Private Harmonization of Legal Regimes:
The Role of Multi-jurisdictional Law Firms and the Diffusion of Legal Human Capital

Gillian K. Hadfield

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Gillian K. Hadfield
USC Gould School of Law
Center for Advanced Study in the Behavioral Sciences

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Abstract

Multijuralism is a fundamental attribute of the globalizing world, not merely as a result of the public creation of multijural states or trading zones, but also as a result of privately generated multi-jurisdictional transactions and relationships. Both public and private rule-making are important to the development of law in multijural settings. As important, however, is the dynamic development of rules through the process of interpretation and adjudication. Indeed, harmonization of law through the adoption of literally similar legal rules or contract provisions may have little impact on the harmonization of the ultimate legal treatment of particular conduct if legal rules are interpreted and adjudicated differently in different legal regimes. Courts need access to grounded problem-specific knowledge in order for harmonization to be effective across multiple jurisdictions. The principal source of this judicial legal human capital (Hadfield 2006) is the legal human capital generated by lawyers for clients and shared with courts in the process of dispute resolution. Consequently the global markets in which lawyers' investments in multijural legal human capital take place are important not merely for how well they serve the interests of particular clients but, more fundamentally, for how well they work to generate the legal human capital that ultimately feeds into the quality of the harmonization work of courts. These global legal markets, however, are characterized by both market failure and monopoly restrictions. Market failures arise because of the difficulties that attend the production and distribution of information, difficulties that in other settings are mitigated through the use of intellectual property protection, public subsidy and so on. Law firms are an important organizational form for overcoming legal human capital market failures. In the multijural setting, however, extensive jurisdiction-specific monopolies over the provision of legal services inhibit the development of truly multi-jurisdictional law firms. Reducing the barriers to multi-jurisdictional legal practice is an important policy step in the direction of promoting the harmonization of law in a multijural world.

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I. Introduction

Much of the work of designing legal regimes for the globalizing economy, including the work addressed to the issue of reconciling differences in multijural settings, focuses on the content of written legal rules. The reconciliation of legal rules or the encouragement of economic growth through legal reform is by and large seen as a project of identifying the statutory provisions that legislatures can implement and is evident in efforts to write uniform model laws for implementation in multiple jurisdictions. Even when the potential for private harmonization and the capacity for non-state actors, including international law firms, to develop solutions for multi-jurisdictional transactions and disputes is recognized (see e.g., Bonell 1992, Teubner 1995, McBarnet 2002), the emphasis is on the content of the rules—generally embedded in private contractual provisions—that these actors are likely to devise.

Both public and private rule-making are important to the development of law in multijural settings. As important, however, is the dynamic development of rules through the process of interpretation and adjudication. Indeed, harmonization of law through the adoption of literally similar legal rules or contract provisions may have little impact on the harmonization of the ultimate legal treatment of particular conduct if legal rules are interpreted and adjudicated differently in different legal regimes. As some students of comparative law will tell us, for example, different approaches to the interpretation of provisions in a civil code as compared to statutes in a common law setting can lead to substantially different results, despite the apparent similarity in legal language (Valcke

1996). Legal rules as written do not remain static even if they remain unchanged on the books; they evolve through interpretation and practice. This is as true in civil code regimes as it is in common law regimes: the French law of torts is hardly the same today as it was in 1804, although the language of the relevant code provisions is unchanged since it was enacted in the Code Napoleon. Much of the work of harmonization thus takes place through mechanisms that coordinate not the explicit language of law but rather its interpretation and application. Much of this work takes place within adjudicatory settings, namely courts, regulatory agencies and arbitral forums.

The integration of distinct legal regimes then, whether within a national territory or across national borders, depends on the dynamic process by which the interpretation of the law evolves within these regimes. Relatedly, the ultimate impact of different legal regimes depends on the competence with which law is applied—the incidence of a form of legal error—and how the application of law responds to local and changing conditions, that is, how rules are adapted over time and space. As Berkowitz, Pistor and Richard (2002) have emphasized in the context of legal transplants, merely tracking law on the books does not tell us a great deal about how law plays out in a given environment in practice.

What determines the dynamic quality and content of law? In recent work, I have explored this question using the concept of *shared legal human capital*, meaning systemic knowledge shared among the legal actors in a legal regime about the detailed relationship between legal rules and the environment in which they are deployed. Shared legal human capital, I argue, determines the capacity of the legal regime to accurately implement a legal rule—to interpret the evidence presented, for example, and to

determine the optimal application of the rule to the evidence. A model developed in Hadfield (2006a) assumes that a significant part of this knowledge is initially available only from ground-level actors in a legal regime (such as transacting parties or those subject to regulation) and shows how the diffusion of such knowledge within the legal system and its incorporation into the way legal rules are interpreted and applied (what I call rule adaptation) depends on the institutional environment in which adjudication takes place. Publication of detailed factual and legal analysis in individual cases, for example, transmits what is learned in adjudication to other lawyers, judges, legal analysts, litigants and so on. The model analyzes the institutional factors that will influence the rates at which shared legal human capital will accumulate, legal errors (about the environment and the intelligent application of rules to that environment) will be reduced, and legal rules will be adapted. Hadfield (2006b) explores these institutional factors in a comparative analysis of common law and civil law regimes.

