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LEGAL BARRIERS TO INNOVATION:

THE GROWING ECONOMIC COST OF PROFESSIONAL CONTROL OVER CORPORATE LEGAL MARKETS

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INTRODUCTION

Few commentators, outside of the practicing bar and the judiciary, find much to recommend in the modern system of professional regulation of lawyers. While the topic (to date) has attracted only a small share of scholarly attention, justifications for the traditional exclusive control exercised by the bar and judiciary over the practice of law have drawn withering critiques from several directions for decades. Bill Simon called for the abandonment of legal professionalism thirty years ago and again in the wake of the savings and loan crisis of the late 1980s and the Enron debacle of 2001, emphasizing the failure of self-regulation and the absence of justification for corporate attorney-client privilege in particular.[1] Deborah Rhode has for almost three decades assailed the failure of the profession to put aside self-interest and live up to its obligation to promote access to the justice system and the interests of consumers of legal services, particularly personal (as opposed to business) legal services.[2] Both Rick Abel and Deborah Rhode made the argument twenty-five years ago that the American Bar Association (ABA) is inherently incapable of producing any regulations save those that promote the interests of lawyers.[3]

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1. William H. Simon, *The Ideology of Advocacy: Procedural Justice and Professional Ethics*, 1978 WIS. L. REV. 29 (1978); William H. Simon, *The Kaye Scholer Affair: The Lawyer's Duty of Candor and the Bar's Temptations of Evasion and Apology*, 23 LAW & SOC. INQUIRY 243, 245 (1998) ("Kaye Scholer indicates limitations on the profession's willingness and ability to set and enforce plausible standards of practice."); William H. Simon, *After Confidentiality: Rethinking the Professional Responsibilities of the Business Lawyer*, 75 FORDHAM L. REV. 1453, 1454 (2006) ("Corporate confidentiality is dead, and the bar's attempt to suggest that things could be otherwise is an exercise in myth making.").

2. *See, e.g.*, Deborah L. Rhode, *Policing the Professional Monopoly: A Constitutional and Empirical Analysis of Unauthorized Practice Prohibitions*, 34 STAN. L. REV. 1, 61 (1981) (arguing that "parochial perspective is apparent in unauthorized practice enforcement"); *see also* DEBORAH L. RHODE, ACCESS TO JUSTICE 88 (2004) (noting inconsistency between public messages of the American Bar Association (ABA) that efforts to strengthen unauthorized-practice-of-law definitions and enforcement are designed exclusively to protect consumers and candid comments from bar leaders that the ABA's function is to protect the interests of lawyers); Deborah L. Rhode, *Professionalism in Perspective: Alternative Approaches to Nonlawyer Practice*, 1 J. INST. STUDY LEGAL ETHICS 197, 203, 205 (1996) [hereinafter Rhode, *Professionalism in Perspective*] (arguing that the "main danger [of opening access to nonlawyers] lurking in the shadows is the bar's own interest in restricting competition" and noting that the bar usually relies on "unsupported or anecdotal assertions" about the quality of nonlawyer practice).

3. Richard L. Abel, *Why Does the ABA Promulgate Ethical Rules?*, 59 TEX. L. REV. 639 (1981) (characterizing ABA ethical rule-making as a structurally unavoidable symbolic, not instrumental, exercise to legitimate lawyers' self-interested market conduct in the face of public interest and ethical demands); Deborah L. Rhode, *Why the ABA Bothers: A Functional Perspective on Professional Codes*, 59 TEX. L. REV. 689, 720-21 (1981) ("No matter how well-intentioned and well-informed, lawyers regulating lawyers cannot escape the economic, psychological, and political constraints of their position. . . . To effect significant improvements in the quality, cost and delivery of legal services, the bar must accept fundamental change in its regulatory structure.").

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Stephen Gillers offered a scathing critique in 1985 of the ABA's (then) new Model Rules of Professional Conduct, concluding that "[t]he lawyers who approved the Rules looked after their own."[4] Twenty years ago David Luban called for the deregulation of routine legal services (such as completion of forms, drafting and probating of wills, uncontested divorces) and argued that the attorney-client privilege and related duties of confidentiality (a lynchpin of the bar's justification for key elements of its regulatory regime) were not justified in the organizational (corporate) context.[5] In a careful history of regulation of the unauthorized practice of law (UPL) completed for the American Bar Foundation in 1980, Barlow Christensen reached the "shocking" conclusion that UPL restrictions were no longer defensible.[6] David Wilkins raised serious questions in 1992 about the validity of the bar's defense of self-regulation based on professional independence and unique bar expertise to judge lawyers' conduct.[7] Anthony Kronman saw no hope for the recovery of lawyerly ideals through self-regulation in the face of modern corporate legal practice in his plaint for the "lost lawyer" in 1993: any lawyer seeking those ideals has no alternative, he counseled, than to "stay clear of the . . . large-firm practice."[8] Jonathan Macey called for the abandonment of self-regulation of the profession after Enron.[9] Benjamin Barton has recently argued that the judicial protection of lawyer self-governance is one among many examples of how the judiciary systematically favors the private interests of lawyers.[10] There is thus no shortage of scholarly critique.[11]

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4. Stephen Gillers, *What We Talked About When We Talked About Ethics: A Critical View of the Model Rules*, 46 OHIO ST. L.J. 243, 245 (1985).

5. DAVID LUBAN, LAWYERS AND JUSTICE: AN ETHICAL STUDY 217-34, 269-73 (1988).

6. Barlow F. Christensen, *The Unauthorized Practice of Law: Do Good Fences Really Make Good Neighbors—or Even Good Sense?*, 5 AM. B. FOUND. RES. J. 159, 215 (1980) ("Barring actual evidence of serious injury, the profession has no justification, except perhaps for purely selfish reasons, for denying to the public the right to choose from whom it will purchase legal services.").

7. David B. Wilkins, *Who Should Regulate Lawyers?*, 105 HARV. L. REV. 799 (1992).

8. ANTHONY KRONMAN, THE LOST LAWYER: FAILING IDEALS OF THE LEGAL PROFESSION 378 (1993).

9. Jonathan Macey, *Occupation Code 541110: Lawyers, Self-Regulation, and the Idea of a Profession*, 74 FORDHAM L. REV. 1079, 1096 (2005) ("Legal self-regulation displays the typical self-interested behavior of a cartel without any of the concomitant benefits . . . .").

10. Benjamin H. Barton, *Do Judges Systematically Favor the Interests of the Legal Profession?*, 59 ALA. L. REV. 453 (2008) [hereinafter Barton, *Do Judges Systematically Favor the Interests of the Legal Profession?*]. Barton has elsewhere examined the weakness of traditional defenses for lawyer self-regulation such as consumer protection and professional independence. *See* Benjamin H. Barton, *An Institutional Analysis of Lawyer Regulation: Who Should Control Lawyer Regulation—Courts, Legislatures, or the Market?*, 37 GA. L. REV. 1167 (2003); Benjamin Hoorn Barton, *Why Do We Regulate Lawyers?: An Economic Analysis of the Justifications for Entry and Conduct Regulation*, 33 ARIZ. ST. L.J. 429 (2001).

11. *See, e.g.*, Charles Silver, *When Should Government Regulate Lawyer-Client Relationships? The Campaign to Prevent Insurers from Managing Defense Costs*, 44 ARIZ. L. REV. 787 (2002); Fred C. Zacharias, *The Future Structure and Regulation of Law*

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Most of these critiques focus on one of two costs of failed self-regulation. The first predominates (perhaps because corporate scandals are one of the few topics in the professionalism literature that can generate headlines) and concerns the loss that comes from failure of independent advice and ethical, public-spirited, conduct by lawyers. Here the concern is to find ways to restore lawyers to Kronman's golden age of lawyer-statesmen: above politics, above deception, above greed. This strand in the (admittedly small) literature principally concerns the role of elite lawyers advising corporations and organizations. The second category of critiques (an even smaller literature) emphasizes restrictions on thc exercise of choice by consumers, particularly individual as opposed to organizational clients, and in particular the limited access to legal services that self-interested bar restrictions on supply impose. Because those who teach and study the legal profession often do so from the vantage point of legal ethics, the focus in the existing literature is thus substantially on the implications of self-regulation for ethical outcomes and the capacity for the legal profession to serve the public interest in terms of ensuring both compliance with law and access to the justice system.

As important and worthy as this focus is, however, it is also likely responsible for the infinitesimal effect that these wide-ranging and persistent critiques have had on the actual practice of lawyer self-regulation in the United States. If anything, the ABA has in recent years renewed its commitment to the very justifications for self-regulation—the need to protect client confidentiality, guard against conflicts of interest, protect the public from unauthorized practice, and maintain the independence of the legal profession—that have been so soundly rejected by legal scholars. In the face of a recommendation in 2000 from its own commission to relax restrictions on the capacity for lawyers and nonlawyers to join in the provision of legal and nonlegal services (the multidisciplinary practice, or MDP, debate), for example, the ABA retrenched, issuing a ringing statement that it remained committed to the profession's core values and would not budge on the requirement that lawyers, and lawyers alone, be authorized to provide legal services. Indeed, the ABA expanded its traditional list of core values (confidentiality, loyalty, avoidance of conflict of interest, professional independence, competence, access to justice) to include "the lawyer's duty to help maintain a single profession of law,"[12] thus making overt the responsibility of lawyers to resist efforts (which are hinted at in much of the scholarly critique and which I will make explicit below) to establish different standards for different types of legal practice such as by distinguishing appearances in court from transactional advice,[13] and corporate practice from

Practice: Confronting Lies, Fictions, and False Paradigms in Legal Ethics Regulation, 44 ARIZ. L. REV. 829 (2002).

12. ABA CTR. FOR PROF'L RESPONSIBILITY, RESOLUTION OF HOUSE OF DELEGATES ADOPTING REVISED RECOMMENDATION 10F (2000), *available at* http://www.abanet.org/cpr/mdp/mdprecom10f.html.

13. Intercstingly, Utah enacted a statute in 2003 that defined the practice of law (and

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the provision of services to individuals in nonbusiness matters. The association also reiterated its stance that "[j]urisdictions should retain and enforce laws that generally bar the practice of law by entities other than law firms."[14] In 2003, over serious antitrust concerns raised by the Federal Trade Commission and the Department of Justice,[15] and by the ABA Section of Antitrust Law (which urged the ABA to "embrace competition among lawyers and nonlawyers in the provision of legal information and legal services"),[16] the ABA urged states to regulate in accordance with "the basic premise that the practice of law is the application of legal principles and judgment to the circumstances or objectives of another person or entity."[17] The occasion for the effort devoted to producing a model definition of the practice of law was articulated as follows by the ABA President:

> The Association's interest in the parameters of the practice of law has been highlighted in recent years by the work of the Commission on Nonlawyer

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hence limited the monopoly of lawyers) exclusively in terms of court appearances representing others. UTAH CODE ANN. § 78-9-102 (2003). It was quickly repealed in 2004. H.B. 234, 2004 Gen. Sess. (Utah 2004).

14. ABA CTR. FOR PROF'L RESPONSIBILITY, *supra* note 12.

15. Letter from the U.S. Dep't of Justice and the Fed. Trade Comm'n to the ABA Task Force on the Model Definition of the Practice of Law (Dec. 20, 2002), *available at* http://www.abanet.org/cpr/model-def/ftc.pdf [hereinafter Letter from DOJ and FTC].

16. Letter from the ABA Section of Antitrust Law to the Task Force on the Model Definition of the Practice of Law (Apr. 2, 2003) [hereinafter Letter from ABA Antitrust Section], *available at* http://www.abanet.org/cpr/model-def/antitrust.pdf. The ABA Section on Delivery of Legal Services also opposed the effort to define the practice of law so as to preclude nonlawyer delivery, urging the profession to rely on the value it provides, and not the protection it receives, to ensure its dominance in the market. Memorandum from Mary K. Ryan, Chair, ABA Standing Comm. on the Delivery of Legal Services, to Lish Whitson, Chair, ABA Task Force on the Model Definition of the Practice of Law (Dec. 19, 2002), *available at* http://www.abanet.org/cpr/model-def/scdls.pdf ("The greatest threat to the public arises not when lay people, in the performance of their professional or business roles touch on issues concerning legal rights and responsibilities, but when lay people mislead consumers into the belief that they are lawyers or have the qualifications that a lawyer has.").

17. ABA TASK FORCE ON THE MODEL DEFINITION OF THE PRACTICE OF LAW, REPORT TO THE HOUSE OF DELEGATES, RECOMMENDATION (2003) [hereinafter ABA DEFINITION RECOMMENDATION], *available at* http://www.abanet.org/cpr/model-def/recomm.pdf. The draft definition that was criticized by the FTC, the DOJ, the Antitrust Section, and others went further to explicitly indicate that a person is presumed to be practicing law when giving legal advice, "[s]electing, drafting, or completing legal documents or agreements," "[r]epresenting a person before an adjudicative body, including, but not limited to, preparing . . . documents or conducting discovery," and "[n]egotiating legal rights or responsibilities on behalf of a person" and that the practice of law "shall be performed only by those authorized by the highest court" of a given jurisdiction. ABA TASK FORCE ON THE MODEL DEFINITION OF THE PRACTICE OF LAW, DRAFT DEFINITION OF THE PRACTICE OF LAW (Sept. 18, 2002), [hereinafter ABA DRAFT DEFINITION], *available at* http://www.abanet.org/cpr/model-def/model_def_definition.html. In its final report, the Task Force expressed the view that the giving of legal advice is "[i]nherent" in selecting and drafting documents and representation in court. ABA TASK FORCE ON THE MODEL DEFINITION OF THE PRACTICE OF LAW, REPORT 4 (2003) [hereinafter ABA DEFINITION REPORT], *available at* http://www.abanet.org/cpr/model-def/taskforce_rpt_803.pdf.

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> Practice and the Commission on Multidisciplinary Practice. The common thread in the work of these entities has been the revelation that there are an increasing number of situations where nonlawyers are providing services that are difficult to categorize under current statutes and case law as being, or not being, the delivery of legal services. This growing gray area may be partially responsible for the spotty enforcement of unauthorized practice of law statues across the nation and arguably an increasing number of attendant problems related to the delivery of services by nonlawyers.[18]

This is compelling evidence that the organized bar's regulatory agenda is still set not by calls among legal scholars for a revised approach to self-regulation to improve legal ethics and access to justice, but rather a continued use of the rubric of consumer protection (for which, as Deborah Rhode long ago pointed out, there is little evidence for the claim that there are risks generated by nonlawyer provision of services)[19] to justify rigorous protection of the legal-services monopoly held by lawyers.

