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What Do We Talk About When We Talk About Control?

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INTRODUCTION

Litigation investment, or champerty, is the maintenance of a stranger's lawsuit for profit.[1] Litigation investment is expanding in the United States, and as it expands, the controversy surrounding it grows.[2] Litigation investment occurs when nonlawyers invest for profit in litigation in which they otherwise have no interest.[3] For purposes of this Article, litigation is the expenditure of money by a party to enforce (or defend) an existing or anticipated legal claim, where the money is used either to purchase the services of an attorney in anticipation of an appearance before, or submission of materials to, an adjudicative body.[4] In the last quarter of the twentieth century various critics emerged who argued that the American system of litigation was in need of reform, in part because plaintiffs' attorneys had started to view litigation as an investment, which resulted in a marked increase in frivolous and/or socially unproductive litigation.[5]

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1. Litigation investment is champerty. "'[C]hamperty is maintaining a suit in return for a financial interest in the outcome . . . .'" Osprey, Inc. v. Cabana Ltd. P'ship, 532 S.E.2d 269, 273 (S.C. 2000) (quoting *In re* Primus, 436 U.S. 412, 424 n.15 (1978)). For review of the history and current state of the law of champerty, see Anthony J. Sebok, *The Inauthentic Claim*, 64 VAND. L. REV. 61 (2011).

2. *See, e.g.*, Binyamin Appelbaum, *Putting Money on Lawsuits, Investors Share in the Payouts*, N.Y. TIMES, Nov. 15, 2010, at A1; Richard A. Epstein et al., *Room for Debate, Investing in Someone Else's Lawsuit*, N.Y. TIMES (Nov. 15, 2010), http://www.nytimes.com/roomfordebate/2010/11/15/investing-in-someone-elses-lawsuit.

3. For an excellent review, see STEVEN GARBER, ALTERNATIVE LITIGATION FINANCING IN THE UNITED STATES: ISSUES, KNOWNS, AND UNKNOWNS (2010); MAX VOLSKY, INVESTING IN JUSTICE: AN INTRODUCTION TO LEGAL FINANCE, LAWSUIT ADVANCES AND LITIGATION FUNDING 24–25 (2013).

4. A broader definition of litigation might include all legal dispute resolution, including informal negotiation over disputed legal claims. Any investment of time and money, even by a layperson—such as the drafting of a demand letter to a debtor by a creditor—could, in theory, count as litigation. *See* Marc Galanter, *Reading the Landscape of Disputes: What We Know and Don't Know (and Think We Know) About Our Allegedly Contentious and Litigious Society*, 31 UCLA L. REV. 4, 11–18 (1983) (discussing the "construction of disputes" in society). The definition used in this Article is narrower.

5. *See* Jeremy Kidd, *To Fund or Not To Fund: The Need for Second-Best Solutions to the Litigation Finance Dilemma*, 8 J.L. ECON. & POL'Y 613, 630 (2012) ("[T]he plaintiffs' bar has strong monetary incentives to *create* liability through repeated litigation of presently

Litigation investment is now the object of a similar sort of critique based on the fear that litigation will be subject to a new round of commercialization.[6]

One of the leading arguments against litigation investment is that it will interfere with the relationship between the party who has the claim and her lawyer.[7] The Institute for Legal Reform has argued that litigation investment "undercuts plaintiff and lawyer control over litigation because the [litigation investment] company, as an investor in the plaintiff's lawsuit, presumably will seek to protect its investment, and can therefore be expected to try to exert control over the plaintiff's and counsel's strategic decisions."[8] This concern is echoed by those worried that an attorney may not be able to fulfill her ethical obligations if her client signs a litigation investment contract. For example, the Professional Ethics Commission of the Maine Board of Overseers of the Bar, like most ethics committees asked for their opinion, said

> [W]hile we cannot say that it is per se unethical for a lawyer to assist a client in obtaining personal injury lawsuit advances, we do find that the above scenario raises a number of potential ethical problems that should be of concern to the lawyer. . . . [T]he lawyer must guard against any risk that the financing company will attempt to control the litigation or otherwise interfere with the lawyer's exercise of professional judgment.[9]

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non-meritorious claims."). *See generally* Anthony J. Sebok, *Dispatches from the Tort Wars*, 85 TEX. L. REV. 1465 (2007) (discussing tort reform and the attack on the entrepreneurial plaintiffs' bar). Nora Engstrom gives a very different evaluation of the entrepreneurial plaintiffs' bar, arguing that the "settlement mills," operated by lawyers with an "entrepreneurial (rather than professional) orientation," serve a valuable social function. Nora Freeman Engstrom, *Sunlight and Settlement Mills*, 86 N.Y.U. L. REV. 805, 819 (2011).

6. *See, e.g.*, U.S. CHAMBER INST. FOR LEGAL REFORM, SELLING LAWSUITS, BUYING TROUBLE: THIRD-PARTY LITIGATION FUNDING IN THE UNITED STATES 5 (2009), *available at* http://ilr.iwssites.com/uploads/sites/1/thirdpartylitigationfinancing.pdf (arguing that litigation investment funders "'have no interest in the justice . . . only in the chances of success—as they will demand a share of the damages awarded in return for putting up the stake money'" (quoting Joshua Hamerman, *Hedge Funds: A Litigious Bunch*, INVESTMENT DEALERS' DIG., Dec. 17, 2007, at 9)); Kidd, *supra* note 5, at 630–31; Joanna M. Shepherd, *Ideal Versus Reality in Third-Party Litigation Financing*, 8 J.L. ECON. & POL'Y 593 (2012); Roger Parloff, *Have You Got a Piece of This Lawsuit?*, FORTUNE (June 28, 2011, 2:06 PM), http://features.blogs.fortune.cnn.com/2011/06/28/have-you-got-a-piece-of-this-lawsuit-2/.

7. *See, e.g.*, U.S. CHAMBER INST. FOR LEGAL REFORM, *supra* note 6, at 15 (explaining that third-party funding thus "places the power to make strategic decisions about the case in the hands of the funder").

8. U.S. CHAMBER INST. FOR LEGAL REFORM, STOPPING THE SALE ON LAWSUITS: A PROPOSAL TO REGULATE THIRD-PARTY INVESTMENTS IN LITIGATION 1 (2012), *available at* http://www.instituteforlegalreform.com/uploads/sites/1/TPLF_Solutions.pdf. As one commentator has stated, "A primary concern with litigation funding is the potential for litigation funding companies to direct or regulate the professional judgment of the attorneys with whom they deal in order to protect the companies' investments. In so doing, the companies may impair the attorney's representation of his client." Douglas R. Richmond, *Other People's Money: The Ethics of Litigation Funding*, 56 MERCER L. REV. 649, 669 (2005).

9. Prof'l Ethics Comm'n Me. Bd. of Overseers of the Bar, Op. 191 (2006), *available at* http://www.mebaroverseers.org/attorney_services/opinion.html?id=87348; *see* State Bar of Mich., Op. RI-321 (2000), *available* at https://www.michbar.org/opinions/ethics/numbered_opinions/ri-321.cfm; Julia H. McLaughlin, *Litigation Funding: Charting a Legal and Ethical Course*, 31 VT. L. REV. 615, 650 (2007) (noting that litigation investment contracts

The Ethics Committee of the Commercial and Federal Litigation Section of the New York State Bar Association cautioned in its report that litigation investment "arguably creates a tension between the [third-party litigation financing] investor's interest in instructing, or even mandating, that the party make certain strategic decisions that best serve the investor's goals, and the party's or *lawyer for the party's exercise of independent judgment*."[10] The American Bar Association (ABA) Commission on Ethics 20/20 and the New York City Bar Association were not as concerned over the risk that litigation investment would interfere with an attorney's exercise of independent judgment or loyalty.[11] The New York City Bar opinion even suggested that, consistent with obtaining consent from the client under New York Professional Conduct Rule 1.7(b)(4), a litigation investor *may* "influence [a lawyer's] professional judgment in determining the course or strategy of the litigation, including the decisions of whether to settle or the amount to accept in any settlement."[12]

These concerns have worked their way into the legal regulation of litigation investment. Litigation investment is allowed in only approximately one-half of U.S. jurisdictions.[13] Many courts have held that the common law still requires some supervision of litigation investment contracts (although under what basis is not clear, since many of these courts have also rejected common law champerty).[14] Virtually all jurisdictions that allow it, however, restrict the degree of control that strangers can exercise over the litigation.[15] Usually, an investor's power to control the

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"threaten to undermine the duty of loyalty owed to a client by creating a contractual relationship with a third party").

