

2012

# Nonlawyers Influencing Lawyers: Too Many Cooks in the Kitchen or Stone Soup?

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## Recommended Citation

Michele M. DeStefano, *Nonlawyers Influencing Lawyers: Too Many Cooks in the Kitchen or Stone Soup?*, 80 *Fordham L. Rev.* 2791 (2012).

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# NONLAWYERS INFLUENCING LAWYERS: TOO MANY COOKS IN THE KITCHEN OR STONE SOUP?

Michele DeStefano\*

## INTRODUCTION

“Bring what you’ve got. Put it in the pot.”<sup>1</sup>

Most of us have heard the folk story of Stone Soup, wherein two hungry travelers convince a town that they can make soup from a stone. Although there are many different versions of the story—some of which depict the travelers as con artists—in every version, the message is that it is not the stone that makes the soup rich and flavorful, but instead, the individual ingredients that each of the townspeople is able to provide. The story not only transcends time, culture, and generation, but also applies to all kinds of disciplines, perspectives, and areas of expertise.<sup>2</sup>

Just like really good soup, really good ideas often result from open and diverse environments in which people from different disciplines, with varying expertise and perspectives, “bring what [they]’ve got and put it in the pot.”<sup>3</sup> There are many examples that support this premise.<sup>4</sup> Pulitzer

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1. HEATHER FOREST, *STONE SOUP* 28 (Susan Gaber illus., 1998).

2. There are many different versions of the fable. See, e.g., *Folk & Fairytale Variations, Part 2: Stone Soup*, MGPL WEBRARY, <http://www.webrary.org/kids/jbibfairytalevariations2.html#STONE%20SOUP> (last visited Apr. 21, 2012) (listing several versions); *Stone Soup: Folktales of Aarne-Thompson-Uther Type 1548*, U. PITT. (D.L. Ashliman ed. trans., Nov. 15, 2008), <http://www.pitt.edu/~dash/type1548.html> (translating variations on the tale). Although some versions of this story depict the travelers as tricksters taking advantage of villagers, this Article bases its analogy and references to Stone Soup on Heather Forest’s children’s book, which depicts the travelers as catalysts to collaboration among villagers. See generally FOREST, *supra* note 1.

3. FOREST, *supra* note 1.

4. See Felix Maringe et al., *Leadership, Diversity and Decision Making*, CTR. FOR EXCELLENCE IN LEADERSHIP 13 (Mar. 2007), <http://www.lums.lancs.ac.uk/files/r9.pdf> (“The increasingly diverse nature of work place groups and teams has been documented since the

and Nobel Prizes have been awarded to teams, as opposed to single individuals.<sup>5</sup> Whatever the explanation for this team success—whether people are collaborating more frequently now than before, whether the scientific community had not previously recognized that inventions are a team effort, or whether the problems have become more complicated<sup>6</sup>—scientific research today is often conducted, and reports often written, by multiple scientists and specialists.<sup>7</sup> Some of the most cutting-edge fields in science are interdisciplinary, such as cognitive neuroscience, biotechnology, and biopharmaceuticals.<sup>8</sup> Similarly, researchers have concluded that diversity of opinion, experience, and discipline can add value. Studies have shown time and time again that diverse teams make better decisions about complex problems.<sup>9</sup>

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late 1980's at least. Since then, numerous writers have suggested that diverse teams may be advantageous to organisations, especially in performing decision making tasks." (citations omitted)); see also Lu Hong & Scott E. Page, *Group of Diverse Problem Solvers Can Outperform Groups of High-Ability Problem Solvers*, 101 PNAS 16,385, 16,385 (2004) ("In the past, much of the public interest in diversity has focused on issues of fairness and representation. More recently, however, there has been a rising interest in the benefits of diversity.").

5. See *Sensory Scientists and Marketing Researchers, Their Role in the Product Innovation Process*, INSIGHTS NOW! (Mar. 11, 2011), <http://www.insightsnow.com/expertise/sensory-scientists-and-marketing-researchers-their-role-in-the-product-innovation-process> ("[T]wo-time Pulitzer Prize winner Walter Lippman emphasizes the power of critical thinking through collaboration."); see also Jonah Lehrer, *Groupthink: The Brainstorming Myth*, NEW YORKER, Jan. 30, 2012, at 22, 23 (citing Ben Jones's study of peer-reviewed papers and patents over the past fifty years that shows that teaming has increased in over 95 percent of scientific fields). But see SEALE HARRIS, BANTING'S MIRACLE: THE STORY OF THE DISCOVERER OF INSULIN 98–103, 126–27 (1946) (discussing how 1923 Nobel Prize co-winners Frederick Banting and J.J.R. Macleod disputed who deserved the credit for discovering insulin).

6. See Lehrer, *supra* note 5 (citing Ben Jones's study explaining that the increase in collaboration is because "all the remaining problems are incredibly hard").

7. *Frontier Fables*, ECONOMIST, Sept. 10, 2011, at 97 (reviewing FUTURE SCIENCE: ESSAYS FROM THE CUTTING EDGE (Max Brockman ed., 2011)) ("Modern scientific papers can have dozens of specialised authors."); Susan Cain, Op-Ed., *The Rise of the New Groupthink*, N.Y. TIMES, Jan. 15, 2012, at SR1 ("[R]ecent studies suggest that influential academic work is increasingly conducted by teams rather than by individuals."); Lehrer, *supra* note 5, at 23 ("Today, regardless of whether researchers are studying particle physics or human genetics, science papers by multiple authors receive more than twice as many citations as those by individuals."); see also Lawrence H. Summers, *The 21st Century Education*, N.Y. TIMES, Jan. 22, 2012, at ED26 ("[T]he fraction of economics papers that are co-authored has more than doubled in the 30 years that I have been an economist.").

8. Consider the success of the Broad Institute, a cooperative effort between Harvard and MIT that funds experimental, fully collaborative research between scientists in different fields to come up with innovative solutions to problems in biology, genetics, and genomics. See Gina Kolata, *Power in Numbers*, N.Y. TIMES, Jan. 3, 2012, at D1 (attributing the success of Dr. Eric Lander and the Broad Institute to multidisciplinary collaboration and Dr. Eric Lander's multifaceted expertise in math, molecular biology, medicine, and genomics). Even the structure and form of MIT's Building 20 force scientists and researchers to comele. Lehrer, *supra* note 5, at 26–27.

9. See *infra* Part I.B. Diversity has many different definitions. In this Article, unless otherwise specified, "diversity" applies to both observable categories of human heterogeneity, including race, ethnicity, national origin, gender, age, physical appearance, social class, economic status, and disability, and nonobservable categories, including leadership and communication style, lifestyle, experience, expertise, beliefs, organizational

Although the attention may be new, the premise is not. Indeed, trans-disciplinary interaction is credited for the prolific creative era of the 1920s—when writers, poets, artists, and architects all met in cafes to connect, debate, and share ideas<sup>10</sup>—which gave us some of the most transcendent, timeless, art and literature in history.<sup>11</sup> Importantly, and perhaps counterintuitively, the power of diverse networks is not contingent on the strength of the ties; even weak ties or alliances with other disciplines add value.<sup>12</sup> Outside influence, no matter how limited, enhances innovation and problem solving.<sup>13</sup>

Yet, the rules regulating the U.S. legal profession foster a closed environment, one that discourages nonlawyer influence on lawyers and alliances between legal and non-legal professionals. In light of our growing understanding of other fields, it may be time to reexamine some of these rules and their underlying assumptions. The Model Rules of Professional Conduct, the bar licensing requirements, the application of the work-product doctrine and attorney-client privilege, and even the way law firms structure themselves consistently impede an open multi-disciplinary approach. Instead, they favor a closed environment and/or an exclusive one-on-one relationship between attorneys and their clients.<sup>14</sup> In some way or another, they support the notion that when lawyers work with nonlawyers, there are too many cooks in the kitchen.<sup>15</sup>

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affiliation, religion, and level of education. See Hong & Page, *supra* note 4, at 16,385 (“In the common understanding, diversity in a group of people refers to differences in their demographic characteristics, cultural identities and ethnicity, and training and expertise.”); Frances J. Milliken & Luis L. Martins, *Searching for Common Threads: Understanding the Multiple Effects of Diversity in Organizational Groups*, 21 ACAD. MGMT. REV. 402, 405 (1996) (emphasizing observable categories); Tony Simons & Lisa Hope Pelled, *Understanding Executive Diversity: More than Meets the Eye*, 22 HUM. RESOURCE PLAN., no. 2, 1999, at 49, 49–50 (emphasizing non-observable categories).

10. STEVEN JOHNSON, WHERE GOOD IDEAS COME FROM: THE NATURAL HISTORY OF INNOVATION 163 (2010).

11. See *infra* note 32 and accompanying text.

12. See *infra* Part I.C.

13. See *infra* Part I.D.

14. See *infra* Part II.

15. Legal education is also not collaborative. For many law students, law school involves attending traditional mono-discipline classes taught by one professor utilizing a Socratic or soft-Socratic method, with around 80–100 other students who are not nearly as diverse as the U.S. population generally. Students are rarely assigned team projects. Although students do join study groups, research on these groups indicates that students are not inclined to seek their peers’ opinions or engage in group work. See Dorothy H. Evensen, *To Group or Not to Group: Students’ Perceptions of Collaborative Learning Activities in Law School*, 28 S. ILL. U. L.J. 343, 366 (2004). Despite believing that “multiple perspectives” is an important factor in succeeding in law school, see *id.* at 404–05, students “persistently h[old] to notions of learning as an individual, idiosyncratic enterprise and appear[] disdainful or dismissive of pedagogical attempts to encourage group activity,” *id.* at 385.

On the one hand, this is not surprising given the rules regulating lawyers. On the other hand, it is. First, some of the biggest breakthroughs in how we think about the law in the past thirty years come from the “law and” movement—e.g., law and economics, law and society, etc. See, e.g., Francesco Parisi, *Multidisciplinary Perspectives in Legal Education*, 6 U. ST. THOMAS L.J. 347, 353 (2009). Second, law schools now seek to hire professors who, in addition to having J.D.s, also have degrees in another discipline. See Neil H.

This notion, and the rules and regulations supporting it, is driven in part by a belief in the benefits of a unique and confidential relationship between lawyer and client—possibly one of the most valuable things lawyers offer to clients.<sup>16</sup> It is also undeniably motivated by a legitimate desire to protect clients, the public, and the professionalism and integrity of the legal profession by ensuring lawyers' independent judgment.<sup>17</sup> However, as Bruce Green pointed out over ten years ago, "The premise of these rules is essentially that, when lawyers practice law, they must avoid the corrupting influence of nonlawyers (other than, of course, their own clients); clients are best served by lawyers who preserve their 'professional independence' by avoiding unholy alliances with the laity."<sup>18</sup> Further, as Green and others also claim, these protectionist notions are likely also driven by a desire to ensure that the legal profession maintains its monopoly over the legal marketplace.<sup>19</sup>

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Buchanan, *Why Interdisciplinary Legal Scholarship Is Good for the Law, the Academy, and Society at Large*, VERDICT (Jan. 19, 2012), <http://verdict.justia.com/2012/01/19/why-interdisciplinary-legal-scholarship-is-good-for-the-law-the-academy-and-society-at-large>.

Given that law schools have begun to rethink the value of interdisciplinary scholarship, perhaps change is on the horizon for legal education. See, e.g., Parisi, *supra*, at 348. Indeed, legal education programs have developed over the past ten years that focus on learning team skills and that are designed to break down the barriers between law and other disciplines. See, e.g., B614 *The Legal Profession*, IND. U. MAURER SCH. L., <http://apps.law.indiana.edu/degrees/courses/lookup.asp?course=30> (last visited Apr. 21, 2012); LAWWITHOUTWALLS, <http://lawwithoutwalls.org> (last visited Apr. 21, 2012); *Leipzig-Miami Seminar*, U. MIAMI SCH. L., [http://www.law.miami.edu/about\\_us/leipzig\\_seminar.php?op=6](http://www.law.miami.edu/about_us/leipzig_seminar.php?op=6) (last visited Apr. 21, 2012); *Ph.D Program (JSP)*, BERKELEY L., <http://www.law.berkeley.edu/160.htm> (last visited Apr. 21, 2012); *Problem Solving Workshop 5*, HARV. L. SCH., <http://www.law.harvard.edu/academics/curriculum/catalog/index.html?o=14956> (last visited Apr. 21, 2012).

16. See, e.g., Anthony J. Sebok, *The Inauthentic Claim*, 64 VAND. L. REV. 61, 135 (2011); see also *MNC Credit Corp. v. Sickels*, 497 S.E.2d 331, 333–34 (Va. 1998) (basing its decision that legal malpractice claims were not assignable on the special relationship between the attorney and client); Sebok, *supra*, at 67 & n.24 (similar).

17. See Bruce A. Green, *The Disciplinary Restrictions on Multidisciplinary Practice: Their Derivation, Their Development, and Some Implications for the Core Values Debate*, 84 MINN. L. REV. 1115, 1128–32 (2000) (exploring the justifications for New York's ethical ban on advertising and statutory ban on corporations practicing law, and explaining that "[t]here was more than a hint about the need to preserve the practice of law as a profession"); *id.* at 1139–40 (recalling the opinion of one committee member that "there is nothing inherently 'unethical' in the formation of partnerships between lawyers largely engaged in certain kinds of work and an expert" but that rules banning it were necessary "[a]s a matter of professional policy" (alteration in original) (quoting *Proposed Supplements to Canon of Professional Ethics*, 13 A.B.A. J. 268, 273 (1927))); see also JULIUS HENRY COHEN, *THE LAW: BUSINESS OR PROFESSION?* (rev. ed. 1924); Russell G. Pearce, *The Professionalism Paradigm Shift: Why Discarding Professional Ideology Will Improve the Conduct and Reputation of the Bar*, 70 N.Y.U. L. REV. 1229, 1259 (1995) (identifying business professionalism regulations, adopted by the ABA and Ethics and Professional Responsibility Committee, intended "to protect clients and to encourage lawyers to perform [these practices] in a 'professional' manner").

18. Green, *supra* note 17, at 1117.

19. See *infra* Part II.A; see also Green, *supra* note 17, at 1118 (contending that the "actual motivation" of the existing rules is to "thwart competition" and demonstrating this is so by tracing the history behind the rules); *id.* at 1131–33 (explaining that the primary motivating factor was to keep a monopoly and increase profits, but the "justification" was to protect clients from lawyers that would be corrupted by lay people's influence); *id.* at 1135

Ironically, these strategic protectionist maneuvers may be misguided and counterproductive. First, they do not represent the way many U.S. lawyers actually practice. Second, in an economic downturn, where the line between what is business and what is law is anything but clear, such tactics may limit lawyers' range of business opportunities. Instead of protecting lawyers' economic futures, it may provide the impetus for nonlawyers, who want a piece of the lawyers' pie, to innovate.<sup>20</sup> Indeed, we have already seen this taking place with legal process outsourcing, where nonlawyers (and ex-lawyers) form multidisciplinary teams to provide quasi-legal or extra-legal services inside and outside the United States, in an effort to achieve better, more efficient results.<sup>21</sup> Third, in a globalized legal market, other countries like the United Kingdom and Australia have embraced nonlawyer influence and alliances with lawyers through outside investment in law firms and claims. As lawyers from these countries compete with those in the United States, it is possible that U.S. lawyers soon will be—or perhaps already are—left behind by those who are answering the needs of large corporate clients by providing trans-disciplinary “soup.”

The broad thesis of this Article is that an environment that fosters input from nonlawyers is better than a closed one, and that the time has come to rethink the U.S. legal profession's rules and structures that were designed to narrow exposure to, and influence by, nonlawyers. To illustrate this contention, this Article highlights one recent movement in the globalized legal marketplace that remains stymied in the United States: nonlawyer

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(explaining that bar leaders admitted that their motivation in preventing corporations from practicing law was “primarily to protect lawyers' livelihood”); *id.* at 1145 (“[T]he core values rationale is a belated explanation for restrictions that, at their inception, were transparently motivated by the financial self-interest of the bar's leadership.”); *infra* note 119 (identifying authors who criticize unauthorized-practice-of-law rules as protecting the legal monopoly). Some might argue it is driven by a desire to cabin off the legal marketplace from capital markets or to resist the idea that there is a legal market. Proving the reasons behind the rules is outside the scope of this Article, but understanding their motivation is worthy of more discussion.

20. It is not that the rules, in and of themselves, make this more likely, but that they impede structures utilizing teams of lawyers and nonlawyers that could best perform the work.

21. Legal process outsourcing companies perform not only the repetitive administrative functions associated with legal work and paralegal work, but also the complex work involved in legal research, due diligence, contract negotiations, etc. *See, e.g.*, Milton C. Regan, Jr. & Palmer T. Heenan, *Supply Chains and Porous Boundaries: The Disaggregation of Legal Services*, 78 *FORDHAM L. REV.* 2137, 2139–40 (2010); Jayanth K. Krishnan, *Outsourcing and the Globalizing Legal Profession*, 48 *WM. & MARY L. REV.* 2189, 2201–04 (2007); Laura MacIntyre, *Outsourcing Out in the Open*, *HC ONLINE* (Apr. 8, 2009), <http://www.hcamag.com/resources/Outsourcing/outsourcing-out-in-the-open/115396>. These outsourcing companies were originally offshore in places like India, where costs savings could be realized. However, legal outsourcing firms are emerging in various parts of the United States as well. *See* Steve Mark, Tahlia Gordon, Marlene Le Brun, & Gary Tamsitt, *Preserving the Ethics and Integrity of the Legal Profession in an Evolving Market: A Comparative Regulatory Response* 11 (June 3, 2010) (unpublished manuscript), available at [http://www.lawlink.nsw.gov.au/lawlink/olsc/ll\\_olsc.nsf/vwFiles/UK\\_paper.doc/\\$file/UK\\_paper.doc](http://www.lawlink.nsw.gov.au/lawlink/olsc/ll_olsc.nsf/vwFiles/UK_paper.doc/$file/UK_paper.doc). *See generally* Laurel S. Terry, *The Legal World Is Flat: Globalization and Its Effect on Lawyers Practicing in Non-global Law Firms*, 28 *NW. J. INT'L L. & BUS.* 527 (2008) (demonstrating that globalization is relevant to all lawyers).

investment in claims i.e., claim funding.<sup>22</sup> The current rules and regulations governing nonlawyer investment in claims epitomize the U.S. legal profession's stance on collaboration between lawyers and nonlawyers.<sup>23</sup> Many states completely outlaw claim funding by nonlawyers based on outdated and arguably inaccurate interpretations of the ancient doctrines of maintenance, interfering in a legal proceeding by a third party that is not a party to the suit; champerty, maintenance for a profit; and barratry, inciting litigation.<sup>24</sup> Although some states have abolished these antiquated barriers to claim funding, many states make approval contingent on the third-party funder having absolutely no control, input, or influence over litigation decisions and case management—a rule that, as a practical matter, is unrealistic.<sup>25</sup>

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22. The nomenclature to describe this kind of third-party capital investment in arbitration or litigation claims is all over the map and woefully unresponsive. It has been referred to as “third-party funding,” “third-party litigation funding or financing,” or most commonly “alternative litigation funding or financing.” See, e.g., ABA Comm’n on Ethics 20/20, White Paper on Alternative Litigation Finance 1 & nn.1–4 (draft Oct. 19, 2011) [hereinafter ABA White Paper], available at [http://www.americanbar.org/content/dam/aba/administrative/ethics\\_2020/20111019\\_draft\\_alf\\_white\\_paper\\_posting.authcheckdam.pdf](http://www.americanbar.org/content/dam/aba/administrative/ethics_2020/20111019_draft_alf_white_paper_posting.authcheckdam.pdf) (listing articles using various terms). The term “third-party” is insufficiently descriptive because, as the U.S. Chamber Institute for Legal Reform (ILR) has pointed out, third parties provide many types of litigation funding, some of which have been around for years: nonrecourse loans to both law firms and clients, insurer-insured agreements, transfer of claims in bankruptcy proceedings, transfers of patent claims, and contingency fees. See Letter from John H. Beisner, Skadden, Arps, Slate, Meagher & Flom LLP, to ABA Comm’n on Ethics 20/20, at 2 (Feb. 15, 2011) [hereinafter Beisner Letter], in ABA Comm’n on Ethics 20/20, Comments: Alternative Litigation Financing Working Group Issues Paper 136 (2011), available at [http://www.americanbar.org/content/dam/aba/migrated/2011\\_build/ethics\\_2020/comments\\_on\\_alternative\\_litigation\\_financing\\_issues\\_paper.pdf](http://www.americanbar.org/content/dam/aba/migrated/2011_build/ethics_2020/comments_on_alternative_litigation_financing_issues_paper.pdf); see also *id.* at 1 (“ILR is a not-for-profit advocacy organization affiliated with the United States Chamber of Commerce . . .”). “Alternative” is more apt, but, as discussed later, it is not clear that this funding method differs from methods that have been available for decades. See *infra* Part IV.A. Further, the term “litigation” is underinclusive, as this kind of activity funds many kinds of claims at various stages, including arbitration and collection of judgment. Finally, the term “financing” may suggest many different types of transactions, including loans repayable with interest at a fixed rate, whereas the actual practice is more like a contingency fee, in which capital is exchanged for the promise to repay the principal plus a percentage of the profit only if the claimholder prevails. “Funding” is a more accurate term since it suggests ownership and control over the decisions to fund. Thus, this Article uses the terms “claim funding” or “outside investment in claims.”

23. Arguably, the same can be said about the ABA’s current stance on nonlawyer investment in law firms and multidisciplinary partnerships, both of which are barred by Model Rule 5.4. See MODEL RULES OF PROF’L CONDUCT R. 5.4 (2009).

24. See *In re Primus*, 436 U.S. 412, 424 n.15 (1978) (“[M]aintenance is helping another prosecute a suit; champerty is maintaining a suit in return for a financial interest in the outcome; and barratry is a continuing practice of maintenance or champerty.”); see *infra* notes 187–89 and accompanying text.

25. Vicki Waye, *Conflicts of Interests Between Claimholders, Lawyers and Litigation Entrepreneurs*, 19 BOND L. REV. 225, 237 n.56 (2007) (Austl.) (“Even though most litigation funders do not appoint the client’s legal advisers and representatives, they are likely to be influential in the client’s decision making. Some funders work with preferred firms partly to minimise conflicts and disputes over claim management.”).

This Article starts with the premise that law is a business, and thus the legal market cannot be insulated from capital markets.<sup>26</sup> Because what happens in other parts of the world invariably affects what happens in the United States,<sup>27</sup> there will be strong pressure for the United States to allow investment in claims in all fifty states, and to a greater degree than currently allowed. Although the bar may be able to resist buy-in for some unpredictable but possibly significant period of time, this Article contends that lawyers and clients will potentially benefit if the U.S. bar embraces claim funding in the commercial context and implements a regulatory system to maximize its advantages and minimize its potential risks. Further, this Article utilizes the example of claim funding to show that granting nonlawyers more influence could stimulate much needed innovation in the provision and management of legal services, enhance problem solving and efficiency for the benefit of clients and society, and increase lawyer's ability to compete in a global marketplace. Instead of equating outside influence by nonlawyers with having "too many cooks in the kitchen," the U.S. legal profession could take advantage of a regulated level of influence to help create the richest stone soup possible.

Part I of this Article describes the benefits that come from open environments. It reviews literature from other fields that show that open and diverse environments yield more innovation and better problem solving and decision making. Part II reviews the many rules, doctrines, and structures affecting the U.S. legal profession that encourage or require lawyers and clients to work in closed environments. By utilizing claim funding as an example, Part III shows how the legal marketplace in other countries has opened itself up to outside influence more than has the marketplace in the United States. Part IV assesses the risks and benefits of influence by nonlawyers in the commercial claim funding context. It argues that, with the right level of regulation, and when the agreement is between the corporate claimholder and the funder, the inherent benefits outweigh the risks. Further, it contends that embracing commercial claim funding may lead to innovation, better case management, and enhanced problem solving, and that rejecting such investment may be a recipe for trouble. Ultimately, this Article concludes that the legal profession's continued attachment to rules and structures that compel closed environments and severely restrict the influence of nonlawyers on lawyers (at least in the commercial context) may leave the U.S. legal profession woefully behind other countries, and U.S. lawyers with a smaller piece of the pie.