In this paper, I shift the frame to focus not on the consequences of self-regulation for ethics and access to justice but rather on the significant and increasing costs of self-regulation for what has been for decades the core market in which legal services are provided: services to corporate and other business entities. The impact of supply control exercised by the bar has, of course, long been recognized as a potential cause of high prices for legal services, prices that we have seen spiral in the past decade.[20] Among the very few incursions into the bar's self-regulation have been Supreme Court decisions striking restrictions that explicitly hobble price competition such as minimum fee schedules,[21] advertising,[22] and residency restrictions,[23] and the Department of Justice's challenge (resulting in a consent decree) to ABA law school accreditation practices that imposed restrictions on faculty compensation.[24] These are undoubtedly important economic effects arising from supply control, but as I and others have previously noted,[25] particularly in

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18. ABA TASK FORCE ON THE MODEL DEFINITION OF THE PRACTICE OF LAW, CHALLENGE STATEMENT, *available at* http://www.abanet.org/cpr/model-def/model_def_challenge.html.

19. Rhode, *Professionalism in Perspective*, *supra* note 2.

20. Kevin Quinn and I have calculated, based on data from the Ameriean Lawyer Media made available to us through the Law Firms Working Group, for example, that the "high" and "low" rates for partners and associates in the most profitable corporate law firms has increased between 25% and 40% in real (CPI-adjusted) terms over the past eight years.

21. Goldfarb v. Va. State Bar, 421 U.S. 773 (1975).

22. Bates v. State Bar of Ariz., 433 U.S. 350, 377 (1977) ("The ban on advertising serves to increase the difficulty of discovering the lowest cost seller of acceptable ability. As a result, to this extent attorneys are isolated from competition, and the incentive to price competitively is reduced.").

23. Supreme Court of N.H. v. Piper, 470 U.S. 274, 281 (1985) (noting among other considerations in a Privileges and Immunities analysis that "law is important to the national economy").

24. United States v. ABA, 934 F. Supp. 435 (D.D.C. 1996).

25. *See, e.g.*, Gillian K. Hadfield, *The Price of Law: How the Market for Lawyers*

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the corporate-client market served by the largest and most elite law firms, artificial restrictions on the supply of lawyers and price competition among them cannot explain much of the explosion in legal costs of the past two-to-three decades. Moreover, while imperfections in the market for lawyers such as specialization, information asymmetries, and winner-take-all dynamics[26] account for distortions in pricing, the real culprit in the enormous increase in the cost of legal services is the more subtle dynamic of how the content of legal products is determined. The entropic growth in the complexity of law and legal procedures, rooted in the traditional practices of lawyerly reasoning and dispute resolution,[27] is the primary driver of increased costs. Put differently, the question is not (just) why does it cost so much per hour to conduct massive e-discovery in an antitrust case or draft the documents for an IPO or conduct patent litigation, but rather why has the legal system come to require such enormous complexity and quantity of legal effort to achieve the transactional and dispute-resolution goals of business entities? This, I believe, is the much more significant and much deeper consequence of the bar's continued self-regulation and the extensive limitations it places not only on who may deliver but, perhaps more importantly, who may *invent* legal products and services. The current regulatory model stands as a tremendous barrier to innovation in legal markets and thus as a severe obstacle to the effort to meet the needs of a rapidly transforming globally competitive economy.

The Article proceeds as follows. Part I gives a brief overview of the emergence of the modern professional regulatory regime in the late nineteenth century and advances the claim that the regulatory regime has failed to distinguish between the fundamentally different issues at stake in the economic sector as opposed to what I call the political/democratic sector of the legal world. I argue here that by conflating these two sectors in the analysis of the appropriate level and locus of professional regulation, lawyers use their legitimately unique roles in political and democratic fields to illegitimately protect the production and distribution of a fundamental, fundamentally economic, service. Part II then delineates the market conditions that are controlled by the judiciary and, primarily, the organized bar. Part III evaluates the economic implications of these regulatory controls, emphasizing the obstacles to innovation of lower cost and more effective inputs for economic transactions and dispute management. Finally, I offer conclusions about the need for lawyers, judges, antitrust authorities, legislatures, and, most importantly, the corporate clients whose interests professional regulation is ostensibly intended to serve, to take steps to make fundamental changes in the regulation of corporate legal markets.

Distorts the Justice System, 98 MICH. L. REV. 953, 962, 984 (2000); Richard H. Sander & E. Douglass Williams, *Why Are There So Many Lawyers? Perspectives on a Turbulent Market*, 14 LAW & SOC. INQUIRY 431, 449-51 (1989).

26. *See* Hadfield, *supra* note 25, at 963-82.

27. *Id.* at 964-68.

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I. THE REGULATORY STRUCTURE OF LEGAL MARKETS

A. *The Self-Governing Profession in the United States: Not We the Titmice of England*

> "Your mere *nisi prius* lawyer," said Burke, when harassed with the technical objections of his adversaries on the impeachment of Hastings—"Your mere *nisi prius* lawyer knows no more of the principles that control the affairs of state, than a titmouse knows of the gestation of an elephant." The remark was as true as it was pungent, when applied to the [English] bar to which he referred. But it has no just application to ours. If the fundamental proposition I have stated is sound, if the constitution that affords the basis of government as well as of forensic law, belongs to the judicial department to determine and to administer, then it is placed in the safe-keeping of the American bar. And we enjoy, as I have said, such a prerogative as never before was conferred upon a body of advocates.[28]

For most professions, self-governance is understood to be rooted in a delegation of the legislature's power to regulate. The state creates the profession's monopoly—and can take it away. The state grants the authority to self-regulate—and can take it away. Policy toward the regulatory regime is framed as a comparative exercise, evaluating the relative strengths and weaknesses of state-governance and self-governance. Self-governance is justified on a claim to relative expertise and hence enhanced capacity to achieve the public interest by those who are themselves members of the profession.[29]

Lawyers too claim expertise as a basis for self-governance. But the somewhat hazy structure of the regulatory regime governing lawyers in the United States at its core challenges the idea that the legislature is the ultimate regulator and the profession merely its delegate. Beginning with the creation of the American Bar Association in 1878, the American legal profession has woven a powerful, but perhaps untested, claim to a fundamental authority over the regulation of the entire legal system. It is a claim rooted in the constitutional structure of American democracy, an authority that, if credited, displaces the power of the legislature to regulate.[30]

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28. Edward J. Phelps, Annual Address (Aug. 20, 1879), *in* REPORT OF THE SECOND ANNUAL MEETING OF THE AMERICAN BAR ASSOCIATION 188 (1879).

29. For an overview of the economic analysis of self-regulation, see Anthony Ogus, *Rethinking Self-Regulation*, 15 OXFORD J. LEGAL STUD. 97, 97-108 (1995).

30. Other legal professions also claim an inherent supralegislative authority to regulate themselves. The Canadian Bar Association, for example, has claimed that the General Agreement on Trade in Services (GATS), which requires states to take steps to ensure that regulation in services is necessary to ensure quality and based on objective and transparent criteria, does not apply to lawyers. "Our view is that the legal profession should not have to prove the 'necessity' of rules which it is convinced are required to preserve its integrity and protect the public." *See* Paul D. Paton, *Legal Services and the GATS: Norms as Barriers to*

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The rhetoric even at the ABA's founding is stirring and startling in this regard. In his address to the Second Annual Meeting at Saratoga Springs in August of 1879, one ABA founder, Edward J. Phelps (later ABA President from 1880-81 and Kent Professor at Yale Law School from 1881 to his death in 1900),[31] articulated in powerful terms the "special" status of the lawyer in American society, as guardian of a constitutional structure that placed law above politics and lawyers above the state. He claimed that the American bar, unlike the "titmouse" of England, has a unique role in governance, administering the fundamental legal scheme on which American democracy is built:

> Lawyers in other countries have nothing to do, as lawyers, with constitutional principles of government, or with the basis on which its administration stands. They deal exclusively with the administration of justice, civil and criminal, between man and man, under a government established and fixed, with the operations of which they have professionally no concern. We, on the other hand, are charged with the safekeeping of the constitution itself.[32]

At the time he made these statements, Phelps and the ABA were stepping into what they perceived as a postwar vacuum of considered legal authority[33] and seeking to re-elevate the bar to the status it had held and then lost since lawyers played such a significant role in the creation of the country and foundational constitutional interpretation.[34] Phelps appealed in particular to the chaos and "scenes of a desolation and sorrow . . . over graves numberless to our arithmetic"[35] after the Civil War as the setting in which "[w]e come together . . . [t]o renew again, in faith and hope, the work which Marshall and his associates began, of cementing and building up on firm and lasting foundations, the American constitution."[36]

From its inception, the ABA set out to execute what it perceived as its fundamental role in regulating the legal system across the full spectrum, with

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Trade, 9 NEW ENGLAND J. INT'L & COMP. L. 361, 399 (2003) (quoting the Canadian Bar Association).

31. *See* Edward John Phelps, American Lawyer and Diplomat, http://family.phelpsinc.com/bios/edward_j_phelps.html.

32. Phelps, *supra* note 28, at 188.

33. Robert Gordon has observed:

> After the revolution it turned out that the new states, the new nation and the new economy required more regular and sustained attention to governance than part-time legislators and juries could provide. America did not have, and did not want, a powerful career civil service. Lawyers stepped forward to fill the vacuum. They had the credentials and legitimacy because they had articulated the grievances of the Revolution in legal terms; they had drafted the new Federal and State Constitutions, and gradually got them accepted as legal texts subject to lawyers' arguments and judges' interpretations.

Robert W. Gordon, *Portrait of a Profession in Paralysis*, 54 STAN. L. REV. 1427, 1440 (2002).

34. For a history of the role of the bar in the days of the early Republic and the loss of status in the period up to the Civil War, see Christensen, *supra* note 6, at 169-75.

35. Phelps, *supra* note 28, at 191.

36. *Id.*

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committees established not only for professional discourse in substantive areas of law and legal practice (Commercial Law; Patent, Trademark and Copyright Laws; Insurance Law; Taxation and International Law) but also on "Jurisprudence and Law Reform," "Judicial Administration and Remedial Procedure," "Legal Education and Admissions to the Bar," and "Grievances."[37] None of this attention to the structure of the legal system was organized under a delegation of an authority to regulate from state legislatures. Rather, the bar turned to the courts for assistance in implementing its proposed regulations. As early as the second annual meeting of the ABA in 1879, for example, the Committee on Legal Education and Admission to the Bar had recommended that bar admission be conditioned on three years of legal education;[38] by 1899 the constitutional authority of the state supreme court to require three years of legal education for bar admission, despite a contrary statute passed by the state legislature, was secured in Illinois.[39] By 1934 "[t]he determined effort on the part of the American Bar Association . . . to place the regulation of federal trial court procedure in law actions under the control of the Supreme Court of the United States, [had] at last been successful."[40] Today, the ABA claims that "judicial regulation of *all* lawyers is a principle firmly established . . . in every state."[41] For the most part, this means that regulation of lawyers is largely derived from the resolutions passed by majority voting in state bar associations on the basis of ABA recommendations.[42]

The basis for regulation of the practice of law by the judiciary, and hence effectively by the bar, however, still rests on a somewhat hazy and untested footing, elucidated only piecemeal through litigation in cases before state and sometimes federal courts. Many state legislatures appear to assert the power to regulate the legal profession through explicit statutory provisions establishing the requirement that the practice of law be restricted to those admitted to and in good standing with the state bar association.[43] But state supreme courts also frequently claim that the authority to regulate the profession lies inherently in the judicial branch and that, indeed, legislative interventions are unconstitutional under state constitutions explicitly or implicitly providing for a

37. ABA, CALL FOR A CONFERENCE; PROCEEDINGS OF CONFERENCE; FIRST MEETING OF THE ASSOCIATION; OFFICERS, MEMBERS, ETC., 38-39 (1878).

38. Report of the Committee on Legal Education and Admissions to the Bar, *in* REPORT OF THE SECOND ANNUAL MEETING OF THE AMERICAN BAR ASSOCIATION 236 (1879).

39. Blewett Lee, *The Constitutional Power of the Courts Over Admission to the Bar*, 13 HARV. L. REV. 233 (1899).

40. Edson R. Sunderland, *The Grant of Rule-Making Power to the Supreme Court of the United States*, 32 MICH. L. REV. 1116 (1934).

41. ABA SECTION OF LEGAL EDUC. & ADMISSIONS TO THE BAR, LEGAL EDUCATION AND PROFESSIONAL DEVELOPMENT—AN EDUCATIONAL CONTINUUM 116 (1992).

42. In most states, the substance of professional regulation is based on the ABA's Model Code of Professional Responsibility as adopted by state bar associations.

43. *See, e.g.*, CAL. BUS. & PROF. CODE § 6125 (Deering 2007); N.Y. JUD. CT. ACTS LAW § 478 (Consol. 2008); TEX. GOV'T CODE ANN. § 81.102 (Vernon 2007).

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tripartite separation of powers.[44] As recently as 2004, for example, the New Hampshire Supreme Court held unconstitutional legislation that required the state bar association to hold a binding referendum on whether or not to require all practitioners in the state to be members of the association.[45] The Court had previously, at the request of the bar association, imposed this requirement, "unifying the bar."[46] State courts also assert the right to define and prohibit the unauthorized practice of law, regardless of whether there is any UPL statute on the books.

Congress has largely remained out of the field of lawyer regulation, deferring to state courts and legislatures. Only in a few select fields have Congress or federal agencies (notably the Securities and Exchange Commission and the Internal Revenue Service) taken clear steps to regulate lawyer conduct.[47] Even here, however, the regulatory structure is murky. Congress could assert authority over the regulation of legal markets under the Commerce Clause; the U.S. Supreme Court has held that the Sherman Act does extend to at least some of the practices of local bar associations,[48] finding sufficient interstate commerce to authorize federal legislation. Federal courts, however, have appealed to the traditional role of the state, particularly state courts, in regulating the profession when construing federal statutes narrowly so as to limit the applicability of federal law to the practice of law.[49] Just two years

44. The Texas Supreme Court has employed a common formulation. *See* Eichelberger v. Eichelberger, 582 S.W.2d 395, 398-99 (Tex. 1979) (holding that "[t]he *inherent* judicial power of a court is not derived from legislative grant or specific constitutional provision, but from the very fact that the court has been created and charged by the constitution with certain duties and responsibilities," and "from the doctrine of separation of powers between the three governmental branches . . . . to enable our courts to effectively perform their judicial functions and to protect their dignity, independence and integrity.") (emphasis added).