10. ETHICS COMM. OF THE COMMERCIAL & FED. LITIG. SECTION OF THE N.Y. STATE BAR ASS'N, REPORT ON THE ETHICAL IMPLICATIONS OF THIRD-PARTY LITIGATION FUNDING 10 (2013), *available at* http://www.benthamimf.com/docs/default-document-library/nys-bar---opinion-of-ethical-implications-04-16-13.pdf?sfvrsn=2 (emphasis added).

11. *See* Ass'n of the Bar of the City of N.Y. Comm. on Prof'l Ethics, Formal Op. 2011-2 (2011), *available* at http://www.nycbar.org/ethics/ethics-opinions-local/2011-opinions/1159-formal-opinion-2011-02; *see also* AM. BAR ASS'N COMM'N ON ETHICS 20/20, INFORMATIONAL REPORT TO THE HOUSE OF DELEGATES 22–23 (2012), *available at* http://www.americanbar.org/content/dam/aba/administrative/ethics_2020/20111212_ethics_20_20_alf_white_paper_final_hod_informational_report.authcheckdam.pdf.

12. Ass'n of the Bar of the City of N.Y. Comm. on Prof'l Ethics, Formal Op. 2011-2 ("While a client may agree to permit a financing company to direct the strategy or other aspects of a lawsuit, absent client consent, a lawyer may not permit the company to influence his or her professional judgment in determining the course or strategy of the litigation, including the decisions of whether to settle or the amount to accept in any settlement.").

13. *See* Sebok, *supra* note 1, at 98–99 n.162 (providing a state-by-state review).

14. *See, e.g.*, Saladini v. Righellis, 687 N.E.2d 1224, 1227 (Mass. 1997) (finding that although champerty was no longer recognized in Massachusetts, courts still had inherent power to scrutinize agreements); Brown v. Bigne, 28 P. 11, 12–13 (Or. 1891) (same).

15. *See, e.g.*, Kraft v. Mason, 668 So. 2d 679, 683 (Fla. Dist. Ct. App. 1996) (stating that an alleged champertor was not an officious intermeddler when, among other things, she did not impose her views on the attorneys or litigants); L.A. Cnty. Bar Ass'n Prof'l Responsibility and Ethics Comm., Op. No. 500 (1999), *available* at http://www.lacba.org/showpage.cfm?pageid=433 (citing Killian v. Millard, 228 Cal. Rptr. 877, 878–79 (Ct. App. 1991)) (finding agreement invalid if it was "tainted by outside pressures").

litigation is reduced to zero by reference to the lawyer's ethical obligation not to participate in a case where their client has ceded too much control.[16]

This Article takes up two questions. First, whether the professional independence protected by the restrictions on litigation investment is similar to the professional independence protected by Model Rule of Professional Conduct 5.4 and its various state equivalents.[17] I argue that the doctrines constraining both litigation investment and fee splitting with nonlawyers sweep too broadly when they prevent lay persons from buying an interest in litigation, and that the threat of interference with lawyers' professional independence is, in both cases, overblown. Second, I argue that the current insurance law doctrines concerning third-party liability insurance require litigants to give up much of the control that the doctrines constraining litigation investment and fee splitting with nonlawyers are designed to keep out of the hands of lay investors.

I. THE PROHIBITION ON FEE SPLITTING AND ITS RATIONALE

In this section, I review the prohibition on fee splitting itself and the rationale that is often cited in its support, the preservation of attorneys independent professional judgment.

A. Fee Splitting

Under the Model Rules, fee splitting with a nonlawyer is forbidden. Texas Disciplinary Rule of Professional Conduct 5.04(a) is typical: "A lawyer or law firm shall not share or promise to share legal fees with a nonlawyer [with exceptions not relevant here]."[18] Historically the core concern of the fee-splitting rule is the impermissible solicitation of clients.[19] Other and more modern rationales for the prohibition on fee splitting with nonlawyers are the minimization of the risk of the unauthorized practice of law, and, most important for our purposes, protecting the independent judgment of the lawyer.[20]

In contrast, the District of Columbia permits a nonlawyer to receive a portion of a fee received by a lawyer when the nonlawyer and the lawyer

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16. *See, e.g.*, Prof'l Ethics of the Fla. Bar, Op. 00-3 (2002), *available at* http://www.floridabar.org/tfb/TFBETOpin.nsf/840090c16eedaf0085256b61000928dc/f40a54f76a7da5a585256b800057b541?OpenDocument ("The attorney also shall not allow the funding company to direct the litigation, interfere with the attorney-client relationship, or otherwise influence the attorney's independent professional judgment.").

17. Excluding, of course, D.C. RULES OF PROF'L CONDUCT R. 5.4, which will be discussed separately. *See infra* notes 21–23.

18. TEX. DISCIPLINARY RULES OF PROF'L CONDUCT R. 5.04(a).

19. *See* CHARLES W. WOLFRAM, MODERN LEGAL ETHICS § 16.5.5, at 911–12 (1986).

20. "The provisions of Rule 5.04(a) express traditional limitations on sharing legal fees with nonlawyers. The principal reasons for these limitations are to prevent solicitation by lay persons of clients for lawyers and to avoid encouraging or assisting nonlawyers in the practice of law." TEX. DISCIPLINARY RULES OF PROF'L CONDUCT R. 5.04 cmt. 1. "A person entitled to share a lawyer's fees is likely to attempt to influence the lawyer's activities so as to maximize those fees." RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 10 cmt. b (2000).

form a "joint venture organization."[21] D.C. Rule of Professional Conduct 5.4 provides that, subject to certain limitations, "[a] lawyer may practice law in a partnership or other form of organization in which a financial interest is held or managerial authority is exercised by an individual nonlawyer who performs professional services which assist the organization in providing legal services to clients."[22] The lawyer and the nonlawyer may divide the earnings of the partnership as they see fit.[23]

1. Fee Splitting in a Model Rules Jurisdiction

Conventional wisdom is that it simply is not possible under the Model Rules for a lawyer to give any part of her fees in exchange for money or time invested by a layperson in a case.[24] The conventional wisdom is based on a distinction drawn by the Model Rules between a *financial arrangement*, in which a nonlawyer's profit or loss is directly related to the successfulness of a lawyer's legal business, and a *loan*, in which both the occurrence and amount of repayment does not depend on the lawyer's skills and efforts.[25] According to this analysis, the repayment of debt with funds that come from fees is not the sharing of fees because the lender's profit is not directly related to the size of the contingent fee received by the lawyer. For example, suppose Lawyer establishes a revolving line of credit with Bank, which requires Lawyer to pay interest at 10 percent.[26] Obviously, the revenue used by Lawyer to pay Bank can come from nothing other than fees, unless Lawyer or his firm has property that is producing income (such as the building in which the law firm sits) or Lawyer has personal assets derived from some independent source of income or property that Lawyer uses to secure the loan. It is obvious, therefore, that in the vast majority of loans to lawyers, all payments to creditors constitute, in a literal sense, a sharing of attorney's fees with nonlawyers. Nevertheless, it is well established that interest payments to a commercial lender do not violate the

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21. D.C. Bar, Ethics Op. 322 (2004), *available at* http://www.dcbar.org/bar-resources/legal-ethics/opinions/opinion322.cfm.

22. *Id.*

23. *Id.*

24. *See* 2 GEOFFREY C. HAZARD, JR. & W. WILLIAM HODES, THE LAW OF LAWYERING § 45.4 (3d ed. Supp. 2011) ("[T]he phrase 'shall not share legal fees' [in Rule 5.4(a)] is intended to bar *any* financial arrangement in which a nonlawyer's profit or loss is directly related to the successfulness of a lawyer's legal business.").

25. *Id.*; *see* WOLFRAM, *supra* note 19, § 16.3.