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26. This is evidenced by the number of companies that have begun to take advantage of the increasingly fragmented legal market to offer what used to be deemed legal services, such as LegalZoom, *see* LEGALZOOM, <http://www.legalzoom.com> (last visited Apr. 21, 2012), and the acceptance of outside investment in law firms and claims outside the United States, *see infra* Part III. Furthermore, claiming that law is an industry (with over \$1 billion in gross revenues) and that it has a market (or multiple markets) is not novel. *See generally* ERIN O'HARA & LARRY E. RIBSTEIN, *THE LAW MARKET* (2009).

27. *See* Laurel S. Terry, *A "How To" Guide for Incorporating Global and Comparative Perspectives into the Required Professional Responsibility Course*, 51 ST. LOUIS U. L.J. 1135, 1136-38 (2007).



## I. THE BENEFIT OF OPEN ENVIRONMENTS

"A world where a diverse mix of distinct professions and passions overlap is a world where exaptations thrive."<sup>28</sup>

Recent scientific inquiry into the creative process has revealed that most inventions are neither spontaneous nor created from scratch, but are rather pre-existing ideas applied in new contexts. They primarily result from fostering diverse connections among a broad spectrum of people and professions. In light of this kind of research, many corporations, and even some overseas law firms, have taken steps to create open environments. So far, the U.S. legal profession, at least with respect to its rules and structures generally has not. This part summarizes some of the benefits that U.S. lawyers may be sacrificing in favor of excluding nonlawyer influence.

*A. Third Places and Exaptations*

A "third place," according to the sociologist and anthropologist Ray Oldenburg, is an environment that enables connections among people from different disciplines and is set apart from traditional meeting places like the home or office.<sup>29</sup> Third places flourish because they create open and eclectic environments where people can share the camaraderie of those with a zest for life and engagement, albeit in different disciplines.<sup>30</sup> Sigmund Freud created a third place in Vienna for physicians, philosophers, and scientists to share thoughts on psychoanalysis.<sup>31</sup> Similarly, in the 1920s, writers, poets, artists, and architects met in cafés to connect, debate, and share ideas. According to scholars, it was "rubbing shoulders" with these different types of people that created the "cultural innovation" for which the 1920s are known.<sup>32</sup> Today, that third place might be virtual.<sup>33</sup> So long as the space or place promotes creative interaction among people from

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28. JOHNSON, *supra* note 10, at 162; *see infra* notes 39–44 and accompanying text (explaining exaptation).

29. RAY OLDENBURG, *THE GREAT GOOD PLACE: CAFÉS, COFFEE SHOPS, COMMUNITY CENTERS, BEAUTY PARLORS, GENERAL STORES, BARS, HANGOUTS AND HOW THEY GET YOU THROUGH THE DAY* 20–22 (1989). According to Oldenburg, their virtue is not that they are a "haven of escape from home and work." *Id.* at 21. Rather, their virtue rests on the following: first, they are on "neutral ground," *id.* at 22–23; second, they are inclusive despite differences in background or status and therefore "a leveler," *id.* at 23–26; third, the main activity is "lively flow[ing]" conversation, *id.* at 26–31; fourth, they are places that are very accessible in terms of location and will accommodate individuals or groups during any hour of the day, *id.* at 32–33; fifth, they are filled with "regulars whose mood and manner provide the infectious and contagious style of interaction and whose acceptance of new faces is crucial," *id.* at 33–36; and sixth, they are places that have a certain "low profile," "playful" feeling, "a home away from home," *id.* at 36–41.

30. *See* JOHNSON, *supra* note 10, at 162–63; OLDENBURG, *supra* note 29, at 42. For a modern example of a third place, *see* TECH BREWERY, <http://www.techbrewery.org> (last visited Apr. 21, 2012).

31. *See* JOHNSON, *supra* note 10, at 162–63.

32. *Id.* at 163.

33. An example of a virtual third place could be LawWithoutWalls (a venture founded by the author and co-created with Michael Bossone), where professionals and students from different disciplines collaborate and share information and expertise to create "Projects of Worth." *See* LAWWITHOUTWALLS, *supra* note 15.

different disciplines, backgrounds, and political views, with various types and levels of expertise and passions, there will be “value . . . in the unlikely migrations that happen between the different clusters.”<sup>34</sup>

These “unlikely migrations” spawn innovation. According to Steven Johnson, “Concepts from one domain migrate to another as a kind of structuring metaphor, thereby unlocking some secret door that had long been hidden from view.”<sup>35</sup> The common conception is that inventions are discovered by a scientist, alone in a lab, coming upon the “a-ha” or “eureka” moment, but that is often not the case.<sup>36</sup> Instead, it is the interactions that scientists have with others that lead to breakthroughs.<sup>37</sup> As one scientist explains, “the results of one person’s reasoning bec[o]me the input to another person’s reasoning . . . resulting in significant changes in all aspects of the way the research [is] conducted.”<sup>38</sup> The changes also ultimately alter the end result. In other words, it is the meeting of the minds that enables the migration. And that migration, or exaptation, is the pearl of the oyster.

Exaptation (as opposed to adaptation) occurs when something is borrowed from one field and used to solve a problem in a totally unrelated field.<sup>39</sup> A famous exaptation is Johannes Gutenberg’s printing press. Each

34. JOHNSON, *supra* note 10, at 162–63; OLDENBURG, *supra* note 29, at 290 (“The individual is warmed and enriched by the breadth of these relationships. The fragmented world becomes more whole and the broader contact with life, thus gained, adds to one’s wisdom and self-assurance. . . . Individuals benefit despite themselves.”); *id.* at 291 (“Consensus, if we are to call it that, follows interaction and involvement more often than it precedes it. Individuals, like neighborhoods, evolve and develop. When people are thrown together, they discover much to like, to get attached to, to add to their lives, and to change their minds about.”).

35. JOHNSON, *supra* note 10, at 159 (citing ARTHUR KOESTLER, *THE ACT OF CREATION* (1964)).

36. *See id.* at 60–61.

37. *See id.* at 61; *see also id.* ch. 3 (describing examples of “slow hunch” innovation); Jonah Lehrer, *How to Be Creative*, WALL ST. J., Mar. 10–11, 2012, at C1 (“We tend to assume that experts are the creative geniuses in their own fields. But big breakthroughs often depend on the naive daring of outsiders. For prompting creativity, few things are as important as time devoted to cross-pollination with fields outside our areas of expertise.”).

38. *See* JOHNSON, *supra* note 10, at 61 (quoting psychologist Kevin Dunbar’s research); *see also* Sarah Greene, Editorial, *Innovations ‘R Us: Networks Move Scientific Discovery Forward at the Speed of Light*, SCIENTIST, Dec. 2010, at 13 (discussing Kevin Dunbar’s research into how scientists formulate important ideas and concluding that the “wide majority of breakthrough concepts originated not in solitary moments at the lab bench, but rather at weekly lab meetings when scientists shared data, findings, errors, and conflicting results”); *supra* note 8 and accompanying text; *infra* note 46 and accompanying text.

39. The term “exaptation” was originally coined by evolutionary biologists Stephen Jay Gould and Elizabeth S. Vrba to describe a change in the biology of a species that was different than adaptation. *See* Stephen Jay Gould & Elizabeth S. Vrba, *Exaptation—A Missing Term in the Science of Form*, 8 PALEOBIOLOGY 4–15 (1982). The term “adaptation” is restricted “only to those structures that evolved for their current utility,” whereas “exaptation” is for “those useful structures that arose for other reasons or for no conventional reasons at all, and were then fortuitously available for other usages.” STEPHEN JAY GOULD, HEN’S TEETH AND HORSE’S TOES 171 (1983); *see* Nicholas Dew et al., *The Economic Implications of Exaptation* 3 (Darden Graduate Sch. of Bus. Admin., Working Paper No. 02-08, 2002), available at [http://ssrn.com/abstract\\_id=348060](http://ssrn.com/abstract_id=348060) (defining exaptation as “a feature co-opted for its present role from some other origin”); Roger Lass, *How to Do Things with*

of the key pieces of the printing press had been developed long before Gutenberg put them together, but no one had been able to create a movable type system. Gutenberg's genius was in borrowing the pieces—some from the mechanics of a screw press used to make wine—and putting them together in a new way.<sup>40</sup> According to Arthur Koestler, “All decisive advances in the history of scientific thought can be described in terms of mental cross-fertilization between different disciplines.”<sup>41</sup> Indeed, the idea that cross-fertilization—as opposed to self-fertilization—is the key to success was one of Charles Darwin's main points in his writings.<sup>42</sup> As shown in his research on orchids, evolution can occur from very limited raw material.<sup>43</sup> In other words, innovation often comes from “refurbished” parts as opposed to newfangled creation.<sup>44</sup>

The same principle applies to business. In his study of business school graduates who had become entrepreneurs, Stanford Business School

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*Junk: Exaptation in Language Evolution*, 26 J. LINGUISTICS 79, 80 (1990). Gould and Vrba suggested that the term “exaptation” included those characteristics that “evolved for other usages (or for no function at all), and later [were] ‘coopted’ for their current role.” Gould & Vrba, *supra*, at 6. In other words, as Johnson explains, exaptation is when “[a]n organism develops a trait optimized for a specific use, but then the trait gets hijacked for a completely different function.” JOHNSON, *supra* note 10, at 153–54.

An archetypal example of an exaptation is bird feathers. *Id.* at 154. Originally, feathers were on creatures to keep them warm, not to help them fly—and indeed, these creatures did not fly. However, as these creatures began trying to fly, these feathers ended up being accidentally useful to help the creatures glide. *Id.* at 154 (describing “[t]he initial transformation [as] almost accidental”). Over time, as “that new property gets put to use, . . . the trait evolves according to a different set of criteria” and “mutations” that enable better gliding (as opposed to just warmth) now begin to repeat themselves due to natural selection. *Id.* at 154. “A feather *adapted* for warmth is now *exapted* for flight.” *Id.* at 155.

Exaptation has also been used to described technical innovations. For example, the compact disc has been identified as “a classic example . . . that illustrates both the processes of adaptation and exaptation.” Dew et al., *supra*, at 8 (explaining how the CD-ROM was patented “as a digital-to-optical recording and playback system,” but researchers used it as “a data storage medium for computers” to record their data, “a function [it] was *not* designed for”).

40. JOHNSON, *supra* note 10, at 152–53 (“[Gutenberg] took a machine designed to get people drunk and turned it into an engine for mass communication.”). Scholars have pointed out that essential to exaptation is the combining of a “new domain of use.” Dew et al., *supra* note 39, at 9 (explaining that exaptation “thrives on . . . technology-domain combinations, not on technology-technology combinations” and “the combination of technology and new domain of use is ‘a quintessential entrepreneurial activity’” (citing Daniel A. Levinthal, *The Slow Pace of Rapid Technological Change: Gradualism and Punctuation in Technological Change*, 7 INDUS. & CORP. CHANGE 217, 220 (1998))). For more examples of exaptations that developed in this way, see JULIE BURSTEIN, SPARK: HOW CREATIVITY WORKS 30–36 (2011) (ordinary noise to sound effects for the movies *Star Wars* and *Wall-E*); JOHNSON, *supra* note 10, at 158–59 (plaster sculptures to DNA replication, and computer code for sharing academic research to the modern, seemingly endless uses of the internet); Dew et al., *supra* note 39, at 12, 16–19 (innovations that saved Apollo 13 crew, tractor design, and continuous exaptations in Japanese car industry).

41. KOESTLER, *supra* note 35, at 230; see also JOHNSON, *supra* note 10, at 159.

42. See STEPHEN JAY GOULD, THE PANDA'S THUMB: MORE REFLECTIONS IN NATURAL HISTORY 19–20 (1980).

43. See *id.* (citing CHARLES DARWIN, ON THE VARIOUS CONTRIVANCES BY WHICH BRITISH AND FOREIGN ORCHIDS ARE FERTILIZED BY INSECTS (1862)).

44. *Id.* at 26.

Professor Martin Ruef found that the most innovative and successful entrepreneurs were those who had broad and diverse social networks.<sup>45</sup> According to others interpreting his data, these entrepreneurs were successful, in part, because they “were able to borrow or co-opt new ideas from these external environments and put them to use in a new context.”<sup>46</sup> Studies on collaboration in the workplace arrive at similar conclusions.<sup>47</sup> Thus unsurprisingly, successful and innovative companies are taking a “kaizen”-like approach,<sup>48</sup> moving away from closed groups toward collaborative networks that increase information flow between diverse groups inside and outside the company<sup>49</sup> to create innovative and profitable products.<sup>50</sup>

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45. Martin Ruef, *Strong Ties, Weak Ties and Islands: Structural and Cultural Predictors of Organizational Innovation*, 11 INDUS. & CORP. CHANGE 427, 429 (2002) (“[T]he propensity of individual entrepreneurs to break with convention is *both* encouraged by social relations—which may bring disparate ideas, routine or technologies to an entrepreneur’s attention—and discouraged by social relations—which may introduce pressures for conformity or concerns about trust.”); see ROB CROSS & ANDREW PARKER, *THE HIDDEN POWER OF SOCIAL NETWORKS: UNDERSTANDING HOW WORK REALLY GETS DONE IN ORGANIZATIONS* 81–83 (2004) (“Research has shown that people with more diverse, entrepreneurial networks tend to be more successful”).

46. JOHNSON, *supra* note 10, at 166; *id.* at 166–67 (describing a similar study by a professor who studied innovation at Raytheon Corporation and found that “innovative thinking was much more likely to emerge from individuals who bridged ‘structural holes’ between tightly knit clusters”); Bruce Kogut & Udo Zander, *Knowledge of the Firm, Combinative Capabilities, and the Replication of Technology*, 3 ORG. SCI. 383, 391 (1992) (“Creating new knowledge does not occur in abstraction from current abilities. Rather, new learning, such as innovations, are products of a firm’s *combinative capabilities* to generate new applications from existing knowledge.”); see also Dew et al., *supra* note 39, at 26 (“[N]ew markets develop as the result of the application of an existing technology to a new domain of use . . . . When an entrepreneur flips a technology into an adjacent possible market this is truly an exaptation of the technology, not an adaptation.”).

47. See, e.g., CROSS & PARKER, *supra* note 45, at 120 (“[Companies] report that focusing on collaborative opportunities instead of on individual accountability improves problem solving, employee morale, and network connectivity.”). There is also research that suggests that the most creative people are often introverts, who may be more creative when they work in private without interruption. See, e.g., KEITH SAWYER, *GROUP GENIUS: THE CREATIVE POWER OF COLLABORATION* 60 (2007); Cain, *supra* note 7 (“[E]vidence from science suggests that business people must be insane to use brainstorming groups. . . . If you have talented and motivated people, they should be encouraged to work alone when creativity or efficiency is the highest priority.” (quoting the organizational psychologist Adrian Furnham)). This critique does not hold true when there is diversity of viewpoint and debate, however. See *infra* note 70 and accompanying text.

48. See Roya Behnia, *‘Legal Kaizens’ and Getting Lawyers to Solve Simple Problems Together*, LEGAL REBELS (Nov. 2, 2011, 8:15 AM), [http://www.abajournal.com/legalrebels/article/getting\\_lawyers\\_to\\_solve\\_simple\\_problems\\_together/?utm\\_source=maestro&utm\\_medium=email&utm\\_campaign=weekly\\_email](http://www.abajournal.com/legalrebels/article/getting_lawyers_to_solve_simple_problems_together/?utm_source=maestro&utm_medium=email&utm_campaign=weekly_email) (explaining that the Japanese word “kaizen,” “[r]oughly translated as ‘improvement for the better,’” is a collaboration method that “get[s] employees to solve simple problems together”); see also Lehrer, *supra* note 37 (“Google hosts an internal conference called Crazy Search Ideas—a sort of grown-up science fair with hundreds of posters from every conceivable field.”).

49. CROSS & PARKER, *supra* note 45, at 39.

50. See JOHNSON, *supra* note 10, at 170–71 (“Apple’s development cycle looks more like a coffeehouse than an assembly line. . . . Apple calls it concurrent or parallel production. All the groups—design, manufacturing, engineering, sales—meet continuously through the product-development cycle, brainstorming, trading ideas and solutions,

Exaptation is the door to productivity and new creation, but because exaptation is the result of exposure to ideas outside the immediate focus of interest, broad diverse connections and networks are the key that opens that door.

### B. Diversity

Unlikely migrations and exaptations occur because different types of people cluster together and converse. Third places enable improved creations because they are open environments that unite people of different disciplines and backgrounds. Similarly, institutions made up of diverse types of people gain positive benefits, improve output, and enhance problem solving. While it may be true that diversity can create conflict,<sup>51</sup> impede communication,<sup>52</sup> and stymie consensus,<sup>53</sup> there is also evidence

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strategizing over the most pressing issues, and generally keeping the conversation open to a diverse group of perspectives.”); Rosabeth Moss Kanter, *When a Thousand Flowers Bloom: Structural, Collective, and Social Conditions for Innovation in Organization*, in 10 RESEARCH IN ORGANIZATIONAL BEHAVIOR 169, 175–77 (Barry M. Staw & L.L. Cummings eds., 1988) (claiming that diversity in resource input is necessary for innovation); Behnia, *supra* note 48 (explaining the theory behind “Kaizen” and how both Pfizer and Cisco have utilized this approach to create more efficient and creative solutions to problems and to more effectively market, and pointing out that Cisco System has created a dialogue not just internally and with customers, but with “anyone interested in [the related] issues”). That said, according to exaptation scholars, there is

some affinity between the concept of exaptation and the concept of *externalities*, which are generally defined as “The effect of one person’s decision on someone who is not a party to that decision.” The difference . . . is that exaptation is a phenomenon that is related to context changes that happen over time, and is not amenable to analysis at a point in time. Exaptations are the effect of technologies that are *later* co-opted for their usefulness. By contrast, externalities are not rooted in changes in context.

Dew et al., *supra* note 39, at 9 (quoting R.H. COASE, *THE FIRM, THE MARKET, AND THE LAW* (1988)).

51. See Carsten K.W. De Dreu & Laurie R. Weingart, *Task Versus Relationship Conflict, Team Performance, and Team Member Satisfaction: A Meta-Analysis*, 88 J. APPLIED PSYCHOL. 741, 741, 746–47 (2003); Jeffrey Pfeffer, *Organizational Demography*, in 5 RESEARCH IN ORGANIZATIONAL BEHAVIOR, *supra* note 50, at 299, 299–357 (Barry M. Staw & L.L. Cummings eds., 1983) (arguing that organizational heterogeneity created conflict that was difficult to resolve); Warren E. Watson et al., *Cultural Diversity’s Impact on Interaction Process and Performance: Comparing Homogeneous and Diverse Task Groups*, 36 ACAD. MGMT. J. 590, 596–98 (1993) (finding that newly formed culturally diverse groups were less process and performance effective than homogeneous groups, i.e., they had “more difficulty in agreeing on what was important and in working together, and they more frequently had members who tried to be too controlling, which hindered member contributions”).

52. See Martha L. Maznevski, *Understanding Our Differences: Performance in Decision-Making Groups with Diverse Members*, 47 HUM. REL. 531, 536 (1994); W. Gary Wagner et al., *Organizational Demography and Turnover in Top-Management Groups*, 29 ADMIN. SCI. Q. 74, 88–89 (1984) (concluding that heterogeneity can create dysfunction and miscommunication that impede progress); Todd R. Zenger & Barbara S. Lawrence, *Organizational Demography: The Differential Effects of Age and Tenure Distributions on Technical Communication*, 32 ACAD. MGMT. J. 353, 353–76 (1989).

53. See Susan E. Jackson, *Team Composition in Organizational Settings: Issues in Managing an Increasingly Diverse Work Force*, in GROUP PROCESS AND PRODUCTIVITY 138, 150–52, 166–67 (Stephen Worchel et al. eds., 1992); Bruce E. McCain et al., *The Effects of Departmental Demography on Turnover: The Case of a University*, 26 ACAD. MGMT. J. 626,

that diverse teams generate “greater innovation, increased productivity, and a competitive advantage in global competition.”<sup>54</sup>

We constantly read articles or hear people claim that there is a power of diversity in decision making. For example, senior in-house attorneys insist on diverse teams from their outsourcers.<sup>55</sup> Senior managers also insist on diverse teams internally.<sup>56</sup> This is because, as a senior legal counselor of a large, publicly traded corporation contended, “combining a broad range of backgrounds and experiences—in our outside counsel, in our in-house legal team and in our greater work force—leads to the development of creative strategies and sophisticated ideas.”<sup>57</sup>

Moreover, empirical research has shown that diversity’s negative repercussions are surmountable.<sup>58</sup> Specifically, diversity has a positive

628–29 (1983); *see also* Maringe et al., *supra* note 4, at 32 (“However, diverse decision making groups have also been associated with negative outcomes such as increased conflict, inadequate communication and increased marginalization of minority groups.”).

54. Susan E. Jackson et al., *Understanding the Dynamics of Diversity in Decision-Making Teams*, in RICHARD A. GUZZO, EDUARDO SALAS, & ASSOCS., TEAM EFFECTIVENESS AND DECISION MAKING IN ORGANIZATIONS 204, 214 (1995); Ruef, *supra* note 45, at 433 (hypothesizing that “[a]ctors embedded in a diverse set of network ties are more likely to be innovative than actors relying on homogenous ties”).

55. In October 2004, Sara Lee’s general counsel Rick Palmore issued a “call to action” to advance diversity in corporate legal departments and law firms. *See* Rick Palmore, *A Call to Action: Diversity in the Legal Profession*, ASS’N CORP. COUNS. (Oct. 2004), available at <http://www.acc.com/vl/public/Article/loader.cfm?csModule=security/getfile&pageid=16074>; *see also* Melanie Lasoff Levs, *Call to Action: Sara Lee’s General Counsel: Making Diversity a Priority*, DIVERSITY & B. (Jan.–Feb. 2005), <http://www.mcca.com/index.cfm?fuseaction=page.viewpage&pageid=803>. By December 2004, over seventy companies’ general counsels had signed it, and both the Association of Corporate Counsel and the Minority Corporate Counsel Association formally endorsed it and developed a supporting website. *Id.*; *see* CLOCALTOACTION WEB DIRECTORY, <http://www.clocaltoaction.com> (last visited Apr. 21, 2012); *see also* Kellie Schmitt, *Corporate Diversity Demands Put Pressure on Outside Counsel*, RECORDER (Dec. 28, 2006), <http://www.law.com/jsp/cc/PubArticleCC.jsp?id=1167214010196> (archived in LexisNexis “Corporate Counsel” database) (describing companies pressuring law firms for greater diversity); Aruna Viswanatha, *On Diversity, It’s Shape Up, or Ship Out*, CORP. COUNSEL (Jan. 9, 2007), <http://www.law.com/jsp/llf/PubArticleLLF.jsp?id=1168263431142> (archived in LexisNexis “Corporate Counsel” database) (same). One of the companies to sign on to this agenda was Wal-Mart, and they continue to ask their outsourcers to commit to diversity. *See* Levs, *supra*; Press Release, Walmart, Wal-Mart Requires Diversity in its Law Firms: Commitment to Participation Already Making an Impact (Dec. 9, 2005), <http://walmartstores.com/pressroom/news/5519.aspx>. For further discussion on Walmart’s requirements for outside counsel, *see* Christopher J. Whelan & Neta Ziv, *Privatizing Professionalism: Client Control of Lawyers’ Ethics*, 80 FORDHAM L. REV. 2577 (2012).

56. *See* Jackson et al., *supra* note 54, at 208 (“Organizations are rapidly restructuring to take advantage of the potential benefits of diverse decision-making teams . . .”).

57. Flor M. Colon, *Better Decision Making Through Diversity*, DIVERSITY IS NATURAL (Summer 2009), <http://www.diversityisnatural.com/colon/> (noting that, at the time, Colon was senior managing counsel for Xerox’s Latin American operations).