45. *In re* N.H. Bar Ass'n, 855 A.2d 450, 451, 456 (N.H. 2004) ("The means by which the judicial branch chooses to organize the Bar, which it is charged with supervising, cannot be restricted by the other branches of government. . . . Otherwise, inherent judicial power is compromised.").

46. *In re* Unified N.H. Bar, 291 A.2d 600, 600 (N.H. 1972).

47. "The Enron-inspired Sarbanes-Oxley Act is the first federal statute in the history of the republic to regulate lawyers directly and broadly. The second came only two years later, when Congress confirmed and extended the power of the Internal Revenue Service . . . to regulate extensively the practice of tax lawyers." William H. Simon, *Introduction: The Post-Enron Identity Crisis of the Business Lawyer*, 74 FORDHAM L. REV. 947, 950 (2005).

48. Goldfarb v. Va. State Bar, 421 U.S. 773, 785 (1975) (stating that the minimum fee schedules established by state and county bar associations are not exempt from the Sherman Act as "state action" because activity is not compelled by direction of state).

49. In 2002, the Federal Trade Commission issued an opinion that attorneys were not exempted from the Gramm-Leach-Bliley Act, imposing restrictions on the sharing of private consumer information by financial institutions. The New York State Bar Association and ABA sought a declaratory judgment that the FTC lacked authority to extend the regulation to attorneys. ABA v Fed. Trade Comm'n, 430 F.3d 457 (D.C. Cir. 2005). The D.C. Circuit agreed that the Act could not reasonably be interpreted by the FTC to apply to lawyers, noting that the Act made no reference to the profession of law, "a profession never before

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after holding that the Sherman Act does prohibit state bar associations from enforcing minimum fee schedules for lawyers, for example, the U.S. Supreme Court held that rules of attorney conduct (specifically advertising regulations) written by the ABA and state bar associations but formally adopted by a state Supreme Court are state action for the purposes of the Sherman Act and hence immune to antitrust attack.[50] Notably, the limitations on congressional authority found by the federal courts have been based on an interpretation of congressional intent, not on constitutional separation of powers grounds. Yet this is the ground on which state supreme courts have often asserted their authority over the legal profession.

The question of the capacity of Congress to regulate the legal profession has thus rarely if ever been sharply posed. Adrian Vermeule has argued persuasively, however, that in other areas state supreme courts' assertion of inherent judicial authority based on separation of powers in state constitutions "sweep beyond any defensible conception of judicial power."[51] Vermeule appeals theoretically to the "seeming contradiction [posed by the judicial assertion of inherent judicial authority] of the institutional design principle, fundamental to the separation of powers, that no institution should be the final arbiter of the limits of its own authority"[52] and practically to "systemic cognitive pressures that drive judges toward implausible assertions of judicial power."[53] Recently Benjamin Barton has documented the multiple settings in which judges, themselves members past and sometimes present of the bar associations and legal professions they regulate, appear to favor the interests of lawyers:

> Why is it that the attorney-client privilege is the oldest and most jealously protected of all the professional privileges? . . .
>
> Why is it that the Supreme Court has repeatedly struck down bans on commercial speech since the 1970s except for in-person lawyer solicitations and some types of lawyer advertising. A ban on in-person solicitation by accountants, by comparison, was struck down.
>
> Why is the *Miranda* right to consult with an attorney protected so much more fervently than the right to remain silent? . . .
>
> Why do courts flatly refuse to enforce a noncompete agreement amongst lawyers? By contrast, other professional noncompete agreements are analyzed on a case-by-case reasonableness basis. . . .
>
> Lastly, why is a legal malpractice case so much harder to make out than a

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regulated by 'federal functional regulators'" and that "Congress does not hide elephants in mouseholes." *Id.* at 467, 469.

50. Bates v. State Bar of Ariz., 433 U.S. 350 (1977). The Court went on to hold that the advertising regulations did, however, violate the First Amendment. In deciding *Bates*, the Court revisited *Parker v. Brown*, 317 U.S. 341 (1943), in which the Court first held that the Sherman Act was not intended to limit state action.

51. Adrian Vermeule, *The Judicial Power in the State (and Federal) Courts*, 2000 SUP. CT. REV. 357, 360.

52. *Id.* at 399.

53. *Id.* at 406.

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medical malpractice case?[54]

And, most potently, "Why are lawyers the only American profession to be truly and completely self-regulated?"[55] Were the question of the allocation of regulatory authority over the legal profession posed sharply, it appears that the constitutional answer might be clear but not the judicial response.

B. *Distinct Professions: The Political and Economic Functions of Law*

One can fairly hear the roar that must have met Phelps' concluding call to arms to those gathered at the second meeting of the American Bar Association: "[L]et us join hands in a fraternal and unbroken clasp, to maintain the grand and noble traditions of our inheritance, and to stand fast by the ark of our covenant."[56] His ringing rhetoric no doubt still stirs the soul of many an attorney some 130 years later. It is a short distance from this overt appeal to the role of lawyers in the protection of American constitutional ideals to the preamble one often finds in modern bar association codes of conduct such as this one from the New York bar:

> The continued existence of a free and democratic society depends upon recognition of the concept that justice is based upon the rule of law grounded in respect for the dignity of the individual and his capacity through reason for enlightened self-government. Law so grounded makes justice possible, for only through such law does the dignity of the individual attain respect and protection. Without it, individual rights become subject to unrestrained power, respect for law is destroyed, and rational self-government is impossible.
>
> Lawyers, as guardians of the Law, play a vital role in the preservation of society.[57]

One does not need to dispute these claims to the fundamental importance of a legal profession in upholding a democratic regime—indeed, the modern world presents many opportunities for seeing what is at stake in preserving access to lawyers to control the power of the state. But one does need to see what is glossed both in the modern rhetoric and the rhetoric of the late nineteenth century. The ABA created a single profession of law; today the ABA makes protection of a single profession of law a core value for lawyers.[58]

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54. Barton, *Do Judges Systematically Favor the Interests of the Legal Profession?*, *supra* note 10, at 456.

55. *Id.*

56. E.J. Phelps, Annual Address by E.J. Phelps, *in* REPORT OF THE SECOND ANNUAL MEETING OF THE AMERICAN BAR ASSOCIATION 192 (1879).

57. N.Y. STATE BAR ASS'N, LAWYER'S CODE OF PROF'L RESPONSIBILITY pmbl. (2005).

58. *See* ABA CTR. FOR PROF'L RESPONSIBILITY, *supra* note 12. Fred Zacharias noted that the opposition to the ABA Commission on Multidisciplinary Practice's recommendations "arose primarily because of the Commission's insistenee that the same rules apply to all lawyers." Zacharias, *supra* note 11, at 842. Zacharias also questions the continuing reliance of the professional regulatory model on the assumption that all clients are the same. *Id.*

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But if the footing for the profession and its place in the regulatory structure is planted on the functions of the legal system, then we have to distinguish two very different functions.

One is the democratic/political function to which Phelps and the New York Bar Association appeal: protecting the architecture of democratic institutions, protecting individual rights, implementing the balance of power that promotes the normative goals of self-governance such as human dignity, autonomy, fairness, and well-being. The other is the role of law in supporting efficient market transactions: establishing real and intellectual property rights, and facilitating contractual and organizational economic relationships in finance, innovation, production, and trade. In this latter function, law is more appropriately judged not by how well it promotes the normative democratic goals of equality, autonomy, dignity, and so on but rather by how well it promotes economic activity and efficiency. This is not to say that economic activity does not also promote democratic goals, or that there is no appropriate role for law that regulates economic activity to better promote democratic nonefficiency goals. It is to say that the values at stake in the regulation of legal services that reduce transaction costs in global supply contracting, increase the liquidity of financial markets, or promote collaborative investment in innovation are categorically different from those at stake in the regulation of legal services ensuring that police searches are in compliance with the Fourth Amendment, hiring is accomplished in a nondiscriminatory manner, and products are safely designed and produced.

Perhaps it was true in the late nineteenth century when Phelps roused the attorneys at the second annual meeting of the ABA that the distinctions between the law that promoted individual rights and the law that supported market transactions were blurred. This was a time before the explosion of the large publicly-traded corporation, when company "ownership was personal and confined to one or a few individuals."[59] As Alfred Chandler described it, in the last decades of the 1800s, most enterprises were "personal enterprises," self-financed with personal wealth and plowed-back profits. As a consequence, "owners managed and managers owned."[60] In this era, it would have been natural to identify business interests with individual interests. Indeed, it was during this time that the *Lochner* doctrine of economic substantive due

59. WILLIAM G. ROY, SOCIALIZING CAPITAL: THE RISE OF THE LARGE INDUSTRIAL CORPORATION IN AMERICA 4 (1997). Roy reports:

> As late as 1890, fewer than ten manufacturing securities were traded on the major stock exchanges . . . . Investors considered manufacturing companies too risky and industrialists resisted surrendering control to outsiders. . . . Carnegie Steel Company, an unincorporated limited partnership, was the largest manufacturing operation in the world.

Id. (citations omitted). Alfred Chandler adds, "Before the appearance of the multiunit firm, owners managed and managers owned." ALFRED D. CHANDLER, JR., THE VISIBLE HAND: THE MANAGERIAL REVOLUTION IN AMERICAN BUSINESS 9 (1977).

60. CHANDLER, *supra* note 59.

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process[61] emerged, resting the right of firms to structure economic activity as they saw fit without government regulation on the Constitution that Phelps had put at the center of the profession's role in American society. It is also in this era that the corporation was recognized for the first time as a "person" with constitutional rights.[62] It is in this era that Brandeis urged prospective lawyers at the Harvard Ethical Society to merge the role of "corporation lawyer" and "people's lawyer."[63] David Luban argues that in Brandeis's vision the "lawyer-statesman" who advises corporations on business matters takes on the function of "curbing" the "excesses of capital"[64] by bringing to bear the judicial and public-spirited perspective that the capitalist lacks.[65] Luban recounts a telling anecdote about Brandeis in 1902 taking his client William McElwain, the owner of a large shoe company, to task in a labor dispute for failing to appreciate the legitimacy of his workers' complaints. Brandeis visited the factory and discovered that the employees worked on an irregular and seasonal basis, which reduced the effective level of their wages though they were well-paid when there was work. Brandeis then devised a plan for adjusting the organization of the work to smooth and increase effective wages.[66] In Brandeis's world of elite corporate lawyers advising owner-managers, the merger of the democratic and the economic functions of the law and the lawyer makes sense.

But the era of the owner-managed firm began to recede almost as soon as it took hold in the legal imagination. By the end of World War I, the corporate revolution brought a shift to the separation of ownership and management and the "managerial capitalism" that characterizes the modern publicly traded corporation.[67] In the years following World War I, this separation in ownership and management intensified as weaknesses in the centralized form of

61. Lochner v. New York, 198 U.S. 45 (1905).

62. Interestingly, the recognition of the corporation's standing to assert Fourteenth Amendment rights under the U.S. Constitution was first decided hy the U.S. Supreme Court in an opinion that found the point unworthy of discussion. Santa Clara County v. S. Pac. R.R. Co., 118 U.S. 394, 396 (1886). The grounds for according the corporation due process rights were challenged much later in dissents first by Justice Black alone, for example in *Connecticut General Life Insurance Co. v. Johnson*, 303 U.S. 77, 85 (1938) (Black, J., dissenting), and then Justice Black with Justice Douglas. Wheeling Steel Corp. v. Glander, 337 U.S. 562, 576 (1949) (Douglas, J., dissenting). The majority opinions in those cases declined to even address the arguments, continuing to assume that the corporation was a "person" for the purposes of the Fourteenth Amendment. In *Wheeling Steel*, Justice Jackson, the majority opinion writer, also wrote separately to emphasize that there was no question that corporations were entitled to the protections of the Fourteenth Amendment, yet still failed to provide substantive reasoning for this argument. *Id.* at 574-75 (Jackson, J., writing separately).

63. LOUIS D. BRANDEIS, BUSINESS—A PROFESSION 313, 321 (1914).

64. *Id.* at 323.

65. David Luban, *The* Noblesse Oblige *Tradition in the Practice of Law*, 41 VAND. L. REV. 717, 717 (1988).

66. *Id.* at 722-23.

67. CHANDLER, *supra* note 59, at 9-10, 455; *see* ROY, *supra* note 59, at 6.

governance characteristic of the privately owned firm became apparent in an expanding and more volatile economy. Corporations moved to a more diversified, multidivisional structure in which day-to-day operating procedures were handled in autonomous units, and the head office focused on finance, long-term forecasting, and budgeting.[68] Management became structural, professional, and contractual, not personal. The most senior levels of management essentially operated "internal capital markets whereby cash flows from diverse sources are concentrated and directed to high yield uses," and the profit goal displaced the functional goals of the day-to-day manager.[69] As the twentieth century progressed, the idea that a complex economic system required complex regulatory systems emerged and courts receded from using *Lochner* to merge questions of economic policy with questions of constitutional rights.

It seems clear today that it is no longer tenable for the functions of a legal system to be all knotted into a common core of fundamental rights of a political, democratic, or constitutional character. Gone are the days when the successors of Louis Brandeis can resolve the contradictions between competitive profit-maximization and the dignity and welfare of workers in a shoe factory by taking the owner-manager out to the woodshed, lambasting him, and then designing for him an improved annual production process that raises both profits and wages. This is not to say there is no role for lawyers to act as an ethical breakwater when advising corporations about whether to facilitate Chinese government censorship of Internet search results, to manipulate their books to defraud investors and employee pension funds, or to resist fair settlement of employment discrimination claims. But it is to say that these normative considerations are of a fundamentally different character from the economic considerations, which dominate the work of the majority of lawyers today, of how to structure the delivery of Internet services in a country that lacks both physical and market infrastructure, how to design financial instruments that better diversify risk, or how to structure a more competitive employee benefits package to improve retention. And it is to recognize that the complexity of the interplay between economic goals and the protection of democratic values have far outstripped what can be accomplished, man-to-man, over an expensive lunch.