One of the important factors determining the quality of law that I identify in this work is the organization and regulation of the legal profession. Explicitly, the model identifies the critical role played by the costs of legal services, costs which are substantially affected by the organization and regulation—particularly the competitiveness—of the market for lawyers (Hadfield 2000). Legal costs are important not merely because they determine access to the law for individual users of the legal system. In a dynamic model legal costs are important because they influence the willingness of litigants to invest in presenting evidence and legal argument about novel or unrecognized conditions to courts.

The model in Hadfield (2006a) rests on an implicit set of assumptions about the capacity of the legal profession to generate the evidence and argument that may ultimately be shared with courts and thus become incorporated into the interpretation, application and evolution of legal rules. This is the set of assumptions that I explore further in this paper. In particular, I ask what impact the organization and regulation of law firms in multijural settings has on the ability of overlapping legal regimes to develop the shared legal human capital necessary to interpret and apply legal rules that cross jurisdictional lines. This is relevant both to the ultimate effect of ostensibly (on-the-books) harmonized legal rules and to the capacity of individual regimes to respond to gaps and conflicts in rules by adapting rules when dealing with multi-jurisdictional matters. (I do not deal here with the important question of the extent to which harmonization is indeed desirable.)

In Section II of this paper I discuss the deeply local and contextual legal problem-solving that may be required when transactions or relationships cross jurisdictional boundaries using as an example a complex Russian securities offering studied by McBarnet (2002). In Section III I then examine the market failures that may attend the production of the specialized legal human capital necessary to engage in cross-border problem-solving and the role of multi-jurisdictional law firms in overcoming some of these failures. Section IV then looks at the obstacles to the development of truly multi-jurisdictional law firms posed by the regulation of the legal profession globally. As I discuss here, globalization of trade in legal services lags far behind globalization more generally. This, I argue, poses a major challenge for the long-run integration of legal regimes in multijural settings.

II. Multi-jurisdictional Problem-Solving and the Role of Shared Legal Human Capital in Harmonization

In the 1995 film *Apollo 13*, depicting the near-fatal complications that developed during the American attempt at a third lunar landing, there is a scene in which NASA engineers are presented with a pile of miscellaneous odds and ends of equipment available to the astronauts on the spacecraft and told to come up with a way to convert those random materials into a highly specific fix for the damaged system that keeps the astronauts' level of carbon dioxide below toxic levels. Modern lawyers operating in a multijural environment are often in a similar, if decidedly less dramatic, situation. Their clients have specific legal needs and constraints and face a hodge-podge of alternative mechanisms available to satisfy those needs and constraints. Lawyers who serve their clients well are experts in evaluating the cost and efficacy of alternative solutions to both transactional and litigation challenges, and, if they are particularly effective, imaginative in their efforts to cobble together a structure that promotes the interests of their clients. Like the NASA engineers, in order to accomplish these tasks, lawyers need to be knowledgeable about the complex ways in which different pieces will fit together and the detailed specifics about the environment in which the solution will be deployed. And they need to know whether and how well the people who will actually implement the solution will be able to carry it out, possibly far away in another world. In the transactional context, Gilson (1984) dubbed lawyers "transaction cost engineers."

McBarnet (2002) provides a case study of the issue of securities in a Russian company to foreign investors in the late-1990s that illustrates this phenomenon well in a regulated transactional setting. The securities offering faced several key legal problems in attracting investors. First, much of the regulatory environment that supports securities

transactions in developed markets—the markets in which the Russian company hoped to find investors—was then absent in Russia. Under the existing legal framework, for example, ownership of company shares was evidenced exclusively by a list of shareholders maintained or controlled by the company itself; efforts to move to an independent registry system were still incomplete and the risk of having ownership rights simply struck off the books was both ongoing and complex to evaluate. As another example, there was no effective financial reporting regulation in place: there was limited public reporting and what public reporting might be forthcoming was subject to little or no oversight and unreliable. Both problems were solved through contractual terms: the company undertook liability for the accuracy of shareholder information held by the registrar, and undertook to publish audited annual financial statements in accordance with U.S. GAAP accounting rules.

A second major difficulty facing a successful securities offering by this Russian company (40% still owned by the state) presented a classic harmonization problem: divergent regulatory treatment, specifically tax treatment, of the securities in question. The Eurobonds the company sought to issue were at the time attractive to foreign investors in part because they had been constructed in such a way as to avoid withholding tax in the issuing country. Competing for these investors was hampered by the fact that these securities were not exempt from withholding tax in Russia. To overcome this obstacle, lawyers for the Russian company put in place an elaborate structure, dubbed the "passport deal," to avoid Russian withholding: the company established an Irish subsidiary, which issued the shares (Ireland did not withhold tax); proceeds from the Irish offering were collected by the Luxembourg subsidiary of a German bank, which

established a secondary market in the securities; the German bank was then able to (finally) route the money to the Russian company through a commercial loan, which did not attract Russian tax. As described by McBarnet who studied the transaction in detail: "The whole structure involved a network of guarantees, pledges of indebtedness on two levels of priority, certificates of indebtedness, and of course the aforementioned loan agreement, each of these also transnational, between Russian company, Irish company, UK, US, German and Austrian underwriters, German bank and its Luxembourg subsidiary." (McBarnet notes the irony of a largely state-owned company going through elaborate procedures to avoid its own tax structure.)