26. This well-known example is drawn from 2 HAZARD & HODES, *supra* note 24, § 45.4 illus. 45-1.

fee-splitting rule.[27] If Bank goes further and acquires a security interest in Lawyer's accounts receivables, the fee-splitting rule is still not violated.[28]

Even within the allegedly safe terrain of lending, there are still disagreements over many subsidiary issues. First, while it is somewhat settled that the lawyer may pass onto the client loan-related costs (e.g., interest) like any other litigation-related expense, even this rule has its critics.[29] Second, while it appears that the better rule is that a lawyer may not use the *client's* recovery as collateral for the loan, even if the loan is being used for the client's benefit and even if the client consents to such an arrangement, at least one jurisdiction, Maine, suggests that with client consent the lender can take a lien in the total recovery.[30] Third, many but not all jurisdictions hold that the mere fact that that the loan is nonrecourse (that is, the obligation to repay is triggered only if there is a positive outcome in the case) does not make it a form of fee splitting.[31] This last point illuminates the ambiguity at the heart of the fee-splitting prohibition. Is it the *sharing* of the lawyer's fee that brings a "loan" within the prohibition or the *contingency* of repayment that makes the loan impermissible?[32] The majority of bar committee opinions that have reviewed this question hold that the better view is that conditioning the repayment amount on the size of the lawyer's fee turns a loan into fee

27. *See, e.g.*, Ill. State Bar Ass'n, Op. 92-9 (1993), *available at* http://www.isba.org/sites/default/files/ethicsopinions/92-09.pdf (stating that establishing a "credit facility" to pay the lawyers' fee, in return for 10 percent financing charge, does not violate Rule 5.4(a)); Or. State Bar, Formal Op. 2005-133 (2005), *available at* https://www.osbar.org/_docs/ethics/2005-133.pdf (same); *see also* Thomas R. Andrews, *Nonlawyers in the Business of Law: Does the One Who Has the Gold Really Make the Rules?*, 40 HASTINGS L.J. 577, 608 (1989).

28. *See, e.g.*, Prof'l Ethics Comm'n Me. Bd. of Overseers of the Bar, Op. 152 (1995), *available* at http://www.mebaroverseers.org/attorney_services/opinion.html?id=89759 (permitting a law firm to open a line of credit with a bank, secured by the firm's receivables); Jennifer Anglim Kreder & Benjamin A. Bauer, *Litigation Finance Ethics: Paying Interest*, 2013 J. PROF. LAW. 1, 16 ("State ethics committees generally now allow attorneys to borrow funds for litigation expenses as long as the financing agreements comply with each state's rules of professional conduct.").

29. *See* Nora Freeman Engstrom, *Lawyer Lending: Costs and Consequences*, 63 DEPAUL L. REV. (forthcoming 2014), *available at* http://ssrn.com/abstract=2286307.

30. *Compare* N.C. State Bar, Formal Op. 12 (2006), *available* at http://www.ncbar.com/ethics/printopinion.asp?id=753 ("Lawyer may never put a client's funds at risk to obtain a loan."), *and* Kreder & Bauer, *supra* note 28, at 17, *with* Prof'l Ethics Comm'n Me. Bd. of Overseers of the Bar, Op. 177 (2001), *available* at http://www.mebaroverseers.org/attorney_services/opinion.html?id=89473 ("[T]he attorney may not allow the financing institution to acquire any lien or other security interest in the client's claim *without* the informed consent of the client." (emphasis added)).

31. *Compare* N.C. State Bar, Formal Op. 12, *and* Phila. Bar Ass'n, Op. No. 2003-15 (2003), *available* at www.philadelphiabar.org/page/EthicsOpinion2003-15?appNum=1 (permitting nonrecourse loans), *with* Prof'l Ethics Comm'n Me. Bd. of Overseers of the Bar, Op. 193 (2007), *available at* http://www.mebaroverseers.org/attorney_services/opinion.html?id=86896, *and* State Bar of Nev. Standing Comm. on Ethics and Prof'l Responsibility, Formal Op. 36 (2007), *available at* http://nvbar.org/sites/default/files/opinion_36.pdf (prohibiting nonrecourse loans).

32. For an example where both features were present and no distinction was drawn between them, see Prof'l Ethics Comm. for the State Bar of Tex., Op. 576 (2006), *available at* https://www.law.uh.edu/libraries/ethics/opinions/501-600/eo576.pdf.

splitting; conditioning repayment of a fixed amount to the success of a case is not fee splitting.[33]

Why is repaying a loan (with funds that could only have come from fees) not fee splitting? As Larry Ribstein has noted, the line between a loan and equity can be blurry, and it can be "gamed" by clever drafting.[34] Ethics opinions are not very helpful in setting out either rationales or criteria to aid in applying the rule. According to one, a "loan" in which the cost of the loan increased in lockstep with the success of the lawsuit supported by the loan was fee splitting because "[b]y tying the proposed funding fee to a percentage of the recovery, the lending company would be directly benefiting from the lawyer's knowledge, skill, experience and time expended to the detriment of the lawyer, who would be solely responsible for paying the funding fee."[35] The distinction drawn here between a nonlawyer enjoying benefits "directly" linked to the lawyer's knowledge, skill, experience, and time and a nonlawyer "indirectly" benefiting from the same suggests that the purpose of Rule 5.4(a) must be more than preventing a nonlawyer from having an equity stake in a lawyer's professional license and the special privileges that come with it.[36] Therefore, we should look to other applications of Rule 5.4(a) to nonloan transactions to see if they can cast a light on what is at stake.

a. Nonlawyer Agents Versus Nonlawyer Investors

Numerous cases and ethics opinions consider the fee-splitting issue in the context of payments made by lawyers to independent contractors and employees.[37] Paying bonuses or contingent fees to experts is ordinarily permissible but may violate the fee-splitting rule if the payment is computed as a percentage of the attorney's fee received in a particular

33. *See* N.C. State Bar, Formal Op. 12; Phila. Bar Ass'n, Op. No. 2003-15. At least one reported decision discloses the existence of a nonrecourse loan to a law firm where the repayment amount was a function of the case recovery of the law firm's client. *See* Lawsuit Funding, LLC v. Lessoff, No. 650757/2012, 2013 WL 6409971, at *5–6 (N.Y. Sup. Ct. Dec. 4, 2013).

34. Ribstein noted that the firm McKee Nelson Ernst & Young in the District of Columbia was an example of the uncertainty between debt and equity in law firm financing. The firm was capitalized with a nonrecourse loan from an accounting firm accompanied by certain repayment obligations that may have crossed "the subtle line into 'equity,'" thus violating the ethics rules "in all 50 states" and possibly even the D.C. rule. Larry E. Ribstein, *Ethical Rules, Law Firm Structure and Choice of Law*, 69 U. CIN. L. REV. 1161, 1173 (2001).

35. Prof'l Ethics Comm. for the State Bar of Tex., Op. 576.

36. "Thus, it cannot be that nonlawyer ownership is just about money and financial structuring of law firms. Rather, it is the concept of allowing nonlawyers to exercise 'ownership' over a legal practice that lies at the heart of this debate." N.Y. STATE BAR ASS'N, REPORT OF THE TASK FORCE ON NONLAWYER OWNERSHIP 71 (2012), *available at* http://www.nysba.org/WorkArea/DownloadAsset.aspx?id=26682.