This is the recognition that so depressed Anthony Kronman in his lament for what he concluded was the largely unrecoverable "lawyer-statesman" of the past.[70] But it need not be so depressing. The dilemma is indeed stark if we think there is but a single legal profession and a single legal system, with an ultimately common touchstone of preserving a free and democratic society and

68. CHANDLER, *supra* note 59, at 456-63.

69. Oliver E. Williamson, *The Modern Corporation: Origins, Evolution, Attributes*, 19 J. ECON. LITERATURE 1537, 1558 (1981).

70. KRONMAN, *supra* note 8, at 3.

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in which all lawyers serve as the guardians of a legal system. But the dilemma dissolves significantly if we acknowledge that legal systems have multiple functions, not all of which are rooted in the protection of individual rights. Most importantly, it dissolves significantly if we make a basic distinction between the market-structuring and efficiency functions of a legal system and the democratic and political functions of a legal system. Determining how to deliver Internet services in light of weak physical and market infrastructure, so as to reduce costs, increase quality, and generate valuable new products falls within the market-structuring and efficiency function. Deciding how to reconcile a demand for censorship of search results with the overall goal of expanding into an untapped market controlled by the censor falls within the democratic and political function. Just as we now draw a line between advising the corporation on how to set up an accounting system and advising the corporation on how to draft a contract between the firm and its investors, we could just as easily draw a line between advising the corporation on how to increase profitability through improved contract and dispute resolution mechanisms and advising the corporation on how to respond to state regulation that seeks to channel market activity towards politically determined goals other than profit maximization. We can certainly draw a line between advising or representing a corporate entity with profit-maximization interests and advising or representing a person with diverse interests that include economic, social, and political well-being. As Kronman recognized, the vast majority of lawyers spend their days immersed in the details of the former, and yet we continue to conceptualize the legal system and the legal profession in terms of the latter. So we see the commercialization of law as a struggle to keep the impressive tide of market incentives from swamping fidelity to "the" profession's "core values" of protecting individual rights and democratic goals. If we cut the ties between the two functions, however, we can begin to build differentiated legal professions that are not dragged under, in either sphere, by the weight of the other.

In other work[71] I have made some initial forays into how the political/democratic sphere (largely serving individuals) is harmed by mergers with the economic/market-structuring sphere (largely serving corporations). I suggest there that separating out the political and democratic functions from the economic can help protect the commitment to justice and fairness that is threatened by the corporate commercialization of legal markets and norms. In the remainder of this Article, I take up the issue of how a regulatory structure for legal markets supplying market-structuring and economic services to corporations[72] operates as a major obstacle to the efficient adaptation to a

71. Gillian K. Hadfield, *The Price of Law: How the Market for Lawyers Distorts the Justice System*, 98 MICH. L. REV. 953 (2000).

72. I will refer to corporations in order to converge with the conventional description of the work of "corporate" law firms. Some of what I say, however, will apply more generally to other business entities and organizations.

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rapidly changing, globally competitive market economy.

II. A HEAVILY REGULATED MARKET: WHAT THE BAR AND JUDICIARY CONTROL

Let us start with the premise that lawyers providing market-structuring services to corporations are themselves operating in a market. They are providing economic inputs. They are not just supplying legal knowledge—an informational input based on their expertise in the content of statutes, regulations, and judicial opinions. They are also producing economic solutions to business problems, such as contracts, dispute resolution mechanisms, financial instruments, property bundles, risk distribution vehicles, and regulatory compliance, and monitoring systems. Lawyers also create organizational, relational, and transactional structures that reduce costs, taxes, liability, and investment risks and increase revenues, market share, and competitive advantage. Purchasers of these solutions evaluate them in terms of how well they serve the corporation's profit-maximizing objectives. Competitors who can develop and offer solutions that produce higher-valued results command higher prices; those who devise and deliver solutions that achieve the same results at a lower price command market share.

Now think about how this market is regulated and how competition between alternative suppliers of these solutions is structured. What follows is a catalogue of the attributes regulated by the bar and the judiciary (what I will jointly refer to as "the legal profession") with respect to the innovation, production, prieing, and delivery of goods and services in this market. The market for corporate legal products and services is one of the most heavily regulated in the economy.

A. *What Counts as a Legal Product*

The legal profession first defines the scope of its regulatory authority: what counts as a legal product and hence is subject to control by the profession. This is done overtly through the definition of "the practiee of law." Although most states have codified the definition,[73] most statutes are relatively vague and determining what counts as "the practice of law" has largely been left to judges. Many courts resist the idea that there can be a clear definition, as in this statement from the Arkansas Supreme Court in 1959, cited as eurrent Arkansas law by the ABA in 2003:

> Research of authorities by able counsel and by this court has failed to turn up

73. *See* ABA TASK FORCE ON THE MODEL DEFINITION OF THE PRACTICE OF LAW, STATE DEFINITIONS OF THE PRACTICE OF LAW [hereinafter ABA STATE DEFINITIONS], *available at* http://www.abanet.org/cpr/model-def/model_def_statutes.pdf, for a listing of statutory definitions compiled by the ABA.

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> any clear, comprehensible definition of what really constitutes the practice of law. Courts are not in agreement. We believe it is impossible to frame any comprehensive definition of what constitutes the practice of law. Each case must be decided upon its own particular facts. . . . The practice of law is difficult to define. Perhaps it does not admit of exact definition."[74]

Others end up in an overtly circular definition such as this from *Corpus Juris Secundum*, quoted by the Indiana Supreme Court in 1938 and reaffirmed by that Court as recently as 1999: "To 'practice law' is to carry on the business of an attorney at law; to do or practice that which an attorney or counselor at law is authorized to do and practice."[75] The most common definitions, appearing in rules of court and sometimes in statutes passed by a state legislature, go only a short distance from the explicitly circular to say that the practice of law is the provision of services that require legal knowledge, skill, judgment, or ability—i.e., what lawyers do.[76] Almost all are clear that the practice of law can be expansively defined to go well beyond representation in a court to include drafting (or sometimes even just filling in the blanks on) contracts, documents, or instruments that affect rights, advising on legal rights and duties, and negotiating, settling, or transacting a matter that involves legal rights and duties. In 2002, an ABA task force attempted to bring order to the field with a model definition. The task force first proposed that "[t]he 'practice of law' is the application of legal principles and judgment with regard to the circumstances or objectives of a person that require the knowledge and skill of a person trained in the law."[77] It presumed that this definition was met when acting on behalf of another in:

> 1) Giving advice or counsel to persons as to their legal rights or responsibilities or to those of others;
> 2) Selecting, drafting, or completing legal documents or agreements that

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74. Ark. Bar Ass'n v. Block, 323 S.W.2d 912, 914 (Ark. 1959) (citing R.I. Bar Ass'n v. Auto. Serv. Ass'n, 179 A. 139 (R.I. 1935)) (cited in ABA State Definitions, *id.*); *see also* Comm. on Prof'l Ethics & Conduct v. Baker, 492 N.W.2d 695, 701 (Iowa 1992) ("It is neither necessary nor desirable to attempt the formulation of a single, specific definition of what constitutes the practice of law.") (quoting Iowa Code of Professional Responsibility for Lawyers); Mass. Conveyancers Ass'n v. Colonial Title & Escrow, Inc., No. Civ.A. 96-2746-C2001, 2001 WL 669280, at *5 (Mass. Super. 2001) (finding that "a comprehensive definition would be impossible to frame" but formulating a general definition); Cardinal v. Merrill Lynch Realty/Burnet, Inc., 433 N.W.2d 864, 867 (Minn. 1988) ("The line between what is and what is not the practice of law cannot be drawn with precision.") (quoting Cowern v. Nelson, 290 N.W. 795, 797 (Minn. 1940)); Nebraska *ex rel.* Johnson v. Childe, 23 N.W.2d 720, 723 (Neb. 1946) ("An all inclusive definition of what constitutes the practice of law is too difficult for simple statement."); Gmerek v. State Ethics Comm'n, 751 A.2d 1241, 1255 (Pa. Commw. Ct. 2000) ("There is no need for present purposes to venture upon a comprehensive survey of the boundaries—necessarily somewhat obscure—which limit the practice of law.").

75. Fink v. Peden, 17 N.E.2d 95, 96 (Ind. 1938), *quoted in* Cincinnati Ins. Co. v Wills, 717 N.E.2d 151 (Ind. 1999).

76. *See* ABA STATE DEFINITIONS, *supra* note 73.

77. ABA DRAFT DEFINITION, *supra* note 17.

affect the legal rights of a person;
3) Representing a person before an adjudicative body, including, but not limited to, preparing or filing documents or conducting discovery; or
4) Negotiating legal rights or responsibilities on behalf of a person.[78]

After being told by the FTC, the Department of Justice, and its own section on Antitrust Law that the definition was too broad,[79] the task force recommended and the ABA adopted a resolution that allowed an arguably broader definition but left the matter to the profession in each state. The resolution stated that each state and territory should adopt a definition that includes "the basic premise that the practice of law is the application of legal principles and judgment to the circumstances or objectives of another person or entity."[80] What is legal judgment? Presumably, the judgment exercised by people trained as lawyers. Law is what lawyers do. Thus the boundaries of the market controlled by the profession encompasses nearly any product or service that assists in the design of organizations, transactions, or systems that have any contact point with the law. In the law-thick world in which modern corporations exist, the practice of law covers just about all structural features of how the corporation goes about its business.

The economic input that legal product markets supply, however, is not limited to what lawyers do. It also includes what judges do: the output of the legal system with respect to the substantive and procedural methods used for dispute resolution. These methods not only resolve disputes once they have arisen, they also inform the design of contracts, transactions, instruments, organizations, products, and processes, due to anticipation of potential disputes. The methods for dispute resolution include procedural rules governing how a dispute is initiated and then adjudicated or settled; evidentiary rules including the process of discovery; rules and practices for interpreting contracts, regulations, and statutes; and rules and practices for remedying defaults and transgressions. While much of substantive law is produced within legislatures and executive agencies, common law courts generate a great deal of law both in traditional common law areas such as tort, contract, and property and through statutory interpretation. Moreover, courts produce—and sometimes claim an inherent exclusive right to produce—laws of evidence, civil procedure (including civil discovery standards), and remedial methods and limits.[81]

Much of what is produced in courts, particularly in the American common law system, is effectively generated by lawyers.[82] Courts only adjudicate the

78. *Id.*

79. *See* Letter from DOJ and FTC, *supra* note 15, and Letter from ABA Antitrust Section, *supra* note 16.

80. ABA DEFINITION RECOMMENDATION, *supra* note 17.

81. *See* Vermeule, *supra* note 51.

82. I model this process and discuss the institutions involved in mediating the inputs of legal effort into legal rule production in Gillian K. Hadfield, *The Levers of Legal Design: Institutional Determinants of the Quality of Law*, 36 J. COMP. ECON 43 (2008); Gillian K.

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disputes that lawyers on behalf of clients bring to them. They only consider the evidence lawyers discover and present. They only hear the experts the lawyers hire and educate in the facts and issues of the case. They only decide the questions of procedural and substantive law that are framed for them by the lawyers who enter and argue motions and conduct trials. The innovations in rules and interpretations and procedures that courts develop are almost entirely rooted in the work of the lawyers who appear before them. In this sense, lawyers produce legal products and services not only directly for the clients who hire them, but also for all those who use the legal system.[83]

B. *Who Can Produce Legal Products*

As the ABA Task Force on the Model Definition of the Practice of Law noted, the reason for defining "the practice of law" is to determine who can provide legal products and services. The profession controls entry into this market. If a product or service provides an input that falls within the "practice of law" then, with few exceptions,[84] only lawyers may be suppliers in that market.[85] The judges that produce law for the market, in a collaborative

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Hadfield, The Quality of Law: Judicial Incentives, Legal Human Capital and the Evolution of Law (Feb. 21, 2007) (unpublished manuscript, on file with author), *available at* http://works.bepress.com/ghadfield; *see also* Gillian K. Hadfield, *Don't Forget the Lawyers: The Role of Lawyers in Promoting the Rule of Law in Emerging Market Democracies*, 56 DEPAUL L. REV. 401 (2007); Gillian K. Hadfield, *The Role of International Law Firms and Multijural Human Capital in the Harmonization of Legal Regimes*, *in* MULTIJURALISM: MANIFESTATIONS, CAUSES AND CONSEQUENCES (Albert Breton, Katharina Pistor and Pierre Salmon eds., forthcoming 2008), *available at* http://works.bepress.com/ghadfield.

83. Roberta Romano has focused in particular on the idea of law as a product in the area of corporate law, where there is a significant literature on "competition" among states to obtain or retain market share in the market for incorporations. Roberta Romano, *Law as a Product: Some Pieces of the Incorporation Puzzle*, 1 J.L. ECON. & ORG. 225, 225-26 (1985). For a discussion of the regulatory competition literature in corporate law and a critique of the analogy between legislatures and profit-maximizing firms in competition, see Gillian Hadfield & Eric Talley, *On Public Versus Private Provision of Corporate Law*, 22 J.L. ECON. & ORG. 414 (2006).

84. The ABA Task Force on the Definition of Law, for example, proposed in its draft definition that "whether or not they constitute the practice of law," nonlawyers could represent themselves or serve as a mediator or arbitrator. ABA DRAFT DEFINITION, *supra* note 17. The proposed restriction of the definition to legal services provided to serve the objectives of a particular client also was understood to exclude the publication of legal self-help books and other legal information; this latter issue has been a significant battle in the profession. *Id.* As recently as 1997, the Texas Bar, for example, opened proceedings in its Unauthorized Practice of Law Committee into the question of whether Nolo Press, a publisher of legal self-help books and software, was engaged in the unauthorized practice of law. *See In re* Nolo Press/Folk Law, Inc., 991 S.W.2d 768 (1999). The Texas Legislature amended its statutory definition of the practice of law in 1999 to explicitly exclude such publications. TEX. GOV'T CODE ANN. § 81.101 (Vernon 1999).