McBarnet's focus is on the design of this transaction and she does not explore the enforcement of the contractual or tax obligations created and avoided by the deal. But it is easy to see the complicated multijuralism implied on the enforcement side. Suppose the Russian company fails to respect the independence of the share registration, in violation of the contract but not Russian law, or arguably fails to meet its financial disclosure obligations in accordance with US GAAP rules. How will Russian courts interpret the contract and the Russian company's conduct? How will they assess damages? Will they issue an injunctive order to correct the share registration? Will they order a restatement or other disclosure of otherwise private financial records? Are these obligations enforceable in foreign courts? An arbitral forum? Suppose the Russian Federation decided that the complicated structure was not effective in avoiding tax obligations. How would a Russian court interpret the structure and the implications of Russian tax law? Would courts in Germany or Luxembourg or Ireland cooperate in subpoenaing documents or individuals or attaching assets located in their jurisdictions?

Would they provide enforcement of the contractual obligations of registration oversight or disclosures? How would they interpret the deal's structure, Russian tax law, the state of Russian company registration and disclosure requirements, and the application of any relevant international treaties for enforcement of foreign court orders?

For the U.S., Canadian or U.K. investors (the primary purchasers of these securities) seeking to enforce or avoid enforcement of the various contractual and regulatory implications of this complicated arrangement, the problem of overlapping jurisdictions is heightened by the need to understand the operation of and possibly choose between court systems quite different from those that operate in common law jurisdictions. Modes of interpretation differ, rules of evidence differ, discovery and interim relief procedures differ, available remedies differ, the roles played by experts differ, the availability and relevance of legal materials differs, the relationship between the courts and the state differs, methods of enforcement for court orders differ, the availability of public enforcement tools such as contempt orders differs, and the list goes on. One can also imagine complex enforcement strategies involving actions in multiple jurisdictions. And control over which courts or forms will resolve even contractual matters can be elusive. As Whytock (2006) has recently emphasized, much of global law ultimately takes place within domestic courts. Efforts to control which court manages a particular transaction or relationship, or to select an international court or arbitral forum, are themselves contractual agreements that one party to the transaction may seek to enforce or avoid in a domestic court.

For the parties to this particular transaction, making its complex design effective—and thus giving the Russian company access to an expanded capital market—

requires substantial amounts of detailed, context specific legal expertise about multiple jurisdictions and their overlaps and interaction. More to the point, however, it requires the various courts and regulatory agencies that might play a role in its enforcement—or in its regulation to comport with state law—to have access to substantial expertise about the detailed nature of the transaction, its commercial and regulatory environment and the legal regimes of other jurisdictions. Will the Russian court, for example, be able to understand the intricacies of US GAAP accounting regulations? Allow testimony from U.S. accounting experts? Recognize established precedents from other legal regimes interpreting and applying these obligations? Enforce private registration obligations that go beyond those required by Russian law? Recognize a difference between a commercial loan and intra-company transfer? As defined by Irish, Luxembourg or German law? Pierce the entire structure and impose tax withholding obligations on the company, leaving the Russian tax authority to enforce these obligations through the Irish, German or Luxembourg courts?

Without substantial legal human capital on which to draw, the various courts that may play a role in the interpretation, enforcement or regulation of this multijural transaction are unlikely to implement "the" substantive legal rules as designed by the parties to this transaction or the states that regulate the transaction. Nor are they likely to evolve over time to increasingly accurate interpretation and implementation of these legal rules. The private effort to harmonize the regulatory regimes is thus likely to be undermined.

This is still true even if in response to efforts such as this one there are public efforts at harmonization—international treaties about tax treatment for Eurobonds, for

example, or the wholesale adoption of US-style accounting regulation by the Russian Federation. Even if legislation is implemented that attempts to direct the legal treatment of arrangements such as this, such legislation still needs interpretation (although perhaps less so) and the evidence, perhaps complex (what do US GAAP rules require? When does a passport deal cross over from legitimate structure to tax evasion?), still needs to be understood in relation to that legislation. As Johnson et al (2000) document with respect to 'tunneling' (the removal of assets from a company by controlling shareholders at the expense of minority shareholders,) the development of effective legal rules to control behavior can require detailed knowledge of the myriad ways in which entities respond to the rules in different environments. The enactment of "harmonized" rules by the state is only a first step, not necessarily even a required first step, toward the development of a harmonized multijural regime. The legal human capital available to individual courts in those multiple jurisdictions is an important factor in the achievement of harmonization.

III.Market Failures in the Production and Distribution of Legal Human Capital and the Role of the Law Firm

Legal human capital is costly. Identifying what knowledge is necessary to resolve a legal issue requires skill and experience, resources and effort; so to does actually producing knowledge to fill identified needs. My premise in Hadfield (2006a) is that this costly work is, primarily, done by lawyers and paid for by their clients. The Russian company and its investors described in Section II both face (different) incentives to expend the considerable resources necessary to develop expertise in how the Russian shareholder registration system is working in practice, Irish securities and tax law, US GAAP rules and their interpretation and application in different settings, German banking law, and so on. These incentives come from the initial incentive to design and evaluate a

mutually attractive transaction and from the later incentive to effectively pursue or defend a legal dispute about the transaction's implementation or regulation by the state.

The key observation is that the legal human capital acquired to promote the private interests of the parties to a transaction or its regulators ultimately must make its way into the legal system as a whole—into courts and other enforcement agencies—in order to improve the quality of the interpretation, application and adaptation of legal rules. Individual legal human capital must become shared legal human capital. Hadfield (2006b) looks at the institutional attributes that can affect the extent to which the sharing of individual legal human capital with courts and other legal professionals occurs. Here I want to focus on a more fundamental question: whether the initial individual incentives to invest in legal human capital are subject to market failures and thus likely to result in underproduction.