58. *See* Hong & Page, *supra* note 4, at 16,389 (“An ideal [problem-solving] group would contain high-ability problem solvers who are diverse.”); Samuel R. Sommers, *On Racial Diversity and Group Decision Making: Identifying Multiple Effects of Racial Composition on Jury Deliberations*, 90 J. PERSONALITY & SOC. PSYCHOL. 597, 598 (2006) (“In other words, to the extent that a group can weather the initial conflict that diversity sometimes creates—or even use that conflict to its advantage—diversity often has observable benefits for group performance and problem solving.”); *see also* Shelley Brickson, *The Impact of*

impact on accuracy, flexibility, group creativity, thoughtfulness, and information sharing.<sup>59</sup> Empirical research on racial diversity evidences that group discussion and thinking by college students is more complex among diverse groups than among all-white groups.<sup>60</sup> Similarly, research on jury deliberations has suggested that racially heterogeneous juries exchange a broader range of information, process that information more methodically and thoroughly, make fewer errors when recalling the evidence, and develop more accurate assessments.<sup>61</sup> This is not simply a result of the contribution of minority members of a group. Instead, research supports the conclusion that racial diversity in and of itself changes the way the majority members think, communicate, deliberate, and approach collaboration.<sup>62</sup>

This benefit is not limited to racial diversity. A study on culturally diverse groups found that over time, these groups were better at identifying problems and generating alternative solutions.<sup>63</sup> Similarly, studies suggest that gender and personality diversity can enhance complex problem solving.<sup>64</sup> This is also the reason, perhaps counterintuitively, why some businesspeople claim there is value in hiring lazy employees. Because lazy people bring different values and perspectives, they “find better ways to do their jobs, ways to do them more efficiently without sacrificing effectiveness.”<sup>65</sup>

Moreover, it appears that functionally diverse groups<sup>66</sup> outperform homogenous groups not only when diverse group members have equal

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*Identity Orientation on Individual and Organizational Outcomes in Demographically Diverse Settings*, 25 ACAD. MGMT. REV. 82, 82–101 (2000) (claiming that the benefits of diversity outweigh the negatives).

59. See Sommers, *supra* note 58, at 598; see also Maringe et al., *supra* note 4, at 32 (explaining that the advantages of diverse groups “include an increase in the quality of group performance through creativity of ideas, cooperation, and the number of perspectives and alternatives considered”); *id.* at 13 (“Since then, numerous writers have suggested that diverse teams may be advantageous to organisations, especially in performing decision making tasks.”).

60. See Anthony Lising Antonio et al., *Effects of Racial Diversity on Complex Thinking in College Students*, 15 PSYCHOL. SCI. 507, 507–09 (2004).

61. See Sommers, *supra* note 58, at 606–07 (finding that whites “made fewer inaccurate statements when in diverse versus all-White groups, despite the fact that they actually contributed more information when deliberating in a diverse setting” and explaining that “[s]uch a conclusion is consistent with previous findings that motivations to avoid prejudice lead Whites to a more systematic and thorough processing of information conveyed by or about Black individuals”); *id.* at 606 (“[T]he presence of Black group members translated into fewer guilty votes before deliberations.”). Sommers conducted a simulated trial to determine the benefits that racial heterogeneity can have on group decision making. See *id.* at 601–03.

62. See *id.* at 606–09.

63. See Watson et al., *supra* note 51, at 599. But see *supra* notes 51–53 and accompanying text.

64. See MARVIN E. SHAW, GROUP DYNAMICS: THE PSYCHOLOGY OF SMALL GROUP BEHAVIOR 394–96 (3d ed. 1981).

65. See, e.g., Doris Tirone, *Lazy Government Employees*, GOVLOOP (Jan. 14, 2011, 6:30 AM), <http://www.govloop.com/profiles/blogs/lazy-government-employees>.

66. Functional diversity is based on the person’s perspective (experience and training) and heuristic (techniques for learning and problem solving). See Hong & Page, *supra* note 4, at 16,386.

abilities to that of the non-diverse group members, but also when the members have less ability.<sup>67</sup> In other words, as the researchers of one particular study concluded, “diversity trumps ability.”<sup>68</sup> While this may not always be true all the time, some research shows that a person’s added value to a team may be more connected to the difference in the way the person thinks and approaches the problem, as opposed to the person’s actual ability to solve the problem.<sup>69</sup> Diversity of opinion spurs innovation: “[T]he encouragement of debate—and even criticism if warranted—appears to stimulate more creative ideas. And cultures that permit and even encourage such expression of differing viewpoints may stimulate the most innovation.”<sup>70</sup> That is true even when the critique is wrong.<sup>71</sup> Thus, as Johnson points out, “It’s not that the network itself is smart; it’s that the individuals get smarter because they’re connected to the network.”<sup>72</sup>

### C. The Power of Weak Networks

Another factor affecting the creative power of open networks is the strength of the ties between those in the network. Strong ties are those that have longevity, strong emotions, and reciprocity, such as those between families and friends.<sup>73</sup> Weak ties, on the other hand, are less time-intensive

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67. *Id.* at 16,385–89.

68. *Id.* at 16,385.

69. *Id.* at 16,389 (arguing that their “result suggests that diversity in perspective and heuristic space should be encouraged” but explaining that there are “communication costs” if the problem solvers are not only diverse heuristically but also in perspective because “problem solvers with diverse perspectives may have trouble understanding solutions identified by other agents.”); Lu Hong & Scott E. Page, *Problem Solving by Heterogeneous Agents*, 97 J. ECON. THEORY 123, 130 (2001) (“[G]iven that all individuals agree on the value of outcomes, collections of agents outperform individuals partially because people see and think about the problems differently.”).

70. Charlan J. Nemeth et al., *The Liberating Role of Conflict in Group Creativity: A Study in Two Countries*, 34 EUR. J. SOC. PSYCHOL. 365, 373 (2004) (citation omitted) (citing generally Charlan Jeanne Nemeth, *Managing Innovation: When Less Is More*, 40 CAL. MGMT. REV. 59 (1997)).

71. Although it has been shown that group brainstorming is not as productive as individual brainstorming if the group does not provide any critical feedback or criticism, research has shown that this is not true when the group is given instructions to debate and criticizes each other’s ideas during the brainstorming session. *See id.* at 371–73 (finding that groups given instructions to debate the suggestions generated more ideas, and the individuals on those teams, on average, produced more additional ideas after the group was disbanded than those in groups given no instructions or told not to debate or criticize each other’s ideas); *see also* Nemeth, *supra* note 70, at 60 (“Minority viewpoints have importance and power, not just for the value of the ideas themselves, but for their ability to stimulate creative thought.”). *See generally* Charlan Jeanne Nemeth, *Dissent as Driving Cognition, Attitudes, and Judgments*, 13 SOC. COGNITION 273 (1995) (contending that minority disagreement increases quality of performance and creativity because multiple perspectives are considered).

72. JOHNSON, *supra* note 10, at 58.

73. *See* Mark S. Granovetter, *The Strength of Weak Ties*, 78 AM. J. SOC. 1360, 1361 (1973); Ruef, *supra* note 45, at 429. These are also arguably the kind of ties between lawyers and their clients—especially those in the commercial context, in which law firms’ or law partners’ client relationships are strong, long-lasting, and require time to cultivate. *See* John C. Coates et al., *Hiring Teams, Firms, and Lawyers: Evidence of the Evolving Relationships in the Corporate Legal Market*, 36 LAW & SOC. INQUIRY 999, 1002 (2011).



and intimate.<sup>74</sup> Perhaps counterintuitively, the network's creative value does not always increase as ties grow stronger; indeed, research shows that just the opposite can be true. Although strong ties can fill disconnects,<sup>75</sup> they can also impede innovation and coerce conformity.<sup>76</sup> Family, friends, and others with close ties can apply pressure in the relationship. In contrast, weak interpersonal ties free individuals to interact with different audiences.<sup>77</sup>

Thus, there is a power in weak ties. Not only do they disseminate ideas more widely and bridge formerly disconnected groups, but they also foster innovation because they "allow for more experimentation in selectively combining ideas from one source with those of another and impose fewer concerns regarding social conformity."<sup>78</sup> It is the informal, sometimes invisible, connections within organizations that bridge disconnected functions.<sup>79</sup> Because the ties are weak, the information coming across them is necessarily from a different context, or as Richard Ogle calls it, a different "idea-space."<sup>80</sup> The best "idea-space" has a mix of weak and strong ties, a blend of old and new. This new co-mingled space enables the tinkering of parts necessary to create a discovery.<sup>81</sup>

#### D. Open Markets

Although "[c]hance favors the connected mind,"<sup>82</sup> discovery is not just a matter of serendipitous diversity. Such chance or luck requires the person, organization, or profession's commitment to open and diverse

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74. See Ruef, *supra* note 45, at 429–30.

75. See RONALD S. BURT, *STRUCTURAL HOLES: THE SOCIAL STRUCTURE OF COMPETITION* 27–30 (1992); Ruef, *supra* note 45, at 430 (explaining that other researchers have claimed that "strong ties can also serve as bridges").

76. See Ruef, *supra* note 45, at 430; *see also id.* at 445 (finding that teams composed of strong-tie networks were less innovative than those with weak-tie networks and suggesting that entrepreneurs can avoid conformity by, among other things, "diversifying their networks to include a wide range of social contacts").

77. See Granovetter, *supra* note 73, at 1369–76 (hypothesizing that weak interpersonal ties enable individuals to reach different audiences than those reachable via strong ties, and that they also increase social mobility and community organization).

78. See Ruef, *supra* note 45, at 430.

79. CROSS & PARKER, *supra* note 45, at vii–viii, 10 (arguing that organization charts do not "really capture the way work gets done in their organization").

80. RICHARD OGLE, *SMART WORLD: BREAKTHROUGH CREATIVITY AND THE NEW SCIENCE OF IDEAS* 13 (2007); *see also* JOHNSON, *supra* note 10, at 167.

81. See JOHNSON, *supra* note 10, at 167; *cf.* GOULD, *supra* note 42, at 24–26 (using the development of a panda's sesamoid thumb and an orchid's petal to conclude that "[n]ature is . . . an excellent tinkerer, not a divine artificer"); Roger Guimerà et al., *Team Assembly Mechanisms Determine Collaboration Network Structure and Team Performance*, 308 *SCIENCE* 697, 697–702 (2005) (finding that the most successful Broadway musicals were those that had networks made up of both people who knew each other well and had worked together before and people who were totally new); Matt Golosinski, *Faculty Research: Brian Uzzi, MORS: Teamwork Takes Center Stage*, *KELLOGG WORLD* (Winter 2005), <http://www.kellogg.northwestern.edu/kwo/win05/departments/uzzi.htm> (reporting Uzzi and his team's findings); Jennifer Robison, *The Power and Potential of Social Networks*, *GALLUP MGMT. J.* 2 (Oct. 13, 2010), <http://gmj.gallup.com/content/143486/Power-Potential-Social-Networks.aspx> (discussing Uzzi's work).

82. JOHNSON, *supra* note 10, at 174.

environments. As Ruef's study indicates, those entrepreneurs who committed themselves to a life full of diverse networks were three times more innovative than those that had more vertical, uniform networks.<sup>83</sup> Many of the most important inventions accredited to one inventor were actually developed over time, alongside many different innovators who helped refine them.<sup>84</sup> It is a commitment to outside influence and open collaboration that makes a difference by creating the opportunity for serendipity.<sup>85</sup>

To make this point, Johnson took "two hundred of the most important innovations and scientific breakthroughs from the past six hundred years, starting with Gutenberg's press: everything from Einstein's theory of relativity to the invention of air conditioning to the birth of the World Wide Web"<sup>86</sup> and plotted them on a four-quadrant diagram. The quadrants were based on whether the developers were individuals and small groups, or collaborative multidisciplinary projects, and whether they had an intent to make money directly on the sale or licensing of the invention or discovery, or a belief in open sourcing, where ideas flow freely in a "non-market."<sup>87</sup> He found that more innovation happened in the quadrant of networks with "non-market" beliefs than in any other quadrant.<sup>88</sup> Furthermore, the least innovation occurred in the first quadrant, made up of individuals and small groups with an intent to market the invention.<sup>89</sup> This suggests that "[t]he promise of an immense payday encourages people to come up with useful innovations, but at the same time it forces people to *protect* those innovations. . . . And so where innovation is concerned, we have deliberately built *inefficient* markets: environments that protect copyrights and patents and trade secrets."<sup>90</sup> These walled-in environments and inefficiencies prevent the number of meetings of the minds that can occur, and the potential improvements and transformations that might result.<sup>91</sup> This kind of research has led various organizations—from IBM, to Procter & Gamble, to Nike—to develop open environments that actually promote

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83. See Ruef, *supra* note 45, at 443; see also JOHNSON, *supra* note 10, at 166.

84. JOHNSON, *supra* note 10, at 221 ("[E]very important innovation is fundamentally a network affair.").

85. See *id.* at 221; cf. Richard Wiseman, *Be Lucky—It's an Easy Skill to Learn*, TELEGRAPH (Jan. 9, 2003, 12:01 AM GMT), <http://www.telegraph.co.uk/technology/3304496/Be-lucky-its-an-easy-skill-to-learn.html> (reporting results from an anecdotal study that showed that "unlucky people miss chance opportunities because they are too focused on looking for something else," whereas "[l]ucky people are more relaxed and open, and therefore see what is there rather than just what they are looking for").

86. JOHNSON, *supra* note 10, at 218–19.

87. *Id.* at 218–20.

88. *Id.* at 228–30.

89. *Id.*

90. *Id.* at 232.

91. See *id.* at 123–24 ("[T]hose walls have been erected with the explicit aim of encouraging innovation. . . . But they share a founding assumption: that in the long run, innovation will increase if you put restrictions on the spread of new ideas, because those restrictions will allow the creators to collect large financial rewards from their inventions. . . . The problem with these closed environments is that they inhibit serendipity and reduce the overall network of minds that can potentially engage with a problem.").

the sharing of “secret” information with business partners, suppliers, customers, and universities.<sup>92</sup>

What does this all have to do with law and the legal profession? While the U.S. legal profession promulgates walls that suppress creativity, other organizations and professions—including foreign legal professions—are breaking down such walls. For example, the U.K. firm Eversheds asked its clients to essentially “run the firm,” instead of keeping them in the dark.<sup>93</sup> Eversheds developed a Client Advisory Board to guide the firm and assess whether it was meeting its targeted goals. The Board is currently in its ninth year, and both the firm and its clients tout the Board’s success in changing the firm. They credit it for building relationships and for the cross-fertilization between client and law firm that has resulted in Eversheds’s innovative and award-winning services.<sup>94</sup> In the face of this shift toward openness, the U.S. legal profession has yet to experiment with a rule structure that embraces the influence of nonlawyers on lawyers.

## II. THE U.S. LEGAL PROFESSION’S ADHERENCE TO CLOSED ENVIRONMENTS

Despite the evidence that open, eclectic environments and weak ties promote inventiveness, creativity in problem solving, and productivity, the U.S. legal profession remains very closed. Many of its regulations and practices discourage the influence of nonlawyers.

### A. Lawyer Regulation

Much has been written bemoaning the U.S. bar licensing requirements as exclusionary, self-interested, and designed to ensure a monopoly over the delivery of legal services.<sup>95</sup> The same claim has been made about many of

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92. See *id.* at 124–25.

93. Client Advisory Board (Dec. 2011) (unpublished proprietary information) (on file with author); Interview with Anonymous Client Relations Partner, Eversheds, in London, Eng. (Nov. 18, 2011) (the partner requested anonymity due to the sensitive nature of these materials).

94. Eversheds won a *Financial Times* Innovation Lawyers Award in 2010 and was shortlisted for a 2011 Award. See *Award Shortlists*, FIN. TIMES, <http://www.ftconferences.com/Innovativelawyers/Page/Award-Shortlists> (last visited Apr. 21, 2012); *FT Innovative Lawyers 2010*, FIN. TIMES, <http://www.ftconferences.com/Innovativelawyers2010/> (last visited Apr. 21, 2012).

95. See, e.g., JEROLD S. AUERBACH, *UNEQUAL JUSTICE: LAWYERS AND SOCIAL CHANGE IN MODERN AMERICA* 106–09 (1976) (claiming that the ABA raised bar membership educational requirements to exclude certain ethnic and racial groups from joining the bar); James E. Moliterno, *Broad Prohibition, Thin Rationale: The “Acquisition of an Interest and Financial Assistance in Litigation” Rules*, 16 GEO. J. LEGAL ETHICS 223, 242 (2003) (“[S]etting higher educational standards for admission to the bar was one means chosen to keep the unwanted out of the profession . . .”); *id.* at 256–57 (contending that abolishing the rules prohibiting lawyers from acquiring an interest in a cause of action and providing financial assistance to clients “would close happily one more chapter on the self-interestedness of bar ethics rules”); Andrew M. Perlman, *A Bar Against Competition: The Unconstitutionality of Admission Rules for Out-of-State Lawyers*, 18 GEO. J. LEGAL ETHICS 135, 147–50 (2004) (attributing strict bar admission requirements to “economic protectionism”); Waye, *supra* note 25, at 232 (making the same point about the “barriers to

the Model Rules of Professional Conduct and the bar's adherence to the theory of self-regulation.<sup>96</sup>

The Model Rules prohibit several types of interchanges between lawyers and nonlawyers. For example, Rule 5.4 prohibits lawyers from sharing legal fees with nonlawyers, and from forming a partnership with nonlawyers "if any of the activities of the partnership consist of the practice of law."<sup>97</sup> Essentially, Rule 5.4 prohibits outside investment in, or ownership of, law firms—something that is allowed in Australia<sup>98</sup> and the United Kingdom.<sup>99</sup> The rule's proponents fear that lawyers will succumb to pressure from outside investors and the lure of financial gain, instead of focusing on the interests of clients or the legal system.<sup>100</sup> Moreover, as its

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entry and licensing" in Australia); see also Penelope Pether, *Sorcerers, Not Apprentices: How Judicial Clerks and Staff Attorneys Impoverish U.S. Law*, 39 ARIZ. ST. L.J. 1, 47–51 (2007) (summarizing the relevant scholarship arguing that the legal profession also attempted to exclude minorities and women from becoming lawyers). See generally SUSAN K. BOYD, *THE ABA'S FIRST SECTION: ASSURING A QUALIFIED BAR* (1993) (discussing the history of ABA's accreditation requirements).

96. See *supra* notes 17–18 and accompanying text; cf. Green, *supra* note 17, at 1157 ("The effort to remove corporations from the field was spearheaded not by clients, but by lawyers whose motivations were, explicitly, to protect lawyers against competition from corporations and, at least implicitly, to protect the profession's native-born, middle- and upper-class elite against competition from lower-class, urban, immigrant practitioners.").

97. See MODEL RULES OF PROF'L CONDUCT R. 5.4(a)–(b) (2009). Some contend that this Model Rule is unconstitutional. See, e.g., Renee Newman Knake, *Democratizing the Delivery of Legal Services: On the First Amendment Rights of Corporations and Individuals*, 73 OHIO ST. L.J. (forthcoming 2012), available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1800258](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1800258) (arguing that recent Supreme Court decisions make blanket prohibitions on outside ownership of law firms unconstitutional). The law firm Jacoby & Meyers has filed three virtually identical lawsuits in New Jersey, New York, and Connecticut making these contentions. See Memorandum of Law in Support of Defendants' Motion to Dismiss, *Jacoby & Meyers Law Offices, LLP v. Presiding Justices*, No. 11 Civ. 3387, 2012 WL 751946 (S.D.N.Y. Mar. 8, 2012) (No. 11 Civ. 3387), 2011 WL 7102194; Nathan Koppel, *Jacoby & Meyers Fights to Let Nonlawyers Buy In*, WALL ST. J., May 19, 2011, at B1. On March 8, 2012, Judge Lewis Kaplan dismissed the New York lawsuit as seeking an unconstitutional advisory decision because other New York laws prohibited outside investment and "plaintiffs could not accept non-lawyer equity investments even if they won on the merits of their constitutional claims." *Jacoby & Meyers*, 2012 WL 751946, at \*1. In North Carolina, state senator Fletcher L. Hartsell, Jr. has drafted a bill that would allow nonlawyer investment in corporate law firms in his state, contending that the existing ban is unconstitutional. See S. 254, Gen. Assemb., 2011–12 Sess. (N.C. 2011), available at <http://www.ncleg.net/Sessions/2011/Bills/Senate/PDF/S254v0.pdf>.

98. Alexia Garamfalvi, *In a First, Law Firm Goes Public*, LEGAL TIMES (May 22, 2007), available at <http://web.archive.org/web/20090304195009/http://www.law.com/jsp/article.jsp?id=1179751700602> (archived and currently available at LexisNexis in "The National Law Journal (Online)" database).

99. See Legal Services Act, 2007, c. 29, pt. 5 (U.K.) (enabling equity investment in law firms in England and Wales by nonlawyer investors). For a comprehensive history of the Act, see generally Christopher J. Whelan, *The Paradox of Professionalism: Global Law Practice Means Business*, 27 PENN ST. INT'L L. REV. 465 (2008).

100. See Milton C. Regan, Jr., *Lawyers, Symbols, and Money: Outside Investment in Law Firms*, 27 PENN ST. INT'L L. REV. 407, 415 (2009) (explaining the history of the rule). As Regan points out, however, "restricting . . . law firm ownership . . . is inapt in a world in which lawyers increasingly are viewed as but one group of professional service providers among many." *Id.* at 408; see also Laurel S. Terry, *The Future Regulation of the Legal Profession: The Impact of Treating the Legal Profession as "Service Providers,"* 2008 J.

title, "Professional Independence of a Lawyer," suggests, Rule 5.4 is designed to ensure that outsiders do not taint lawyers' professional judgment.<sup>101</sup> Thus, as will be discussed in Part III, it is also used as an argument against claim funding.

Furthermore, Rule 5.4 directly prohibits the formation of multidisciplinary partnerships (MDPs) with nonlawyers, in which lawyers share fees with nonlawyers and offer both legal and non-legal services under one roof.<sup>102</sup> The rationale for this prohibition is that MDPs will create conflicts of interest, damage the reputation of the legal profession, risk the attorney-client privilege, and taint a lawyer's independent judgment.<sup>103</sup> Of course, it also happens to protect the profession's economic self-interest.<sup>104</sup> Thus, law firms may create ancillary businesses that provide non-legal service performed by nonlawyers, and they can hire nonlawyers, but nonlawyers cannot own stock in a law firm nor receive profits from the partnership.<sup>105</sup> The most recent ABA proposal, which recommends allowing some outside ownership of law firms, epitomizes the U.S. stance: it is willing to embrace outside influence only if it protects the financial status of the profession and if the outsiders' influence on lawyers is severely restricted.<sup>106</sup>

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PROF. LAW. 189, 209 (explaining that if lawyers want to be treated differently, they need to justify how it is in clients' or society's interest). But as Green points out,

[T]he assumption that lawyers would submit to such influence is at odds with the most fundamental assumption of lawyer professionalism and self-regulation: that lawyers' professional training and character, as certified by the licensing process, together with the disciplinary process and other institutions of internal regulation, are sufficient to ensure lawyers' adherence to their professional obligations to clients and the public.

Green, *supra* note 17, at 1154.

101. MODEL RULES OF PROF'L CONDUCT R. 5.4, cmt. 1 (making clear that its restrictions are designed to "protect the lawyer's professional independence of judgment"); *see also supra* notes 17–18.

102. In 1999, the ABA Commission recommended revising Rule 5.4 to allow MDPs, but the ABA House of Delegates rejected this recommendation in July 2000. *Report and Recommendation of the District of Columbia Bar Special Committee on Multidisciplinary Practice*, D.C. BAR, [http://www.dcbar.org/inside\\_the\\_bar/structure/reports/special\\_committee\\_on\\_multidisciplinary\\_practice/background.cfm](http://www.dcbar.org/inside_the_bar/structure/reports/special_committee_on_multidisciplinary_practice/background.cfm) (last visited Apr. 21, 2012).

103. *See* Thomas R. Andrews, *Nonlawyers in the Business of Law: Does the One Who Has the Gold Really Make the Rules?*, 40 HASTINGS L.J. 577, 600–16 (1989) (examining and criticizing the justifications for the rules that limit lawyers' ability to partner with nonlawyers); Michele DeStefano Beardslee, *Taking the Business Out of Work Product*, 79 FORDHAM L. REV. 1869, 1883 (2011) ("Ironically, these are the same arguments that were used—unsuccessfully—against allowing in-house counsel, ancillary businesses, and lawyers to join legal services organizations.").