85. "The practice of law shall be performed only by those authorized by the highest court of this jurisdiction." ABA DRAFT DEFINITION, *supra* note 17.

enterprise with the lawyers who appear before them, must also be lawyers.[86] What is a lawyer? A person who has satisfied the requirements for admission to the bar established by the profession and, in a majority of states, who maintains active membership in the statewide mandatory bar association.[87]

The close association in the legal imagination between the power of the state and what lawyers and judges do, even when they are working exclusively with matters that impact only the conduct of business relationships, can make it difficult to see how anyone other than members of the profession could provide these legal products and services. The capacity for nonlawyer provision has been most clearly articulated in a small set of routine, largely consumer-service areas principally involving standardized transactions and forms (home sales, basic wills, no-fault divorces, and so on). Where anything other than routine legal information is required, and particularly where judgment and multifaceted analysis is required, the need for lawyers seems inescapable.

Particularly when we are focused on the provision of economic inputs to business entities, however, the capacity for nonlawyers to act as suppliers is substantial. This follows from recognizing that the profession's claim to exclusive competence rests on two contestable premises, the first having to do with the requirement of generalized legal expertise in the provision of advice in a given area of law, and the second with the 'fact' that the state is the exclusive provider of the coercive dispute and transaction management system.

First, on generalized expertise. The model of legal practice that animates professional regulation is still rooted in the solo and (very) small firm practice that dominated at the time of the ABA's founding and was only displaced by the large firm in the area of corporate legal services in the last forty or so years.[88] The commitment of the profession to a single definition of what it

86. Most states and the federal system require that a person be a member of the bar in order to be eligible for appointment or election to the bench.

87. Most states have what is called a "unified" bar, meaning that all lawyers must belong to the state bar association. In states without a unified bar, lawyers who have been admitted to practice are not required to belong to the association. In California, membership in the state bar association is a constitutional requirement. CA. CONST. art. VI, § 9. Some states require judges to be members of the bar; others prohibit this.

88. There are no systematic data on firm size in the early parts of the twentieth century but it is clear that the vast majority of lawyers worked in solo practice or at most two-person partnerships. In 1905 in Philadelphia, for example, a clear majority of the 1900 lawyers at the time were solo practitioners. LAWRENCE FRIEDMAN, AMERICAN LAW IN THE 20TH CENTURY 30 (2002). "In 1900, a firm with twenty lawyers was a giant." LAWRENCE FRIEDMAN, A HISTORY OF AMERICAN LAW 539 (3d ed. 2005). Even as late as the 1960s, the average size of the largest law firms was forty. MARC GALANTER & THOMAS PALAY, TOURNAMENT OF LAWYERS: THE TRANSFORMATION OF THE BIG LAW FIRM 22 (1993) (based on a study of the 35 largest firms). Today the average size of the largest law firms is well over 1000 (calculation by author). In addition, approximately 35% of the profession works in solo practice. CLARA N. CARSON, THE LAWYER STATISTICAL REPORT: THE U.S. LEGAL PROFESSION IN 2000, at 28-29 (2004) (calculation based on data showing that 74% of lawyers are in private practice and 48% of private practitioners are in solo practice).

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means to be a "lawyer" and the requirement that all lawyers undergo the same training and pass a bar exam that tests knowledge of rules across a wide spectrum of fields of practice reflects the view that to be a "lawyer" means, still, to have basic competence to handle the mix of cases that the solo or small-firm general practitioner has always been likely to see. Most people recognize, however, the enormous degree of specialization that has occurred over the past several decades.[89] Here the idea is that a private firm could conceivably develop its own rules and practices for determining contract disputes: what requirements have to be met for a contract to be enforceable, what rules and methods of interpreting contracts and identifying obligations will be employed, what reasons will be accepted as an excuse from a contract, what remedies will be given for breach, and so on. Indeed, if we step outside of the state-produced world of contract dispute resolution—which provides rules for deciding contract disputes, leaves it to individual parties to draft the content of their contracts, and does not get involved unless a lawsuit is filed—there is no reason not to imagine that private firms could provide the fundamental legal products and services here without looking very much at all like the system we associate with "the law of contracts." Those fundamental legal products and services are the inputs that achieve the level of commitment, adaptation, and dispute management necessary for cooperative economic activity—trade, investment, and production—to go forward efficiently.

A private firm might, for example, be retained jointly by parties interested in a contractual relationship, providing custom or standardized terms or procedures and participating in responding to disputes and adaptation needs within the context of an ongoing relationship. The firm perhaps could administer protocols for appeals to external experts or inputs, rather than stepping in to decide who is at fault and who owes what to whom only at the point when the parties' own efforts to manage their dispute break down and the equivalent of a "lawsuit" is filed. This approach to supporting and managing contractual relationships might require very little if any expertise about the state's system of contract law, and hence could potentially be provided by any number of nonlawyer providers.

C. *What Law Schools Must Teach*

The profession's control over who may provide legal products and services extends beyond its guard post at the entrance to law firm offices. The profession requires in every state but California that those who sit for the bar first complete a three-year law degree in a law school accredited by the ABA. Indeed, establishing some control over what constitutes a law degree was a

89. *See* John P. Heinz et al., *The Changing Character of Lawyers' Work: Chicago in 1975 and 1995*, 32 LAW & SOC'Y REV 751, 760-62 (1998).

primary goal for the ABA right from its founding.[90] Today, the ABA plays a substantial role in determining who goes to law school and what happens when they are there. Among the requirements imposed by the ABA are admissions criteria (requiring the LSAT or equivalent), advanced standing limits (limiting the credit that can be given for classes at non-ABA or foreign law schools), the number of hours that must be spent in classes physically taught at a law school (thus excluding distance-education methods,independent research, field placements, clinics without a classroom component, and courses taken in other departments), what classes must be taught by full-time faculty, criteria for evaluating the curriculum, minimum bar passage rates, requirements establishing areas that must be covered by the curriculum, the materials that must be held in the library (not merely made accessible electronically or at nearby libraries), maximum full-time faculty-to-student ratios, and a requirement that any programs other than the JD (PhDs, LLMs, BAs, for example) must be approved by the ABA.[91]

Law school programs are, in fact, highly homogeneous. The program at most law schools today, at its core, follows the model and content originally developed at Harvard in the 1870s: a three-year curriculum with the first year consisting entirely of required courses in Property, Contracts, Torts, Civil Procedure, and Criminal Law and an upper-year largely elective curriculum drawn from courses such as Evidence, Sales, Partnership and Corporations, Constitutional Law, Federal Jurisdiction, and Trusts. Moreover, it was in the 1870s at Harvard that the basic method of legal education was worked out—the case method based on reading and in-class discussion of appellate cases. As Robert Gordon reports, "[B]etween 1925 and 1950 virtually every full-time university-based law school in the country had adopted the Harvard model's basic elements."[92]

Although variety has increased over the years—with expansion in core subjects to include, for example, Intellectual Property, Tax, Administrative Law, Family Law, and many smaller courses in a wide range of specialized topics—and law schools have introduced materials in addition to the basic casebooks, the curriculum that the modern ABA oversees has varied little at its core since the ABA was established in the nineteenth century. While mere force of history may have been enough to ensure such unvarying reproduction of what it means to train "a lawyer," it seems likely that the professional control exercised by the ABA has played no small part in setting for today standards that were acquired yesterday by the members of the profession who

90. *See* ABA, *supra* note 37.

91. ABA SECTION OF LEGAL EDUC. & ADMISSIONS TO THE BAR, 2007-2008 STANDARDS AND RULES OF PROCEDURE FOR APPROVAL OF LAW SCHOOLS 19-20, 22, 25-29, 32, 37-38, 42 (2007).

92. Robert W. Gordon, *The Geologic Strata of the Law School Curriculum*, 60 VAND. L. REV. 339, 340 (2007).

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perform accreditation reviews.[93] The bar's explicit control over the content of the bar exam also plays a powerful role. It not only establishes was law schools must accomplish (through minimum bar passage rates required by the ABA for accreditation) it also shapes students' beliefs about what they need to learn and hence demand for law school courses that track the exam.

The profession thus has substantial control over the supply of people who fit into the category of "lawyer" and thus the supply of those who may provide legal products and services. It determines what attributes are selected for (such as the specific skills needed for the LSAT) in determining the population of providers. It determines what methods and techniques are brought to bear on thinking about the potential problems that buyers of legal services might have and the solutions that "lawyers" offer.

D. *Which Markets the Producers of Legal Products Can Serve*

Because the profession regulates at the state level, although often on the basis of regulatory standards developed by the ABA, providers of legal products and services must be licensed in each state in which they seek to operate. This means that a lawyer admitted only in New York, for example, cannot do any of the things that constitute the "practice of law" in California: draft contracts, negotiate settlements, provide representation in court, engage in pretrial activity such as taking depositions or reviewing documents, or give legal advice on behalf of clients in California. In recent years, in recognition of the reality of national law firm practice and the multistate presence of many clients, the ABA has urged relaxation somewhat of the requirement that individual lawyers be admitted to the bar in a state before providing services to clients in that state. In 2002, for example, it recommended that states allow the following: in the case of in-house counsel, to provide services to their employer in any state; to engage in out-of-state nonlitigation work that arises out of the lawyer's practice in the state in which he or she is admitted to practice; to work on a temporary basis in another state so long as a lawyer admitted in that state is active in the representation; to engage in pretrial and other ancillary activities in a state in which the lawyer expects to be admitted *pro hac vice*;[94] or to represent a client in an out-of-state alternative dispute resolution proceeding such as a mediation or arbitration.[95]

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93. The current nineteen-member Accreditation Committee consists of seventeen people who have completed the JD degree; the remaining two hold PhDs in subjects other than law. *See* American Bar Association, Accreditation Committee Members, http://www.abanet.org/legaled/committees/comaccredit.html.

94. A court can grant a lawyer's motion to appear *pro hac vice* and bestow temporary authority to appear or participate in a particular case.

95. ABA CTR. FOR PROF'L RESPONSIBILITY, CLIENT REPRESENTATION IN THE 21ST CENTURY: REPORT OF THE COMMISSION ON MULTIJURISDICTIONAL PRACTICE 4-5, 21 (2002), *available at* http://www.abanet.org/cpr/mjp/home.html.

The restrictions left in place by the fundamental scheme of state-by-state professional regulation, however, and the continued adherence to the prohibition on out-of-state lawyers place substantial restrietions on the type of entities that can compete in the legal market and the legal products and services that might be delivered. Few markets in the modern economy operate under sueh restrictive limitations on interstate commerce.

E. *How Firms That Provide Legal Products Must Be Organized and Financed*

For a long time, firms that provide legal products and services had to be organized exclusively as partnerships among lawyers. In recent years, most states have allowed lawyers to form limited liability corporations. The LLC, however, must be fully owned and managed by lawyers. Lawyers may not share revenues ("fees") with nonlawyers. Corporations, other than those privately owned and managed exclusively by lawyers, are prohibited from providing legal services, even if all serviees to clients are in fact delivered by lawyers employed by the corporation.

This places significant restraint on the way in which legal-product firms are financed. Law firms cannot seek public investment on the stock exchange. They eannot diversify through capital strategies. A "start-up," even one dreamt up by a lawyer, cannot seek angel investors or tap into venture capital networks to build the business.

Nor can a firm that provides legal products and services expand or develop the content of these products and services by integrating expertise in law with, for example, expertise in accounting, finance, organizational behavior, business strategy, public relations or engineering—except insofar as such expertise is offered or ultimately controlled by people who are members of the bar and subject to professional regulation by the bar. Law firms can have ownership interests in other professional service firms but they must keep the practice of law protected from those services and they eannot adopt ownership structures that allow non-lawyers a share of the 'law' side of the business. Lawyers can be employed by corporations to provide services to that corporation only, and through this vehicle legal services can potentially be integrated with other business inputs. Lawyers employed by a corporation, however, generally cannot provide services to anyone other than the corporation, even by contract and consent. An insurer, for example, that enters into a contract with an insured under which the insurer agrees to assume the costs of any litigation that might arise in the event of a claim cannot in many states use staff lawyers who are subject to litigation guidelines or cost-containment measures to conduct the litigation.

The rationale for the prohibition on the provision of legal products and services by corporations that one finds in the courts reinforces the concept that only lawyers who have trained and practiced as lawyers should have access to the market. With analysis that others have already noted is weak, courts often

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dispose of challenges to the corporate practice-of-law doctrine by reasoning that only those who have completed a JD, sat for a bar exam, and are capable of meeting the requirements of moral character may practice law; since corporations are not human beings and so cannot earn degrees, take bar exams, or display moral character, they cannot practice law.[96] In 2000, the ABA, over the recommendation of its own Commission on Multidisciplinary Practice, reinvigorated its commitment to prohibiting the provision of legal products and services by any entities other than law firms owned and managed exclusively by lawyers, asserting that intolerable risks to the "core values" of the profession were posed by allowing any other entities to provide legal products and services.[97]

F. *What Terms Must Be in a Legal Services Contract*

The "core values" of the legal profession that the profession claims are irretrievably threatened by allowing corporations other than those owned and managed exclusively by lawyers to practice law are independent legal judgment, protection of client confidences, undivided loyalty, and avoidance of conflicts of interest. These shibboleths of traditional legal practice, seen from within the legal community, seem self-evidently essential to what it means to "practice law," particularly in the service of protecting the rights of the individual against a powerful state. But from the perspective of the market structure for the legal products and services lawyers supply to business entities, the shibboleths of legal practice amount to mandatory terms in the contracts between suppliers and purchasers.

Lawyers offering legal products and services *must* promise to reach judgments based exclusively in legal reasoning ("independence") and not those that are combined with input from other professionals such as accountants, business consultants, insurance agents, or public relations managers unless lawyers have the final decision-making authority. This prohibits, for example, private practitioners from supplying precisely the kind of integrated legal analysis and subordination to ultimate business judgment that corporations assemble within their increasingly large in-house legal departments.

Lawyers offering legal products and services *must* include confidentiality provisions in their contracts with their clients. Clients can exclude these provisions but only by invoking complex rules determined by the profession regarding adequate waiver or informed consent and who within a client corporation possesses authority to exclude confidentiality protections. They may have special difficulty excluding the profession's only significant

96. *See* Grace M. Giesel, *Corporations Practicing Law Through Lawyers: Why the Unauthorized Practice of Law Doctrine Should Not Apply*, 65 MO. L. REV. 151, 173-74 (2000).