37. *See* Patterson v. Law Office of Lauri J. Goldstein, P.A., 980 So. 2d 1234, 1234 (Fla. Dist. Ct. App. 2008); Atkins v. Tinning, 865 S.W.2d 533, 534 (Tex. App. 1993); *see also* TEX. DISCIPLINARY RULES OF PROF'L CONDUCT R. 5.04 cmt. 1; D.C. Bar, Op. 322 (2004), *available* at http://www.dcbar.org/bar-resources/legal-ethics/opinions/opinion322.cfm.

matter.[38] A similar line of authority relates to the payment of bonuses to nonlawyer employees of law firms. While Model Rule 5.4(a)(3) is an express exception to the fee-splitting rule, permitting the compensation of nonlawyer employees on a profit-sharing basis, some cases and ethics opinions state that the amount of compensation may not be tied to or contingent upon the firm's receipt of a fee from a particular matter.[39]

Ethics opinions barring fee splitting with nonlawyer agents emphasize that there is an ineliminable risk that, when an agent's earnings are contingent on the outcome of a case on which he works, he may act against the client's interests by (1) deciding where to invest time and other resources among multiple clients based on which case promises the greatest reward, or (2) "steering" new clients to the lawyer even though they otherwise would be better served by going to a different lawyer.[40]

These risks are not present—or are not present in the same way—in the case of a nonlawyer investor. The incentive for an agent to self-deal is different than for an investor—passive or active—to use whatever leverage she may have to maximize the value of her equity stake. First, although much of the controversy surrounding reforming Rule 5.4(a), from the Kutak Commission to the most recent efforts led by the ABA's Commission on Ethics 20/20 Alternative Law Practice Structures (ALPS) Working Group, focused on nonlawyers as either employers or partners, it is far more likely that nonlawyer ownership will take the form of investment capital.[41] Investors are less likely to take steps to cause lawyers to commit malpractice or to degrade the reputational capital of the firm. As Edward

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38. *See, e.g.*, State Bar of Mich., Op. RI-104 (1991), *available at* http://www.michbar.org/opinions/ethics/numbered_opinions/ri-104.cfm (finding that it was permissible to pay a contingent fee to tax expert, but the fee could not be calculated as a percentage of the tax savings realized by the client because that would violate the fee-splitting rule); *accord* Pa. Bar Ass'n Comm. on Legal Ethics and Prof'l Responsibility, Informal Op. No. 93-164 (1993), *available at* 1993 WL 851259.

39. *See, e.g.*, Trotter v. Nelson, 684 N.E.2d 1150, 1154–55 (Ind. 1997); *In re* Anonymous Member of the S.C. Bar, 367 S.E.2d 17, 17–18 (S.C. 1988); State Bar v. Faubion, 821 S.W.2d 203, 208 (Tex. App. 1991); Prof'l Ethics of the Fla. Bar, Op. 02-1 (2002), *available at* http://www.floridabar.org/tfb/tfbetopin.nsf/SearchView/ETHICS,+OPINION+02-1?opendocument; N.Y. State Bar Ass'n Comm. on Prof'l Ethics, Op. 887 (2011), *available at* http://old.nysba.org/Content/ContentFolders/EthicsOpinions/Opinions826900/EO_887.pdf; N.Y. State Bar Ass'n Comm. on Prof'l Ethics, Op. 733 (2000), *available at* http://old.nysba.org/Content/ContentFolders/EthicsOpinions/Opinions676750/EO_733.pdf (stating that a nonlawyer marketer may receive a bonus based on the firm's overall profits but not on particular matters referred to the firm as the result of the marketer's efforts); N.C. State Bar, RPC Op. 147 (1993), *available at* http://www.ncbar.com/ethics/printopinion.asp?id=147; Phila. Bar Ass'n, Op. 2004-3 (2004), *available at* http://www.philadelphiabar.org/page/EthicsOpinion2004-3?appNum=3.

40. *See* TEX. DISCIPLINARY RULES OF PROF'L CONDUCT R. 5.04 cmt. 1; D.C. Bar, Op. 322 (2004), *available at* http://www.dcbar.org/bar-resources/legal-ethics/opinions/opinion322.cfm.

41. The debate over the Kutak Commission's recommendations was captured by the following possibility offered by its critics: what if a large consumer retail store (like Sears) began to hire lawyers and paralegals and offered legal services in the store. 2 HAZARD & HODES, *supra* note 24, § 45.3; Cindy Alberts Carson, *Under New Mismanagement: The Problem of Non-lawyer Equity Partnership in Law Firms*, 7 GEO. J. LEGAL ETHICS 593, 608–10 (1994) (describing problems with nonlawyer partners in a multidisciplinary partnership).

Adams and John Matheson have pointed out, "nonlawyer-controlled law firms, which could take the form of private entities with nonlawyer ownership or publicly traded corporations, would be in the business of providing legal services and would succeed only by providing sound legal judgment to consumers, as is the case now."[42] Further, if the investor is investing in the lawyer's net profits, and not individual cases, then the investor faces the same malpractice risk as the lawyer. If the lawyer accedes to investor's demands to recommend to the client an action in violation of her professional responsibilities, the lawyer's malpractice risk will be reflected in lower net profits, which will reduce the investor's return on her investment.[43]

Finally, the risk that nonlawyer investors might "steer" clients to lawyers inappropriate for their needs was one of the main rationales for the Professional Ethics Commission for the State Bar of Texas Opinion Nos. 467 and 576.[44] The risk, as stated, seems far-fetched in general (a lawyer's landlord is not often in the position to refer clients), and in the case of investment by hedge funds or shareholders, it seems especially far-fetched: investors in a contingent fee firm are not in a better position than the firm to identify and persuade potential clients to retain the firm; that is, an investor lacks what one would think is precisely the type of expertise that he wishes to purchase with his investment.[45]

b. Particular Matter Versus General Firm Revenue

As noted in the section above, one of the reasons that ethics committees found fee splitting with nonlawyer agents of lawyers objectionable is that it

42. Edward S. Adams & John H. Matheson, *Law Firms on the Big Board?: A Proposal for Nonlawyer Investment in Law Firms*, 86 CALIF. L. REV. 1, 16 (1998) ("Indeed, if the stock of the firm were publicly traded, the value of a firm's stock would directly reflect the market's perception of the ability of the firm to render quality, professional legal services. To the extent that the law firm's reputation is tarnished because it provides inadequate services, the stockholders stand to lose.").

43. This prophylactic reflects the same incentive structure built into MODEL RULES OF PROF'L CONDUCT R. 1.5(e) (2013), which permits a firm that refers a case to another firm to share in the latter's fees as long as it also shares the latter's malpractice risk.

44. As the Commission noted in Opinion No. 576:

> The Committee reasoned [in Opinion No. 467] that a percentage rental agreement is prohibited for lawyers because an arrangement under which a nonlawyer landlord could receive a percentage of legal fees earned by a law firm would create an incentive for the landlord to refer legal business to the law firm, a result that Rule 5.04(a) is intended to prevent. Similarly [in this case], the proposed arrangement here would create an incentive for the lending company to refer cases to lawyers using its services.

Prof'l Ethics Comm. for the State Bar of Tex., Op. 576 (2006), *available at* https://www.law.uh.edu/libraries/ethics/opinions/501-600/eo576.pdf.

45. Some writers have suggested that investment in a firm's profits could be restated as derivatives, which would create certain advantages, especially in terms of raising capital. *See* Bruce MacEwen, Milton C. Regan, Jr. & Larry Ribstein, *Law Firms, Ethics, and Equity Capital*, 21 GEO. J. LEGAL ETHICS 61, 76 (2008). Proposals for law firms to raise capital through stock offerings would seem simply impossible in a Model Rules jurisdiction. Erin J. Cox, Comment, *An Economic Crisis Is a Terrible Thing To Waste: Reforming the Business of Law for a Sustainable and Competitive Future*, 57 UCLA L. REV. 511, 526 (2009).

occurred in a piecemeal fashion. If, on the other hand, compensation is tied to general firm revenue, the fee-splitting rule is not violated.[46] As one bar committee put it, the Model Rules "generally stand for the proposition that paying a percentage of firm net profits to nonlawyer employees is permissible, whereas paying a percentage of a fee *in an identifiable case or series of cases* is not."[47] The distinction drawn between firm receivables or revenue, which is comprised of a pool of fees received by the firm, and the fees received in a specific case, like the distinction between loan and equity, is one of the clues that will help us understand the rationale behind Rule 5.4(a).

A handful of opinions deny that there is a difference between the revenue from a single case, a set of cases, or a firm's general revenue of profitability. In Texas, a bar committee held that a lawyer could not pay his landlord rent that increased (or decreased) depending on his firm's "gross receipts" because the contract would violate Texas Rule 5.04(a).[48] Even more directly in tension with the proposition that a lawyer may pay an investor a portion of his firm's net profits is a decision by the Wisconsin Supreme Court that involved an investor who sought to invest in a lawyer's future "products liability litigation."[49] The court upheld the ruling of a disciplinary action against a lawyer in an unrelated matter but endorsed the conclusion that the investment was fee splitting.[50] The Wisconsin case might be distinguishable from the investment analyzed in D.C. Opinion No. 322 in one regard: the investor in the former case was investing in a defined class of cases (products liability) while the nonlawyer in the latter case was receiving compensation based on the lawyer's firm's net profits. The Texas case can only be explained as either an outlier or a mistake.