Market failures routinely characterize the production and distribution of information. Information is hard to package and price. It is difficult to exclude others from using information and thus difficult to ensure that all those who value the information pay for it and so are included in the demand that generates production and distribution incentives. Because of these problems, many markets for ideas are supplemented by intellectual property regimes such as patent and copyright law and by public production or subsidy of intellectual endeavors through grants, university funding and so on. The highly specific nature of the legal knowledge that supports particular transactions, however, makes these methods of supporting the production and distribution of legal human capital inadequate. Although a portion of legal human capital clearly can be subsidized by public funding of legal education and law reform efforts, this kind of

abstract knowledge takes a lawyer only so far in devising a structure that is adapted to the needs and legal environment in which a client resides. Patent and copyright protections are also ill-suited to the protection of investments in legal human capital at least in part because of the ineffability of much legal knowledge: much of what is valuable in legal work is the exercise of judgment and an appreciation for how multiple considerations work together to recommend a particular course of action or strategy. Some legal products can be encapsulated—in standard contract provisions or other documents, for example—but much of what can be learned is learned only through shared practice—learning-by-doing, together.

If legal human capital were *completely* specialized to a particular transaction, such that what was learned in one was not valuable to what was needed in another, the difficulties that attend markets in information would be largely inconsequential for legal design. Researching and analyzing a client's legal problem takes lawyers' time and other resources, which *can* be packaged and priced. If of no value to anyone else, the demand for the information and ideas produced by the lawyers who put together and evaluated the Russian securities offering described above would be completely captured by the demand for lawyers' time generated by the Russian company, the prospective investors, the German bank, and so on.

But much of what lawyers learn *in situ* in solving a particular client's problem is of value to others. This is evident in the phenomenon of specialization: I want a lawyer working on my transaction who has done others like it because I anticipate that the experienced lawyer will do a better job of anticipating the problems I face and know the terrain of possible solutions better. Moreover, information displays increasing returns to

scope. The value of information about new Russian registration or German banking or EU tax laws, or court procedures, is higher to the lawyer who is already well-informed about the problems faced and solved in putting together the 'passport' deal or steeped in the practical realities of enforcing the deal in various courts. Pieces of information overlap and weave and are almost continually transformed by the accumulation of other information as implications, significance and meaning shift.

Because of the accumulated nature of legal expertise, the production and distribution of legal human capital presents problems for legal design. We want lawyers to invest optimally in learning, not merely with a view to the value of that learning for a particular piece of work done for a particular client, but also with a view to the value of that knowledge for future clients, including state regulators. We want legal human capital to be shared among lawyers, and in multijural settings we want information shared across jurisdictional boundaries so that what one lawyer has learned from her experience in Irish courts can be shared with another who is working on designing a securities offering for a Russian company or contemplating a German challenge to a questionable tax-avoidance structure implemented with the cooperation of a German bank. This means we need to pay attention to the incentives lawyers face to gain and share information with each other.

Beyond professional camaraderie and intellectual curiosity, the incentive for lawyers to invest in and share expertise about transactions is a function of the extent to which they can expect to capture some of the value of those efforts. In the absence of formal intellectual property protections which would allow lawyers to license their expertise in exchange for a royalty or other fee, lawyers need to ensure that they receive

some of the fees generated by legal work that makes use of their expertise. They do this by working in collaborative settings: partnerships and firms. Within the confines of a firm, and with established rules about the sharing of income and opportunities that come into the firm, lawyers overcome many of the difficulties of transactions in intellectual work and ideas, particularly knowledge that is difficult to reduce to written form. In a smaller firm, knowledge is shared informally through conversation and feedback on strategies, documents and so on. In a larger firm, more formal mechanisms for exchange also arise: databases of memoranda, model contracts, forms and other writings and established training sessions or even (in multi-locational firms) conferences and workshops for firm members. In many settings, large and small, overt mentoring relationships are established, with junior lawyers assigned to work with senior lawyers to learn both didactically and by osmosis from exposure to the daily practice of law. Rotation among different offices is often used to expose younger lawyers to the work of more senior lawyers in multiple locations. In all these settings, protection against the distribution of valuable information to those outside the firm is assisted by confidentiality obligations and access restrictions (only firm members can attend a firm luncheon or look through password-protected databases, for example) and by the sheer need to be in frequent and informal contact with experts in order to learn much of what they know.

The function of the law firm as a solution to problems of generating and sharing human capital has been studied by three important contributions. Gilson & Mnookin (1989) and Galanter & Palay (1991) both analyze the value of human capital transfers from experienced to novice practitioners and the role of the law firm in facilitating the sharing of senior lawyers' (partners') human capital with a number of junior lawyers

(associates.)[1] Galanter & Palay in particular emphasize the capacity to maximize the value of senior human capital by overcoming the limit that any individual can only work so many hours; the fact that human capital is non-rival (many can use it at once without reducing its value to any one of them) implies that the value of senior human capital can be expanded by sharing that knowledge with others with a fresh labor supply to exploit it. Gilson & Mnookin (1989) focus on the law firm's investment in the associate's training, paying him or her more than she is worth during the apprenticeship period. Gilson and Mnookin (1985) look to the sharing of law firm profits as a portfolio mechanism to reduce the risk associated with investment in specialized human capital through diversification.