97. *See* ABA COMM'N ON MULTIDISCIPLINARY PRACTICE, REPORT TO THE HOUSE OF DELEGATES (2000), *available at* http://www.abanet.org/cpr/mdp/mdpfinalrep2000.html.

exception to the confidentiality obligation in the business setting, which is that the lawyer may disclose client confidences if the lawyer needs to do so to protect his or her own interests.[98] Moreover, lawyers may not offer in the marketplace legal products or services—such as by combining with other professionals—that invite a purchaser, implicitly or explicitly, to modify the profession's default confidentiality protections. This effectively makes these terms mandatory in the contracts that suppliers of legal products and services offer.

Lawyers *must* include what in other settings would be regarded as noncompete provisions in the contracts they offer, promising to substantially restrict the supply of their services to those with interests (here, the profit-making interests) adverse to the purchaser.. Exclusion of these terms is, as with confidentiality, complex, and subject to subtle rules determined by the profession.

Last, also in the name of preventing conflicts of interest, lawyers *must* restrict the financial terms of their contracts with purchasers of legal products and services to exclude a wide variety of alternative compensation mechanisms: ancillary business deals or security arrangements that are negotiated under conventional competitive market norms;[99] shared litigation costs between lawyer and client except in a contingent fee arrangement; payment by a third party where the third party retains any capacity to influence the services provided; limitations on legal malpractice liability in the absence of independent legal representation for the waiver transaction; media or literary rights prior to the completion of litigation; and proprietary interest in a cause of action other than a lien or contingent fee. These restrictions have been held to prevent, for example, a legal product in which an insurance company contracts with the insured to cover the cost of any litigation arising from policy claims and to finance that offering by employing staff attorneys who conduct the litigation when the payor uses various techniques (e.g., audits, litigation guidelines, and preapproval) to control litigation costs.[100]

This complex of restrictions on the nature of the possible contracts suppliers can offer in the market for legal products and services amounts to an

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98. A lawyer may reveal information regarding client representation for the following reasons:

> [T]o establish a claim or defense on behalf of the lawyer in a controversy between the lawyer and the client, to establish a defense to a criminal charge or civil claim against the lawyer based upon conduct in which the client was involved, or to respond to allegations in any proceeding concerning the lawyer's representation of the client.

MODEL RULES OF PROF'L CONDUCT R. 1.6(b)(5) (1983).

99. In order to engage in a business transaction or security arrangement with a client, the terms must be transmitted in writing, the lawyer must be confident that the transaction is fair and reasonable for the client, the client must be advised to seek independent legal advice, and the client must give informed consent in writing.

100. For a discussion and compilation of regulatory activity in this area, see Silver, *supra* note 11.

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extraordinary level of ex ante consumer-protection regulation for corporations and other business entities. Most commentators, however, recognize that corporations are as capable of assessing the quality and risks of legal services delivered through markets as they are of assessing the quality and risks associated with procuring the other business inputs on which they rely, such as accounting, investment banking, consulting, and engineering services. All of these services are complex and require specialized expertise. All are subject to contract and tort liability regimes, in addition to market competition and reputation, to regulate the quality of service. Moreover, many corporations have in-house or on retainer attorneys who act as their buying agents in the legal market, providing a high level of expertise in the capacity to analyze the costs and benefits of alternative legal products and services. This is hardly the setting in which concerns for the significant imbalances in bargaining power or information that animate conventional consumer protection regulation are present. The point is doubly made when we focus on the fact that the values at stake in the market for business legal products and services are fundamentally profits, not political or democratic rights or values.

III. OBSTACLES TO INNOVATION IN CORPORATE LEGAL MARKETS

Lawyers in their regulatory mode overtly resist the idea that law is a "business" rather than a noble profession,[101] hearkening back to de Tocqueville's notion that the legal profession is the American aristocracy and that "lawyers, like aristocrats, have a calling higher than mere bourgeois commercialism."[102] But while it is clear that there are functions that lawyers perform that go above and beyond the mundane provision of economic services, it is also clear that a great deal of legal work is, and should be appreciated as, economic activity that contributes to the effective functioning of a market economy.

The extensive regulation imposed on this market by the profession has substantial economic costs. Conventional economic critiques of this regulation focus on supply restriction and resulting increases in price due to scarcity. Because of significant expansions in the number of seats available in law schools and the substantial growth in the sheer size of the American legal profession over the last several decades, however, it has been hard to credit supply restriction as the fundamental cause of high prices and total costs for legal services. "Too few lawyers" seems hardly to be the case.

The far more significant effect of regulation on the market for corporate legal services, I argue, is the effect on innovation in legal products and services,

101. *See, e.g.*, Lawrence J. Fox, *Accountants, the Hawks of the Professional World: They Foul Our Nest and Theirs Too, Plus Other Ruminations on the Issue of MDPs*, 84 MINN. L. REV. 1097, 1103-04 (2000) ("We are not just another set of service providers. We are not just another cohort of business consultants. . . . [W]e are a priesthood.").

102. Luban, *supra* note 65, at 719.

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the primary source in most markets of cost reductions and improvements in quality. Professional regulation of legal markets dampens, even extinguishes, at every turn the energy of market creativity that, as we increasingly recognize in most other markets, drives the modern economy forward. There are four major effects on innovation arising from professional regulation of legal markets.

A. *Top-Down Standardization of the Product*

By defining the practice of law as the deployment of conventionally understood legal skills to resolve legal problems as distinct from accounting, strategy, finance, or other problems, and by setting out the hard-to-modify contractual terms on which legal services can be provided, professional regulation of law overtly restricts what a legal provider can provide. Developing integrated legal products or services that would combine tax and accounting processes, for example, is effectively forestalled by a regulatory determination that nonlawyers may not participate if the boundaries between "law" and "not law" are not sharply demarcated. This takes the conventional methods for delivering legal results and reifies them as definitive of what a legal product is and must be. Innovators of new methods are restricted to tinkering within this restricted space of possible products.

The mandatory terms imposed on contracts for legal services in the guise of protecting core values in the profession, in the interests of clients, also substantially inhibit market feedback on what clients value and how much they value it. Because confidentiality protections are costly—perhaps significantly so if they restrict the capacity to integrate the provision of services with other professionals or to offer products through a corporation not exclusively owned and managed by lawyers—making them mandatory in legal contracts significantly restricts the capacity for the market to produce efficient transactions. The benefits of confidentiality have to be traded off against its costs; and in some settings, no doubt some clients would prefer less confidentiality if it resulted in a less costly input. Such tradeoffs are best determined by the market, not the regulator/provider. Similarly, mandatory terms to avoid conflicts of interest restrict efficient transactions. Terms of this type are undoubtedly valuable to purchasers of legal products and services in many settings, but again they restrict the capacity of the market for legal products and services to produce an efficient tradeoff between the value of exclusive service and other values such as cost and quality of service. This is particularly true when terms are implemented through ex ante restrictions on the organizational structure through which legal products are offered. Pressure on precisely this point has led the profession to relax the requirements on lawyers serving as mediators, that is providing simultaneous services to parties with 'adverse' interests. In other settings, restraints of trade, through which suppliers promise not to supply the competitors of a "client" firm in order to secure the client's competitive advantage, are clearly seen as reducing the

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efficiency of the markets in which the "client" firm operates.

It is also because of the prophylactic method of regulation—restricting the organizational structures of firms that can participate in legal markets—that protection of lawyerly independence also operates as a costly mandatory term in contracts for legal products and services. In the context of serving corporate profit-making goals, the quality of legal advice is measured against the capacity to serve these goals. In some cases, that quality is clearly tied to the capacity of the legal provider to take a stance on what the law requires or permits that is independent of the judgments reached by nonlawyers. The incentive of the lawyer to provide, and the corporate client to ensure, independent advice, however, is clearly market-driven, just as the engineer who advises on the structural integrity of the bridge and the corporation that builds the bridge have market incentives to ensure that the engineer's advice is independent of what the company's financial executives want to hear. Legal liability, for the corporation and the engineer, shores up weaknesses in these market incentives.

In legal markets, however, regulators insist that ex ante limitations addressed to the potential for failures of independent judgment must be employed as the exclusive means of ensuring the independence of legal advice. Ex post methods of regulating the independence of legal advice would require the corporation to disclose its lawyers' advice just as it must now disclose the advice from its engineers to test the extent to which the corporation and the engineer have both lived up to their obligation to protect the independence of the engineer's advice. Legal liability incentives to support independent legal advice, however, are specifically disabled by professional regulation through the protection of attorney-client and work-product privileges.

Moreover, regulation mandating independent legal judgment that is not even remotely subject to the input of other professionals or experts, as with mandatory confidentiality and conflict-of-interest terms, restricts the capacity for the market to determine the appropriate tradeoff, from the client's profit-maximizing perspective, between independence of legal judgment and integration of legal judgment with the many other factors that play into corporate decision-making. The restrictions that professional regulation has imposed on the capacity of insurers, to offer lower premiums for policies under which the insurer provides, and therefore controls the cost of, litigation services are but one example of how professional regulation to protect professional independence prevents the market from deciding just how much independence is worth. The substantial obstacle to innovative thinking that professional regulation poses stems from the exclusive focus on the means of delivering legal inputs to business ends (advice, document production, adversarial representation in litigation, regulatory, and negotiation settings) rather than the ends themselves. These ends are goals such as achieving sufficient contractual commitment to support eooperative ventures, redistributing risks to lower-cost risk bearers, generating incentives, assembling collaborative work teams across international borders, reducing the costs of supply and logistics through global

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supply chains, achieving compliance with regulatory regimes, maintaining access to economic inputs and markets, securing competitive advantage, controlling liability exposure, and so on. Richard Susskind, a leading U.K. thinker on the impact of information technology on the practice of law, begins his influential book *The Future of Law* with a powerful anecdote that conveys this point:

> It is said that one of the world's leading manufacturers of electric power tools invites its new executives to attend an induction course, at the opening session of which they are urged to consider a slide projected onto a large wall screen. The image put before them is of a gleaming electric drill and the executives are asked if this is what the company sells.
>
> The executives look uncertainly around one another and tend as a group to concede that, yes, this is indeed what the company sells. It seems like a safe bet. They are immediately challenged by the next slide, however, that of a photograph of a hole, neatly drilled in a wall.
>
> 'That is what we sell', the trainers suggest . . . .[103]

The extensive professional regulation of legal markets effectively ensures that legal providers continue to focus on building better drills and not figuring out how to produce better holes at lower cost.

B. *Homogeneity of the Idea Pool*

What prevents legal innovators from challenging the professional definitions? Even if the legal profession tightly delimits the box that defines what a legal product is, it has always been understood that innovative problem-solving requires "out of the box" thinking. Innovators have long been imagined as disaffected or isolated iconoclasts tinkering away in the garage, on the periphery of the markets that their inventions might transform. Where are the "garage guys" in law?

Professional regulation effectively blocks the inventive activities that might transform legal markets both directly and, probably more importantly, indirectly. Directly, professional regulation ensures that only those who have gone through extensive induction into the conventional practice of law may participate in legal markets and thus gain exposure to the types of problems that existing legal services are and are not solving. Professional regulation also severely restricts both the pool of talent on which the market can draw and the extent to which the market can offer products that accomplish the integrated goals of a client. Professional control also limits who can sell into the market

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103. RICHARD SUSSKIND, THE FUTURE OF LAW: FACING THE CHALLENGES OF INFORMATION TECHNOLOGY 1 (1996). Mark Chandler, general counsel at Cisco Systems, uses Susskind's anecdote to convey the same point in his pleas to the profession to do a better job of helping him to contribute to his company's bottom line. *See* Mark Chandler, Gen. Counsel, Cisco Systems, Inc., Luncheon Address at the Northwestern School of Law's 34th Annual Securities Regulation Institute: State of Technology in the Law (Jan. 25, 2007), *available at* http://blogs.cisco.com/news/2007/01/cisco_general_counsel_on_state.html.

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the inventions they generate if the "invention" includes a service component and cannot be hived off in, for example, a piece of software. This regulatory structure is akin to requiring that anyone with a "mission to make the world's information universally accessible and useful"[104] complete a degree in library science and maintain standing in the professional association of librarians before embarking on the mission—a requirement that surely would have hobbled the garage activities of Internet search innovators Sergey Brin and Larry Page of Google. Even though the legal profession is populated by hundreds of thousands of lawyers operating in one-person shops,[105] few of these have access to the legal problems of the larger business clients that dominate the demand side of the market for corporate legal services.

The greater impact of professional regulation on the capacity for innovation in legal products or services, however, probably comes from an indirect obstacle. This is the homogeneity of the population of potential innovators, and thus the "idea pool" from which innovations can emerge. Although the iconoclastic lone inventor is an appealing image, variety is not only the spice of life, it is also the wellspring of creativity. The idea that variation in a data set contributes to the capacity of statistical methods to reach more reliable estimates of the relationships among variables has long been understood. It is also accepted that variation in a gene pool contributes to the potential for adaptive mutations that improve biological fitness and that variation, in the form of loose ties, in the identity of those who make up social networks increases the likelihood of learning about a good job or business opportunity. But more recently the idea that the diversity of a community contributes to its capacity for creative problem-solving has been emphasized in both academic research[106] and popular thought.[107] Wikis, peer production,

104. Google Groups, About Google Groups, http://www.google.com/googlegroups/about.html.

105. In 2000, estimates are that 32%, NALP FOUND. FOR LAW CAREER RESEARCH & EDUC. & THE AM. BAR FOUND., AFTER THE JD: FIRST RESULTS OF A NATIONAL STUDY OF LEGAL CAREERS 27 (2004), to 48%, AM. BAR FOUND., THE LAWYER STATISTICAL REPORT (2004), of the approximately one million lawyers practicing in the United States were solo practitioners. Only 5% of new lawyers in their first ten years of practice, however, are solo practitioners. NALP FOUND. FOR LAW CAREER RESEARCH EDUC. & THE AM. BAR FOUND., *supra*, at 13, 27 (2004). The share of new lawyers in large firm practice diminishes substantially as one moves down the *U.S. News and World Report* rankings of law schools from which they graduated. Whereas 50% of graduates from the top ten law schools and 33% from the top eleven to twenty law schools are in firms of more than 100 lawyers, only 15% of those from schools ranked 21 to 100 and 9% of those from "Tier 3" are in this practice environment. *Id.* at 44.

