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An MDP Primer

ABA Annual Meeting - Presidential Showcase
*May It Please the Court...I am from Arthur
Price & Deloitte: MDPs, Should Trial Lawyers
Care?*



New York City - July 8, 2000
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Summary

- The MDP Phenomenon: accounting firms now provide legal services
- Global responses to MDPs
- Common regulatory questions
- The ABA MDP Commission Reports
- My recommendations & rationale
- The results of my German MDP research
- Conclusion

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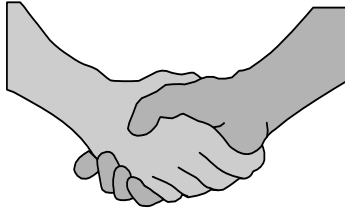
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The “MDP” Phenomenon

- **Number of Big 5 “Legal Advisors”**

(excluding tax lawyers)

- PricewaterhouseCoopers (Landwell) (1735)
- Arthur Andersen Legal (1718)
- KPMG (1264)
- Ernst & Young (954)
- Deloitte & Touche (691)
- Big 5 are 3 of 10 largest “law firms”
- Cutting edge: McKee Nelson Ernst & Young; KPMG-MoFo; merger of Clifford Chance-Rogers & Wells-Puender Volhard (an MDP)



- **But one must also consider ‘Main Street’ MDPs (elder & family law)**

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The Arguments *Pro* and *Con*

- **Advantages**

- It should be the client’s choice to use MDPs
- Convenience of 1-stop shopping
- Better service because of broader expertise
- More cost-effective (in money & time)
- Main Street MDPs may mean decreased intimidation & increased access to lawyers

- **Disadvantages**

- Lawyer’s independent judgment’s undermined
 - Confidentiality concerns (*cf.* auditors)
 - Conflicts of interest (different standards, use of screens)
 - Competition affects availability & choice of lawyers
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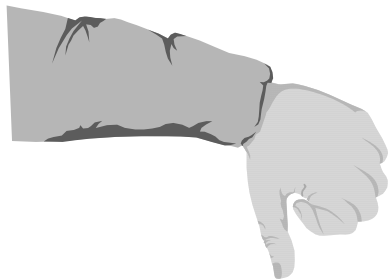
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Global Responses to MDPs

- **Countries with a large MDP presence:**
 - Australia
 - Brazil
 - England
 - France
 - Germany
 - Netherlands
 - Spain
 - **Bar & regulatory responses:**
 - CCBE
 - International Bar Ass. (IBA)
 - Union Int'l de Avocats (UIA)
 - Australia
 - Canada
 - Dutch case before the ECJ
 - England
 - France
 - U.S. (ABA held 3 hearings before issuing its 6/99 report)
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US legal ethics rules ban MDPs



- **ABA Model Rule of Professional Conduct 5.4:**
 - No partnership or fee sharing with nonlawyers
 - **Key Concerns:**
 - independence of legal judgment
 - conflicts of interest
 - confidentiality
 - **MDPs exist in the US but say they are not practicing law**
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Common Regulatory Questions:

- MDPs raise similar issues worldwide
- The ABA hearings provide a good overview & these materials are on the Internet
- My ABA testimony included a 40-item *Issue Checklist*
- I grouped the issues into three categories:
 - 1) *threshold*;
 - 2) *functional*; and
 - 3) *substantive ethics* issues
- My charts summarizing all pre-report testimony are on the Commission's website



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Key *Threshold* Issues:

- Standards to use when deciding?
- Core values to protect?
- Same rules for Main St. & Wall St.?
- Which side has the *burden of proof*?
- Is there client demand for MDPs?
- Have MDPs harmed clients?
- Are U.S. lawyers & nonlawyers doing what would be law practice if done in a law firm?

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If MDPs, Key *Functional* Issues:

- **Forms of Association**

- which ABA Model (1-5)?
- lawyer-majority?
- professions to include?
- brand names?
- passive investment?
- disclosure requirements (to client? to regulator?)

- **Scope of Practice**

- ban on both legal & audit?
- ban litigation?
- DC model- only use to deliver legal services?

- **Functional Ethics**

- must MDP lawyers use legal ethics rules?
 - must nonlawyers use legal ethics rules or register?
 - should the MDP entity itself be regulated?
 - what if the rules clash?
 - enforcement mechanisms?
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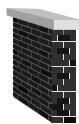
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Key *Substantive Ethics* Issues:



- **Protecting confidentiality**

- May an MDP lawyer share info with MDP nonlawyers? role of screens?