104. Andrews, *supra* note 103, at 616–21; *cf.* Green, *supra* note 17, at 1155–56 (predicting, among other things, that "[t]he bar will continue its effort to expand its professional turf" and only embrace collaboration with nonlawyers "in forms in which lawyers would be economically and professionally dominant" but will continue to "employ the rhetoric of lawyer independence . . . to promote lawyers' economic dominance").

105. *See* MODEL RULES OF PROF'L CONDUCT R. 5.4.

106. The ABA's most recent proposal is to adopt rules similar to those that exist in Washington, D.C., which allows some nonlawyer ownership of law firms as long as lawyers maintain a controlling financial interest and voting rights, and nonlawyers do not have their own clients or offer any nonlegal services to clients. *See* ABA Comm'n on Ethics 20/20,

In addition, other rules may also inhibit open interaction and alliances between lawyers and nonlawyers. Consider Rule 1.6, “Confidentiality of Information.”<sup>107</sup> This rule states that the lawyer owes the client a duty to not reveal any information related to the representation without informed consent.<sup>108</sup> Yet, the only real way to get informed consent is to tell the client all the possible negative consequences from disclosure.<sup>109</sup> Arguably, this restriction could inhibit communication.

Rule 1.6 also interacts with both the work-product and attorney-client privilege doctrines, which protect information from disclosure to adversaries in litigation. Although these doctrines do allow disclosures to third-party consultants and experts in certain circumstances, courts interpret these exceptions narrowly and often consider the protective doctrines waived or inapplicable if information is shared with third-parties.<sup>110</sup> Protection under the attorney-client privilege, in particular, is harder to garner when the lawyer’s advice is a mixture of business and law.<sup>111</sup> Under most courts’ narrow interpretations of the privilege, it rarely, if ever, covers the type of collaborative communications with external consultants that can enhance decision making and problem solving.<sup>112</sup> Given that case law and the Federal Rules of Civil Procedure make clear that the work-product

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Report on Alternative Law Practice Structures (Discussion Draft Dec. 2, 2011), in Letter from Jamie S. Gorelick & Michael Traynor, Co-Chairs, ABA Comm’n on Ethics 20/20, to ABA Entities et al. (Dec. 2, 2011), available at [http://www.americanbar.org/content/dam/aba/administrative/ethics\\_2020/20111202-ethics2020-discussion\\_draft-alps.authcheckdam.pdf](http://www.americanbar.org/content/dam/aba/administrative/ethics_2020/20111202-ethics2020-discussion_draft-alps.authcheckdam.pdf); Joe Palazzolo, *ABA Inches Closer to Vote on Nonlawyers Owning Stake in Firms*, WALL ST. J. L. BLOG (Dec. 6, 2011, 3:27 P.M.), <http://blogs.wsj.com/law/2011/12/06/aba-inches-closer-to-vote-on-nonlawyers-owning-stake-in-firms/>.

107. MODEL RULE OF PROF’L CONDUCT R. 1.6.

108. *Id.* This duty lasts forever—except when the lawyer is sued by the client for malpractice or attempting to recover legal fees. See Daniel R. Fischel, *Lawyers and Confidentiality*, 65 U. CHI. L. REV. 1, 1–2, 10 (1998) (“Confidentiality means everything in legal ethics unless lawyers lose money, in which case it means nothing.”); David A. Green, *Lawyers as “Tattletales”: A Challenge to the Broad Application of the Attorney-Client Privilege and Rule 1.6*, *Confidentiality of Information*, 20 GA. ST. U. L. REV. 617, 636–38 (2004).

109. MODEL RULES OF PROF’L CONDUCT R. 1.0(e) & cmt. 6.

110. See Michele DeStefano Beardslee, *The Corporate Attorney-Client Privilege: Third-Rate Doctrine for Third-Party Consultants*, 62 SMU L. REV. 727, 760–63 (2009) (arguing that the courts’ narrow construction of the exception “bars protection for most communications with most third-party consultants”); Beardslee, *supra* note 103, at 1929 (contending that the work-product doctrine “fails to provide predictable protection for the responsibilities and obligations of the contemporary corporate attorney”).

111. The attorney-client privilege protects only mixed communications that are “predominantly legal,” *Zenith Radio Corp. v. Radio Corp. of Am.*, 121 F. Supp. 792, 794 (D. Del. 1954), or “made primarily for the purpose of generating legal advice,” *McCaugherty v. Siffermann*, 132 F.R.D. 234, 240 (N.D. Cal. 1990); see Beardslee, *supra* note 110, at 751–52. Making this determination, however, is extremely complicated in the corporate context, given that in-house counsel usually provide mixed business and law advice. See *id.* at 752–55.

112. The majority view is that the third party exception only applies to third parties with “ministerial responsibility” or who merely translate information and do not provide any increment of their own knowledge or expertise. *United States v. Kovel*, 296 F.2d 918, 921 (2d Cir. 1961); Beardslee, *supra* note 110, at 745–46 & n.83.

doctrine protects materials prepared by nonlawyers, and is not waived unless disclosure increases the chances of exposure to an adversary,<sup>113</sup> the doctrine would appear to be the legal profession's "secret door" to a "third place"—a license to brainstorm with nonlawyers to find more innovative, effective solutions to clients' problems. Unfortunately, courts often deny such protection if the nonlawyer professionals who created the work behaved as a typical business consultant.<sup>114</sup> These doctrines exacerbate the pressures to restrict access to materials and are part of the frame of reference in applying Rule 1.6. Lawyers thus may decide to be cautious and not share information with others, even if it would greatly benefit case strategy, management, or financing.<sup>115</sup> They share confidential information at their own—and their clients'—peril.

Another example of a seemingly good rule gone bad is Rule 5.5, which prohibits the "Unauthorized Practice of Law"<sup>116</sup> (UPL). On its face, this rule and corollary state bans appear to protect clients and the public, but it is a bait and switch. "Practice of law" has been construed very broadly to include accounting, insurance, marriage counseling, real estate brokering, business consulting, and loan and mortgage brokering.<sup>117</sup> Although it is likely accurate to include such services as part of the holistic legal service that lawyers provide,<sup>118</sup> and likely desirable to exclude outsiders who are incompetent or a danger to the client, UPL restrictions ultimately exclude outsiders who are neither, and thus create a monopoly for lawyers, as Judge Richard Posner and others have pointed out.<sup>119</sup> Green explains, "[O]ver

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113. See, e.g., *Mondis Tech., Ltd. v. LG Elecs., Inc.*, Nos. 2:07-Civ. 565, 2:08-Civ. 478, 2011 WL 1714304, at \*2–3 (E.D. Tex. May 4, 2011) (concluding that a party could share information with a third-party claim funder without waiving work-product doctrine protection); 8 CHARLES A. WRIGHT, ARTHUR R. MILLER, & RICHARD L. MARCUS, *FEDERAL PRACTICE AND PROCEDURE* § 2024, at 530–32 (3d ed. 2010). The test for waiver of the work-product doctrine is much different than the test for waiver of the attorney-client privilege. See Beardslee, *supra* note 103, at 1898–99. The author is currently writing another article on waiver and the common interest doctrine as it relates to claim funding.

114. Beardslee, *supra* note 103, at 1913–15 (providing examples from recent cases involving public relations consultants to support this contention).

115. Beardslee, *supra* note 110, at 763–64.

116. See MODEL RULES OF PROF'L CONDUCT R. 5.5 (2009).

117. See Green, *supra* note 17, at 1149 (citing N.Y. State Bar Ass'n Prof'l Ethics Comm., Op. 206 (Nov. 22, 1971)).

118. In some ways, such a broad definition makes sense given that clients seek lawyers' services for more than what could traditionally be called 'legal' advice. See Beardslee, *supra* note 110, at 736–42; Mary C. Daly, *Choosing Wise Men Wisely: The Risks and Rewards of Purchasing Legal Services from Lawyers in a Multidisciplinary Partnership*, 13 GEO. J. LEGAL ETHICS 217, 281 (2000) ("The needs of clients are increasingly difficult to pigeonhole as 'legal,' 'accounting,' 'financial planning,' 'environmental planning,' etc. And the boundaries between the law and other disciplines are blurring.").

119. See Richard A. Posner, *The Material Basis of Jurisprudence*, 69 IND. L.J. 1, 6 (1993) ("The legal profession in its traditional form is a cartel of providers of services related to society's laws."); *id.* at 1 (describing "[t]he profession [as] an intricately and ingeniously reticulated, though imperfect, cartel," protected by "[g]overnmental regulations designed to secure the cartel against competition and new entry from without"); see also George W.C. McCarter, *The ABA's Attack on "Unauthorized" Practice of Law and Consumer Choice*, ENGAGE, May 2003, at 131, 132 ("[S]cholars who have examined the data have consistently found no genuine threat to the public from lay provision of legal services."); Deborah L.

time, the effect of the bar association rulings became less to protect the professional elite from lower-class competitors than to protect all lawyers against competition from nonlawyers . . . and, beyond that, to expand lawyers' turf."<sup>120</sup> These rules not only deter nonlawyers from practicing law, but they also discourage lawyers from collaborating with nonlawyers. Because the dividing line is so obscure, lawyers may not want to risk aiding the unauthorized practice of law, or may not want to assume the responsibility for supervising nonlawyers' work that would be necessary to eliminate that risk.<sup>121</sup>

The way that the Model Rules are enforced is also consistent with the idea of an independent and closed profession. Those in the legal profession often claim that they are "self-regulated" because the bar regulates and disciplines itself.<sup>122</sup> Even though the legal profession may not, in practice, be solely self-regulating,<sup>123</sup> the theory of self-regulation presupposes a focus on the individual lawyer and on lawyers as a professional entity distinct from other regulated bodies.<sup>124</sup> Thus, the legal profession's continued adherence to the theory of self-regulation perpetuates self-interested behavior and the notion that clients and society are better off with lawyers that work apart—without the influence, experience, and guidance of others.<sup>125</sup>

Even the way in which the Model Rules and their state counterparts are written exemplifies the legal profession's unwavering attachment to the idea of the lone lawyer—the one-to-one, lawyer-client model. Despite the

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Rhode, *Policing the Professional Monopoly: A Constitutional and Empirical Analysis of Unauthorized Practice Prohibitions*, 34 STAN. L. REV. 1, 9 (1981) ("Although the organized bar has often suggested that the campaign against lay practitioners 'arose as the result of a public demand,' the consensus among historians is to the contrary." (quoting John C. Satterfield, *The President's Page*, 48 A.B.A. J. 99, 112 (1962))). See generally Green, *supra* note 17, at 1143–44 (tracing the history of the unauthorized practice of law rule).

120. Green, *supra* note 17, at 1144.

121. Cf. *id.* at 1144 n.153 ("[T]he bar probably assumed that if lawyers were free to ally with other professionals, clients would favor nonlawyer-dominated firms over both law firms and lawyer-dominated multidisciplinary partnerships.").

122. Laurel S. Terry, Steve Mark, & Tahlia Gordon, *Trends and Challenges in Lawyer Regulation: The Impact of Globalization and Technology*, 80 FORDHAM L. REV. 2661, 2669 (2012) ("[T]he term 'self-regulation' is ambiguous and means different things to different people.").

123. See David B. Wilkins, *Who Should Regulate Lawyers?*, 105 HARV. L. REV. 799, 807–09 (1992).

124. See Terry, Mark, & Gordon, *supra* note 122, at 2672 ("'[S]elf-regulation' and independence have been a fundamental part of lawyers' self-identity for many decades, if not centuries."); Wilkins, *supra* note 123, at 853–55 ("[T]he claim that there is an inherent link between the [self-regulatory] disciplinary system and the status of lawyers as 'independent professionals' is firmly rooted in precedent, practice, and professional mythology."); cf. Terry, *supra* note 100, at 189 ("In the *service providers* paradigm, the legal profession is not viewed as a separate, unique profession entitled to its own individual regulations, but is included in a broader group of 'service providers,' all of whom can be regulated together.").

125. Cf. Regan, *supra* note 100, at 408 ("There has been ample criticism for some time that relying heavily on self-regulation provides too much opportunity for self-interested behavior and too little consideration of important social values served by the practice of law. Restricting . . . professional regulation to lawyers rests on and perpetuates the assumption that only lawyers are fit to determine the obligations to which they will be subject.").



fact that a significant portion of U.S. lawyers work in law firms, which are large, diffuse enterprises with complicated organizational structures, the rules of professional conduct in all but two states are written for the individual lawyer who works in solo practice or at a firm with a classic partnership model.<sup>126</sup> These rules are essentially a manual written for a knight working alone to slay a dragon, rather than an army of varied professionals working together to do the same.

### *B. The Structure of Large Corporate Law Practice*

The way that many large law firms are organized also discourages a flow of information between lawyers and nonlawyers, and even among lawyers. The standard U.S. law firm, which, according to Milton C. Regan, is now a “mixture of partnership and corporation,” is in many ways a monolith.<sup>127</sup> Although there have been some changes to management structure of large law firms and the classic partnership model has been replaced,<sup>128</sup> typically they are made up of, owned, and mostly run by lawyers.<sup>129</sup> This structure was designed to protect clients<sup>130</sup> from, among other things, agency problems, such as lawyers pursuing their own interests over their clients interests<sup>131</sup> and what David B. Wilkins calls the “externality” problem—the likelihood that “lawyers and clients together [will] impose unjustified harms on third parties or on the legal framework.”<sup>132</sup>

This structure, however, results in disaggregation within firms.<sup>133</sup> While it is true that lawyers frequently work in teams, many firms today are so

126. See *id.* at 431.

127. *Id.* at 407, 417 (explaining that its current form stems from the classic partnership model that “conceptualizes the law firm as a voluntary association of partners who share equally in the outcomes of a common venture, who participate as equals in self-governance through consensus”).

128. See *id.* at 421–24 (explaining the ways that most law firms have departed from the classic partnership model); *id.* at 423 (“Firms are moving closer to a corporate model: distinct separation of ownership and control, multiple categories of workers and lines of authority, greater standardization of tasks, productivity-based compensation, limited individual liability, and reliance on temporary workers that mimics corporate ‘just in time’ production processes.”).

129. Cf. Elizabeth Chambliss & David B. Wilkins, *The Emerging Role of Ethics Advisors, General Counsel, and Other Compliance Specialists in Large Law Firms*, 44 ARIZ. L. REV. 559, 565 (2002) (studying the emerging role of in-house compliance specialists and noting “the wide variation in [their] titles,” such as “general counsel,” “ethics partner,” “conflicts partner,” and “loss prevention partner”); Regan, *supra* note 100, at 427–28 (“[F]irms have concentrated management authority in executive committees; hired non-lawyers for positions such as chief administrative officer and chief marketing officer; established general counsel positions; designated specific partners as ethics or loss prevention counsel . . .”).

130. See Regan, *supra* note 100, at 419–20 (explaining how the structure is designed to alleviate various costs and externalities).

131. See Wilkins, *supra* note 123, at 819–20.

132. *Id.* at 820.

133. Cf. Regan, *supra* note 100, at 428 (“[T]o serve as an attractive investment (to outside investors), a firm will need to rely less on individual rainmakers and more on the performance of the firm as a whole. . . . This means adopting measures that integrate members more securely within the firm, and taking steps to increase loyalty and commitment to reinforce that integration.”). On a recent virtual session for LawWithoutWalls, Jordan Furlong of Law21 made the points that law firms have a “weak and fragmented culture” and

large and global that they work as “weakly integrated networks of cobranded teams,” as opposed to integrated companies that focus on the performance of the firm as a whole: “Law firms are typically organized as nested pyramids with little cross-cutting communication or sharing of tasks.”<sup>134</sup> Moreover, many employ an “eat what you kill” compensation system that compensates lawyers based on their individual contributions to the firm’s profits.<sup>135</sup> Further exacerbating the problem is the mistaken belief that clients hire lawyers and not law firms.<sup>136</sup> Whether this notion is true or not, its popularity affects internal structure and behavior. As a result, regardless of the way law may actually be practiced,<sup>137</sup> the historical law firm structure appears to prize individual work (or little monopolies) over collaborative, integrated, multidisciplinary teamwork.

### *C. Tension with Actual Practice*

With respect to collaboration between lawyers and nonlawyers, there is tension between the legal profession’s traditional values and the current mode of practicing law.<sup>138</sup> Many corporate lawyers, especially in-house counsel, find that they must work on multidisciplinary teams and collaborate with nonlawyers to provide legal advice.<sup>139</sup>

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“share knowledge grudgingly, if at all.” Jordan Furlong, Remarks in LawWithoutWalls Virtual Thought Leader Session: Law Firm Structure: Then, Now, and the Future (Mar. 14, 2012) (presentation on file with author).

134. Coates et al., *supra* note 73, at 1003.

135. See generally MILTON C. REGAN, JR., *EAT WHAT YOU KILL: THE FALL OF A WALL STREET LAWYER* (2004).

136. See generally Coates et al., *supra* note 73 (reporting and discussing research indicating that, although many general counsels claim that they hire lawyers, not firms, in reality they base hiring and firing decisions not only on individuals, but also on firms and the teams and departments within firms).

137. It is certainly true that many of today’s large corporate law firm lawyers regularly work with experts from other disciplines to provide comprehensive legal services to clients, and that law firms are increasingly utilizing nonlawyers in a variety of functions, including electronic discovery, marketing data management, operations, compliance, and ethics, to help run their firms more efficiently and profitably. Although some may argue that this is not true collaboration, because the lawyers continue to completely control decisions and client fees, it is an example of the attempt to collaborate despite the regulatory constraints. Swapping the incentives by encouraging rather than discouraging such interaction is at least worth considering.

138. Today, although there might be a lead partner on a corporate law case, and some of legal practice is still mired in non-cooperative behavior, there are many different levels of lawyers and different service providers involved in managing a case—not to mention a relationship partner to ensure that the relationship with the client is being handled well. Further, there is research that shows that when star lawyers move firms, general counsels are more apt to follow them when they move in teams. See Coates et al., *supra* note 73, at 1028.

139. Indeed, the exception to waiver for communications between attorneys and third-party consultants was created because “the complexities of modern existence prevent attorneys from effectively handling clients’ affairs without the help of others.” *United States v. Kovel*, 296 F.2d 918, 921 (2d Cir. 1961); see also *NXIVM Corp. v. O’Hara*, 241 F.R.D. 109, 140–42 (N.D.N.Y. 2007) (acknowledging that “[e]ven the most proficient and prolific attorneys have to resort to consultation with others in order to render full and complete legal services to their clients,” but ultimately deciding that the exception did not apply to the facts at hand). As Robert E. Rosen points out, this is the “age of consultants,” and lawyers need to—and often do—consult with nonlawyers to provide comprehensive advice to clients.

Thus, the legal profession has not evaded the team concept or decided that nonlawyer influence is a necessary evil. But its regulations and structure define “team” in a closed manner as a team of lawyers and legal service providers, as opposed to a team made up of lawyers and professionals from other disciplines. This narrow definition inhibits nonlawyer influence over lawyers. Further, lawyering is oriented around an artificial distinction between legal advice and “other” services (for example, business, strategic, financial) when clients clearly want something more holistic and integrated.<sup>140</sup>

The time has come to rethink the implications of these types of rules and perhaps revise them. The bar should design rules that foster open environments that promote innovation in legal services, case management, and problem solving. Lawyers will only be able to expand their influence and economic and qualitative value if they endorse input by nonlawyers—for that is how innovation and change in legal services will be created and adopted.

### III. AN EXAMPLE OF NONLAWYER INFLUENCE EMBRACED OUTSIDE THE UNITED STATES: CLAIM FUNDING

Although many lawyers in the United States work with nonlawyers and may take issue with this Article’s critique of the U.S. legal profession, the reality is that they are doing so despite existing regulations and practices that constrain such behavior. The goal of this Article is not to judge how lawyers actually practice or want to practice, but to critique the rules, regulations, and structures that U.S. lawyers have collectively chosen to adopt. These rules may be motivated to protect lawyers’ independence, but by doing so, they trap U.S. lawyers in a closed market and bar the door to exaptation.

Yet these rules are not inherent to the practice of law—indeed, law practice in Australia and the United Kingdom prove otherwise. It is not that these other constituencies do not believe in the importance of lawyer independence. Like the ABA in the United States, regulatory agencies in other countries also want to protect clients from lawyers who may be affected by personal or professional bias.<sup>141</sup> Nevertheless, these foreign

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Robert Eli Rosen, “*We’re All Consultants Now*”: *How Change in Client Organizational Strategies Influences Change in the Organization of Corporate Legal Services*, 44 ARIZ. L. REV. 637, 648, 656–60 (2002); *see also* Beardslee, *supra* note 110, at 736–42 (discussing “the importance of third-party consultation to the provision of legal advice”).

140. It is not just that the law governing lawyers does not enable lawyers to seek input from nonlawyers in other areas of business. It also restricts lawyers themselves from playing a dual role—one that mixes legal and business advice—that arguably is inevitable for many, if not most, corporate counsel today. *NXIVM Corp.*, 241 F.R.D. at 126 (“In today’s world, an attorney’s acumen is sought at every turn, even average attorneys mix legal advice with business, economic, and political.”).

141. *See, e.g.*, AUSTRALIAN SOLICITORS’ CONDUCT RULES R. 17 (Law Council of Austl. 2011), *available at* [http://www.lawcouncil.asn.au/shadomx/apps/fms/fmsdownload.cfm?file\\_uid=D997CD53-92D0-1795-82F7-5436F67E9BCD&siteName=lca](http://www.lawcouncil.asn.au/shadomx/apps/fms/fmsdownload.cfm?file_uid=D997CD53-92D0-1795-82F7-5436F67E9BCD&siteName=lca) (prohibiting solicitors from acting “as the mere mouthpiece of the client”); MODEL RULES OF PROF’L CONDUCT & PRACTICE R. 13 (Law Council of Austl. 2002), *available at*

regulatory bodies recognize the value of nonlawyer influence on the legal profession and collaboration with nonlawyers.<sup>142</sup> Unlike the United States, both Australia and the United Kingdom embrace outside investment in law firms. The Australian Legal Profession Acts permit lawyers to share revenues and income with nonlawyers in Australia.<sup>143</sup> Similarly, the 2007 U.K. Legal Services Act permits U.K. lawyers to develop alternative business structures, in which lawyers and nonlawyers can form legal partnerships and/or companies offering both legal and non-legal services.<sup>144</sup> Thus, despite sharing the United States' value of professional independence, both the Australian and the U.K. legal professions believe that varying levels of nonlawyer influence on lawyers can provide benefits to clients and consumers, such as an opportunity for financial innovation.<sup>145</sup> The U.S. regulations permit much less nonlawyer influence on lawyers than

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[http://www.lawcouncil.asn.au/shadomx/apps/fms/fmsdownload.cfm?file\\_uid=01EC79F6-1C23-CACD-2252-D298393FBFA0&siteName=lca](http://www.lawcouncil.asn.au/shadomx/apps/fms/fmsdownload.cfm?file_uid=01EC79F6-1C23-CACD-2252-D298393FBFA0&siteName=lca) (same for both solicitors and barristers); AUSTRALIAN BAR ASS'N MODEL RULES R. 18 (2002), available at <http://www.austbar.asn.au/images/stories/PDFs/CurrentABAModelRules2002.pdf> (same for barristers).

142. Conducting a thorough comparison of all of the regulations, rules, and structures addressed in Part II with those in Australia and the United Kingdom is outside the scope of this Article.