106. *See* YOCHAI BENKLER, THE WEALTH OF NETWORKS: HOW SOCIAL PRODUCTION TRANSFORMS MARKETS AND FREEDOM (2006); SCOTT E. PAGE, THE DIFFERENCE: HOW THE POWER OF DIVERSITY CREATES BETTER GROUPS, FIRMS, SCHOOLS, AND SOCIETIES (2007); CASS R. SUNSTEIN, INFOTOPIA: HOW MANY MINDS PRODUCE KNOWLEDGE (2006).

107. JAMES SUROWIECKI, THE WISDOM OF CROWDS: WHY THE MANY ARE SMARTER THAN THE FEW AND HOW COLLECTIVE WISDOM SHAPES BUSINESS, ECONOMIES, SOCIETIES AND NATIONS (2004); DON TAPSCOTT & ANTHONY D. WILLIAMS, WIKINOMICS: HOW MASS

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online networks, open-source software, and the explosion of other methods of facilitating collaboration among a highly diverse set of thinkers throw the uniformity of legal thinkers into sharp relief. Legal regulation is a poster child for the failure to harness the benefits of diversity.

The homogeneity of legal thinkers stems from multiple sources. Those who supply legal markets go through the same educational filter and study a largely homogenous curriculum taught with largely homogeneous methods. They must pass a standardized bar exam that is identical for all providers in a state and sometimes across several states and which looms large over even the elective curricular choices that law students have.[108] In their day-to-day work environment, unless they are in-house at a corporation, they interact almost exclusively with other lawyers with the same credentials and professional understanding of what the job requires. The problems they see are often preidentified and filtered into conventional legal categories: intellectual property rights, pension law, securities regulation, or tax. When they do interact with other professionals (in accounting, finance, strategy, and so on) or with the business managers who are their clients, particularly in the high-billable hour world, the nature of the interaction is highly focused on conventionally framed legal questions, and the opportunity for unplanned discussions about seemingly unrelated issues is sharply curtailed. The extraordinary levels of confidentiality that characterize legal work mean that information exchanged about problems, solutions, and practices is highly restricted, limiting the potential for outsiders to bring fresh insights to long-standing frameworks. The limitations on diversity in the client pool imposed by conflict-of-interest rules ensure further homogeneity of perspective. Moving outside of law firms, the producers of law in courts—judges and the lawyers who appear before them—are also drawn from this homogenous pool.

Additionally, the ongoing nineteenth-century emphasis in law schools on legal education as mastery of doctrine and appellate argument and the limited attention paid to developing competence in problem-solving, judgment under uncertainty, collaboration, client interaction, negotiation, and complex practice, is partly to blame for homogeneity.[109] Law students graduate law school ill-prepared to participate directly in solving the complex legal problems faced by business clients, and so law firms are organized on a tight hierarchy that keeps most beginning lawyers away from client interaction and strategic decision

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COLLABORATION CHANGES EVERYTHING (2006).

108. Many a law professor bemoans the misguided belief among law students that they must concentrate their legal education on the doctrine tested on the bar exam.

109. The ABA itself bemoaned the lack of practical education in law schools in the 1992 "MacCrate Report." ABA SECTION OF LEGAL EDUC. & ADMISSIONS TO THE BAR, LEGAL EDUCATION AND PROFESSIONAL DEVELOPMENT—AN EDUCATIONAL CONTINUUM 4-5 (1992). A study conducted by the Carnegie Foundation for the Advancement of Teaching concluded in 2007 that legal education continues to emphasize almost exclusively the teaching of legal analysis. WILLIAM M. SULLIVAN ET AL., EDUCATING LAWYERS: PREPARATION FOR THE PRACTICE OF LAW 87 (2007).

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making until well into their careers. Added to the enormous burden of generating high billable hours in most corporate law firms, few lawyers early in their careers have much opportunity to lift their heads out of the mounds of parceled-out detail to which they are assigned. This further restricts the landscape available to potential upstarts in the profession.

The cliché often applied to the legal profession is the notion that "when all you have is a hammer, everything looks like a nail." But this captures only a part of why the homogeneity of those who can supply legal products and services has resulted in such stagnation in the nature of legal products and services. Apparently when everyone has a hammer, nobody can even imagine a world without nails.

C. *Restrictions on Scale and Scope Economies*

Innovation is not merely the discovery of new ideas; it is the scaling up of those ideas into implementable organizations, systems, products, equipment, and processes that generate economic value.[110] Professional regulation of legal markets significantly restricts the capacity for scaling up new legal ideas by limiting the potential to exploit economies of scale and scope.

Through extensive ongoing restriction on the capacity of legal providers to supply products or services to entities located outside of the state in which they are licensed, professional regulation of legal markets limits innovation to those that are supported by smaller markets. This restriction does not loom large if we remain focused on the idea that legal inputs are the highly labor-intensive one-on-one advisory and representative services provided by the conventional lawyer. In such a world, the capacity for reaping the benefits of scale—particularly important in markets that display substantial increasing returns because of the importance of human capital—are largely limited to the mechanisms for sharing human capital between experienced and novice lawyers in a firm.[111] The capacity to share human capital through personal relationships is inherently restricted in scale and so the fact that the lawyer who has developed expertise in structuring a particular type of transaction or responding to a particular regulatory regime in a particular industry cannot reap nationwide or global returns to that acquired expertise is not a major loss.

This is all the more true if we consider the paradigmatic role of the lawyer who acts for another in court—there, the idiosyncrasies of particular courts and judges limit the size of the market for the expertise gained that is peculiar to each jurisdiction. Yet, large law firms have largely overcome the restrictions on

110. TECHNOLOGY AND EMPLOYMENT: INNOVATION AND GROWTH IN THE U.S. ECONOMY 25-26 (Richard M. Cyert & David C. Mowery eds., 1987).

111. For a discussion, see GALANTER & PALAY, *supra* note 88, and Ronald J. Gilson & Robert H. Mnookin, *Sharing Among the Human Capitalists: An Economic Inquiry into the Corporate Law Firm and How Partners Split Profits*, 37 STAN. L. REV. 313 (1985).

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deploying expertise developed in the New York or the Palo Alto office on behalf of clients located throughout the country and the world. The ABA has suggested that state bar associations should not find a lawyer who flies in from out of state to conduct a deposition or review documents or negotiate a deal on behalf of a client outside of her home state as engaging in the unauthorized practice of law. Obtaining admission *pro hac vice* and putting a member of the local bar on the briefs, while increasing costs, reduces the effect of state-by-state restrictions on the traditional legal practice.

But if we imagine a world where legal products and services are not as heavily tied to very expensive human capital and personal service—where human capital is transformed into concrete forms such as documents, processes, organizations, and procedures—then the restrictions on the scale of the market loom large. Even assuming that the provider is a lawyer or firm wholly owned by lawyers in one state, this provider is limited to delivering only those products that generate a profit based on in-state sales. Few businesses in the modern global economy are limited to supporting innovation based on such a small market.

Consider even a basic consumer product such as the standard-form simple wills, originally in hard-copy books and now packaged in software and online, delivered by entities such as Nolo Press. State bar associations challenged the sale of these products in their state as unauthorized practice of law (UPL). Even though many states have exempted such products from the UPL restrictions, it is a state-by-state process, and the standards vary from state to state. Moreover, in order to stay on the right side of the UPL restrictions and state bar associations, Nolo Press products and similar products must be generic and not intended to tailor solutions to the unique "circumstances or objectives of another person."[112] More elaborate products that use, for example, artificial intelligence mechanisms to tailor documents or route nonstandard issues into online advisory services or "chat with a lawyer now!" mechanisms are presumably beyond the pale.

Cisco Systems, for example, would face UPL limitations on commercializing an online mechanism it developed in-house for rationalizing and significantly reducing the cost of producing nondisclosure agreements (NDAs) if it attempted to integrate the blank forms with tailored solutions. Cisco's online contract builder allows engineers and executives to produce their own NDAs without interaction with a lawyer unless, in answering a series of questions, the transaction is flagged by the system as requiring a tailored evaluation; in that case, the system has a "trap-door" that electronically routes the document and transaction to the legal department for more careful assessment and, if needed, specialized drafting. Cisco can do this in-house—and can support the level of investment required to produce this product on the basis of its own significant scale as a user—but what it cannot do is offer the

112. ABA DRAFT DEFINITION, *supra* note 17.

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product including trap-door evaluation and specialization to the worldwide market. That also means it is not cost-efficient to Cisco to invest in further innovations in the procedure that might be warranted.

The response of state bar associations to outsourcing of legal services—whereby the preparation and review of documents is farmed out to out-of-state or out-of-country providers (India is a prime supplier)—demonstrates the impact of restricted scale on innovation in legal products. Opinions from state bar ethical committees make clear that these services may only be provided to a client through retention and personal supervision by a lawyer with a traditional client relationship.[113] Nonlawyers or out-of-state lawyers can supply legal services to lawyers, but not directly to the market. This limits the scale of these operations to what can be channeled through conventional one-on-one lawyer-client relationships and the labor-intensive exercise of case-by-case judgment.

By defining legal practice as only those economic inputs that include a large individual human capital component, professional regulation of legal markets inhibits, for example, the extension into legal markets of the large-scale information processing that underlies much of the revolution in the modern economy. Google and Wal-Mart both owe their success to innovations in massive data analysis that allow the production of better search results, marketing, retail product design, inventory, and logistics.[114] Much of legal advice consists of lawyerly predictions about legal outcomes: the likelihood that contract or patent language will be challenged or that it will effectively prevent certain conduct; the probability that a product or process will generate liability and a given level of damages; the expected value of additional effort spent on refining compliance systems or filing another motion. Legal markets, however, use painfully little actual data to make these predictions, despite the fact that together clients, law firms, regulatory agencies, and courts have within their computer databases massive quantities of data about the factors that affect patent litigations or contract negotiations or liability risks. Reaping the rewards from large-scale data analysis, however, requires access to a large market to sell the products of that analysis. By restricting legal judgments to those made by individual lawyers licensed in a local jurisdiction, however, professional regulation hobbles access to markets of that size and the economies of scale available in data analysis.

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113. *See, e.g.*, Ass'n of the Bar of the City of N.Y., Comm. on Prof'l & Judicial Ethics, Formal Op. 2006-3 (2006), *available at* http://www.abcny.org/Ethics/eth2006.htm.

114. JOHN BATTELLE, THE SEARCH: HOW GOOGLE AND ITS RIVALS REWROTE THE RULES OF BUSINESS AND TRANSFORMED OUR CULTURE (2005). Wal-Mart achieved enormous gains from collecting the massive quantities of data generated in individual stores from barcode scanning and sharing this information with suppliers who could use it to redesign products and logistics. Numerous companies now employ these techniques. PAUL WESTERMAN, DATA WAREHOUSING: USING THE WAL-MART MODEL (2001); Evan Schuman, *At Wal-Mart, Worlds* [sic] *Largest Retail Data Warehouse Gets Even Larger*, EWEEK, Oct. 13, 2004, http://www.eweek.com/c/a/Retail/At-WalMart-Worlds-Largest-Retail-Data-Warehouse-Gets-Even-Larger.

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Professional regulation also inhibits exploitation of economies of scope through the development of crossover processes, procedures, structures, or products that serve the integrated business needs of clients. Accountants, for example, may through their expertise in managing financial systems have lower-cost access to solutions for the legal dimensions of financial systems such as tax and securities regulation. Organizational theorists may be in a position to more effectively design mechanisms to manage legal employment obligations. Strategy consultants may be more likely to devise innovative methods of managing contractual relationships and achieving the goals of securing commitment and efficient adaptation to changing business environments. These economies of scope, however, are substantially limited by the requirement that only lawyers provide ultimate advice about meeting legal obligations, reducing the incentive of nonlawyer experts to invest in and exploit their knowledge. Prohibition of fee sharing or nonlawyer ownership of legal providers ensures that the only solutions produced in the market are those that are derived from primary legal expertise, making use of nonlegal expertise only as outside consumers of accounting, organizational, or strategy advice. There is little incentive to invest in devising new products and processes that fall in the specialized overlaps of these fields.

D. *Restriction on Methods of Financing Legal Innovation*

Innovation in legal markets is also severely hampered by limitations on the capacity for innovators to finance their entrepreneurial efforts. The prohibition on the corporate practice of law effectively eliminates the basic mechanism used to fuel innovative activity in most markets. Even assuming away the obstacles imposed by professional control over the attributes of legal products, the homogeneity of the pool from which innovators may be drawn, and the exclusion of expertise drawn from nonlegal fields, legal innovators cannot contemplate seeking outside investors to finance the initial efforts that pay off in the purchase of the business by an existing entity or an IPO. Risks in legal innovation cannot be spread through the mechanisms essential to the modern economy: diversified portfolios, large-scale and liquid capital markets, and tailored financial instruments. Venture capitalists face little incentive to invest in new legal ideas and to network entrepreneurs who can take good ideas and convert them into scalable, commercially viable innovations. An expert in organization, for example, who sees a way of more effectively managing even the conventional law firm, can only ever aspire to employee status, subject to supervision by lawyers, in the new entity he or she might create.[115]

Legal innovation is largely restricted to the plowed-back profits and owner-manager mechanisms that financed companies in the late-nineteenth century

115. *See, e.g.*, L.A. County Bar Ass'n, Prof'l Responsibility & Ethics Comm., Op. No. 488 (1996), *available at* http://www.lacba.org/showpage.cfm?pageid=5041.

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before the advent of the modern corporation, which brought with it the separation of ownership and control and the explosion of stock markets and financial institutions that prompted significant economic growth in the first part of the twentieth century.[116] This hobbles producers of legal products and services with the triple weights of restricted expertise (lawyers are experts in law, not management), limited access to capital (the only assets are cash flow), and lack of diversification (partners who leave profits in the firm see their investments rise and fall on the basis of the success of this one firm). These weights limit not only the growth of legal businesses, they stymie the potential for substantial innovation by ruling out innovations that require more sophisticated forms of financing.