2. Fee Splitting in D.C.

Since 1990 the District of Columbia has permitted nonlawyers to form law partnerships with lawyers.[51] This is a form of nonlawyer investment, although it was designed to accommodate the demands by other professionals such as accountants and financial planners to form partnerships with lawyers.[52] Firms that partner with professionals from other disciplines do not typically bill their clients through contingent fee agreements, although nothing in the language of Rule 5.4(b) prevents the

46. *See, e.g.*, State Bar of Mich., Op. RI-143 (1992), *available at* https://www.michbar.org/opinions/ethics/numbered_opinions/ri-143.cfm.

47. D.C. Bar, Op. 322 (2004), *available at* http://www.dcbar.org/bar-resources/legal-ethics/opinions/opinion322.cfm (emphasis added).

48. Prof'l Ethics Comm. for the State Bar of Tex., Op. 467 (1990), *available at* https://www.law.uh.edu/libraries/ethics/Opinions/401-500/O467.html.

49. *In re* Disciplinary Proceedings Against Van Cura, 504 N.W.2d 610, 610 (Wis. 1993).

50. *See id.* at 611–12.

51. *See* D.C. RULES OF PROF'L CONDUCT R. 5.4(b).

52. *Id.* R. 5.4 cmt. 3 & 4.

splitting of a contingent fee with a nonlawyer partner.[53] In the words of one commentator, Rule 5.4(b) has "fairly stringent conditions that few firms have thought it worth satisfying."[54] Geoffrey Hazard and William Hodes state that Rule 5.4(b) requires the investor to be active in the law firm formed with the lawyer—in other words, "the nonlawyers must actively assist the lawyers who provide legal services."[55] In addition, the active involvement by the nonlawyer must satisfy the test of "ancillary services," which means a service "directly linked to the legal services being provided to the client."[56]

B. Control of a Lawyer by a Nonlawyer Investor

The Model Rules are designed to preserve the independence of a lawyer's professional judgment. This is the clear purpose of Rules 1.8(f) and 5.4(c). Rule 5.4(a) preserves a lawyer's independent judgment by protecting her against control by nonlawyers. "[F]ee splitting between lawyer and layman . . . poses the possibility of control by the layperson, interested in his own profit, rather than the client's fate."[57] Fear of the control of lawyers by nonlawyers was one of the constant themes of critics of the Kutak Commission and the Ethics 20/20 ALPS Working Group.[58] This is not to deny, however, that other concerns were raised with equal fervor, including the fear that splitting fees with nonlawyers would weaken lawyer self-regulation and would ill serve clients by allowing client confidences to be discovered.[59]

As Bruce Green has noted, professional independence can mean multiple things: independence from clients, third parties, and the judiciary.[60] However, as he notes, Rule 5.4 is "essentially a conflict of interest rule"

53. *See* D.C. Bar, Op. 322 (2004), *available at* http://www.dcbar.org/bar-resources/legal-ethics/opinions/opinion322.cfm.

54. DISTRICT OF COLUMBIA LEGAL ETHICS: A SUMMARY OF THE LAW OF LAWYERING IN THE DISTRICT OF COLUMBIA § 5.4:300 (David B. Isbell ed., 2007), *available at* http://www.law.cornell.edu/ethics/dc/narr/DC_NARR_5.HTM#5.4:300.

55. 2 HAZARD & HODES, *supra* note 24, § 45.6.

56. *Id.*

57. ABA Comm. on Ethics & Prof'l Responsibility, Formal Op. 95–392 (1995) (citation omitted); *see also* Prof'l Ethics Comm'n Me. Bd. of Overseers of the Bar, Op. 193 (2007), *available at* http://www.mebaroverseers.org/attorney_services/opinion.html?id=86896 ("The underlying rationale for [Maine's] rule is that any fee sharing arrangement creates an unacceptable risk that the professional independence of the lawyer will be influenced by the non-lawyer who has an interest in the attorney's fee.").

58. During a debate over Kutak recommendations, a "delegate quipped that the proposed abolition of the prohibitions would be a 'breach of the golden rule. The one who has the gold makes the rules, and the one that has the gold under [then proposed] 5.4, is going to be a non-lawyer.'" Andrews, *supra* note 27, at 605–06.

59. *See, e.g.*, N.Y. STATE BAR ASS'N, *supra* note 36, at 67–77; Ted Schneyer, *"Professionalism" As Pathology: The ABA's Latest Policy Debate on Nonlawyer Ownership of Law Practice Entities*, 40 FORDHAM URB. L.J. 75, 123–24 (2012).

60. *See* Bruce A. Green, *Lawyers' Professional Independence: Overrated or Undervalued?*, 46 AKRON L. REV. 599 (2013).

designed to protect the client from third parties.[61] As one critic of the liberalization of Rule 5.4(a) put it:

> Lawyers have, among others, three core values built into our Codes of Professional Responsibility that the [reformers] want us to eliminate—our total independence from outside influence in the representation of our clients, our undivided loyalty toward our clients, and our obligation to maintain their confidences and secrets. . . . How can lawyers function for their clients when their independence and loyalty are necessarily to be divided between their responsibilities to clients and their responsibilities to their [nonlawyer] partners or employers?[62]

The concern for clients expressed here is threefold: (1) that they receive advice that has not been influenced by third parties; (2) that their ends are placed above all others (loyalty); and (3) that their confidences be maintained. The question of maintaining confidences is an important one, but existing rules of professional responsibility and evidence may be sufficient to answer it, and in any event, this question is outside the scope of this Article.[63] The first and second concerns are closely connected to the concerns raised by the bar committee interpretations of Rule 5.4(a) above and are the concern of this Article.

1. Loyalty

Like "professional independence," loyalty can mean multiple things in legal ethics.[64] It can mean the technical obligations set out in the Model Rules, which Eli Wald described as a "floor," or the slightly more demanding fiduciary-like obligations set out in the *Restatement (Third) of the Law Governing Lawyers*, or the aspiration of zealous advocacy and "warm zeal" suggested by case law and some commentators.[65] At a minimum, the lawyer is an agent of the client, and her primary task is to "promot[e] the objectives of the client" within the limits of the law.[66]

Rule 5.4 is clearly designed to strengthen client loyalty.[67] Critics of nonlawyer investment have argued that loyalty to clients will be compromised by demands of investors to cut expenses or divert resources to cases on the basis of their potential return to the law firm and not based on the needs of the firm's clients.[68] Critics have also pointed to the possibility

61. *Id.* at 616.

62. Robert L. Ostertag, *Multidisciplinary Practice: Our Profession Is Not for Sale*, ABA GPSOLO, Jan./Feb. 2001, at 22, 27–28.

63. *See, e.g.*, Adams & Matheson, *supra* note 42, at 19–21.

64. *See* Eli Wald, *Loyalty in Limbo: The Peculiar Case of Attorneys' Loyalty to Clients*, 40 ST. MARY'S L.J. 909, 919–20 (2009).

65. *Id.* at 920, 923, 928–29.

66. RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 16 cmt. e (2000).

67. *See* Eleanor W. Myers, *Examining Independence and Loyalty*, 72 TEMP. L. REV. 857, 861 (1999) (suggesting that concern about independence from third parties "is primarily a concern about impairing client loyalty").