All of these contributions are focused on explaining the attributes of large law firms in the American context. They are thus specifically interested in the growth of the large multi-specialty law firm and the changing patterns of partnership decisions. In the global context, however, it is the basic formation of shared practices among lawyers (not necessarily large, multi-specialty or patterned on the American model) that, I argue, proves critical to understanding the role of law firms in generating the legal human capital needed to support the expansion of cross-border interaction and the generation of the shared legal human capital necessary to harmonize law in multijural settings. Indeed, in the global context the creation of multi-jurisdictional legal practices and the facilitation of cross-border exchange of legal human capital is a fundamental legal design question,

[1] Gilson & Mnookin are more focused on the need to create an incentive for associates to invest in firm-specific human capital, given the risk of firm opportunism later in their careers, taking somewhat for granted that this human capital is provided in training by the senior lawyers in the firm. Galanter & Palay make this point more explicitly.

one that has by and large not been well understood in the ongoing efforts to develop the legal structures needed to support globalization and multijuralism.

The embedded, local and often ineffable knowledge necessary to design, evaluate and regulate transactions takes on dramatic proportions in the multijural context. The sheer volume of what must be known to effectively evaluate alternatives increases several-fold over what is required in the domestic context. What this implies for multijuralism is a substantial need for legal human capital not only about the particular transaction or relationship at stake, but also about the law, norms and practices of the jurisdictions potentially relevant to the transaction or relationship. Some of this legal human capital—the practices of contract law and enforcement in Irish or Russian courts, for example—will be available to domestic lawyers practicing in particular jurisdictions. Accessing that expertise is possible through the retention of the services of domestic lawyers in the process of putting together the transaction. The very nature of the cross-border setting, however, suggests the need for lawyers from all relevant jurisdictions involved in the transaction. How are these services to be combined?

A simple answer would be to separately retain the services of attorneys possessing the requisite expertise. These services could be retained by each of the transacting parties, or by the primary attorneys responsible for the transaction. The difficulty here, however, is the one we have already explored, namely the economic difficulties of contracting over information. We are concerned not only with accomplishing a particular transaction or regulating a particular relationship, but also with the ongoing capacity of global legal systems to generate investments in legal human capital, the value of which transcends the gains in a particular transaction. What incentive is there for the domestic

Russian lawyer, for example, to invest in legal human capital about U.S. accounting law and practices and how they interact with Russian law and practices beyond what is needed to carry out a specific transaction? To assist in devising a transactional structure that will reduce reliance on Russian legal mechanisms (and hence Russian legal advice) where this is cost-effective? What incentive is there to share expertise in Russian law or legal norms with foreign lawyers—such as those putting together similar deals in other emerging market economies lacking developed registration or disclosure regulation? What incentive do U.S., Canadian or U.K. lawyers have to share their expertise in evaluating these transactions for their investor clients with European lawyers seeking to advise their investor clients? If the legal relationships are limited to separate contracting arrangements, the problems of generating appropriate incentives for the production and distribution of appropriable information lead to underinvestment in trans-border legal expertise and inadequate sharing of global legal human capital.

To support and regulate the multijural transaction or relationship, then, it is important to have in place mechanisms that support the investment in and sharing of the legal human capital specific to such transactions and relationships. This brings us back to the importance of law firms. The law firm, as we have seen, is an organizational structure that helps to overcome the individual disincentive to invest in and share appropriable and generalizable legal human capital. When transactions move across jurisdictional boundaries and the expertise and legal innovation necessary to support them include issues unique to the multijural setting, then the law firm as a solution to the underinvestment problem must also transcend borders. The multi-jurisdictional law firm captures the returns to both generating expertise in multijural transactions and

relationships and sharing legal human capital between lawyers situated in different jurisdictions. It is not necessary for a specific lawyer—Russian, Irish, German, or American in McBarnet's securities example—to anticipate repeat business of this type; it is now sufficient for the firm as a whole to anticipate repeat business to generate incentives for efforts to be made to learn more about the issues at stake and their more general characteristics, and to invest in mechanisms for transferring that information to other lawyers in the firm. If the Russian and U.S. and European lawyers are in the same firm, jointly benefiting from future revenues, the incentive to hoard expertise in domestic legal knowledge is alleviated and the incentive to invest in sharing that information is generated.

The sharing of legal human capital across jurisdictions is particularly important in the multijural context because of the likelihood that lawyers, steeped in their domestic jurisdiction, will fail to appreciate the subtle ways in which legal and non-legal mechanisms operate in foreign environments. This is knowledge that it is difficult to access in the abstract. Indeed, like the proverbial fish that knows nothing of the sea in which it swims, it is likely that the domestic lawyer is oblivious to many of the features of the domestic jurisdiction that make particular transactional solutions or regulatory approaches effective. Yet such knowledge is essential to the ongoing effort to facilitate global interaction. Thus Russian, German, Irish, Luxembourg and American, British or Canadian lawyers are each likely to exercise poor judgment about transactional design or enforcement in the absence of being educated by the other, in an ongoing and embedded way, about the way in which different mechanisms are likely to function in the effort to integrate U.S. accounting practices, common-law contract interpretation, Irish securities

law, German and Luxembourg banking procedures and Russian tax and company laws with enforcement in any one (and probably many) of these individual jurisdictions.

