a similar shakeout, he believes.

Full-scale public ownership is only one governance model on the horizon, MacEwen adds. Law firms on this side of the Atlantic are more likely to experiment with offering minority ownership stakes or combining with business consulting or other symbiotic non-lawyer enterprises. “One of my core beliefs about all of this is that there will be a tremendous era of exploration ... and I guarantee you some of [those efforts] will be dead ends.”

What about Canada?

Of course, in Canada, most large law firms already have full equity partners who are not lawyers, points out McCarthy Tétrault litigator Simon Potter of Montreal, a past president of the CBA and former co-chair of the CBA’s Special Committee on Multi-Disciplinary Practices (MDPs). Patent and trademark agents, partners in Canadian firms, would be forbidden from similar positions in the U.S., where state bar associations still universally prohibit lawyers from splitting legal fees with non-lawyers.

Although the CBA ultimately rejected the idea of non-lawyer-controlled MDPs, and though accounting firms’ quest for dominance over the worldwide legal industry faded in the post-Enron era, most Canadian law societies have amended their ethics codes over the past decade to allow for non-lawyer partners, as long as they’re at law firms where lawyers retain majority control over the organization.

The reality of outside ownership of law firms, says Potter, is inevitable. “It is eventually going to come everywhere.

For law firm founders nearing retirement, publicly traded stock is likely to be worth more than the value of their privately held partnership shares.

That doesn’t mean it is going to take all of us over.”

The vast majority of lawyers still practise in small firms without any great need for the large infusions of capital that non-lawyer investments would bring. Plaintiffs’ firms like Slater & Gordon are an exception, in that they have to fund cases, sometimes for years, before earning fees when settlements or verdicts are reached.

And even at large firms, there are questions of whether selling shares would be worth the bother. Sean Weir, national managing partner of Borden Ladner Gervais LLP in Toronto, is among those who doubt Canadian firms would have much interest in seeking out non-lawyer investors.

Weir says his firm already has plenty of capital at its disposal and would be averse to sacrificing its autonomy. And he adds that he has friends at a non-legal professional services firm who now

regret selling their ownership interests to a major corporation and effectively becoming employees in the process.

But MacEwen says those who believe law firms have little need for outside investments aren’t considering their full potential. “All the ways of growing law firms are increasingly capital-intensive,” he says. “I think it’s a failure of imagination that law firms couldn’t do more if they had real access to capital.”

A perfect storm

Andrew von Nordenflycht, who teaches business strategy at Simon Fraser University’s Segal Graduate School of Business in Vancouver, points out that publicly traded firms also would likely have an edge over their competitors in recruiting top talent.

Not only would they likely have far more money at their disposal with which to offer higher salaries, von Nordenflycht says, they could also offer stock options, so that lawyers wouldn’t have to wait until they make partner to receive firm ownership stakes. Publicly traded firms would also have more capital to acquire related businesses, such as consulting firms.

Williams, the Jomati consultant and former Clifford Chance managing partner, says the possibility of non-lawyer ownership of law firms is arriving at the onset of a “perfect storm of change.” Boomer partners who played instrumental roles in their firms’ growth are retiring; associate salaries, particularly at the top of the market, are at unprecedented levels; and consolidation continues to put more legal work into fewer law firms.

At the same time, corporate legal departments, seeking cost savings, are still trimming their lists of outside counsel, seemingly making all but bet-the-company litigation subject to price wars and putting increased emphasis on creating efficiencies through technology. “All of this will cause [law] firms to re-examine their positions in the market,” Williams maintains.

But von Nordenflycht identifies a different reason, beyond law firms’ desire to expand and enhance their market positions, for going public. “Law firms will go public ... predominantly as a way to cash out senior partners,” he predicts. For law firm founders nearing retirement, publicly traded stock is likely to be worth more than the value of their privately held partnership shares, he says.

Opposition gathers

Still, in a profession historically averse to change, the one certainty is that there will be opposition to non-lawyer ownership of law firms — and lots of it.

For starters, in Canada and the U.S., the dismantling of ethics rules keeping lawyers in charge of the governance of law firms would require grueling jurisdiction-by-jurisdiction approvals by law society and state bar leaders, many if not most of whom practise at small firms with little interest in potentially opening the door to new competition for legal business.

For most Canadian lawyers, the prospect of non-lawyer ownership “sends shivers up the spine ... because it seems to put the lawyer in a position of subservience,” says the CBA’s Potter. The ABA’s Krane notes that such rules exist out of concern that non-lawyers could influence lawyer-client relationships. “I think we are a long way in this country from law firms going public,” he says.

One fear is that outside investors could pressure law firms to drop, or not accept, certain client matters involving the investors’ competitors. Another is that the lawyers who answer to them will be forbidden to take cases or certain types of legal work deemed to be unprofitable or not profitable enough.

To an extent, of course, that happens already. Law firms pursue top-of-the-line assignments over those that are more

price-sensitive, and plaintiffs' lawyers have made something of a science out of assessing claims most likely to net the largest windfall. But what if an investor pressures a firm into abandoning a case midstream once the outlook for a financial reward sours, or limits the number of discoveries to cut down on costs?

MacEwen thinks such arguments are unfounded and unlikely to come true. "What law firms have to sell is their integrity ... and the precision of their advice," he says. Investors of any sophistication are unlikely to risk that for the sake of short-term profitability. Furthermore, he doubts investor pressures to be profitable could be any greater than what law firms already face from partners to increase their own profits.

"There are a lot of outside influences from non-lawyers that we tolerate today," says Krane. He cites the directions received by heavily indebted law firms from their banks to pursue more profitable work or more aggressively collect their accounts receivable.

He believes rule changes allowing for passive non-lawyer investments have a much better chance at being widely accepted. Such deals, he says, could be made dependent on these investors' non-interference in lawyer-client matters, or could be structured to allow only for the sale of a law firm's minority interests.

Potter says it could even be argued that current professional responsibility codes in Canada wouldn't restrict lawyers from practising out of Wal-Mart stores and having all of their overhead and expenses paid by the corporation, as long as the lawyers remained in control of their practices. It's commonplace for power companies and insurers to essentially employ their own law firms, he says. "Are they lawyer-controlled? I think we have to say, yes, they are."

Long-term impacts

At Simon Fraser University, von Nordenflycht has extensively researched the impact outside ownership has had on other professional service firms, including advertising agencies. From 1962 to 1973, 21 ad agencies went public — eight that were among the industry's 25 largest enterprises — at least partially thanks to a booming economy that offered agency owners the chance to cash out at high rates.

Two of them failed and nearly another third re-privatized by 1978, von Nordenflycht found. Still, there is little empirical evidence to suggest that the quality of those agencies' work product waned substantially, he says. "They got a little less creative," von Nordenflycht says. "But they were still some of the most creative agencies in the industry."

He doubts that public ownership of law firms would cause their lawyers to act any less ethically, and he challenges assumptions that publicly traded law firms would be required to reveal privileged information in public disclosures. "It's not like, when you read GM's annual report, you know everything about GM's customers," he says.

And although allowing for non-lawyer ownership of law firms is unlikely to produce tangible evidence of poor service to clients, von Nordenflycht expects a lot of lawyers would consider it a watershed event — on par with the onset of lawyer advertising and the explosion of lateral hiring — that furthered the demise of professionalism.

"If law firms start going public, there will be some sense of loss," he warns. "It undermines some of the sense that it is a profession above the commercial fray." ■

Scott Brede is a legal writer and editor based in Plymouth, Connecticut.

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