68. *See* Carson, *supra* note 41, at 611–13 ("A non-lawyer partner's primary concern is likely to be a good return on his investment."); Lawrence J. Fox, *Accountants, the Hawks of the Professional World: They Foul Our Nest and Theirs Too, Plus Other Ruminations on the*

that nonlawyer owners will accidentally or purposefully cause their own law firms to be conflicted out of cases due to their other nonlegal business activities, thus depriving clients of representation.[69] Finally, critics have expressed the concern that nonlawyer investors would influence the substantive advice that lawyers provide their clients based on various business and political interests that may be affected by the client's cases.[70]

These objections have been met by persuasive rebuttals that point out that while agents of lawyers might act in ways that are self-dealing, owners of law firms are incentivized to act in ways that maximize the law firm's long-term value.[71] But these rebuttals have force in inverse proportion to the type of nonlawyer control under discussion. Where the fear is that the nonlawyer will spend less money on a client, or retain the "wrong" clients, it is easy to see why some version of the efficient market hypothesis could meet this fear. The efficient market hypothesis has some empirical support from the experience of bank lending to law firms. As noted above, the line between a loan and equity is so difficult to draw because of what was termed "clever" drafting—that is, because a loan covenant can be drafted to provide the lender with (in theory) a great deal of control over the future actions of the borrower.[72] For this reason, bank loans to law firms of this nature are analogous to law firm equity ownership. While it is difficult to gather much empirical data due to the confidential nature of the loan agreements, the relationship between banks and law firms is not completely opaque. We know, for example, that since the financial crisis of 2008, banks have begun to exercise increasing control over law firms by setting out detailed constraints in advance.[73] What is interesting is what the banks

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Issue of MDPs, 84 MINN. L. REV. 1097, 1106 (2000) (arguing that Rule 5.4 guards against "interference by nonlaw trained masters who wish us to take short cuts to maximize profits").

69. *See* Carson, *supra* note 41, at 619 ("Conflicts of interest could even be used to the non-lawyer partner's advantage. A virtually unlimited ability to invest would provide corporate and some individual non-lawyer partners with a powerful means to control the market for legal services. For example, a corporation could control consumer and competitor access to legal counsel by maintaining a partnership interest in each of the best law firms in a particular city.").

70. *See* John S. Dzienkowski & Robert J. Peroni, *Multidisciplinary Practice and the American Legal Profession: A Market Approach to Regulating the Delivery of Legal Services in the Twenty-First Century*, 69 FORDHAM L. REV. 83, 138 (2000) (discussing the possibility that real estate investors in law firms could control advice to clients—or worse, the manner that legal service is delivered to clients—in ways that systematically benefit the real estate industry and harm the client). *See generally* Fox, *supra* note 68 (applying the same argument to accountants as investors).

71. *See* Adams & Matheson, *supra* note 42, at 39; Dzienkowski & Peroni, *supra* note 70, at 139; Ribstein, *supra* note 34, at 1173–74; Cox, *supra* note 45, at 528.

72. *See* Larry E. Ribstein, *The Death of Big Law*, 2010 WIS. L. REV. 749, 774.

73. *See* Cox, *supra* note 45, at 524 ("[T]wo main lenders to firms—units of Citigroup Inc. and the bank formerly known as Wachovia—have started attaching more stringent terms to loans, further eroding the desirability of debt. Firms seeking to extend credit lines must now comply with detailed disclosures, and institute a litany of changes demanded by lenders who have been burned by law firms now in default. Citigroup, for instance, now insists that indebted law firms 'plac[e] strict internal controls on discretionary spending, cut[] bonuses, freez[e] associate salaries, postpon[e] new hires or initiatives, lay[] off professional and administrative staff, and revamp[] partner compensation schedules to slow distributions and

seem not to do. Banks do not, it seems, tell lawyers whether to spend *x* dollars on Case *A* or to tell Client *C* that a settlement offer of *y* dollars is reasonable and that in the lawyer's professional opinion, the client should accept it. It seems that lenders have not been inclined to demand this level of control, or (and this amounts to the same thing) it has not been attractive to lawyers to grant this level of control in exchange for capital.[74]

The critics might concede all or some of the previous arguments but retreat to the position that even when nonlawyer investors subjectively attempt to promote the *legal* ends of the clients of law firms, clients will always do worse than if the lawyers with whom they worked did not share ownership of the lawyer's practice. This assumes that nonlawyers are either subject to unconscious bias and that lawyers conform their behavior to these biases in ways that harm clients or that nonlawyers consciously try to promote the legal ends of clients, and their well-intentioned efforts harm clients. And, if either (or both) of these propositions were true, then the client could still be harmed even if the lawyer were loyal, for the lawyer herself is not being asked to do something that is on its face disloyal to the client; the lawyer now faces the problem of what to do with a nonlawyer whose desire to promote the client's ends is sincere, but misguided. While one could describe this as a problem of loyalty for the lawyer (the lawyer has a duty to tell the client that the ends sought by the nonlawyer are well intentioned but wrong), this is really more a problem of different professional values. The problem for the lawyer, if she were frank with her client, is not that the nonlawyer investor is asking the lawyer to be disloyal to the client, but that the nonlawyer investor is asking the lawyer to act in violation of her professional "core values," which may understandably be different from those sincerely held by the nonlawyer.[75]

improve cash positions.'" (alteration in original) (quoting Susan A. Berson, *Loans and Moans: Past Firm Failures Mean Tougher Credit Rules*, A.B.A. J., Sept. 2009, at 30, 30)).

74. This is not to deny that litigation investment creates incentives for lawyers's self-dealing at the expense of the client. I discuss what I term the "Self-Dealing Problem" in litigation investment in another context. *See* Anthony J. Sebok, *Litigation Investment and Legal Ethics: What Are the Real Issues?*, 55 CANADIAN BUS. L.J. (forthcoming 2014). A decision by a funder to advance $1 million or $2 million for legal expenses means $1 million or $2 million dollars for the attorney(s) who will now have more income. It would be naïve to act as if the interests of a claimholder and her attorney are always in alignment when the question arises whether litigation should begin or be continued. But it would be equally naïve to think that there is anything new about this potential ethical conflict. It exists all the time—it is an inescapable feature of the fact that law is a business. The "Self-Dealing Problem" is a problem, but not one limited to litigation investment.

75. The "core values" debate in the legal ethics literature has produced a large literature in itself. In the context of the debate over amending Rule 5.4(a), the literature has played a crucial role. *See* Schneyer, *supra* note 59, at 130–31 ("For many lawyers, the profession's core values are the heart of lawyer professionalism. Consequently, many of the comments opposing the [ABA Ethics 20/20] Working Group's proposal expressed concerns that, by allowing even a very limited form of nonlawyer ownership, the proposal would compromise core values.").

2. Legal Advice Uninfluenced by Nonlegal Values

One goal of Rule 5.4(a) is to ensure that the nonlawyer owner does not influence the lawyer. But this goal has to be unpacked. What does it mean to be "influenced" or "controlled" in this context? Obviously, if a lawyer converses with a nonlawyer and, based on that conversation, comes to a conclusion about a legal issue, there is nothing illegitimate about that. For example, a lawyer might, in conversation with a scientist, come to a conclusion about the chances of his client proving cause-in-fact in a tort suit and then advise the client to settle at a lower amount than she had previously recommended.

In the example above, we can observe two things. First, the lawyer was not compelled to draw the conclusion about causation she drew (although the scientist may have believed that the conclusion was "compelled" by the facts and "laws" of science). Second, the issue was not one involving legal judgment; the nonlawyer influenced the lawyer's judgment about a scientific fact, and the legal judgment came later, produced by the lawyer applying her legal skills and knowledge to the newly revised scientific judgment. A final observation: the process described above seems both normal and desirable. By this I mean it is exactly what a client would want her lawyer to do. In other words, *loyalty* to the client requires the lawyer to sometimes be influenced by a nonlawyer.

For the argument that clients must have access to advice uninfluenced by nonlawyers to work, there must be a domain of advice unlike scientific advice that cannot be adequately generated if nonlawyers play a role in its formation. It follows from the claim that the introduction of "nonlawyer reasons" into the formation of this domain of advice is detrimental to the client that the lawyer must control the formation of this domain of advice—hence the "right" of the lawyer to be free from nonlawyer control *in this domain*. The foregoing is merely a theoretical expression of an intuition that clearly motivates the "core values" argument in legal ethics.[76] If one accepts its premise—that lawyers think about their clients' ends differently from nonlawyers—then its conclusion follows, which is that nonlawyers cannot be the final judge of whether their reasons should reach the client. And from this it follows that clients must be shielded from nonlawyers' influence in the formation of legal advice *even if they want it*.[77]

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76. Why lawyers have this intuition can be subjected to numerous types of analysis, some less charitable than others. One of the best attempts at explaining the "core values" belief structure in its relation to Rule 5.4 is Bruce A. Green, *The Disciplinary Restrictions on Multidisciplinary Practice: Their Derivation, Their Development, and Some Implications for the Core Values Debate*, 84 MINN. L. REV. 1115, 1145–46 (2000) (describing the five premises upon which the "core values rationale" relies).