143. See, e.g., *Legal Profession Act 2007* (Qld) ch 2, s 128(1) ("Nothing under this Act prevents an Australian legal practitioner from sharing with an incorporated legal practice receipts, revenue or other income arising from the provision of legal services by the practitioner."); see also *id.* s 111(1) (defining "incorporated legal practice" as "[a] corporation . . . [that] engages in legal practice in this jurisdiction, whether or not it provides services that are not legal services"). Every Australian state and territory but South Australia has passed a similar act based on the Model Legal Profession Bill. *The Model Legal Profession Bill: Status of Implementation*, L. COUNCIL AUSTL., [http://www.lawcouncil.asn.au/programs/national\\_profession/model-bill.cfm](http://www.lawcouncil.asn.au/programs/national_profession/model-bill.cfm) (last visited Apr. 21, 2012); see also Christine Parker, *Peering over the Ethical Precipice: Incorporation, Listing and the Ethical Responsibilities of Law Firms* 6 & n.15 (Melbourne Law Sch., Legal Stud. Research Paper No. 339, 2008), available at <http://cclsr.law.unimelb.edu.au/download.cfm?DownloadFile=7FFE4F7F-D062-CC9B-20BF53A0F42BD562> (noting that the six states that had passed the Legal Profession Act as of 2008 permitted incorporation of law firms). Of course, there are some special requirements. For example, the Act requires that a legal director be appointed to manage the legal services of the corporation and ensure that the corporation complies with (and nonlawyers do not prevent compliance with) the lawyers' professional obligations. See *Legal Profession Act 2007* (Qld) ch 2, s 117.

144. See Legal Services Act, 2007, c. 29, pt. 5 (U.K.); LEGAL SERVICES ACT 2007: EXPLANATORY NOTES pt. 5, ¶ 178 (2007), available at <http://www.legislation.gov.uk/ukpga/2007/29/notes/data.pdf>.

145. See Parker, *supra* note 143, at 13 (explaining that capital can be raised more quickly and efficiently, and that clients have more legal services options); Steve Mark, *The Corporatisation of Law Firms—Conflicts of Interests for Publicly Listed Law Firms* 1 (Oct. 13, 2007) [hereinafter Mark, *Corporatisation of Law Firms*] (unpublished manuscript), available at [http://www.lawlink.nsw.gov.au/lawlink/olsc/ll\\_olsc.nsf/vwFiles/Corporatisation\\_of\\_Law\\_Firms\\_Conflicts\\_of\\_interests\\_for\\_publicly\\_listed\\_law\\_firms\\_October\\_2007.doc/\\$file/Corporatisation\\_of\\_Law\\_Firms\\_Conflicts\\_of\\_interests\\_for\\_publicly\\_listed\\_law\\_firms\\_October\\_2007.doc](http://www.lawlink.nsw.gov.au/lawlink/olsc/ll_olsc.nsf/vwFiles/Corporatisation_of_Law_Firms_Conflicts_of_interests_for_publicly_listed_law_firms_October_2007.doc/$file/Corporatisation_of_Law_Firms_Conflicts_of_interests_for_publicly_listed_law_firms_October_2007.doc). In Australia, outside investment in firms has innovated corporate law; according to Steve Mark, it has turned corporate law on its head. See Steve Mark, *Remarks in LawWithoutWalls Virtual Thought Leader Session: Law Firm Structure: Then, Now, and the Future* (Mar. 14, 2002) (PowerPoint presentation on file with author). It has changed what duties public corporations owe to shareholders and at the same time managed the risks identified above. See Mark, *Corporatisation of Law Firms*, *supra*, at 12–13.

those of these other countries. This is exemplified by its stance on outside investment in claims, also known as claim funding.

Claim funding is nonrecourse financing in which third parties provide funding for a legal claim in exchange for a share of the proceeds from the judgment or settlement.<sup>146</sup> In this scenario, the third-party funder assumes the risk—if the claim is not successful, the third party cannot recover the funds advanced.<sup>147</sup> Claim funding is considered a fledgling industry in the United States,<sup>148</sup> but it has existed for much longer in other countries. There are different kinds of legal claim funding, and many laws regulating when and how capital can be invested in litigation, which vary by country and by regions within countries.

This Article is only concerned with commercial claim funding, as opposed to individual or consumer claim funding.<sup>149</sup> Commercial claim funders offer different deals in different situations: the level, type, and timing of funding can vary; the contract can be with the claimholder or the lawyer;<sup>150</sup> and the funders' percentage of the recovery after the principle can vary from a flat percentage to a waterfall approach, under which the percentage increases as rates of return increase. Some claim funders purchase portions of the claim asset itself, while others purchase an interest in the outcome—the proceeds of the claim asset. Additionally, some newer players offer value-added services in addition to funding.<sup>151</sup> Lastly, commercial claim funding arrangements differ in the level of influence and control the funders exert over the management of the case.<sup>152</sup>

The following sections provide snapshots of the status of commercial claim funding in Australia and the United Kingdom. It then compares them to the state of the industry in the United States. As will be explicated below, the level of acceptance of claim funding varies greatly, with the

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146. ABA White Paper, *supra* note 22, at 6 (using the term “alternative litigation finance”).

147. *See id.* at 7.

148. *See infra* notes 212–14 and accompanying text.

149. *See supra* note 22.

150. *See, e.g.,* Legal Asset Funding, LLC v. Veneski, No. 3:04-Civ. 01156, 2006 WL 2623884, at \*1 (M.D. Pa. Sept. 12, 2006) (describing a financing agreement in which the funder purchased an attorney's interest in a contingency fee). Commercial claim funding agreements between funders and lawyers (or law firms) are rarer and more problematic from an ethical and public policy standpoint. Because they raise different questions, funding contracts between funders and lawyers or firms are outside the scope of this Article. Instead, this Article focuses on funding agreements with corporations or governmental entities.

151. Sometimes these services are included as part of the contract with the claimholder and therefore appear to be more conditional than optional—that is, a condition for the funding. Other times, funders provide these services in addition to those in the contract and therefore are completely optional.

152. *See* Sebok, *supra* note 16, at 109 (explaining that “[t]he degree of control the investor obtained by contract can, in theory, extend over a spectrum ranging from relatively minor control (for example, control over what documents the investor can see) to almost complete control (for example, control over selection of counsel or veto power over settlement)"); Waye, *supra* note 25, at 236 (explaining that “[t]he arrangements made between litigation funders, claim holders and legal practitioners vary in the degree of control exerted by the funder over the prosecution of the claim, and in relation to the nature of financial arrangements funders make with legal practitioners”).

United States being the least tolerant of the three. That said, it appears that commercial claims are a real asset class and that there is a sizeable market for commercial claims across the globe.<sup>153</sup>

#### A. Australia

Commercial claim funding is widely allowed in Australia, where most jurisdictions have statutorily eliminated champerty.<sup>154</sup> Indeed, in most of Australia, third-party funders are allowed to control any and all aspects of the litigation. Even in jurisdictions that have not abolished champerty, Australian courts have avoided finding agreements with commercial claim funders champertous because other doctrines exist to prevent outsiders, who want to use the court system to harass or ruin competitors, from misusing the courts.

In *Campbells Cash & Carry Pty Ltd. v Fostif Pty Ltd.*,<sup>155</sup> the High Court of Australia confirmed that arrangements allowing funders to provide all instructions to the solicitors, settle the claim for no less than 75 percent of the amount claimed, and receive up to 33.3 percent of any amount that the claimants recovered were neither against public policy nor an abuse of the court's process.<sup>156</sup> On the contrary, they actually improved access to justice. As Justice Michael Kirby, concurring in the court's judgment, explained, "A litigation funder . . . does not invent the rights. It merely organises those asserting such rights so that they can secure access to a court of justice that will rule on their entitlements one way or the other, according to law."<sup>157</sup> He emphasized that "the alternative is that very many persons . . . are unable to recover upon those claims in accordance with their legal rights."<sup>158</sup> The court found it "hardly surprising" that such investors would want to control the litigation,<sup>159</sup> but believed that other existing doctrines regulating abuse of process and lawyers' conflicting duties were sufficient to ensure that agreements were not champertous.<sup>160</sup> Thus, the Australian courts recognize "[t]he importance of not preventing 'humble men' from receiving 'contributions to meet a powerful

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153. The value of claim funders' investments in U.S. lawsuits has been estimated to exceed \$1 billion. See Binyamin Appelbaum, *Putting Money on Lawsuits, Investors Share in the Payouts*, N.Y. TIMES, Nov. 15, 2010, at A1.

154. See Wayne Attrill, *Ethical Issues in Litigation Funding*, CLAIMS FUNDING INT'L 1, 2 (Nov. 12, 2008), [http://www.claims-funding.eu/uploads/media/Ethical\\_Issues\\_Paper.pdf](http://www.claims-funding.eu/uploads/media/Ethical_Issues_Paper.pdf); see *infra* note 187 and accompanying text (defining champerty).

155. (2006) 229 CLR 386 (Austl.).

156. See *id.* at 414–15, 433–34 (Gummow, Hayne, & Crennan JJ).

157. *Id.* at 468 (Kirby J).

158. *Id.* at 442.

159. *Id.* at 433–34 (Gummow, Hayne, & Crennan JJ).

160. See *id.* at 435 ("Why is that fear [of champerty] not sufficiently addressed by existing doctrines of abuse of process and other procedural and substantive elements of the court's processes? And if lawyers undertake obligations that may give rise to conflicting duties there is no reason proffered for concluding that present rules regulating lawyers' duties to the court and to clients are insufficient to meet the difficulties that are suggested might arise.").

adversary,”<sup>161</sup> even if, to receive those funds, there will be certain conditions that enable the funder to influence the manner in which the claim is resolved.<sup>162</sup>

Given these types of decisions, there is an expanding market for commercial claim funders in Australia.<sup>163</sup> There are at least five third-party funding companies, comprising approximately 95 percent of the market.<sup>164</sup> One, IMF (Australia) Ltd., is listed on the Australian Stock Exchange.<sup>165</sup> IMF has grown at a rate of 100 percent per year since listing and it represents claims of more than A\$1 billion.<sup>166</sup> As of 2006, Australian claim funders have collectively invested approximately A\$20 million per year.<sup>167</sup> Further, the Law Council of Australia has recommended that the price of the funding should not be regulated, but instead should be left up to the market and funders’ level of acceptable risk, such as insurance premiums.<sup>168</sup> Apparently, a new asset class has emerged in the Australian capital markets.<sup>169</sup>

161. *Id.* at 482–83 & n.416 (Kirby J) (quoting *Martell v. Consett Iron Co. Ltd.*, [1955] 1 Ch. 363 at 386 (Danckwerts J.) (Eng.)).

162. See *Domson Pty Ltd. v. Zhu* [2005] NSWSC 1070, ¶¶ 74–77 (Austl.). In *Domson*, the court rebuked the plaintiff claimholder’s argument that its agreement with the funder was champertous and that it did not have to pay because of the degree of control given to the funder. See *id.* ¶¶ 72–77. It said that “no public policy was in fact infringed” and that “[i]t sits ill in the mouth of [the plaintiff] to submit that the agreement could have given rise to an abuse of process” since “[t]he funding arrangement . . . assisted [the plaintiff] in ultimately establishing a meritorious claim.” *Id.* ¶ 78.

163. See, e.g., Nikki Tait, *Party Funds Backing \$174M Claim Against Auditor*, FIN. TIMES, Jan. 5, 2007, at 1 (“Litigation funding . . . has become more established in some overseas jurisdictions, notably Australia.”).

164. See LAW COUNCIL AUSTR., STANDING COMM. OF ATT’YS-GEN., LITIGATION FUNDING 6 (Sept. 14, 2006) [hereinafter 2006 STANDING COMM. SUBMISSION], available at [http://www.lawcouncil.asn.au/shadomx/apps/fms/fmsdownload.cfm?file\\_uuid=8C744AB2-1C23-CACD-2297-5D181CEBB545&siteName=lca](http://www.lawcouncil.asn.au/shadomx/apps/fms/fmsdownload.cfm?file_uuid=8C744AB2-1C23-CACD-2297-5D181CEBB545&siteName=lca).

165. See Susan Lorde Martin, *Litigation Financing: Another Subprime Industry that Has a Place in the United States Market*, 53 VILL. L. REV. 83, 107 (2008).

166. See *id.*; Virginia Marsh, *Australian Company Pioneers Approach*, FIN. TIMES, Jan. 5, 2007, at 3.

167. Martin, *supra* note 165, at 109 & n.204 (citing John Walker, *Litigation Funding for Consumers of Civil Justice System Services*, IMF (AUSTL.) LTD 3 (Nov. 1, 2006), available at <http://www.imf.com.au/pdf/LitigationFundingForConsumers.pdf>).

168. See LAW COUNCIL AUSTR., STANDING COMM. OF ATT’YS-GEN., LITIGATION FUNDING 7–9 (Oct. 6, 2005) [hereinafter 2005 STANDING COMM. SUBMISSION], available at [http://www.lawcouncil.asn.au/shadomx/apps/fms/fmsdownload.cfm?file\\_uuid=FFCE6A85-1C23-CACD-224A-8A0F93EC7C7C&siteName=lca](http://www.lawcouncil.asn.au/shadomx/apps/fms/fmsdownload.cfm?file_uuid=FFCE6A85-1C23-CACD-224A-8A0F93EC7C7C&siteName=lca) (discussing the Law Council’s recommendations); see also Martin, *supra* note 165, at 111. In Australia, commercial claim funders provide the same benefits and offerings as insurance carriers, such as legal strategy services and decision making, finance, and indemnification. See *id.* at 109.

169. See Monica Porter, *The Jury’s Out over Third-Party Investment in Legal Actions*, FIN. TIMES, Apr. 7, 2007, at 6 (describing commercial claim funding as “a new asset class for adventurous investors”); Michael Legg et al., *Litigation Funding in Australia* 41 (Univ. of N.S.W. Faculty of Law Research Series, Paper No. 12, 2010), available at <http://law.bepress.com/cgi/viewcontent.cgi?article=1207&context=unswwps> (“[L]itigation funding has a bright future in Australia.”).

### B. The United Kingdom

In the United Kingdom, third-party funding of litigation was not allowed until 1967,<sup>170</sup> when the Criminal Law Act of 1967<sup>171</sup> abolished torts and crimes for maintenance and champerty.<sup>172</sup> As the Court of Appeal (Civil Division) points out, the statute did not abolish the doctrine of champerty in practice. Instead, “champerty survives as a rule of public policy capable of rendering a contract unenforceable.”<sup>173</sup> Thus, U.K. courts will consider the level of involvement of the funder, the time at which the agreement was made, the share of the recovery allotted to the funder, and the importance of increasing access to justice—which the courts generally believe agreements with third-party funders do—in determining whether to enforce claim funding agreements.<sup>174</sup>

Generally, U.K. courts uphold agreements with funders as long as they do not play too active of a role in controlling the litigation,<sup>175</sup> but this determination can be difficult to make. For instance, in *Queen ex rel. Factortame v. Secretary of State for Transport*,<sup>176</sup> the court upheld a funding agreement with a third-party funder, who had counseled the claimholder and lawyers on settlement, advised and liaised with damages experts, and offered forensic accounting services.<sup>177</sup> The court emphasized that funding came in only *after* the issue of liability was already decided, when there was only the remote possibility that the House of Lords would reverse the decision on appeal,<sup>178</sup> and the funder “had no role at all to play” in the appeal.<sup>179</sup> The court did not find the funder’s other involvement or his advice on settlement champertous because the lead attorney had retained control of the litigation by using separate counsel for each claimant and a reputable, experienced firm of solicitors.<sup>180</sup> Similarly, in *Arkin v. Borchard*

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170. See Anthony J. Sebok, *Betting on Tort Suits After the Event: From Champerty to Insurance*, 60 DEPAUL L. REV. 453, 453 n.3 (2011).

171. Criminal Law Act, 1967, c. 58 (U.K.).

172. See *id.* §§ 13(1), 14(1); *Queen ex rel. Factortame v. Sec’y of State for Transp.*, [2002] EWCA (Civ) 932 [31], [2003] Q.B. 381 at 399 (Eng.).

173. *Factortame*, [2002] EWCA (Civ) at [31], [2003] Q.B. at 399. Indeed, it is just this type of “public policy” that prevents officers of the court in the United Kingdom from offering contingency fee arrangements. *Trendtex Trading v. Credit Suisse*, [1980] 1 Q.B. 629 at 663 (Eng.); *Giles v. Thompson*, [1993] 3 All E.R. 321 at 332 (Steyn L.J.) (Eng.) (“Contingency fee agreements are nowadays perhaps the most important species of champerty. Such agreements are still unlawful.”). Contingency fee agreements are only unenforceable, however, when “the provision of litigation or advocacy services [are] concluded by those with rights to conduct litigation.” *Factorame*, [2002] EWCA (Civ) at [54], [2003] Q.B. at 405.

174. See *id.* at [79]–[90], [2003] Q.B. at 412–14.

175. An example is IM Litigation Funding, which a group of attorneys founded in 2002. See 2006 STANDING COMM. SUBMISSION, *supra* note 164, at 4 (discussing the role of litigation funding firms).

176. [2002] EWCA (Civ) 932, [2003] Q.B. 381.

177. See *id.* at [28]–[30], [2003] Q.B. at 398–99.

178. See *id.* at [81], [2003] Q.B. at 412.

179. *Id.*; see also *id.* at [82], [2003] Q.B. at 412 (holding that the agreement was not contrary to public policy).

180. *Id.* at [90], [2003] Q.B. at 414.



*Lines Ltd.*,<sup>181</sup> the Court of Appeal approved third-party funding, but stressed that the claimholder was “the party primarily interested in the result of the litigation and the party in control of the conduct of the litigation.”<sup>182</sup>

So far, U.K. courts have not gone as far as Australian courts in allowing a funder to exert control over the management of a case,<sup>183</sup> but this may change in the near future. The commercial claim funding industry is not as developed in the United Kingdom as it is in Australia, but it is growing fast and some predict that litigation is increasing.<sup>184</sup> Moreover, contingency fees are not allowed in the United Kingdom, so claim funding provides access to an otherwise unavailable court system.<sup>185</sup> Courts and regulators alike view claim funding as a way for more litigants to access justice.<sup>186</sup> Thus, it would not be surprising if the United Kingdom followed Australia’s lead.

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181. [2005] EWCA (Civ) 655, [2005] 1 W.L.R. 3055 (Eng.).

182. *Id.* at [40], [2005] 1 W.L.R. at 3070.

183. See Attrill, *supra* note 154, at 6 (“English courts are yet to go as far as the High Court, particularly on the vexed issue of the degree of control the funder may have over the proceedings, but there are unmistakable signs that they are moving towards accepting a wider role for funders.”).

184. See Mary Jacoby, *U.K. Auditions Litigation: Regulators Urge U.S.-Style Suits Against Cartels*, WALL ST. J., Jan. 16, 2007, at A12 (analyzing claim funding in the United Kingdom); see also Martin, *supra* note 165, at 113 (making the same point that the United Kingdom is closing the gap with Australia); Andrew Hill, *Ignore the ‘Trends’ and Examine the Retail Detail*, FIN. TIMES, Jan. 5, 2007, at 18.

185. See Martin, *supra* note 165, at 112–13. In the United Kingdom and Australia, plaintiffs cannot engage attorneys on a contingency basis and losing plaintiffs have to pay the defendant’s legal expenses. See Waye, *supra* note 25, at 232. But see U.S. CHAMBER INST. FOR LEGAL REFORM, THIRD PARTY FINANCING: ETHICAL & LEGAL RAMIFICATIONS IN COLLECTIVE ACTIONS 15 (Nov. 2009), available at <http://www.instituteforlegalreform.com/sites/default/files/images2/stories/documents/pdf/research/thirdpartyfinancingeurope.pdf> (suggesting that the relationships developed between third-party funders and attorneys provide more control to the financier); Herbert M. Kritzer, *Seven Dogged Myths Concerning Contingency Fees*, 80 WASH. U. L.Q. 739, 757–72 (2002) (examining the returns lawyers earn on the time they invest in contingency fee cases). Although lawyers cannot have a fee indexed to the recovery in the United Kingdom, they can be given what is called a conditional fee, which is an uplift on the fee that is not tied to the recovery. See Tariq Ahmad, *European Court of Human Rights/United Kingdom: Use of Conditional Fee Agreements Seen as Violation of European Convention on Human Rights*, LIBR. CONGRESS (Jan. 24, 2011), [http://www.loc.gov/lawweb/servlet/lloc\\_news?disp3\\_l205402484\\_text](http://www.loc.gov/lawweb/servlet/lloc_news?disp3_l205402484_text).

186. In the United Kingdom, the structure of the legal profession and the regulatory framework are different than in the United States: there are barristers and solicitors, and class actions are not allowed. See John C. Coffee, Jr., *Law and the Market: The Impact of Enforcement*, 156 U. PA. L. REV. 229, 266–67 (2007) (“Class actions remain rare to unknown in Europe (including the United Kingdom) . . .”). Therefore, these countries view claim funding as a way for more litigants to access justice. See 2005 STANDING COMM. SUBMISSION, *supra* note 168, at 10 (noting that “access to justice” was an important consideration); Martin, *supra* note 165, at 106–07; *id.* at 112–13 (“In the UK, the Civil Justice Council, an advisory public body responsible for overseeing the modernization of the civil justice system, concluded in April 2007 that litigation funding played an important role in facilitating access to justice and that no new regulations of the industry were necessary.”); Attrill, *supra* note 154, at 6.

### C. The United States

Commercial claim funding's level of acceptance in the United States is dramatically behind that of Australia and the United Kingdom. Although claim funding is allowed in some states, its status is still very precarious. In some places, the defenses of champerty, maintenance, and barratry<sup>187</sup> sometimes work to void claim funding arrangements.<sup>188</sup> In those states where these doctrines still exist, either at common law or by statute, claim funding is either prohibited or severely restricted. In the other states, courts have either eliminated these doctrines or failed to adopt them in the first place.<sup>189</sup> Although some courts recognize that "agreements to purchase an interest in an action may actually foster resolution of a dispute,"<sup>190</sup> many of the courts upholding these agreements do so with little enthusiasm. Like their counterparts that invalidate these agreements, these courts express concern that claim funding will instigate litigation of unjustified claims,<sup>191</sup>

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187. See *In re Primus*, 436 U.S. 412, 424 n.15 (1978) ("[M]aintenance is helping another prosecute a suit; champerty is maintaining a suit in return for a financial interest in the outcome; and barratry is a continuing practice of maintenance or champerty."); ABA White Paper, *supra* note 22, at 10 ("Champerty is considered a type of maintenance."). For a description and analysis of these doctrines in the claim funding context, see generally Douglas R. Richmond, *Other People's Money: The Ethics of Litigation Funding*, 56 MERCER L. REV. 649 (2005).

188. See, e.g., *MNC Credit Corp. v. Sickels*, 497 S.E.2d 331, 333–34 (Va. 1998) (citing *Goodley v. Wank & Wank, Inc.*, 133 Cal. Rptr. 83, 87 (Cal. Ct. App. 1976)). According to at least one scholar, "Assignment of personal injury tort claims is prohibited throughout the United States." Sebok, *supra* note 16, at 62. Some courts will distinguish between an agreement that assigns the cause of action itself and one that assigns a portion of the proceeds, viewing the latter, which is similar to an insurance contract, as an enforceable equitable assignment. See *id.* at 85; see also *Costanzo v. Costanzo*, 590 A.2d 268, 271 (N.J. Super. Ct. 1991). Other courts claim that there is no distinction. See, e.g., *Karp v. Speizer*, 647 P.2d 1197, 1199 (Ariz. Ct. App. 1982); *Town & Country Bank of Springfield v. Country Mut. Ins. Co.*, 459 N.E.2d 639, 640–41 (Ill. App. Ct. 1984); Sebok, *supra* note 16, at 121 ("[T]he common law of the United States embraces free assignability in all choses of action except personal injury . . . legal malpractice (except when it does), and fraud (except when it does)"). For a thorough discussion of this aspect of the case law and the history of the doctrine, see generally Sebok, *supra* note 16.

189. See ABA White Paper, *supra* note 22, at 112 (explaining that some state courts have held that the English common law prohibitions on champerty were never adopted, while others abandoned or struck down the champerty laws that were adopted from England, or otherwise made clear that they would enforce claim funding agreements to some degree). According to research conducted by Anthony Sebok, twenty-eight jurisdictions specifically allow champerty, with some limitations. Sebok, *supra* note 16, at 98–99 & n.162; see also Paul Bond, *Making Champerty Work: An Invitation to State Action*, 150 U. PA. L. REV. 1297, 1333–41 (2002). According to the ABA, there may be even more jurisdictions that tolerate champerty to some degree, "[g]iven the somewhat ancient status of the decisions" which prohibit the practice. See ABA White Paper, *supra* note 22, at 12.