In the absence of a truly multi-jurisdictional law firm in which lawyers from different countries share in firm profits, lawyers have an incentive to hoard information about their respective expertise in order to preserve the value of their services in future transactions. Lawyers also have a disincentive to devote effort to identifying transactional, regulatory or enforcement solutions that reduce reliance on the legal environment in which they are expert. Both actions increase their bargaining power in the distribution of the rents generated in any given transaction or litigation that requires their input. Relatedly, in the absence of future profit-sharing, individual lawyers in separate jurisdictions have little incentive to innovate costly solutions for cross-border transactions and relationships if they do not have reliable access to the other jurisdiction in the future. The truly multi-jurisdictional law firm, in which all members of the firm reliably share in the increased present and future value created by improved information-sharing and innovation, can help to alleviate these sub-optimal incentives.

As those who have studied the economic function of law firms have emphasized, however, in order for the sharing of future revenues to support current collaborative efforts such as information-sharing and transactional innovation, it is important for the law firms' 'hold' on the value of the information to persist. This means that the risk that lawyers in the firm will opportunistically defect in the future, taking with them the value created by their joint efforts, has to be effectively reduced in order for the firm to serve its function. Both Gilson & Mnookin (1989) and Galanter & Palay (1991) look at the risk that junior associates will abscond with the value of the mentorship and training they

have received from senior partners or degrade the value of the investment by shirking; this risk, they argue, is managed by the partnership decision, which holds out a large partnership prize for the associate who remains loyal, hard-working and productive through a probationary period. Gilson & Mnookin (1985) looks at the risk that the lawyers whose specialties turn out to be profitable will abandon the lawyers whose specialties turn out to be unprofitable, or threaten to leave if they are not given a greater share of firm revenues, thus undoing the value of diversification that they suggest motivates the creation of large multi-specialty firms. This risk, they claim, is reduced by the law firm's creation of a valuable set of clients who are bonded to the law firm rather than particular lawyers and the establishment of a firm-level reputation, reducing the value to a given lawyer of defecting.

In order for the multi-jurisdictional law firm to support the sharing of information and investments in innovative cross-border transactional solutions, then, it is important for the law firm to effectively share profits among lawyers from different jurisdictions (to prevent hoarding and shirking), and to be largely protected against hold-up and abandonment threats by lawyers from different jurisdictions.

IV. Global Regulation of Legal Services and the Obstacles to Multi-jurisdictional Law Practice

The globalization of the legal services market lags substantially behind the globalization of other goods and services, with an arcane web of barriers to the creation and stability of the truly multi-jurisdictional law firm. Barriers to the sharing of law firm profits among a multi-jurisdictional set of lawyers abound in the form of restrictions on the formation of business relationships such as partnerships, or even employment relations, between lawyers from different jurisdictions. Restrictions on the creation of

firm reputation, as a bonding mechanism for the firm, are widespread, particularly for multi-jurisdictional firms. And most critically, the legal profession in most countries, organized as a self-governing body often considered beyond the reach of state regulation, operates a tight cartel over access to the provision of legal services that either rely on the country's law or are provided to the country's residents. The hold-up threat created by these cartels effectively thwarts efforts to form an enduring commitment between lawyers from multiple jurisdictions to share the profits generated by sharing expertise and innovating new solutions for cross-border transactions and relationships.

In the domestic context, the capacity of bar associations (directly or through their influence on statutes regulating the legal professions) to restrict entry into the practice is well-documented. Restrictions adopted in different jurisdictions include numerical quotas (particularly with respect to notaries, who generally hold a territorial monopoly on the preparation of certain documents), control over bar exam passage rates and the accreditation of law schools, limits on advertising, ranging from complete bans on any form of advertising to prohibitions on the content, form or medium of advertising and price controls.[2] Moreover, most jurisdictions control the organizational form of law practice. In most countries, for example, law firms must operate as partnerships among lawyers; some jurisdictions now allow law practice to be organized as a limited liability corporation but continue to require that the corporation be owned exclusively by lawyers and limited to the provision of legal services (excluding combinations with other services

[2] Minimum fee schedules for lawyers persist in the EU, for example, in Germany, Italy and Austria. Notaries are subject to minimum and/or maximum fee schedules in Austria, Belgium, France, Germany, Greece, Italy, Netherlands and Spain. (EC 2004)

providers such as management consultants and accountants).[3] In major European countries such as Germany (Paterson et al 2003), as well as in Asian countries such as Japan (Kelemen and Sibbitt 2002) and transition countries such as Slovakia[4], law firms may not operate multiple offices. "Almost everywhere" in the OECD countries, lawyers are subject to local presence requirements (OECD 2000), meaning that lawyers cannot provide legal services (electronically, by telephone, etc.) without setting up shop in the country. In the U.K. lawyers with authority to appear in court (barristers) must work as self-employed solo practitioners and may not enter into practice arrangements with solicitors; in some countries such as Slovakia, lawyers may not be employed by other lawyers, limiting the potential for law firms to grow through the use of associates prior to partnership. In many jurisdictions throughout the world, lawyers are prohibited from presenting themselves to the market as specialists in particular areas of law. Many of these regulations are of dubious value to the welfare of domestic markets, although they are all generally defended as being necessary to protect the independence of the legal profession and protect the consumers of legal services. Of greatest concern for the development of multijural transactions and relationships, however, are the restrictions these domestic regulations place on foreign lawyers and the emergence of multi-jurisdictional law firms.