77. *See id.* ("Even if the legal services were rendered exclusively by lawyers in the multidisciplinary firm, these lawyers could not be counted on to serve skillfully and in accordance with the legal profession's ethics rules . . . . *The clients should not be allowed to contract to accept service under a different set of norms* from those governing the attorney-client relationship, or even to assume the risk that the lawyers would violate their duties to their clients, because their clients would have to be self-destructive or misguided to do so." (emphasis added)).

C. Why Can't a Client Order Her Lawyer To Accept the Legal Views of a Nonlawyer?

One might ask why, if a lawyer has a duty of loyalty to her client, the client could not, in theory, order the lawyer to allow her legal reasoning to be influenced by a nonlawyer's efforts at reasoning about legal questions.[78] The argument that the client cannot be allowed to do this, because the lawyer's duty to the client is nonwaivable, is circular. It has to be grounded in an argument. If the argument is that a client cannot understand the consequences of giving such an order to her lawyer, it may make sense to ask whether this may be true for some clients but not others and some types of nonlawyers and not others.[79]

Before these more nuanced questions are asked, however, a more general point should be made. The question posed in this section might seem to be a red herring in the following way. Perhaps Rule 5.4 should be amended to allow a client to order her lawyer's legal reasoning to be influenced by a nonlawyer after the client has learned something about the case, or after it has progressed, so that the client's choice is not only about a class of reasons but also contingent on the identity of the nonlawyer and the specific facts of a case to which that class of reasons will be applied. But the problem of nonlawyer investment in law firms—especially as framed in this Article, where the investment comes from the capital markets—has nothing to do with the quaint hypothetical posed at the beginning of this section. A client cannot possibly know in advance the identity of the nonlawyers who will affect her lawyer's legal reasoning, or how they will do so, or when they will do so, if all she knows is that her lawyer is employed by a firm that is partly owned by shareholders, a private equity firm, or a consulting group.

This objection is very serious. Recall the arguments made earlier about the market pressures that will produce a hands-off approach in the work of the lawyers in firms owned by nonlawyers. The question is not, "Can a client rationally choose to have her lawyer influenced in her day-to-day legal practice on the client's behalf?" That question is more relevant for certain models of alternative litigation funding.[80] The question I want to pose here is, granting that there is some subtle effect on the legal practice of lawyers in a firm partly owned by nonlawyers that would potentially influence the reasons of lawyers working in that firm, is it rational for a client to seek to retain such a firm? The answer, it seems to me, depends on the benefits that accrue to the client in exchange for allowing her lawyers to

78. In theory, a client could require her lawyer to confer with, and perhaps even to follow instructions from, a nonlawyer with regard to her case where the client has signed a contract directly with the nonlawyer. This could happen in the case of litigation investment contracts. *See* Michele DeStefano, *Nonlawyers Influencing Lawyers: Too Many Cooks in the Kitchen or Stone Soup?*, 80 FORDHAM L. REV. 2791 (2012). It most certainly happens when people who become clients sign insurance contracts, as I will explain in the next section.

79. *See id.* at 2829–30 (discussing the benefits of nonlawyer participation in litigation).

80. *See generally* Maya Steinitz, *The Litigation Finance Contract*, 54 WM. & MARY L. REV. 455 (2012).

be influenced by nonlawyers. One such benefit, especially for plaintiffs seeking contingency fee representation, is that her lawyer will have sufficient capital to pursue her case to its completion. The story of the Woburn litigation in *A Civil Action* is a sobering reminder of what happens when an attorney attempts to complete complex litigation with insufficient capital.[81] Even if the advantage to clients is less dramatic, coming in the form of reduced hourly fees (and a well-insured, solvent lawyer to sue in the event of malpractice), the transaction may be worthwhile to the client.

II. WHEN CLIENTS CAN TRANSFER CONTROL TO NONLAWYERS: THE CASE OF INSURANCE LAW

Another way to ask whether there is something so wrong about a client ordering her lawyer to accept the legal views of a nonlawyer, such that it should be treated as a nonwaivable part of the Model Rules, is to ask whether courts allow clients to do the same thing in other parts of the law. The answer is that we do—in the context of the everyday, "garden variety," liability insurance contract.

In almost every liability insurance contract, the insurer demands from the insured that it cede control of any litigation that may occur in the future where the insured is a defendant. The insurer makes this demand a condition of coverage by the insurer.[82] The courts that have permitted insureds to transfer control over litigation have done so without any illusions about what they were permitting. The Missouri Supreme Court observed in *In re Allstate Insurance Co.*[83] that under the typical third-party liability insurance contract

> [t]he insurer has the contract right to direct the litigation against [the] insured. It may evaluate claims and decide whether to settle . . . . It may make economic decisions without the assent of the insured. The insured may want a quick settlement to eliminate further demands on time and energy, but the insurer does not have to settle unless a satisfactory offer is forthcoming. Or the insurer may accept a settlement offer even though the insured wants to go to trial to establish freedom from fault. The insurer may decide what to spend in defense, what discovery is to be had, and what experts to hire. It also has the right to select counsel to defend its interests.[84]

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81. *See* Robert F. Blomquist, *Bottomless Pit: Toxic Trials, the American Legal Profession, and Popular Perceptions of the Law*, 81 CORNELL L. REV. 953, 977 (1996) (reviewing JONATHAN HARR, A CIVIL ACTION (1995)).

82. Charles Silver, *Does Insurance Defense Counsel Represent the Company or the Insured?*, 72 TEX. L. REV. 1583, 1594–95 (1994) ("[Standard general liability insurance contracts] grant[] the company *plenary and exclusive control of the defense.* Ordinarily, the company can select counsel to defend the insured, discharge appointed counsel and name a replacement without the insured's consent, bargain with appointed counsel over fees, monitor counsel and direct litigation strategy, require counsel to inform the company of settlement demands and procedural developments, direct counsel to initiate settlement discussions, settle claims without an insured's consent and decline to settle claims over an insured's objection, and file appeals." (emphasis added) (citations omitted)).

83. 722 S.W.2d 947 (Mo. 1987) (en banc).

84. *Id.* at 952.

There is a downside for the insured to exclusive insurance company control.[85] This has been exemplified by several cases.[86] In response to the risks summarized in *In re Allstate Insurance Co.*, courts developed various doctrines to protect the insured from the reality that all the incentives pointed towards the insurer sacrificing the insured's interests after litigation has begun. The most significant of these is the duty to settle in good faith.[87]

The duty of good faith is implied by the law's "covenant of good faith and fair dealing," which is imputed into insurance policies.[88] The duty is breached if the insurer's conduct during the insured's litigation damages "the very protection or security which the insured sought to gain by buying insurance."[89] Although, in theory, the duty applies to any aspect of the insurer's behavior that affects the interests of the insured, in practice courts are usually unwilling to find violations of the duty where insurers have settled within policy limits.[90] Charles Silver and Kent Syverud call these "full coverage cases" and note that the disputes that arise from these cases have to do with objections by insureds over the noneconomic injuries they suffer resulting from the insurer's decision to settle the lawsuit against the insured and pay the entire amount of the settlement.[91] Full coverage cases are the best place to look to see what limits, if any, courts place on the transfer of control of litigation by insureds. Where an insured (or some other party) is asking a court to set aside the contract terms that give the insurer control over the litigation in a full coverage case, the conflict is not over the settlement amount, but something else—either how to conduct the litigation or whether to settle at all. The dispute is about control over legal judgment: who has it, and whether the law can allow a nonlawyer to have final say over the implementation of that judgment, notwithstanding the views of the litigant or her own attorney.