190. *Saladini v. Righellis*, 687 N.E.2d 1224, 1226–27 (Mass. 1997) (quoting *McInerney v. Massasoit Greyhound Ass'n*, 269 N.E.2d 211, 217 (Mass. 1971)) (internal quotation marks omitted).

191. Sebok, *supra* note 16, at 126 (explaining that although "[t]here is no common law prohibition of maintenance (or champerty) in New York," "New York's law of assignment and maintenance is concerned almost exclusively with contracts made *before* the lawsuit is filed" to prevent instigating litigation).

interfere in the attorney-client relationship and the independence of the lawyer,<sup>192</sup> and disenfranchise plaintiffs.<sup>193</sup>

In some of those states that have abolished champerty, maintenance, and barratry, courts may still invalidate agreements with third-party funders as unconscionable<sup>194</sup> or against public policy. These courts refuse to uphold claim funding agreements if the third party is an "officious intermeddler," i.e., attempting to influence trial strategy or settlement.<sup>195</sup> For example, Florida defines officious intermeddling as "'offering unnecessary and unwanted advice or services . . . esp[ecially] in a highhanded or overbearing way.'"<sup>196</sup> Thus, intermeddling can be found even if the claimholder retains the power to select his or her attorney, settle, or abandon the suit,<sup>197</sup> and select the theory and strategy for the case.<sup>198</sup>

192. There are many opinions from bar committees around the country emphasizing this issue, which encompasses the effect a third-party funding agreement has on a litigant's settlement power, the attorney-client privilege and work-product doctrine, and the sanctity of the lawyer-client relationship in general. *See, e.g.*, State Bar of Ariz. Comm. on the Rules of Prof'l Conduct, Op. 01-07 (Sept. 2001) (permitting a lawyer to set up a line of credit with a third-party lender to advance a client's costs provided that "representation of the client will not be 'materially limited' by the lawyer's responsibilities to the lender"); Fla. Bar Prof'l Ethics Comm., Op. 00-3 (Mar. 15, 2002) (allowing that attorney to recommend a client to a funder in limited circumstances, provided that the attorney does "not allow the funding company to direct the litigation, interfere with the attorney-client relationship, or otherwise influence the attorney's independent professional judgment"); N.J. Advisory Comm. on Prof'l Ethics, Op. 691 (Jan. 2001) ("Counsel must refrain from any relationship with or responsibilities to the [funder] which could in any way impair his or her duty of undivided fidelity to the client."); *see also* Sebok, *supra* note 16, at 135 (same); ABA White Paper, *supra* note 22, at 17-22. For a discussion of these issues, *see infra* Part IV.

193. *See Echeverria v. Estate of Lindner*, No. 018666/2002, 2005 WL 1083704, at \*8 (N.Y. Sup. Ct. Mar. 2, 2005) (remarking, in upholding the agreement, that "the Attorney General seems to have given these types of funding institutions his blessing"); Martin, *supra* note 165, at 109 ("Nevertheless, there has also been a longstanding fear in the United States that litigation financing would strip plaintiffs of their power to control their litigation and would interfere with the relationship between attorney and client."); Sebok, *supra* note 16, at 69-70 (citing *MNC Credit Corp. v. Sickels*, 497 S.E.2d 331, 333 (Va. 1998)).

194. *See, e.g.*, *Fausone v. U.S. Claims, Inc.*, 915 So. 2d 626, 630 (Fla. Dist. Ct. App. 2005) (intimating that it might not uphold future agreements where interest rates "are higher than the risks associated with the transaction" and commenting that "a company that only loaned money when it was secured by high-grade personal injury claims would seem to be able to charge a lower interest rate than some of the rates described in this opinion, even when the arrangement is a nonrecourse loan").

195. It appears that in many of the states where prohibitions against champerty still exist, the test is whether there is "officious intermeddling," which includes offering advice in the conduct of the litigation, determining trial strategy, or controlling settlement. *See Kraft v. Mason*, 668 So. 2d 679, 682 (Fla. Dist. Ct. App. 1996); Isaac Marcusshamer, Note, *Selling Your Torts: Creating a Market for Tort Claims and Liability*, 33 HOFSTRA L. REV. 1543, 1551 n.34 (2005) (citing 4 WILLIAM BLACKSTONE, COMMENTARIES \*134-35); *see also* ABA White Paper, *supra* note 22, at 12.

196. *Kraft*, 668 So. 2d at 682 (quoting WEBSTER'S NEW WORLD DICTIONARY 988 (2d college ed. 1986)). *But see* Sebok, *supra* note 16, at 116 (arguing that giving advice is too low a standard and that intermeddling should mean that the funder has acquired the claimholder's right to make certain decisions regarding the litigation).

197. *See Am. Optical Co. v. Curtiss*, 56 F.R.D. 26, 27 (S.D.N.Y. 1971).

198. *See* Sebok, *supra* note 16, at 111-12; *see also id.* at 109-10 & n.196 (explaining how a funder might legally contract to get practical control over settlement or control the theory of the case and describing terms of a contract illustrating different types of demands a

Even when courts uphold claim funding agreements, they make clear that they might not do so in the future if the agreements establish a relationship with the funder that is anything more than passive, or if the contract was with the lawyer. They suggest that agreements that permit investors to take anything more than a passive role in the case—choose the attorney, select trial strategy, participate in settlement talks, or receive payment directly from the lawyers—would violate public policy.<sup>199</sup> The ABA has taken the same position, contending that an agreement that prevents a plaintiff from changing attorneys without consent of the funder would violate public policy.<sup>200</sup> Indeed, some states have enacted legislation requiring that claim funding contracts specifically deny funders the right to make any decisions regarding the claim or settlement of it.<sup>201</sup> Thus, if the agreement grants the funder any type of active role, the courts may void it as against public policy.<sup>202</sup>

As with lawyers involvement with nonlawyers generally, another driving concern in this context is that claim funding will cause lawyers to violate the Model Rules governing lawyers' independent professional judgment,<sup>203</sup>

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third-party funder might make). Other states, including Colorado, do not show much concern over control issues. *See, e.g.,* Bashor v. Northland Ins. Co., 480 P.2d 864, 867 (Colo. Ct. App. 1970) (holding a contract lawful regardless of whether or not the claimholder retains the power to select its attorney, and finding the argument for its illegality “a little paradoxical coming from defendant who is operating under a similar contract, *i.e.*, the insurance policy”); Sebok, *supra* note 16, at 113 (interpreting this case as taking the position that “if the suit brought is meritorious—meaning that the plaintiff wanted to bring it, but was wanting of resources—then the degree of control exercised by the funder is irrelevant”).

199. *See, e.g.,* Anglo-Dutch Petrol. Int'l, Inc. v. Haskell, 193 S.W.3d 87, 104 (Tex. Ct. App. 2006).

200. *See* ABA White Paper, *supra* note 22, at 22; *see also id.* at 25 (“Even in states permitting an ALF supplier to obtain an interest in a party’s cause of action, retention by the supplier of control over the decision-making of the party and its counsel, via a contractual provision between the supplier and the party, may be deemed unlawful as champerty or maintenance.”).

201. *See, e.g.,* OHIO REV. CODE ANN. § 1349.55(B)(3) (LexisNexis Supp. 2011); Richmond, *supra* note 187, at 682 (“[T]he funding company should agree that it will neither attempt to direct nor regulate the attorney’s judgment in the case being funded.”); *cf.* Martin, *supra* note 165, at 109 (“[I]n the United States, litigation funders merely advance money to plaintiffs to use any way they wish; they do not directly fund the litigation at all, a role that is, however, permitted for U.S. attorneys.”); ABA White Paper, *supra* note 22, at 26 (explaining that “some ALF suppliers disclaim any control over the decision-making of lawyers, stating that they are in an entirely passive role,” and some courts note that “the ALF supplier exercised no control over the lawyer’s representation of the client.”).

202. It is not clear, however, how passive a role a funder will play even if the agreement is silent on the issue. The funder wields considerable power as keeper of the checkbook and with that power has *de facto*, if not *de jure*, influence. *See infra* note 220. In one Florida case, in which the funder had the contractual rights to approve filing issues, control attorney selection, review attorney bills, find expert witnesses, and veto any settlement agreements, the court treated the funder as a “party” with respect to a fee-splitting statute. *See Abu-Ghazaleh v. Chaul*, 36 So. 3d 691, 693–94 (Fla. Dist. Ct. App. 2009).

203. Model Rule 2.1 requires lawyers to exercise objective independent judgment. *See* ABA White Paper, *supra* note 22, at 23–26; *cf.* Richmond, *supra* note 187, at 651–52 (contending that litigation funding is ethical but that “[c]ritics of the practice are concerned that litigation financiers will potentially manipulate the parties to whom they make loans or

conflicts of interest,<sup>204</sup> fee splitting,<sup>205</sup> and confidentiality.<sup>206</sup> Even when the contract is between the funder and the client, the ABA predicts that problems will arise about “who actually owns the claim, who controls the lawsuit, the role (if any) of the [funder] participating in significant decision-making during the litigation, and how to resolve conflicts between the client’s directive, the [funder]’s financial expectations, and the lawyer’s assessment of the client’s best interests.”<sup>207</sup> Essentially, the ABA fears that even lawful agreements between the funder and the client (whether a corporation or consumer) could interfere with the ability of the attorney to render independent judgment.<sup>208</sup>

There is the potential for a large claim funding market in the United States. In 2005, publicly listed U.S. companies reported approximately \$52 billion of exposure to contingent obligations,<sup>209</sup> and this number may be understated given that it excludes claims that could not be monetized and claims by companies as plaintiffs.<sup>210</sup> Some have estimated that litigation funding could be a billion dollar business in the United States.<sup>211</sup> Indeed, outsiders have been investing in claims in the United States for about twenty years.<sup>212</sup> Outsider funding has been used in the consumer context to fund many large, well-known cases, such as the Vioxx litigation and some asbestos cases.<sup>213</sup> It has also been used in the commercial context within

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will act in ways that impair the professional judgment of the attorneys to whom they advance expenses”).

204. See ABA White Paper, *supra* note 22, at 17–22 (identifying the conflicts of interest issues); see also *Oliver v. Bd. of Governors*, 779 S.W.2d 212, 215 (Ky. 1989) (“[A]n attorney’s primary loyalty will, as a practical matter, rest with the person or entity who pays him.”).

205. See ABA White Paper, *supra* note 22, at 31.

206. See *id.* at 23 (explaining that lawyers should be careful to warn clients that the attorney-client privilege may be waived if confidential information is disclosed to third-party funders); see also *supra* notes 107–15 and accompanying text.

207. See, e.g., ABA White Paper, *supra* note 22, at 25–26.

208. *Id.* at 28 (making this claim as it relates to requirements for consent of the ALF to settle).

209. SEC, REPORT AND RECOMMENDATIONS PURSUANT TO SECTION 401(C) OF THE SARBANES-OXLEY ACT OF 2002 ON ARRANGEMENTS WITH OFF-BALANCE SHEET IMPLICATIONS, SPECIAL PURPOSE ENTITIES, AND TRANSPARENCY OF FILINGS BY ISSUERS 71 (June 15, 2005), available at <http://www.sec.gov/news/studies/soxoffbalancrpt.pdf>.

210. See *id.* at 72 & n.175.

211. See *New York City Bar Gives Thumbs Up to Litigation-Funding*, THOMSON REUTERS NEWS & INSIGHT (June 20, 2011), [http://newsandinsight.thomsonreuters.com/Legal/News/2011/06\\_-\\_June/New\\_York\\_City\\_Bar\\_gives\\_thumbs\\_up\\_to\\_litigation-funding/](http://newsandinsight.thomsonreuters.com/Legal/News/2011/06_-_June/New_York_City_Bar_gives_thumbs_up_to_litigation-funding/) [hereinafter *NYC Bar*] (“The practice of seeking funding for cases from outside investors has been on the rise for 20 years, the [New York City Bar] [A]ssociation said. It has moved from a cottage industry of personal-injury cases to a \$1 billion business involving a wide swath of commercial litigation.”).

212. See, e.g., *Killian v. Millard*, 279 Cal. Rptr. 877, 878 (Cal. Ct. App. 1991) (describing how the plaintiffs were “[u]nable to personally finance their lawsuit” and thus “syndicated it by creating 50 ‘units’ for sale at \$10,000 per unit with a 2-unit minimum per investor”); Susan Lorde Martin, *Syndicated Lawsuits: Illegal Champerty or New Business Opportunity?*, 30 AM. BUS. L.J. 485, 498 (1992).

213. See Martin, *supra* note 165, at 84 n.4 (“Nevertheless, it is fairly well known that many large lawsuits, such as the vitamins anti-trust suit, the asbestos cases and the Vioxx cases, have been supported by litigation financing companies which are funded by banks,

the United States.<sup>214</sup> Currently, commercial claim funding is offered to plaintiffs and defendants by hedge funds, commercial banks,<sup>215</sup> investment banks,<sup>216</sup> and specialty companies dedicated to the claim funding industry, including Juridica, Burford, BlackRobe Capital, Fullbrook Capital, and IMF (United States).<sup>217</sup>

Thus, the commercial claim funding train has left the station. It is broadly allowed in Australia and the United Kingdom (among other countries<sup>218</sup>), and it is occurring within the United States as well, as even the ABA has recognized.<sup>219</sup> Yet the U.S. legal profession only wants to allow claim funding if the third-party funder has absolutely no influence over the litigation, case management, or settlement decisions. Although protecting lawyers' independent judgment is important, and contracts can certainly be written to literally meet that expectation, barring the funder from having any influence is incompatible with claim funding in practice.<sup>220</sup>

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private equity and hedge funds.”); Alison Frankel, *The Loan Arrangers*, AM. LAW., Oct. 1, 2005, at 74 (available on LexisNexis in “The American Lawyer” database).

214. See generally Frankel, *supra* note 213; NYC Bar, *supra* note 211. Commercial claim funders helped finance the recent Ecuadorian case against Chevron. See Patrick Radden Keefe, *Reversal of Fortune*, NEW YORKER, Jan. 9, 2012, at 38, 43 (noting that Burford Capital invested millions of dollars in the case).

215. Credit Suisse owns PeachTree Financial Solutions, which “purchase[s] assets including structured legal settlements, annuities, lottery winnings, sports contracts and life insurance policies.” See *About Us*, PEACHTREE FIN. SOLUTIONS, <http://peachtreefinancial.com/company/> (last visited Apr. 21, 2012).

216. See Michael G. Blum, *Financial Management in a Contingent Fee Practice*, FINDLAW (Feb. 2, 2012), <http://practice.findlaw.com/financing-a-law-firm/financial-management-in-a-contingent-fee-practice.html>.

217. In the consumer personal injury plaintiff context, there are many players and the amounts advanced are small. See Martin, *supra* note 165, at 107. In the commercial context, the amounts appear to be much bigger. See, e.g., *Burford Capital Profits Up 965%*, STOCKMARKETWIRE (Apr. 4, 2012, 09:02 AM), <http://www.stockmarketwire.com/article/4343538/Burford-Capital-profits-up-965pct.html> (reporting that Burford expected net profits of \$32 million after nine of its investments either concluded entirely or completed trial in 2011). Insurance companies may also participate in the industry. For example, if a claim financier agrees to provide \$3 million to a claimholder, the claim financier might work with a broker to buy insurance against losing its principal, which might cost it 10 to 15 percent of the original investment. The insurance agency and broker could share the proceeds of the policy in some fashion.

218. Claim funding is also allowed in Switzerland and Germany. See Andreas Frischknecht & Vera Schmidt, *Privilege and Confidentiality in Third Party Funder Due Diligence: The Positions in the United States and Switzerland and the Resulting Expectations Gap in International Arbitration*, TDM (SPECIAL ISSUE), Oct. 2011, at 1, 16, available at [http://www.transnational-dispute-management.com/search/get\\_page.asp?v2=download&v1=tv8%2D4%2Darticle04%2Epdf](http://www.transnational-dispute-management.com/search/get_page.asp?v2=download&v1=tv8%2D4%2Darticle04%2Epdf).

219. See ABA White Paper, *supra* note 22, at 41. (“The market for alternative litigation finance involves suppliers and customers who demand this form of financing. Because of this demand, and because of the complexity of regulation in various states, the specific form of ALF transactions will undoubtedly continue to evolve.”).

220. See ABA White Paper, *supra* note 22, at 24. Although some third-party funders claim that they do not have, or desire to have, any influence or control over case management and that they play an entirely passive role, see *id.* at 26, and although some courts accept that this is the case, see, e.g., *Anglo-Dutch Petrol. Int’l Inc. v. Haskell*, 193

This stance on claim funding is representative of the profession's stance on nonlawyer influence in general. Both are shortsighted. There are significant disadvantages to not embracing outside influence—for example, commercial claim funding—and there are potential benefits to broadening acceptance of both.

#### IV. CLAIM FUNDING AND INFLUENCE ON LAWYERS BY NONLAWYERS: A RECIPE FOR STONE SOUP

Given that open environments enhance innovation, efficiency, and problem solving, the legal profession should seek ways to open itself up to the opinions and consultation of professionals in other disciplines. Commercial claim funding is but one example of the legal profession's refusal to embrace outside collaboration with nonlawyers. Permitting commercial claim funding is one way to accrue the benefits of an open environment, which might outweigh the risks to a lawyer's independent judgment so long as they are managed properly and the funding agreement is between the funder and the claim holder—the type of agreement on which this Article focuses. Refusing to embrace outside influence, both generally and through commercial claim funding specifically, is not only misguided, but also untenable because it puts U.S. lawyers at a disadvantage vis-à-vis global competition.

This Article assumes that law is in many ways a business, and that alternative claim funding will become more accepted in the U.S. commercial context, where the claimholder's and funder's bargaining powers and savvy are in line.<sup>221</sup> The next section contends that claim funding's benefits outweigh the risks, that the risks of outside influence are not uncharted or unmanageable, and that refusing to manage the transition and further allow claim funding could make the U.S. legal market even more isolated and irrelevant.

##### *A. Commercial Claim Funding: Potential Benefits*

With the right structures in place, claim funding can provide benefits to lawyers, claimholders, and the legal marketplace generally. The next section shows what type of benefits that outside influence, in the form of commercial claim funding, could yield.

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S.W.3d 87, 104 (Tex. Ct. App. 2006), this simply cannot be accurate given the funder's interest in its investment.

221. Again, the focus here is on the commercial context and specifically on funding agreements between funders and corporations or funders and governmental entities—not agreements between funders and law firms. See *supra* note 150. Further, a survey of commercial claim funders found that most are “only interested in commercial matters involving no physical or mental injuries to the claimholder and avoid[] claims which otherwise might lead to a divergence in interests between them and the claimholder such as family law or defamation matters.” Waye, *supra* note 25, at 252. Admittedly, there are different concerns with claim funding in the consumer sector, for example, around the equality of bargaining power. These concerns, however, are not present in the commercial context.

### 1. Specific Benefits

Much has been written on the agency costs that exist between clients (principals) and their lawyers (agents).<sup>222</sup> Although many of these costs do not apply as fully in the commercial context, where clients are often sophisticated repeat players with seasoned in-house counsel<sup>223</sup> and greater bargaining power,<sup>224</sup> commercial claim funders have the potential to reduce some of the costs that remain.<sup>225</sup> Because lawyers are not necessarily experts in finance, third-party funders are better able to help claimholders understand the value of their claim<sup>226</sup> and the appropriate costs to spend pursuing the claim.<sup>227</sup> Specifically, claim funders can help determine the level of resources to devote to a case, establish optimal settlement ranges based on econometric principles and data, and provide a second opinion on case prospects. The funder can also help the lawyer and claimholder build economic arguments to be used in settlement negotiations.<sup>228</sup>

Furthermore, claim funders can provide continuous monitoring of the attorneys to ensure that deadlines and performance standards are met and that hourly billing or other fee arrangements are appropriate. Even passive third-party funders attempt to have some influence over how much lawyers are paid for their work.<sup>229</sup> But regardless of the level of control that they exercise, claim funders have a special expertise in project management and lack a personal relationship with the law firm.<sup>230</sup> A third-party claim funder's interest overlaps with the claimholder's interest because both are

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222. See, e.g., Waye, *supra* note 25, at 228–32; Wilkins, *supra* note 123, at 824–30.

223. Coates et al., *supra* note 73, at 1000 (discussing how the asymmetry of information has decreased, although it still exists, because of the rise of general counsel within large corporations).

224. See Waye, *supra* note 25, at 255 (explaining that funders and “commercially sophisticated” clients “have relatively equal bargaining power”); *cf. id.* at 231–32 (explaining that insurers and the government fall into this category).

225. See Max Schanzenbach & David Dana, How Would Third Party Financing Change the Face of American Tort Litigation? The Role of Agency Costs in the Attorney-Client Relationship (Sept. 14, 2009) (unpublished manuscript), available at [http://www.law.northwestern.edu/searlecenter/papers/Schanzenbach\\_Agency%20Costs.pdf](http://www.law.northwestern.edu/searlecenter/papers/Schanzenbach_Agency%20Costs.pdf) (arguing that agency problems in the lawyer-client relationship may be mitigated with third-party financing by aligning incentives between the attorney and the client and providing a better understanding of the value of the claim to all parties). But see Maya Steinitz, *Whose Claim Is This Anyway?: Third Party Litigation Funding*, 95 MINN. L. REV. 1268, 1338 (2011) (arguing that the potential benefits of third-party funding will increase agency problems, but ultimately concluding that, with careful management, “litigation finance is an industry whose time has come”).

226. See Waye, *supra* note 25, at 248 (“One of the most significant benefits of litigation funding is the commercial objectivity funders bring to claim evaluation.”)

227. See *id.* at 251.

228. See *id.* at 238.

229. See *id.* at 241 (intimating that funders employ “cost management techniques,” including “tender procedures,” “budgetary capping,” and “approval procedures for non-budgeted services and expenses and flat fees for certain tasks”).

230. *Cf.* Steinitz, *supra* note 225, at 1276 (arguing that, in general, funders “provide monitoring services”).



concerned with maximizing the value of the claim.<sup>231</sup> Therefore, the funder plays the role of watchdog and actively monitors this discrepancy between lawyer and client to minimize the amount of shirking.<sup>232</sup> For this reason, funders promote efficiency, which in turn assists the client.<sup>233</sup>

In-house counsel are increasingly seeking ways to decrease costs of outside legal counsel through alternative fee arrangements, and claim funders only increase the potential of finding new arrangements because third-party funding is essentially a type of alternative fee arrangement.<sup>234</sup> Third-party investors force law firms to change the way they bill and to decrease, better manage, and cap their rates. When a third-party investor arranges or provides for funding, the funder can negotiate more precise, market-oriented costs. Even semi-active funders will stay involved to ensure that lawyers stay within those budgets. In-house counsel likely do not enjoy dealing with outside counsel on billing issues or fees, so third-party funders can play that role for the in-house counsel, since they can (and want to) make sure that lawyers follow the set spending protocols and bill on time in a transparent manner.

Finally, the presence of a third-party funder signals to the opposing party that the claim is worth investing in, which means that some group of investors subjected it to due diligence and think it is likely to be meritorious. Although the Chamber of Commerce and other opponents often argue that outside investment in claims will increase unmeritorious claims and derail settlement,<sup>235</sup> the signaling function suggests that it may actually make settlement more likely in many cases.

In sum, the specific benefits that third parties potentially add to legal case management are: (1) an increased understanding of the value of the claim; (2) optimized settlement levels; (3) financial monitoring that decreases shirking and increases efficiency; (4) better alignment between out-of-pocket expenditures and the value of the claim; (5) innovation in billing structure; and (6) increased transparency on all financial aspects of claim management.

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231. See Waye, *supra* note 25, at 229 (“[I]n the lawyer-client relationship it is assumed that the rational self-interested client’s preference will be to maximize claim value whereas the rational self-interested lawyer’s interest will be to maximize fees and to minimize effort.”). This might not be true if the funder finances the suit “to gain a competitive advantage over the defendant.” *Id.* at 244 n.84. Further, there will be circumstances where the claim holder’s and funder’s interests diverge. For example, the funder may have a different time line and attitude toward risk, and the claimholder might have an interest in reputation consequences or ongoing relationship with the opposing party. This highlights the need for embedded controls, but as stated, making such recommendations is outside the scope of this Article.