In most jurisdictions, conventional authorization to practice law in the country—being physically present in the country and providing legal services to foreign or domestic clients, or providing services to clients located within the country from outside

[3] The capacity of the legal profession to restrict the formation of multi-disciplinary partnerships—between lawyers and accountants, for example—was recently upheld by the European Court of Justice against an attack under the EU competition laws in the *Wouters* case (C-309/99.)

[4] Parliamentary Act No. 132/90 Coll. On Advocacy.

the country—is limited to those who have been admitted to practice by that country. The requirements for admission to practice generally include completion of a law degree (often within the country itself), passing an examination (usually administered only in the language of the country), meeting various moral standing criteria (such as the absence of a criminal record and evidence of good moral character), and, in many places, completion of a period of apprenticeship with practicing lawyers in the country. Historically, there have been citizenship and residence requirements imposed on would-be practitioners; some countries (such as Greece) continue to impose this requirement. Effectively, these requirements make it very difficult for foreign lawyers to gain admission to practice in a jurisdiction other than their own.

In the European Union, various directives and court decisions have attempted to reduce the barriers to practice between Member States. Member States are not, for example, allowed to impose citizenship or residency requirements on lawyers seeking to gain admission to the bar in a given State. Member States are also obligated to recognize the law degrees offered by other Member States as fulfilling the education requirement, subject to the requirement that the prospective lawyer pass an aptitude test or undertake a period of adaptation to local practice. Most recently, the 1998 Lawyers' Establishment Directive has exempted applicants from the requirement of completing an aptitude test or an adaptation period if he or she has "effectively and regularly pursued for a period of at least three years an activity in the host Member State in the law of that State, including Community law." These provisions apply only to Member States, however: lawyers from non-Member States are generally subject to the much more stringent requirements of admission to practice described above.

Many countries allow some legal practice by foreign lawyers who do not gain admission to the local bar (often called foreign legal consultants), generally under the restriction that the practice is limited to advice on matters of the foreign law or international law, although some (such as Greece, Luxembourg, and Denmark (CCBE 2006)) prohibit any practice by foreign lawyers. In China foreign lawyers are restricted to providing advice exclusively on foreign law, prohibited from opening more than one office or entering into any partnerships with domestic firms; in Japan, foreign lawyers are required to maintain residency in Japan and in Korea no foreign lawyer has ever been granted authority to engage in even the limited assistance to Korean lawyers allowed by statute. (Kim 2006) Other countries (such as Germany) require the foreign lawyer to work in collaboration with a lawyer admitted to practice in the host country (OECD 2000 (1996 data)); others (such as Japan, Mexico, France, Turkey) prohibit foreign law firms from employing local lawyers (OECD 2000 (1996 data), Kelemen and Sibbitt 2002). In some countries (such as Russia and Indonesia), foreign firms are prohibited from practicing under their home name and required instead "to practice under the aegis of a local client, a local firm, or simply to list their resident foreign lawyers." (Abel 1994) In the United States, where the legal profession is regulated at the state level, only half of the states recognize foreign legal consultants; requirements differ state-by-state but generally restrict the foreign legal consultant to advising on matters of his or her home country's law; some also allow advice on international law or third-country law. (Silver 2005) Some require the foreign legal consultant to practice alongside a local lawyer; some do not. (Hill 2006). Most allow foreign legal consultants to be employed by or

enter into partnership with lawyers in the host state; some (such as North Carolina) do not. (Silver 2005)

The most liberal regime for foreign lawyers exists in the European Union, where lawyers from one Member State are permitted to practice law in another Member State under their home professional title, expressed in the language of their home country.[5] While such lawyers may give advice on the law of either their home country or the host country, they may be required by the host country to practice in conjunction with a lawyer in the host country for the purposes of representing a client before the host country's courts.[6] They may also be restricted from engaging in activities reserved to notaries (such as preparing deeds, administering estates and conveyancing.) Furthermore, lawyers from Member States are permitted to form partnerships with or be employed by lawyers in the host country, if these practice arrangements are available to lawyers admitted to practice in the host country.

Efforts to reduce barriers to cross-national legal services are apparent in the General Agreement on Trade in Services (GATS) governing WTO Member States, but it is clear that the impact of GATS is still slight. GATS requires Member States to engage in negotiations to reduce trade barriers in services, including legal services, and to establish disciplines governing the licensing of services with a view to ensuring that licensing requirements are based on objective criteria and not overly burdensome as a restriction on the supply of the service. (Terry 2004) Lawyers, however, have had little trouble in the international context, as they have had little trouble in the domestic context,

[5] The European Court of Justice recently held that registration with a member state could not be conditioned on a demonstration of proficiency in the language of the host country. Commission of the European Communities v Grand Duchy of Luxembourg, C-193/05 (19 Sept 2006).

[6] Article 5(3) of Directive 98/5.

defending limitations on practice as justified by the independence of the profession and the need to protect the consumers of legal services. By and large, the impact of GATS is to require that Member States allow lawyers from other Member States to gain access to the legal profession on the same terms as their own citizens, that is, to satisfy the same requirements of legal education, training, language, form of practice etc. as their citizens must satisfy. Much deference to the local regulation of legal practice by lawyers therefore continues.