A cursory review of the case law shows that, in full coverage cases, common law courts uphold the insurance contract as written. The clearest example of this comes from cases involving doctors who object to their insurer settling medical malpractice claims within policy limits. Doctors resent being sued in medical malpractice and probably believe that

85. Silver, *supra* note 82, at 1597.

86. *See, e.g.*, Betts v. Allstate Ins. Co., 201 Cal. Rptr. 528, 546 (Ct. App. 1984) (noting that the insurance company's appointed defense attorney took advantage of the insured by "actively working to protect [the insurance company] and persisting in manipulating [the insured] against her own best interests"); Rosenzweig v. Blinshteyn, 544 N.Y.S.2d 865, 867 (App. Div. 1989) (encountering a defense counsel appointed by the insurance carrier who adopted a defense to avoid the payment of any monies by the insurance company, regardless of the consequences to the insureds, who were his "ostensible clients").

87. *See* W.E. Shipley, Annotation, *Duty of Liability Insurer To Settle or Compromise*, 40 A.L.R.2D 168 (2009); Kent D. Syverud, *The Duty To Settle*, 76 VA. L. REV. 1113 (1990).

88. *See, e.g.*, Hall v. Svea Mut. Ins. Co., 493 N.E.2d 1102, 1104–05 (Ill. App. Ct. 1986).

89. Rawlings v. Apodaca, 726 P.2d 565, 573 (Ariz. 1986). The implied covenant of good faith and fair dealing can be traced back as far as the late nineteenth century. *See* Brassil v. Md. Cas. Co., 104 N.E. 622, 624 (N.Y. 1914).

90. *See* Charles Silver & Kent Syverud, *The Professional Responsibilities of Insurance Defense Lawyers*, 45 DUKE L.J. 255, 263 (1995); Syverud, *supra* note 87, at 1159.

91. Silver & Syverud, *supra* note 90, at 263–64.

settlements injure their reputations. Even if they can be confident that settlements will be sealed or protected from public access, doctors may still feel, with some reason, that they have a right to a public judgment by a court where allegations against them impugn their professional (and perhaps personal) character.[92] The short answer to these insureds is: "Tough luck." As James Fischer puts it, "These individuals have, of course, an option. They can defend at their own expense or they can bargain for 'consent to settle' provisions."[93] Subject to the rights gained if the insured purchases them back from the insurer, the standard liability insurance contract does not require an insurer to take into account the insured's litigation preferences if it settles within policy limits.[94]

An example of the scope of control allowed under the standard liability insurance contract can be seen in *Hurvitz v. St. Paul Fire & Marine Insurance Co.*[95] The insureds, a physician and his wife, were sued by another physician, their former business partner, on various civil claims including defamation and intentional interference with contractual relationships.[96] The insured filed counterclaims.[97] The insurer provided an attorney for all the claims but one, the intentional interference with contractual relationships, which the insureds defended on their own.[98] Over the objections of the insureds, the insurer concluded a global settlement with the former partner, and all claims, including the intentional interference with contractual relationships and the counterclaims, were dismissed.[99] The insureds sued the insurer, claiming that the insurer secured a settlement that was favorable to the insurer and not favorable to

92. *See* 1 DAVID W. LOUISELL & HAROLD WILLIAMS, MEDICAL MALPRACTICE § 10.06 (2014) (discussing physicians' resistance to settlement). Of course, doctors are not alone in feeling this way. Drivers may also feel this to some degree as well, and resent when their insurance company settles what they believe is a frivolous whiplash claim instead of resisting the groundless claim until it is dropped or defeated in court:

> The policyholder wishes to contest liability, perhaps to avoid the stigma of responsibility or the economic consequences of a finding of fault. A defense limited to the issue of damages may be perceived by the policyholder as an acknowledgment of legal responsibility. For some individuals such an admission may be difficult to make even in the face of clear evidence of fault. Some individuals can live with the vagaries of life. They will accept the decision to focus the litigation on minimizing the loss even though it means admitting, or being understood as admitting, responsibility for conduct they do not actually believe was legally wrongful. Other individuals will find such conduct morally and emotionally repugnant.

James M. Fischer, *Insurer-Policyholder Interests, Defense Counsel's Professional Duties, and the Allocation of Power To Control the Defense*, 14 CONN. INS. L.J. 21, 40 (2008).

93. *Id.* A "consent to settle" provision gives the insured control over whether to settle, but not the conduct of the litigation in other regards. Syverud, *supra* note 87, at 1175–76.

94. Syverud, *supra* note 87, at 1159; *see* Webb v. Witt, 876 A.2d 858, 867 (N.J. Super. Ct. App. Div. 2005) (holding that the absence of a consent to settle clause is not against public policy; "[p]resumably, the premium paid to the insurer reflects the presence or absence of a consent to settle clause").

95. 135 Cal. Rptr. 2d 703 (Ct. App. 2003).

96. *Id.* at 705–06.

97. *Id.* at 706.

98. *Id.* at 706–07.

99. *Id.* at 707.

the insureds and it coerced the insureds into accepting the settlement by refusing to pay invoices of their independent defense counsel.[100] The settlement allegedly impaired the insureds' negotiating position; caused injury to their reputation; precluded them from filing a malicious prosecution action against their former partner; provided funds to the former partner to use to finance his defense of future lawsuits brought by the insureds; deprived the insureds of insurance financing for their future litigation against the former partner; and impacted the insureds' future insurability.[101] The court upheld the dismissal of the insureds' suit.[102] The court conceded that, by settling the claim, the insurer exposed the insureds to costs, including unwanted media attention and the loss of potentially valid counterclaims.[103] But, the court also noted:

> *These are the ordinary consequences of settlement*. . . . Liability insurance exists primarily to protect the insured's finances. The covenant of good faith and fair dealing requires the insurer to minimize the possibility of an award that exceeds the policy's limits—it does not require the insurer to fight a legal action until the bitter end when the costs of defense exceed the benefit to be achieved.[104]

The court noted that the insureds' complaint "[put] a reverse spin" on bad faith doctrine: instead of arguing that the insurer acted in bad faith when it unreasonably refused to settle a case within policy limits, they were arguing that the insurer engaged in bad faith conduct when it accepted a settlement over the insureds' objection even though there was no risk to the insureds of an excess judgment.[105] The insured's desire to control the litigation, while understandable, is something they gave away when they bought insurance. The protection the law provides them in the wake of that decision—the doctrine of good faith—does not require the insurer to take into account "the entire range of the insured's well-being," but just one thing: the monetary judgment at risk in the claim against the insured.[106]

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100. *Id.* at 708.

101. *Id.* at 706–08.

102. *Id.* at 708–09.

103. *Id.* at 712 ("The decision to settle rather than continue litigation invariably involves a conflict between the desire to vindicate oneself and the desire to minimize the costs of litigation and avoid the risk of loss. Defendants who settle face an uphill battle in convincing others, including members of the interested public or the media, that they were completely innocent of the charges. Moreover, when a defendant pays money or gives up something of value to settle a claim, he or she loses the ability to later pursue a malicious prosecution claim.").

104. *Id.* at 713 (emphasis added).

105. *Id.* at 713 (citing W. Polymer Tech., Inc. v. Reliance Ins. Co., 38 Cal. Rptr. 2d 78 (Ct. App. 1995)).

106. *Id.* at 711–12; *see, e.g.*, Shuster v. S. Broward Hosp. Dist. Physicians' Prof'l Liab. Ins. Trust, 591 So. 2d 174, 176 (Fla. 1992); Jon Epstein, Annotation, *Liability of Insurer to Insured for Settling Third-Party Claim Within Policy Limits Resulting in Detriment to Insured*, 18 A.L.R.5TH 474 (1994).

CONCLUSION

This Article argues that the reform of the prohibition on fee splitting should begin by analyzing why nonlawyers want control. The reason for this starting point is threefold. First, the fear that nonlawyers will use control to self-deal in a disloyal fashion, while legitimate in some contexts, may be pure fiction in others. Second, the fear that nonlawyers will use control to influence the reasons that clients receive concerning legal decisionmaking, while genuine, needs to be balanced against client autonomy: loyalty to clients may require lawyers (and nonlawyers) to allow clients to hear opinions from whomever the client chooses. Third, and finally, client autonomy to involve nonlawyers in legal decisionmaking is not an aspiration or a theoretical possibility. This concept is quite real and is defended vigorously by the courts in the context of third-party liability insurance contracts. It is not clear why similar autonomy should not be encouraged with equal vigor in the context of third-party nonlawyer investment in law firms where there is a demand by clients for lawyers who are employed by firms owned in part by nonlawyers.