232. *But see* Steinitz, *supra* note 225, at 1322–25 (arguing that the result is a “fragmentation of the triangular attorney-client-funder relationship,” which does the opposite, in that it reduces the possibility of having “agents-watching-agents”).

233. Waye, *supra* note 25, at 241.

234. Steinitz, *supra* note 225, at 1284 (“Litigation funding represents one such alternative modality. Instead of costly legal bills based on hours worked, clients can shift the costs entirely onto investors.”); *id.* (“[T]his development creates pressure on attorneys’ traditional pricing models.”).

235. Beisner Letter, *supra* note 22, at 3–4, 12.

## 2. General Benefits

Claim funding also has the potential to redefine the traditional lawyer-client relationship. Claim funding involves another party in the relationship, and when multiple voices and perspectives mix, problems are solved more efficiently and creatively.<sup>236</sup> Unlike the ties between lawyers and their corporate clients, which could be described as strong, the ties between the claimholder and passive funder are weak. As discussed above, even when the ties are weak, innovation, enhanced problem solving, and efficiency increase.<sup>237</sup>

Commercial claim funding enables nonlawyers, nonpracticing lawyers, and other types of professionals to have influence in claim management.<sup>238</sup> As explained above, even limited involvement of a third-party funder can lower costs, shorten the time for return, and sometimes enhance the actual value of the case.<sup>239</sup> Furthermore, some commercial funders provide a more active, non-subservient form of funding that helps with claim strategy and management.<sup>240</sup> Although there are legitimate concerns to heightened influence by third-party commercial funders, in this context, the contracting parties are of similar or equal bargaining power, and thus neither the claimholder nor the funder will have total control. This enables a partnership under which the funder provides advice to the claimholder that, in turn, influences how the claimholder interacts with and directs its lawyer. Thus, whether the relationship that the lawyer and claimholder have with the funder is weaker or stronger, the number of voices has changed along with the flow of discourse.

In addition, the funder may provide law-related advice to the lawyer, which may influence the lawyer and actually help the lawyer to provide better, more holistic legal advice back to the client.<sup>241</sup> To that end, the more active commercial funders offer a range of services, including electronic discovery management, legal process, outsourcing, and access to outside experts in multidisciplinary fields such as public relations, marketing, forensic accounting, or investment strategy.<sup>242</sup> While the

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236. See *supra* Part I.

237. See *supra* Part I.C (discussing benefits of weak ties).

238. Arguably this is more true in the active, as opposed to passive, context.

239. See Jason Lyon, *Revolution in Progress: Third-Party Funding of American Litigation*, 58 UCLA L. REV. 571, 603 (2010) (describing Juridica and Burford's "painstaking process of case selection"); Jennifer Banzaca, *Litigation Funding: In Turbulent Markets, Hedge Fund Managers Turn to Litigation Funding for Absolute, Uncorrelated Returns* 2-3, HEDGE FUND L. REP. (June 24, 2009), <http://www.hflawreport.com> (password required) (describing funders' due diligence before investing and their preference for lawyers with track records of success); see also *Investment Policy*, JURIDICA INVS. LTD, <http://www.juridicainvestments.com/about-juridica/investment-policy.aspx> (last visited Apr. 21, 2012).

240. Those that play this heightened role act more like venture capitalists with a substantial role in business management and less like an ordinary shareholder.

241. See *supra* Part I.

242. BlackRobe Capital, for example, states on its website that it "supplies capital and works with the claimholder, the claimholder's lawyers, and professional experts to offer extra-legal management expertise and strategic insight in large-scale domestic and

lawyer could simply hire outside services without the funder, there are some important differences that may provide added benefits.

First, it is not clear that the lawyer (or client) could afford to hire the experts without funding. Many cases are funded because the law firm and the claimholder need additional capital to successfully pursue the claim. Hiring additional experts in law-related fields is a luxury that cannot always be afforded.

Second, the service could be offered differently than is currently allowed in the United States.<sup>243</sup> The funder could offer services that clients claim they need and want as part of a multidisciplinary partnership.<sup>244</sup> It could also provide economies of scale because the experts are often already a part of the funder's company and relationships are already established with outsourcers. Currently, at a large publicly traded corporation, in-house counsel must pull together the various service providers needed to manage the case. These general counsels have complained about the failure of the law firm to help the corporate client hire the various service providers.<sup>245</sup> The commercial claim funder could fill that gap, acting as the quarterback for all the litigation support, legal, and law-related services.<sup>246</sup> Further, the party recommending or marshaling the expert advice is not the lawyer, but the funder, whose interests are aligned (albeit somewhat differently) with those of the client.

As discussed, these differences can pose real problems, but they also present opportunities. The value of third-party funding lies in the "collisions that happen when different fields of expertise converge in some

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international litigation and arbitration." BLACKROBE CAPITAL, <http://www.blackrobecapital.com/> (last visited Apr. 21, 2012). Fulbrook Capital states on its website that it "offers a range of litigation support services, including patent evaluation, electronic discovery management and legal outsourcing." FULBROOK MGMT., <http://fulbrookmanagement.com/> (last visited Apr. 21, 2012).

243. The ABA Commission recommended allowing MDPs, but the ABA House of Delegates rejected the recommendation. See Edward J. Cleary, *Multidisciplinary Practice: One Year Later*, BENCH & B. MINN. (Sept. 2000), [http://www2.mnbar.org/benchandbar/2000/sep00/mdp\\_prof-resp.htm](http://www2.mnbar.org/benchandbar/2000/sep00/mdp_prof-resp.htm).

244. See Daly, *supra* note 118, at 227–34; Carol A. Needham, *Permitting Lawyers to Participate in Multidisciplinary Practices: Business as Usual or the End of the Profession as We Know It?*, 84 MINN. L. REV. 1315, 1327 (2000); Laurel S. Terry, *A Primer on MDPs: Should the "No" Rule Become a New Rule?*, 72 TEMP. L. REV. 869, 911 (1999) (noting that the ABA Commission on MDPs "concluded that there was client demand for MDPs on the part of both individual and corporate clients, as well as interest among lawyers in forming partnerships with nonlawyers"); Katherine L. Harrison, Comment, *Multidisciplinary Practices: Changing the Global View of the Legal Profession*, 21 U. PA. J. INT'L ECON. L. 879, 915–16 (2000).

245. See Daly, *supra* note 118, at 263, 280 (describing the "client driven demand for one stop shopping" behind push for MDPs and noting data confirming the existence of that demand).

246. See generally Michele D. Beardslee, *If Multidisciplinary Partnerships Are Introduced into the United States, What Could or Should Be the Role of General Counsel?*, 9 FORDHAM J. CORP. & FIN. L. 1 (2003) (arguing that general counsels should play this role internally for their clients, if and when multidisciplinary partnerships are allowed).

shared physical or intellectual space.”<sup>247</sup> With the cacophony of voices, there is more opportunity for exaptation and tinkering—using parts from other disciplines in new areas, or using old parts in new ways.<sup>248</sup>

These new voices will help drive change, both in the relationships between claimholders and their lawyers, and the financial structure of the legal marketplace. Claim funders can provide information to the marketplace about claim value and resolution statistics that will enhance transparency and likely lead to more and earlier settlements. Claim funding may also drive (and enable) the insurance industry to provide more innovative after-the-event policy solutions. Or it may help general counsel manage costs in a more economically rational way. In either case, commercial claim funding represents a form of financial innovation, moving a type of investing from non-law fields into law and providing alternatives to traditional funding arrangements.

This relationship may, as Johnson points out, create a “messier and more chaotic” process, but “it avoids this chronic problem of good ideas being hollowed out as they progress through the development chain.”<sup>249</sup>

### *B. Claim Funding: It Is Not that Alternative*

Despite its benefits, commercial claim funding in the United States raises the following important questions: (1) what is at risk if the default assumptions are changed to more broadly embrace this practice; and (2) are those risks manageable? As indicated above, the general concerns about opening up the legal profession to nonlawyer influence involve threats to confidentiality, impairment of the lawyer’s independent judgment, and the potential for conflicts of interest. Although legitimate, all of these concerns likely can be mitigated with the right level of regulation and the attorney’s competent advising of the client.

With respect to confidentiality, the main concern is that lawyers might share confidential information with third-party funders who will waive the protections that the attorney-client privilege or work-product doctrine affords.<sup>250</sup> Although both are currently being tested in the commercial funding context,<sup>251</sup> even the ABA agrees that ensuring that the lawyer provides adequate notice and warning about information-sharing can minimize the risks associated with potential waiver.<sup>252</sup> Putting aside the issue of when the attorney-client privilege or work-product doctrine should protect communications with commercial claim funders, waiver of these

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247. JOHNSON, *supra* note 10, at 163. Obviously, this cannot occur if the funder ends up being a single and controlling voice. This Article assumes that will not be the case in the commercial context given the similar bargaining powers of the parties and that funders will likely utilize strategic advisors from outside the law to make recommendations on strategy and case management.

248. See *supra* note 81 and accompanying text.

249. JOHNSON, *supra* note 10, at 171.

250. See ABA White Paper, *supra* note 22, at 32–33.

251. See *id.* at 36–37.

252. *Id.* at 32–38.

protections is a familiar and inherent risk of any communication that involves a third-party consultant.<sup>253</sup>

Similarly, the arguments that claim funding agreements may interfere with a lawyer's ability to provide independent legal advice as required under Model Rule 5.4(c), or interfere with the lawyer's duty of loyalty creating a conflict of interest, are also familiar ones. Although these are the same "risks" that naysayers have highlighted to prevent multidisciplinary practice and outside investment in law firms,<sup>254</sup> we have accepted them in other contexts, such as in contingency fee and insured-insurer arrangements.<sup>255</sup> Thus, these risks are neither foreign nor intractable. Further, with claim funding's risks come some specific and unquantifiable benefits—some of which neither the contingency fee nor insurance contexts offer.

### 1. The Contingency Fee Analogy

In some ways, outside investment in claims is very similar to contingency fees, which have long been accepted in the United States.<sup>256</sup>

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253. There are strong arguments that both the work-product doctrine and the attorney-client privilege might apply to communications between third-party funders and claim holders when the third-party funder is exerting influence and control over the litigation and/or claim management. For example, in this situation (as opposed to when the funder is acting in a more passive role) the third party funder is acting as a consultant and, therefore, there is more support for the argument that communications with a third-party funder should be protected by the attorney-client privilege because they were necessary for the lawyer to provide legal advice to the client about whether to file the claim, proceed with trial, or settle the case.

254. See *supra* notes 97–104 and accompanying text.

255. Although it is definitely true that both of these contexts are rife with problems, the U.S. legal profession has allowed them, perhaps because the risks are worth managing. To that end, other scholars have made these same analogies to support third-party funding of legal claims in the United States. See, e.g., Martin, *supra* note 165, at 109–10 ("The same rules that protect defendants from being poorly represented by lawyers paid by insurance companies should be able to protect plaintiffs from having litigation funders exert pressure on their lawyers."); Sebok, *supra* note 16, at 99–100 (considering contingency fees a form of maintenance); Steinitz, *supra* note 225, at 1332–36 (comparing funding agreements to insurance contracts); Waye, *supra* note 25, at 235 (analogizing to insurance contracts); cf. Richard W. Painter, *Litigating on a Contingency: A Monopoly of Champions or a Market for Champerty?*, 71 CHI.-KENT L. REV. 625, 668–87 (1995) (comparing the costs and benefits of lawyers providing funding via contingency fees to nonlawyers providing financing through credit and legal-cost insurance). The Law Council of Australia has recommended that commercial claim funders be "treated the same as insurance carriers" with regard to regulation of fees. See Martin, *supra* note 165, at 111. Courts outside the United States have also made this analogy. See, e.g., *Campbells Cash & Carry Pty Ltd. v Fostif Pty Ltd.* (2006) 229 CLR 386, 434 (Gummow, Hayne, & Crennan JJ) (Austl.) (asserting that funders should be able to influence and exert the same level of control over litigation as insurers); *Project 28 Pty Ltd v Barr* [2005] NSWCA 240, ¶¶ 68–71 (Austl.) (comparing the funder-claimholder relationship to that of the insured-insurer relationship and noting that, in the latter context, absolute control over proceedings was accepted as long as there was not harm to the claimholder's interest). As a profession, we have also accepted the same risks to lawyer independence and conflicts of interest in the context of in-house counsel.

256. See Murray L. Schwartz & Daniel J.B. Mitchell, *An Economic Analysis of the Contingent Fee in Personal-Injury Litigation*, 22 STAN. L. REV. 1125, 1125 (1970); William

In a contingency fee arrangement, lawyers receive a percentage of a settlement or judgment instead of being paid up front.<sup>257</sup> Contingency fees are not considered loans or governed by usury laws because, just like commercial claim funders, contingency lawyers “fund” the pursuit of the client’s claim and risk losing all the money they have contributed if the client does not prevail.<sup>258</sup> Both contingency fee lawyers and commercial claim funders are repaid by taking a success fee.<sup>259</sup> The rates do not vary widely. A typical contingency fee arrangement yields approximately 33 percent of the recovery to the contingency lawyer, plus costs of litigation.<sup>260</sup> A funder can receive between 30 and 50 percent of the recovery.<sup>261</sup>

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R. Towns, *U.S. Contingency Fees—A Level Playing Field?*, WIPO MAG., Feb. 2010, at 3, available at [http://www.wipo.int/wipo\\_magazine/en/pdf/2010/wipo\\_pub\\_121\\_2010\\_01.pdf](http://www.wipo.int/wipo_magazine/en/pdf/2010/wipo_pub_121_2010_01.pdf) (claiming “contingency fee arrangements ha[ve] become widespread” and been around for 100 years). The U.S. Chamber Institute for Legal Reform rejects this analogy. See Beisner Letter, *supra* note 22, at 3–4.

257. Herbert M. Kritzer, *The Wages of Risk: The Returns of Contingency Fee Legal Practice*, 47 DEPAUL L. REV. 267, 270 (1998) (“Thus, the lawyer effectively insures the client for the expenses associated with pursuing a claim. In addition to insuring for the out-of-pocket expenses, the lawyer also insures the value of his or her time. If the lawyer obtains no recovery for the client, the lawyer absorbs the entire opportunity cost of the time expended on the case.”); Stewart Jay, *The Dilemmas of Attorney Contingent Fees*, 2 GEO. J. LEGAL ETHICS 813, 816 (1989) (“It goes without saying that this is an unusual form of ‘insurance’ in that the attorney, unlike an insurance company, is not guaranteed a premium.”).

258. For this reason, some state court decisions have held that claim funding agreements are not loans and therefore cannot be considered usurious. See, e.g., *Dopp v. Yari*, 927 F. Supp. 814, 824 (D.N.J. 1996); *Kraft v. Mason*, 668 So. 2d 679, 683–84 (Fla. Dist. Ct. App. 1996); *Nyquist v. Nyquist*, 841 P.2d 515, 518 (Mont. 1992); *Anglo-Dutch Petrol. Int’l, Inc. v. Haskell*, 193 S.W.3d 87, 98–99 (Tex. Ct. App. 2006). Similarly, the U.S. Chamber Institute for Legal Reform has claimed that the practice of third-party funding “avoids prohibitions against usury.” JOHN BEISNER, JESSICA MILLER, & GARY RUBIN, U.S. CHAMBER INST. FOR LEGAL REFORM, *SELLING LAWSUITS, BUYING TROUBLE: THIRD PARTY LITIGATION FUNDING IN THE UNITED STATES 2* (Oct. 2009), available at <http://www.instituteforlegalreform.com/sites/default/files/thirdpartylitigationfinancing.pdf> (“Third-party financing contracts generally resemble non-recourse loans: if the party recovers nothing, it does not have to repay the funding company.”). Other state courts, however, have characterized funds from claim investors to be loans that trigger usury rules and limitations, at least in the consumer context. See, e.g., *Oasis Legal Fin. Grp., LLC v. Suthers*, No. 10CV8380, slip op. at 6 (Colo. Denver Dist. Ct. Sept. 28, 2011), available at [http://www.coloradoattorneygeneral.gov/sites/default/files/press\\_releases/2011/09/29/oasis\\_order.pdf](http://www.coloradoattorneygeneral.gov/sites/default/files/press_releases/2011/09/29/oasis_order.pdf) (holding that “the transactions” between the funder and claim holder “create debt under the plain language of the UCCC” and “are ‘loans’ governed by the UCCC”); *Lawsuit Fin., LLC v. Curry*, 683 N.W.2d 233, 238–40 (Mich. Ct. App. 2004).

259. See Jay, *supra* note 257, at 814 (“All [contingent fees] share the basic feature that the lawyer receives a fee for services only if there is a monetary recovery by the client. The fee is commonly based on a percentage of the recovery by the plaintiff, which could be the gross amount or a net amount recovered after litigation expenses are deducted. Alternatively, contingent fees can be hourly in nature, meaning that the lawyer bills for the total hours spent on the case only if the representation has been successful.”); Waye, *supra* note 25, at 262 (“[T]he funder is usually entitled to a portion of the representative plaintiff’s damages as a success fee. The success fee represents the profit due to the funder for accepting litigation risk.”).

260. Kritzer, *supra* note 257, at 285 (explaining that it is about one-third); cf. Lester Brickman, *Contingent Fees Without Contingencies: Hamlet Without the Prince of*

There are a few important differences between claim funding and contingency fees. First, the contingency agreement is always offered at the beginning—the claim cannot get off the ground without it. This—along with the fact that in America,<sup>262</sup> each side generally pays its own legal fees—is one of the major factors opponents use to argue that contingency fees lead to baseless lawsuits that would not be brought otherwise.<sup>263</sup> Claim funding, on the other hand, usually comes in after a claim has been brought.<sup>264</sup> It is therefore curious why there are accusations that claim funding violates laws against champerty but contingency fee arrangements do not.<sup>265</sup>

Second, because defendants find contingency fees less appealing, plaintiffs utilize them more often.<sup>266</sup> Claim funding, however, appeals to

*Denmark?*, 37 UCLA L. REV. 29, 30 (1989) (arguing against the “unassailability of the standard one-third rate”).

261. Waye, *supra* note 25, at 253 (“While success fees of between 30–50% may appear, from an outsider’s perspective, to be profit gouging on the part of funders, sophisticated commercial operators are prepared to share their business risk at this price.”). The typical fee of IMF, is “thirty percent of the net proceeds of the case plus reimbursement of its costs” and “IMF’s average case lasts just more than three years.” Martin, *supra* note 165, at 107. Further, between 2002 and 2006, its return on capital of about A\$30 million has yielded A\$8 million in earnings before interest and taxes (EBIT), or about a 7 percent per annum return on capital. *Id.* at 108. In Australia during the same period, the major liability insurance carriers had a return on capital of between 15 and 22 percent. *Id.* at 108. In the United Kingdom, IM Litigation Funding generally receives between 25 and 50 percent of the proceeds of the case after expenses are reimbursed. *Id.* at 113.

262. Beisner Letter, *supra* note 22, at 3 (“In most other legal systems, the losing party must pay the opposing party’s attorneys’ fees and costs. Often referred to as the ‘English Rule,’ this approach discourages the filing of questionable claims because the losing litigant can be stuck with a hefty bill.”); see also David P. Riesenberg, Note, *Fee Shifting in Investor-State Arbitration: Doctrine and Policy Justifying Application of the English Rule*, 60 DUKE L.J. 977, 979–80 (2011).

263. Beisner Letter, *supra* note 22, at 3.

264. Claim funding often comes in after a plaintiff has already begun the suit, at a point where he, without more funds, will have to walk away from pursuing a claim that was already in progress. See, e.g., *supra* notes 176–79 and accompanying text. In fact, some jurisdictions only allow third-party funding that comes in after a lawsuit is filed. See Sebok, *supra* note 16, at 74 n.53.

265. According to the ABA,

these doctrines evolved to take account of the development of contingent-fee financing, the provision of state rules of professional conduct preserved the distinction between prohibited assistance or acquisition of an interest in the client’s cause of action, on the one hand, and permitted contingent-fee financing on the other. In substance, however, the permitted and prohibited transactions are similar—a non-party provides financial assistance to a party, or acquires an interest in the party’s cause of action.

ABA White Paper, *supra* note 22, at 22. Opponents to contingency fee arrangements also claim that they stir up litigation. See Jay, *supra* note 257, at 816 (explaining that critics contend that contingency fees “encourage[] unnecessary litigation”).

266. Towns, *supra* note 256, at 5 (“Some studies suggest defendants are unlikely to choose contingency fee arrangements over fixed fee or hourly billing arrangements, because they view litigation as a purely negative gamble.”); cf. Jay, *supra* note 257, at 814 (citing studies showing many plaintiffs could not bring their suits without contingency fee arrangements). Although generally contingency fee arrangements are offered to plaintiffs, some law firms offer partial contingency fee arrangements to defendants. For example, according to its website, Kirkland & Ellis states that “[d]efense cases can also be structured

both plaintiffs and defendants.<sup>267</sup> Because they would assume some of the risk, claim funders can offer corporate defendants cost certainty regarding their future defense expenses, which would relieve the financial pressure to capitulate to plaintiffs' settlement demands.<sup>268</sup>

Finally, in addition to offering the safety and predictability of a contingency fee arrangement, commercial claim funding contracts offer greater benefits to corporate clients because they are made between the client and the funder, not the lawyer.<sup>269</sup> For example, claim funding offers the ability to project the value of a claim asset on a company's books prior to actual recovery<sup>270</sup> and to pursue smaller or non-core claims that, without this arrangement, would be unaffordable. Whereas in a contingency fee arrangement, the interests of the lawyer and the client may at times be misaligned and create conflicts of interest in the lawyer-client relationship,<sup>271</sup> contracting with the claimholder directly means that there is a lower risk of infringing on the lawyer-client relationship, the lawyer's independent judgment, and the rules about fee splitting.<sup>272</sup> Claim funders can also advance funding to help a corporate client continue to operate while awaiting a potentially enormous recovery that would make the client more than whole again, something that the Model Rules prohibit lawyers from doing.<sup>273</sup> Further, only certain attorneys are willing to work on a

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as partial contingency fees with success contingent on agreed upon results or milestones being achieved." *Alternative Fee Arrangements*, KIRKLAND & ELLIS, <http://www.kirkland.com/sitecontent.cfm?contentID=341> (last visited Apr. 21, 2012).

267. That said, funding defendants is not likely to be as enticing to funders because the recovery is generally lower.

268. Holly E. Loiseau et al., *Third-Party Financing of Commercial Litigation*, 24 IN-HOUSE LITIGATOR, Summer 2010, at 1. Commercial claim funders can insure their investments, thereby limiting this risk. See *supra* note 217.

269. This is not always the case and sometimes the agreements are between the attorney and funder. Although it has been done in the United States, the issues around lawyer independence and conflicts of interest are exacerbated, albeit surmountable. Cf. Richmond, *supra* note 187, at 652 (arguing that litigation funding is ethical and that agreements can be made between the attorney and the funder).

270. See also Martin, *supra* note 165, at 112 ("The financing of lawsuits by third parties also serves as a risk management tool for companies that are willing to give up a share of the proceeds of the litigation in exchange for reducing the downside litigation risks and for getting some of the potential returns up front."). It also offers the ability to provide off-balance sheet financing for claim defenses.

271. See Jay, *supra* note 257, at 816 (discussing the potential possibilities for abuse, such as overcharging and lack of time commitment by the attorney because the lawyer has a certain financial stake in the outcome).

272. See Steinitz, *supra* note 225, at 1292 (noting that agreements between claimholders and funders skirt around fee-splitting prohibitions). According to opponents, however, there still may be a conflicts of interest problem. See, e.g., ABA White Paper, *supra* note 22, at 17 (identifying the conflicts of interest issues, including that "[a]n agreement between an ALF supplier and a client, permitting the ALF supplier to have veto power over the selection of counsel, may limit the client's right to terminate counsel in a manner that is inconsistent with Model Rule 1.16(a)").