Both the OECD and the European Commission have recently devoted substantial attention to reviewing the control of the legal (and other professions) by self-governing bodies under competition law (OECD 2000, EC 2004), however little progress has been made in shifting the balance of regulation. The Council of Bars and Law Societies of Europe (CCBE) and the International Bar Association (IBA) both have adopted strong positions defending the bulk of self-governance of the legal profession, seeking to establish as a core principle the uniqueness of the legal profession and the need for deference to its special status among the professions.[7] The legal professions throughout the world largely share the view that the legal professions and only the legal professions can determine appropriate regulation of the practice of law; and that, indeed, given its essential independence from the state, the legal profession falls outside of the purview of government. As articulated by the Canadian Bar Association: "Our view is that the legal

[7] The International Bar Association, for example, has adopted a resolution on 'core values' in the legal profession that requires a recognition that the legal profession is different from other services, fulfilling a special function, and that no deregulation of the profession should occur which fails to observe the principle that "preservation of an independent legal profession is vital and indispensable for guaranteeing human rights, access to justice, the rule of law and a free and democratic society." IBA, Resolution on Deregulating the Legal Profession, available at www.ibanet.org/aboutiba/resolutions.asp. The CCBE also emphasizes the uniqueness of the legal profession and advocates only minimal changes in the existing regime of self-governance. CCBE (1998)

profession should not have to prove the 'necessity' of rules which it is convinced are required to preserve its integrity and protect the public." (Paton 2003)

All told, the web of continuing regulation of individual country legal markets imposes tremendous barriers to the creation of multi-jurisdictional law firms, particularly expanding beyond the EU, and thus to the resolution of the disincentives facing lawyers to invest in the global legal human capital necessary to support globalized exchange and the development of multijuralism. Overt restrictions on the formation of partnerships and other business relationships clearly limit the growth of multi-jurisdictional law firms. Mere collaboration or networks of independent firms cannot substitute for the internalization of incentives that occurs with the creation of a business entity that shares profits among lawyers in multiple jurisdictions. Even where such profit-sharing arrangements are possible, by making it so difficult for out-of-country lawyers to provide legal services, the existing state of regulation undermines the capacity for multi-jurisdictional law firms to avoid the risk of hold-up that destabilizes cooperative agreements to share information and innovate cross-border transactional and regulatory solutions. The stability of a multi-jurisdictional law firm depends on the capacity of the firm to retain sufficient independent access to individual jurisdictions (and the clients resident there) in order to make the profits available from continuing in the firm greater than the profits available from defection for lawyers from the separate jurisdictions. Access to clients and business has to be a firm asset, not an individual lawyer asset, in order to stabilize the firm and thus generate the benefits of shared information and innovation. Much of the regulation of the global profession, however, prevents exactly this.

Surveys of international law practice confirm that the incentives for truly collaborative multi-jurisdictional practice are weak. Silver (2003) concludes that U.S. law firms, which still dominate lists of multi-jurisdictional law firms, are increasingly "going global by going local," that is, by staffing foreign officers with lawyers who are foreign-trained and who practice the law of the host country. She sees in this strategy a segregation of U.S. and foreign practice, and thus limited opportunities for shared practice and collaborative work. Abel (1994), documenting the number and nature of international law practices around the globe in the late 1980s, emphasizes that foreign firms face the risk that by expanding their services in a given country they will restrict the referrals they receive from local lawyers. In light of the regulatory structure in most countries, which makes access to locally admitted lawyers essential for some of the services that a law firm might need to provide in a given transaction or litigated dispute, we can understand the limited extent to which local and foreign lawyers are likely to collaborate. The local monopoly gives the local bar substantial hold-up power to extract sunk investments in collaboration and innovative legal work, including the work to develop reputation and a network of client referrals.

V. Conclusion

Multijuralism is a fundamental attribute of the globalizing world, not merely as a result of the public creation of multijural states or trading zones, but also, perhaps more pervasively, as a result of privately generated multi-jurisdictional transactions and relationships. Much of the wrestling with the challenges generated by multijuralism is done not by legislatures or law reform commissions, or even by private trade associations, but by lawyers designing transactions and dispute resolution strategies for

their clients, engaging in the grounded problem-solving that generates a form of legal human capital that is unavailable to abstract legal design. As a consequence, private and and problem-specific legal work plays a basic role in the harmonization of law in multijural settings.

Both private and public harmonization efforts, however, depend ultimately not just on the work of lawyers, legislatures and law reformers; they also depend on courts and other adjudication bodies. The legal rules that are written into statutes, treaties and guidelines are not static and self-effectuating; they are dynamic and in need of interpretation, application and adaptation to local and changing circumstances. Courts therefore need access to grounded problem-specific knowledge in order for harmonization to be effective across multiple jurisdictions. My claim is that the principal source of this judicial legal human capital is the legal human capital generated by lawyers for clients and shared with courts in the process of dispute resolution. What is not produced, however, cannot be shared. Consequently the global markets in which lawyers' investments in multijural legal human capital take place are important not merely for how well they serve the interests of particular clients but, more fundamentally, for how well they work to generate the legal human capital that ultimately feeds into the quality of the harmonization work of courts.

These global legal markets, however, are characterized by both market failure and monopoly restrictions. Market failures arise because of the difficulties that attend the production and distribution of information, difficulties that in other settings are mitigated through the use of intellectual property protection, public subsidy and so on. Law firms are an important organizational form for overcoming legal human capital market failures.

In the multijural setting, however, extensive jurisdiction-specific monopolies over the provision of legal services inhibit the development of truly multi-jurisdictional law firms. Reducing the barriers to multi-jurisdictional legal practice is an important policy step in the direction of promoting the harmonization of law in a multijural world.

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