Limitations on the permissible terms in compensation contracts also substantially restrict the capacity of legal innovation by reducing access to mechanisms that can generate needed economic incentives for collaborative production. Although bar associations have generally permitted law firms to include nonlawyer employees in compensation and pension plans that include a profit-sharing component, for example, the sharing of profits cannot be tied directly to fees collected in particular transactions or cases, or to the generation of new business.[117] Thus the compensation mechanism cannot be tied to productivity of a particular nonlawyer employee. Joint ventures between lawyers and nonlawyers are also heavily restricted in the mechanisms they can use to share fees, requiring separation in legal and nonlegal service provisions and application of the profession's regulation of legal markets to nonlegal markets. The prohibition on contracts with lawyers that restrict postemployment access to markets or clients eliminates access to a standard contractual mechanism used to support the incentive to share trade secrets and invest in information assets in many industries.

Finally, because of bar restrictions on the financing of legal providers, there is no incentive for analysts to develop expertise in spotting important developments in legal products or business strategies, or for business schools to produce expertise in law firm management. There is no incentive for venture capitalists to network entrepreneurs who may develop better legal products and services. But these are basic mechanisms by which the modern economy drives innovation and cost reduction in products and services.

CONCLUSION: THE ECONOMIC COST OF PROFESSIONAL REGULATION OF CORPORATE LEGAL SERVICES

Several years ago I wrote a few papers about the possibility of private

116. *See* CHANDLER, *supra* note 59; ROY, *supra* note 59.

117. *See, e.g.*, MODEL RULES OF PROF'L CONDUCT R. 5.4(a)(3) (1983); D.C. Bar Ass'n, Op. 322 (2007), *available at* http://www.dcbar.org/for_lawyers/ethics/legal_ethics/opinions/opinion322.cfm; Fla. Bar, Prof'l Ethics Comm., Op. 02-1 (2002), *available at* http://www.floridabar.org/tfb/TFBETOpin.nsf/.

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production of commercial law, particularly contract and corporate governance law.[118] I envisioned a mechanism that would develop improved systems, rules, and procedures through competitive incentives to figure out how to offer lower-cost and higher-quality management of contractual and corporate owner-manager relationships. The mechanisms this private market could produce, I imagined, could differ significantly from the legal systems we now use to govern corporate contracting and governance. Contracting mechanisms could, for example, combine multiple nonlegal components (economic expertise, organizational expertise, and dispute-resolution expertise) with legal components to support contractual commitment or generate appropriate managerial incentives. Invariably in presenting this work to law school audiences I met the economist's favorite riposte: if this is such a great idea, why isn't anybody doing it?

At the time, the answers that occurred to me appealed to a lack of creativity and risk taking among lawyers and the need for substantial scale to achieve the level of durability that would be required before entities would agree to contract under the rules of PrivateContracting, Inc. rather than the well-established common law of the state of New York or California. I now believe that the significant obstacle lies in the continued regulation of legal markets by the profession. This professional regulation limits what may be offered as a legal product or service, homogenizes the pool of potential innovators in terms of training and risk orientation, prohibits the corporate practice of law, severely restricts the available financing for large-scale legal ventures, and constrains the capacity to exploit economies of scope and scale in developing better methods of producing what business clients ultimately need: holes in walls, not more elaborate drills. PrivateContracting, Inc. simply cannot exist under the current scheme of professional control over legal markets.

Whether PrivateContracting, Inc. would ever get off the ground if these restrictions were lifted I cannot say. That is the entrepreneurial question that only the market can answer. But there can be no question that the economic impact of professional regulation on innovation in legal products and services is extensive and growing more costly each year, as the pace of innovation, transformation, and globalization increases in most sectors of the economy. Moreover, the obstacles to legal innovation are clearly a far more important factor in the spiraling costs of legal services than even the extraordinary increases in hourly legal fees that preoccupy corporate America. So long as legal services are limited to conventional models of what it means to solve a client's legal problem, and the production of legal products is limited to members of the profession (those in practice and those on the bench), the ballooning complexity of law will remain largely uncontrolled and the cost of

118. *See* Gillian K. Hadfield, *Delivering Legality on the Internet: Developing Principles for the Private Provision of Commercial Law*, 6 AM. L. & ECON. REV. 154 (2004); Gillian K. Hadfield, *Privatizing Commercial Law*, 24 REGULATION 40 (2001); Hadfield & Talley, *supra* note 83.

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high-priced legal minds with it. The scramble for legal talent in the large corporate law firm, the simultaneous escalation of associate salaries and billable hour requirements, the soaring profits shared with a firm's equity partners to ensure retention—all of these phenomena are traceable to real needs for high-quality human-capital inputs into the products produced by legal markets that allow no other outlets for siphoning off economic pressure.

Corporate clients have in recent years mounted significant efforts to reduce the costs of legal services with powerful general counsel moving more and more legal work in-house or offshore, deploying more technology to manage legal information, document production and review, and experimenting with flat fees, task-based billing, auctions for legal work, billing audits, and more aggressive service contracts to reign in bills from outside counsel. These efforts, however, can never do more than squeeze legal costs on the margin to eliminate, where it exists, the fat produced by blunted competition, imperfect information, uncertainty, and convention. The root of the extraordinary costs of modern business legal services lies not merely in how they are priced but how they are produced. It is not enough to reduce the cost of combing through the millions of documents now routinely produced in large corporate litigation with e-discovery by developing software that can process the documents or sending the documents to Indian or American contract lawyers for review at a low hourly rate. The fundamental mechanism that is maintaining a system that has decided that millions of documents are necessary to resolve a business dispute has to be opened to market pressure and subjected to innovative efforts to figure out how to get the cost of procedures in line with their value. So long as lawyers and judges exercise a monopoly over the production of these mechanisms, there is little reason to think that the entrepreneurial vigor that is transforming every other market will reach the legal market. Corporate clients would be better served to focus on the root cause of increasingly unsupportable legal costs—the system of professional regulation—and the most significant effect of that system—the obstruction of legal innovation.

Achieving regulatory change will require major shifts in U.S. perspectives about what is at stake in the design of professional regulation of lawyers. The origins of American professional regulation in the vision of the role of the lawyer as a fundamental guardian of the Constitution, democracy, and individual rights casts a long shadow not only over the regulatory justifications offered by the profession but also over the framework that critics of professional regulation bring to bear. Both advocates and critics continue to merge the political/democratic and economic functions of modern legal systems and to articulate standards for both that are appropriate only to one, to the detriment of both. Serious attention to the independence, confidentiality, quality, and conflict-free provision of accessible service to citizens is severely limited by the interests that animate American corporate practitioners who, as the studies of the Chicago bar in 1975 and 1995 have demonstrated, dominate the elite of the profession and the regulatory bodies of bar associations and the

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bench.[119] Conversely, critics of professional regulation of the corporate side of the market by and large articulate their criticisms in terms of the failure to achieve, as in major corporate scandals, the ethical lawyering to which the citizen should have access in a democratic society.

The political/democratic and economic spheres of the legal system, however, are distinct and should be recognized as such for the purposes of regulatory design. They have different goals, different market structures, and serve normatively distinct ends. The financial interests of lawyers should be reined in where access to legal services is necessary to protect democratic interests rooted in our normative goals of equality, dignity, fairness, and individual wellbeing; a vigorous market for these legal services may very well not be appropriate. But where the interests at stake are the profit-making endeavors of entities, our primary concern in the design of regnlation should be the efficiency of legal markets and their capacity to promote the efficiency of other markets. Here a vigorous market that delivers more effective and lower-cost legal inputs and channels market pressures into innovation rather than spiraling hourly rates should be the goal.

The foundation of the existing American system of professional regulation is murky, refracted through conflicting claims of federal, state, legislative, judicial, and constitutional authority. This makes the path to significant adaptation of the nineteenth-century system under which twenty-first-century businesses now labor difficult to discern. Lawyers themselves, of course, are clearly in a position to shift their regulatory stance, but the likelihood of them doing so against what they perceive as professional self-interest seems slim. Perhaps increased scrutiny from antitrust authorities, foreign and domestic, will prompt lawyers to revisit their exercise of regulatory authority. In the United States, however, this will face the obstacle generated by the judicial conclusion that the Sherman Act is not intended to reach state action and that professional regulation is sanctioned by the judiciary. One might be hopeful that state judges will be able to distance themselves from identification with their professional colleagues at the bar long enough to recognize the exceedingly weak claim to public interest that bar rules can support when it comes to regnlating the provision of corporate legal services. Perhaps if these courts can perceive the substantially distinct spheres of the profession—the political/democratic sphere on the one hand and the economic on the other—they can at least recognize the error in upholding professional regulation as inherent to the separation of powers in all settings.

It is likely, however, that substantial realignment of the regulation of corporate legal markets will require Congress to take a strong stand with respect to the importance of these markets to interstate and global commerce.

119. *See* JOHN P. HEINZ & EDWARD O. LAUMANN, CHICAGO LAWYERS: THE SOCIAL STRUCTURE OF THE BAR (1982); JOHN P. HEINZ ET AL., URBAN LAWYERS: THE NEW SOCIAL STRUCTURE OF THE BAR (2005).

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This will require Congress to put the largely hidden claim to exclusive jurisdiction made by state court judges to the test in federal courts.

While the American bar has successfully sloughed off calls for opening up legal markets in the past and the power of the ABA nationally makes the prospect for political change seem utopian, the wheels are already in motion elsewhere in the world to create a substantially new legal industry. It is from these global developments that the greatest pressure to reform the American legal industry is likely to come. In the fall of 2007, the "titmouse" scorned by the founders of the ABA, the United Kingdom, adopted sweeping reforms of its already much-more-open legal markets.[120] Under the reforms, there are few unauthorized practice of law limitations (the exceptions are largely with respect to litigation, conveyancing, probate, and notarizing documents). There are now few restrictions on the way in which a legal provider is organized—corporations may offer legal services—or financed or managed—nonlawyers may start, fund, and operate businesses that provide legal goods and services. Legal businesses can be publicly traded. Lawyers may combine with nonlawyers—investment bankers, accountants, communications experts, strategy consultants, and so on—to provide integrated legal products. There are multiple avenues of professional training and professional regulation. But all professional bodies are required to keep their regulatory functions separate from their associational functions and are ultimately responsible to an overarching, publicly accountable regulatory body—The Legal Services Board—composed of a majority of lay people who have never been lawyers or others subject to the regulatory power of the board. The membership of the Board is appointed by the Lord Chancellor, who is an elected member of Parliament serving as the Secretary of State for Justice. As a cabinet member heading the Ministry of Justice, the Lord Chancellor is responsible for the operation and independence of the courts. There is thus a coherent and politically accountable locus for policymaking with respect to the functioning and effectiveness of the legal system as a whole.

The changes in the U.K. are likely to presage, eventually, changes throughout Europe in the organization and sophistication of legal markets. Reform in the U.K. has come explicitly through the application of antitrust rules to the practice of law in Europe. In 2000, the Organization for Economic Cooperation and Development (OECD) published a report evaluating the impact of professional regulation (including the regulation of lawyers) on competition and economic welfare.[121] In 2001, the U.K. Office of Fair Trading (responsible for competition law and enforcement) issued a similar report evaluating the competitive effects of professional regulation by the law

120. Legal Services Act 2007, c. 29 (Eng.), *available at* http://www.opsi.gov.uk/acts/acts2007/ukpga_20070029_en_1.

121. OECD DIRECTORATE FOR FIN. & ENTER. AFFAIRS, COMM. ON COMPETITION LAW & POLICY, COMPETITION IN PROFESSIONAL SERVICES (2000), *available at* http://www.oecd.org/dataoecd/35/4/1920231.pdf.

societies and concluded that the restrictions on the ownership and structure of legal services providers were excessive.[122] This report triggered a responsive report on competition issues in the regulation of legal practice by the Lord Chancellor,[123] as well as the Clementi Report,[124] upon which the Legal Services Act of 2007 was based and which provides explicitly for the application of competition law to the conduct of professional bodies of lawyers.[125] Assessments in the United Kingdom and the OECD were followed by studies at the European Commission, which has signaled clearly that competition laws will be applied to the regulatory limitations placed on the practice of law.[126]

As against the murky, fragmented, and self-interested responsibility for policy resting with individual state courts and bar associations, the absence of national policymaking and the lack of antitrust enforcement in recent years in the United States, the United Kingdom, and emerging European Union models are striking. Clearly these regulatory approaches appear capable of fashioning a legal industry that can respond to the significant change in economic activity and the demand for legal innovation that a globalizing economy generates. We may well be witnessing the revenge of the titmouse, having in fact grasped the significance of the elephant, unburdened by the need to infuse the structure of corporate legal markets with the ponderous weight of upholding the American constitutional order. Without a significant shift in the United States, however, the American legal profession is likely to grow only increasingly out of step with the needs of a transformed global economy. American lawyers have long dominated in international legal circles, largely because of their greater orientation to problem-solving and strategy in the provision of traditional legal services. Truly innovative lawyering for the new economy, however, needs a far less restrictive and myopic regulatory model.

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122. JOHN VICKERS, U.K. OFFICE OF FAIR TRADING, COMPETITION IN PROFESSIONS (2001), *available at* http://www.oft.gov.uk/shared_oft/reports/professional_bodies/oft328.pdf.

123. LORD CHANCELLOR'S DEP'T, IN THE PUBLIC INTEREST? A CONSULTATION FOLLOWING THE OFFICE OF FAIR TRADING'S REPORT ON COMPETITION IN THE PROFESSIONS (2002), *available at* http://www.dca.gov.uk/consult/general/oftrept.htm.

124. SIR DAVID CLEMENTI, REVIEW OF THE REGULATORY FRAMEWORK FOR LEGAL SERVICES IN ENGLAND AND WALES: FINAL REPORT (2004), *available at* http://www.legal-services-review.org.uk/content/report/report-chap.pdf.

125. Legal Services Act, 2007, c. 29, §§ 57-61 (Eng.), *available at* http://www.opsi.gov.uk/acts/acts2007/ukpga_20070029_en_1.

126. COMM'N OF THE EUROPEAN COMMUNITIES, PROFESSIONAL SERVICES—SCOPE FOR MORE REFORM (2005), *available at* http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2005:0405:FIN:EN:PDF; COMM'N OF THE EUROPEAN COMMUNITIES, REPORT ON COMPETITION IN PROFESSIONAL SERVICES (2004), *available at* http://www.eadp.org/main7/position/Regulated%20professionsfinal_ communication_10feb04_en.pdf.

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