273. See Richmond, *supra* note 187, at 649–50.



contingency basis, whereas an outside claim funder affords the claimholder the comfort of hiring one of their preferred providers.<sup>274</sup>

Lastly, the fact that the funding is provided by a third party is a reason why it should be embraced. The third party is a nonlawyer—an additional professional that can add value to the litigation process and the claim.<sup>275</sup>

Commercial claim funding has many of the positives that contingency fee arrangements offer, and some of the risks associated with contingency fee arrangements are reduced.<sup>276</sup> Furthermore, the differences that do exist potentially yield extra benefits with alternative commercial claim funding that do not exist in the contingency fee context.

## 2. The Insurance Analogy

When the claim funding agreements are between the claimholder and the funder, several aspects of this relationship are analogous to that between a typical insurer and an insured.<sup>277</sup>

First, similar issues concerning conflicts of interest and independence of the lawyer exist in the relationship between a typical insurer and an insured. As Maya Steinitz points out, when the insurer pays the insured's attorney, "doors open to conflicts of interest between insurer and insured, and between insurer and attorney."<sup>278</sup> The funder has a relationship with the claimholder much like the insurer's relationship with the insured, and as in the insurance context, if a conflict arises between the two, the lawyer's primary duty of loyalty lies with the client.<sup>279</sup> Claim funding actually avoids the problematic aspect of the insured-insurer relationship that arises when the insurer is also the attorney's client,<sup>280</sup> because the lawyer's duty

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274. Coates et al., *supra* note 73, at 1012–15 (finding that chief legal officers "place primary weight on relationship factors when hiring outside counsel for important matters" and that selection is "almost always determined" by prior personal experience working with the lawyer or team of lawyers); *id.* at 1009 ("By 2003, more than 60 percent of our survey respondents allocated 80+ percent of their outside spend on fewer than 25 law firms, and 39 percent allocated 80+ percent to fewer than 10 law firms."). Many law firms cannot offer the same amount of funding or the same deal as a commercial claim funder. It is not uncommon for a commercial claim funder to come into the case after the law firm has over-extended its funding capacity.

275. See Sebok, *supra* note 16, at 100 (pointing out that courts struggle with "the degree to which, non-lawyer third parties may support meritorious litigation to which they are not a party"). See generally Part I.

276. Of course, there may be other negatives that come with commercial claim funding that do not come with contingency arrangements.

277. There is much debate over whether an analogy can be made between the insurer-insured relationship and funder-funded relationship, but others have made a similar analogy. See, e.g., Beisner Letter, *supra* note 22, at 23–24; Steinitz, *supra* note 225, at 1332–33; Waye, *supra* note 25, at 235.

278. Steinitz, *supra* note 225, at 1296.

279. *Id.* at 1333 ("[T]he insurer's responsibility for the defense also affords it the right to control the litigation, though insurer's [sic] generally permit private counsel of the insured to advise and often employ outside counsel with obligations to the client."); Waye, *supra* note 25, at 235.

280. Waye, *supra* note 25, at 235; see also Steinitz, *supra* note 225, at 1334 ("In certain relatively limited circumstances, insurance law imposes on the insurer a duty to hire independent counsel for the insured.").

must still lie with the insured if there is a conflict.<sup>281</sup> In contrast, if the claim funder does not retain the lawyer, the funder is not a client within the Model Rules' definition, and thus escapes some of the conflicts issues that plague the insurance structure.<sup>282</sup>

Second, the two arrangements are comparable with respect to the degree of control and influence the insurer or claim funder exercises. In the insured-insurer relationship, the insured often must agree to delegate a great deal of control over claim resolution strategies and choice of lawyer to the insurer in exchange for coverage, and the insurer can settle on any terms if the insured has given informed consent and has delegated the authority.<sup>283</sup> These are not considered violations of Model Rule 5.4(c).<sup>284</sup> In the commercial claim funding context, on the other hand, the claimholder still uses its choice of counsel and has more leverage at the outset to negotiate to either maintain or delegate decision-making power without forfeiting the funding—that is, claimholders can still get the funding if they maintain control, although the amount or the level of recovery offered to the funder may differ depending on the level of control ceded.

Third, as in the insured-insurer relationship, in the commercial context, the funder is not actually acting for the claim holder's benefit but instead in its own self-interest.<sup>285</sup> Both parties, which are sophisticated and have legal representation, understand this.<sup>286</sup> As such, insurers are not

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281. Waye, *supra* note 25, at 235. That said, the law recognizes that this is not always how insurer-paid attorneys behave and it has developed rules and remedies in response—not unlike what is recommended here.

282. MODEL RULES OF PROF'L CONDUCT pmbl. ¶ 17 (2009) ("Most of the duties flowing from the client-lawyer relationship attach only after the client has requested the lawyer to render legal services and the lawyer has agreed to do so."); *cf. id.* R. 1.7 cmt. 13 ("A lawyer may be paid from a source other than the client . . ."); *see also* Waye, *supra* note 25, at 234 (making the same point in the context of the Australian model rules and case law).

283. Waye, *supra* note 25, at 246 (making a similar point in the context of Australian law); *see also* Martin, *supra* note 165, at 109–10 ("On the other side of a lawsuit it is well-accepted that insurance companies are going to assume control of the litigation for their defendants/insureds. The same rules that protect defendants from being poorly represented by lawyers paid by insurance companies should be able to protect plaintiffs from having litigation funders exert pressure on their lawyers. In the United States, loyalty is an essential element of lawyers' responsibilities to their clients."); Steinitz, *supra* note 225, at 1333 (explaining that in addition to having the "right to control the litigation," "[t]he insurer may also negotiate and control settlement").

284. *Cf.* MODEL RULES OF PROF'L CONDUCT R. 5.4 cmt.1–2; *id.* R. 1.8(f) (allowing the attorney to accept payment from a third-party with client's informed consent and if it will not interfere with the attorney's independent judgment).

285. This is why many court decisions hold that the common interest doctrine does not apply to the relationship between alternative claim funders and the claimholder. *See, e.g.,* Leader Techs., Inc. v. Facebook, Inc., 719 F. Supp. 2d 373, 376 (D. Del. 2010) ("[F]or a communication to be protected, the interests must be 'identical, not similar, and be legal, not solely commercial.'" (quoting *In re Regents of the Univ. of Cal.*, 101 F.3d 1386, 1389 (Fed. Cir. 1996))). This is far from clear, however. *See* ABA White Paper, *supra* note 22, at 26. Some scholars claim that the common interest applies in this context. *See, e.g.,* Richmond, *supra* note 187, at 675–76.

286. Even if the claim is managed by a general counsel of a large corporation, the corporate claimholder arguably should have separate legal counsel to advise them on the case. This lawyer would, under Model Rule 1.4, be in charge of advising the client corporate

considered fiduciaries of the insured,<sup>287</sup> nor are commercial claim funders considered fiduciaries of commercial claimholders.<sup>288</sup> Instead, they work in collaboration and take into account each other's interests and objectives.<sup>289</sup>

Fourth, although there is no fiduciary duty, there are doctrines of law that regulate the relationship for the protection of the client. For instance, there might be certain situations wherein the claimholder might reasonably expect the funder to act in its interest (with respect to confidentiality, for example, although this should be spelled out in a contract between sophisticated parties)<sup>290</sup> and which may give rise to an implied duty of good faith.<sup>291</sup> For example, because state insurance law imposes a duty on the insurer to act in good faith in approving settlements, it is required to do so with due regard to the insured's interests. A similar duty could be implied when the client claimholder agrees to allow the funder to approve the settlement and the client claimholder communicates those decisions to the lawyer as though they were the client's own. If the client claimholder delegates control to the funder, there might be some kind of implied duty of good faith and fair dealing on the part of the funder, which would mitigate the conflict of interest for the lawyer.

While it is true that there is a well-established legal structure dealing with insurer-insured relationships, but none for claim funding, the point of this Article is that the risks posed by commercial claim funding are neither new nor unmanageable. Therefore, the U.S. legal profession should not use these risks to continue to prohibit claim funding in this context.

### 3. Summary and a Caveat

Commercial claim funding challenges the traditional model of the lawyer-client relationship. There are legitimate concerns over the level of influence that a funder might have over a claimholder and the lawyer, but these risks are mitigated in the commercial context, wherein the funder

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claimholder on the benefits and risks to such a deal. See, e.g., ABA White Paper, *supra* note 22, at 27 (citing MODEL RULE OF PROF'L CONDUCT R. 1.4).

287. Waye, *supra* note 25, at 255–56 & n.137 (defining the “distinguishing characteristic of a fiduciary relationship” as “serv[ing] exclusively the interests of a person or group of persons . . . a relationship in which the parties are not each free to pursue their separate interests” (quoting *Hosp. Prods. Ltd. v U.S. Surgical Corp.* (1984) 156 CLR 41, 96–97 (Mason J) (Austl.)).

288. Waye, *supra* note 25, at 255–56 & n.142 (“In a fiduciary relationship the principal is entitled to the single-minded loyalty of the fiduciary and the fiduciary must prefer the interests of the principal to his or her own interests.”).

289. *Id.* at 256 n.142 (explaining that the fiduciary relationship goes “further than the implied duty of good faith, which requires that the contracting parties regard the interests of each other as well as their own, in a spirit of co-operation. Under the duty of good faith the contracting parties must refrain from arbitrary or unreasonable conduct”).

290. *Id.* at 256.

291. *Id.* (“The characterization of the relationship between funder and claimholder as non-fiduciary does not exclude the imposition of an implied duty of good faith . . .”).

contracts with the claimholder who has equivalent bargaining power. Further, lawyers answer to two masters all the time.<sup>292</sup>

With respect to influence, lawyers have a duty to provide their independent judgment, but the law at least in theory (attorney-client privilege exceptions and work-product doctrine) embraces the idea that a lawyer who provides holistic legal service<sup>293</sup> must sometimes seek the advice and counsel of others.<sup>294</sup> It is not clear how this relationship adds any risks over and above those inherent in the relationship between general counsel and corporate client,<sup>295</sup> contingency fee lawyer and client, or insured-insurer. Further, as pointed out by the *Factortame* court in Australia, issues of confidentiality and independent judgment become less problematic when: (1) the funder contracts directly with the claimant as opposed to the lawyer or law firm;<sup>296</sup> (2) the contracting parties are of equal or similar bargaining power and business savvy as is true in the commercial context; and (3) the lawyers are highly skilled and experienced and are selected, and are retained by the client.<sup>297</sup> Thus, these potential issues simply do not justify blanket annulment on public policy grounds.<sup>298</sup>

There are many arguments against claim funding that are not addressed in this section, such as that claim funding turns legal claims into a commodity, that claimholders will lose control of their claims, that lawyers will become the instrumentality of their clients, or that clients will cede total control to funders. These arguments are left unaddressed for three

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292. See *supra* notes 280–81 and accompanying text. Indeed, the ABA revised the Canons to permit lawyers to serve as in-house corporate lawyers in 1928. See Green, *supra* note 17, at 1151 (“[T]he bar associations’ own rules and ethics opinions have eroded the assumptions that nonlawyers will derogate the legal profession’s ethics standards and will influence lawyers with whom they work to abrogate these standards.”). This is also true in the insured/insurer relationship as discussed. See *id.* at 1152 (“[L]awyers may be employed by insurance companies to represent policyholders.” (citing *Cincinnati Ins. Co. v. Wills*, 717 N.E.2d 151, 156–59 (Ind. 1999))).

293. See Beardslee, *supra* note 103, at 1876 (“Corporate clients today want and need lawyers to provide holistic legal advice, that is, legal advice that takes into account business concerns and sometimes, legal advice couched in business terms.”); *supra* note 139 and accompanying text.

294. See *supra* note 139 and accompanying text.

295. Internal and external professionals are put on teams with internal and external lawyers, and they work together to solve legal and business problems. See Rosen, *supra* note 139, at 648–49.

296. Waye, *supra* note 25, at 234–35 (explaining that when the funder contracts with the claimholder, the funder is not considered a client and therefore conflicts of interest rules do not apply; instead, conflicts that arise between the client and funder “are regulated by generalized duties of care and loyalty to the client”). Although there is still a large amount of uncertainty, the commercial client has a greater ability to accurately assess the case’s value, the potential litigation expenses, and the deal offered by the funder, unlike in the context of consumer claim funding or even typical plaintiff contingency fee arrangements. Cf. Jay, *supra* note 257, at 815 (“[T]he great majority of consumers of legal services who agree to contingent fee arrangements lack the ability to gauge accurately whether a projected recovery will exceed litigation expenses.”).

297. See *supra* note 180 and accompanying text; see also *Project 28 Pty Ltd v Barr* [2005] NSWCA 240, ¶ 83 (Palmer J) (Austl.) (emphasizing that the firm retained was reputable).

298. Waye, *supra* note 25, at 226.

reasons. First, the force of these concerns varies depending on the type of funding (size of claim/recovery and level of control and influence sought by the funder) and type of client.

Second, these issues can arguably be cabined with some degree of regulation. Clearly, some clients will be willing to cede control to funders, and there may be some instances where the governing law should protect the client from itself and ensure that lawyers do not become the instrumentality of the client. Also, there might be some regulations around disclosure of terms and allowable rates of return. It is not clear, however, that a continued insistence that law is not a business but a profession will actually prove to make lawyers act as desired professionals. Only by beginning with the premise that law is a business can we improve lawyer actions by accepting the business aspects and seeking to improve their impact.

Third, this Article does not aim to determine what type of funding should be allowed and what level of influence a funder should be able to wield. Instead, it aims to use claim funding as an example to show that: (1) the United States continues to reject outside influence by nonlawyers; (2) embracing outside influence may yield benefits otherwise not available; (3) doing so may not be as problematic as opponents think (at least in the corporate context); and (4) a continued attempt to retain a monopoly on legal and related legal services—which necessarily includes a rejection of all forms of outside influence—may be more risky than all of the identified risks combined. It is to the last contention that the following section turns.

### *C. Continuing to Prevent Outside Influence by Nonlawyers: A Recipe for Failure*

What is true of bacteria is also true in business:

When the living is good, . . . bacteria have less of a need for high mutation rates, because their current strategies are well adapted to their environment. But when the environment grows more hostile, the pressure to innovate—to stumble across some new way of eking out a living in a resource-poor setting—shifts the balance of risk versus reward involved in mutation.<sup>299</sup>

Arguably, “the living is [no longer] good” in the U.S. legal marketplace, which has grown more “hostile” in the past ten years—plagued with inefficiencies and failures to innovate and to keep pace with other countries.<sup>300</sup> Notwithstanding the evolution in alternative fee

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299. JOHNSON, *supra* note 10, at 145–46. This author is clearly not the first to claim that innovation is needed in legal practice and education in order for U.S. lawyers to continue to compete with non-U.S. lawyers and with nonlawyers. Others have even questioned whether we are approaching the “end of lawyers.” See generally THOMAS MORGAN, *THE VANISHING AMERICAN LAWYER* (2010); RICHARD SUSSKIND, *THE END OF LAWYERS?: RETHINKING THE NATURE OF LEGAL SERVICES* (2008); Larry E. Ribstein, *The Death of Big Law*, 2010 WIS. L. REV. 749.

300. For example, the legal profession has failed to embrace technology. See generally SUSSKIND, *supra* note 299.

arrangements, pressures exist to develop new lawyer-client economic paradigms.

Any innovation or “mutation” holds with it the possibility of risks, but given the current environment, it is clear that the potential upside of change and mutation is worth the risk. Claim funding is simply one example of a “new way of eking out a living.” The U.S. bar won’t allow lawyers to loan money to clients because of usury laws, so third-party claim funders figured out another way to offer it—it is essentially a mutation on the contingency fee.

Currently, lawyers in the United States have a monopoly on taking risks in cases and investing in claim assets.<sup>301</sup> This is not the case in other parts of the modern economy, because many lawyers are not equipped to conduct a thorough economic and financial analysis of the prospects of the litigation, and they often lack the ability to manage the risk they take on. In the United Kingdom and Australia, outside investment in law firms is allowed and happening now. By incorporating neutral third-party investors, who are detached from the legal process, these firms will be better equipped to offer more creative and efficient ways to finance and manage cases because they foster open environments, diversity, and multidisciplinary collaboration. As Clayton M. Christensen has pointed out about the effect of “disruptive innovation” in other contexts, by the time the U.S. marketplace realizes the value it should have placed on commercial claim funding and embracing nonlawyer outside influence in general, it will only be able to, at best, compete with a copy-cat entry behind competitors that were first movers in the marketplace.<sup>302</sup>

Preventing outside claim financiers from investing in and having influence on claim management threatens to stymie growth of the U.S. legal market. Embracing such a structure shifts the traditional paradigm from one of potential risk to one of potential reward. As Johnson points out, “Innovative environments thrive on useful mistakes, and suffer when the demands of quality control overwhelm them.”<sup>303</sup> The ABA will only be able to resist the pressure to allow investment in claims for so long. Allowing investment in commercial claims would ensure that U.S. lawyers not only remain at the table, but have a say on what is served and how. The bar would not only reap economic benefits by moving early, but would also help lead the development of this industry and the regulations that will be needed to ensure that the benefits are maximized and the risks curtailed.

The reality is that, if we do not do it, non-U.S. players will. There are almost 100,000 people employed in the legal services sector in Australia, and this sector generated A\$18 billion in income during the 2007–08 fiscal

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301. See Painter, *supra* note 255, at 631–32 (contending that permitting nonlawyer competition in this area would be “a useful way to combat abuse of market power”).

302. Cf. CLAYTON M. CHRISTENSEN, *THE INNOVATOR’S DILEMMA* xv, xxiii–xxvi (Collins Business Essentials 2005) (1997).

303. JOHNSON, *supra* note 10, at 148.

year, and contributed A\$10.9 billion to the country's economy.<sup>304</sup> Although the United States has the largest market for legal services,<sup>305</sup> there is a huge opportunity for international expansion. U.S. law firms understand this and have been steadily expanding internationally.<sup>306</sup> It is not just American law firms, but also British and Australian firms setting up offices in these international markets. So in some ways, it is a race to be first before the markets are satiated.

U.S. players are also finding ways to work around the rules. Burford Capital is listed on the London Stock Exchange but clearly offers services in the United States.<sup>307</sup> American law firms are also entering the outside investment industry.<sup>308</sup> As Bill Henderson explained in a recent blog entry:

Despite the stringent regulations placed on lawyers, ingenious entrepreneurs—most of them non-lawyers—are finding ways to get into the legal services business. Nobody needs to unlock the front door for them to enter. They are climbing through the first floor windows, scaling down our chimneys, and seeping through our basement walls. In ten years, much of the deregulation agenda will come to pass without any formal deregulation. U.S. consumers and businesses are already voting with their feet.<sup>309</sup>

Opening up the closed U.S. legal marketplace in various ways will ensure that these new innovations are monitored and appropriately regulated.<sup>310</sup>

304. *Snapshot of the Legal Profession*, LAW COUNCIL AUSTRALIA (Sept. 2009), [http://www.lawcouncil.asn.au/shadomx/apps/fms/fmsdownload.cfm?file\\_uid=A770EF94-1E4F-17FA-D2D1-BA99625CD699&siteName=lca](http://www.lawcouncil.asn.au/shadomx/apps/fms/fmsdownload.cfm?file_uid=A770EF94-1E4F-17FA-D2D1-BA99625CD699&siteName=lca).

305. Bruce E. Aronson, *Elite Law Firm Mergers and Reputational Competition: Is Bigger Really Better? An International Comparison*, 40 VAND. J. TRANSNAT'L L. 763, 769 (2007).

306. *Id.* at 790 (noting that United States firms' recognition of international opportunities has led to "substantial growth in the number of overseas offices and attorneys of elite law firms over the last decade").

307. Press Release, Burford Capital, Burford Reports Continued Activity and Entry into UK Market: Acquisition of Leading UK Litigation Insurance Provider to Form Basis for Market Entry (Dec. 12, 2011), [http://newsandinsight.thomsonreuters.com/uploadedFiles/Reuters\\_Content/2011/12\\_-\\_December/chevron--burford.pdf](http://newsandinsight.thomsonreuters.com/uploadedFiles/Reuters_Content/2011/12_-_December/chevron--burford.pdf).

308. See Vanessa O'Connell, *Litigation Funding Market Heats Up*, WALL ST. J. L. BLOG (Oct. 3, 2011, 2:26 PM), <http://blogs.wsj.com/law/2011/10/03/litigation-funding-market-heats-up/> (reporting that Simpson Thacher & Bartlett has referred a client to a claim funder and that Crowell & Moring has used claim funding).

309. William Henderson, *Are We Asking the Wrong Questions About Lawyer Regulation?*, TRUTH ON MARKET (Sept. 19, 2011, 7:58 AM), <http://truthonthemarket.com/2011/09/19/william-henderson-on-are-we-asking-the-wrong-questions-about-lawyer-regulation/> (providing examples of companies that are innovating and skating close to violating many of the Model Rules of Professional Conduct that inhibit collaboration between lawyers and nonlawyers).

310. Many scholars argue that the real solution is optimal regulation. See, e.g., Martin, *supra* note 165, at 114–16 (recommending licensing for funders and compliance with certain requirements "to preserve the advantages of litigation financing while eliminating abuses"); Steinitz, *supra* note 225, at 1325–36 (recommending reforming the attorney-client-funder relationship, applying consumer protection and contract-design principles, requiring court supervision, and tailoring securities regulation for claim-backed securities); Wayne, *supra* note 25, at 274 (recommending "that funding agreements in class actions be subject to judicial approval but only on limited grounds that might justify their vitiating for matters such as unconscionability or misleading and deceptive conduct").

Transdisciplinary legal environments exist in places all over the globe and although “thunder’s rolling down the tracks,”<sup>311</sup> the sky is not falling. But it might if U.S. lawyers do not (in Bruce Springsteen fashion) “grab [their] ticket and [their] suitcase” and get on “this train.”<sup>312</sup>

### CONCLUSION

The U.S. legal profession has created a closed environment that quarantines itself from not only the capital marketplace but from the professional services marketplace and therefore from potential growth and innovation. The U.S. legal profession’s stance on commercial claim funding is merely one example of this attitude. This Article posits that allowing claim funders to fund and exert some influence over the management of commercial claims is a positive good, but more than that, it argues that success “favors the connected mind.”<sup>313</sup> Just as the best Stone Soup is created by the accidental combination of ingredients contributed by an eclectic group of people, serendipitous innovation is created when individuals work in diverse teams and look outside the confines of the puzzle for the answer.<sup>314</sup> The failure to embrace open environments handicaps lawyers from being able to add value and effect change. However, just as Stone Soup is not made from stone, serendipitous innovations are not serendipitous. As Johnson points out, “[t]he challenge” is in developing “environments that foster these serendipitous connections.”<sup>315</sup> The current legal rules do not create an environment that fosters such connections.

The structure and regulations of the U.S. legal profession reject the story of Stone Soup in favor of a fable in which the knight in shining armor cunningly slays the dragon and rescues the fair maiden all by himself. But the days of knights are long gone. Swords and horses have been replaced by modern technology, which is continually innovated by multidisciplinary teams. A single knight cannot compete against an army of professionals, and the fair maidens in this tale are sophisticated, repeat players capable of taking care of themselves in many situations. If it is true that “we become the stories we tell about ourselves,”<sup>316</sup> it is time for us to take off our armor and embrace a new narrative. We can start by reaching out to nonlawyer claim funders and asking them to bring what they’ve got and put it in the pot.<sup>317</sup>

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311. Bruce Springsteen, *Land of Hope and Dreams*, on *WRECKING BALL* (Columbia Records 2012).

312. *Id.*

313. JOHNSON, *supra* note 10, at 174.

314. *Id.* at 108–09.

315. *Id.*

316. Ian Craib, *Narratives as Bad Faith*, in *THE USES OF NARRATIVE: EXPLORATIONS IN SOCIOLOGY, PSYCHOLOGY, AND CULTURAL STUDIES* 64, 65 (Molly Andrews et al. eds., 3d prtg. 2009) (citing Jerome Bruner, *Life as Narrative*, 54 *SOC. RES.* 1 (1987)).

317. See FOREST, *supra* note 1, at 28.