- **Avoiding conflicts of interest**

- How are conflicts imputed? Use of screens?
- Reconciling acc'tant and lawyer conflict rules: Prince Jefri v.KPMG, *direct & indirect conflicts*



- **Independence: *is it compromised in an MDP?***

- **Money & Client Protection Issues**

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The ABA Commission's 6/99 Report & 12/99 Update

- **Forms of Association:**
 - Permits MDPs in any form (Model 5 ok)
 - Doesn't require a lawyer majority
 - No limits on who joins an MDP (*probably*)
 - No passive investment
- **Scope of Practice:**
 - Clarified intent to ban simultaneous legal & audit services
- **Functional Ethics:**
 - MDP lawyers must use legal ethics rules (*probably* based on their status)
 - MDP nonlawyers sometimes must use legal ethics rules
 - Court certification & audit procedure for nonlawyer-controlled MDPs
 - UPL definition included
- **Substantive Ethics:**
 - If even indirect fee split, impute conflicts to nonlawyers in the MDP

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May 2000: The ABA Asks *Whether not How*

- **OVERVIEW:**
 - New *Recommendation* issued in draft form in 3/2000 & in final form in 5/2000
 - Its four paragraphs are more general (& leave room for differences of opinion)
 - It doesn't address many key points (audit-legal, scope of imputation)
 - The accompanying *Report*, however, addresses many questions & is similar in many respects to the 6/99 *Recommendation* (omits certification, UPL definition)
- **Threshold Issues**
 - ¶2: Implement *Recommendation* so as to protect 5 core values (2 additions)
- **Forms of Association:**
 - ¶1: Permits MDPs with nonlawyer professionals only if lawyers have the control and authority necessary to assure lawyer independence (note fuzziness)
 - ¶1: Defines “nonlawyer professionals” as those governed by ethical standards
 - ¶4: Prohibits passive investment
- **Functional Ethics:**
 - ¶3: Regulatory authorities should enforce the existing rules and adopt any additional enforcement needed to implement the recommendation
- **Substantive Ethics:**
 - ¶4: keep status quo re legal ethics rules & nonlawyer delivery of legal services

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The US Consensus & My Recommendation

- **There is Consensus that:**
 - **Bases for Regulation:**
 - the appropriate bases of regulation are client protection & public interest
 - **Client Demand:**
 - there is at least *some* client & lawyer demand for MDPs (although there is disagreement whether this demand is overwhelming or minor)
 - **The MDP Phenomenon**
 - lawyers who are not in law firms now do work that would be considered law practice if done in a law firm
 - **MDP lawyers:**
 - these MDP lawyers claim to be outside the profession's regulatory net (& must do so to avoid ethics rule 5.4)
 - **The future:**
 - there is much uncertainty about MDPs
 - **My Recommendation:**
 - Permit fully-integrated Model 5 MDPs
 - Do not restrict the types of nonlawyers who can join
 - have a legal-audit ban
 - MDP lawyers use legal ethics if holding out-status
 - Nonlawyers use legal ethics where necessary to protect lawyer's obligations
 - For Model 5, use MDP-wide imputation
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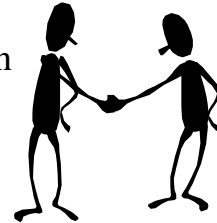
Reasons for my Recommendations:

- **Pragmatic:** there are 3 ways to respond to MDPs
 - **Ignore them** (dual world of attys seems bad to me)
 - **Stop them** (to work, one must be able to enforce UPL)
 - **Regulate them** (seems best to me)
 - **Theoretical:**
 - **Let the clients decide**
 - **Burden of proof:** (should be on "rule retainers")
 - **Burden not met:** (other risks are tolerated in our system based on lawyer trust)
 - **Civil disobedience** (it is not clear enough to override client choice)
 - **Let's focus on protecting core values & our legal system**
 - **Re Control:** McKee Nelson Ernst & Young and the German experience convince me that a lawyer-majority requirement primarily limits Main Street MDPs
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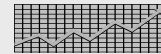
The German Experience with MDPs

- German MDPs have been around at least since the 1960s
- German MDP rules are less developed than one might expect; *e.g.* the new ethics rules took effect in 1997 after a 10 year gap
- There have been rule invalidations by the German Constitutional court (e.g. who may join an MDP)
- German MDPs rules & practice are in flux more than one might expect
- Many German MDPs are small firms



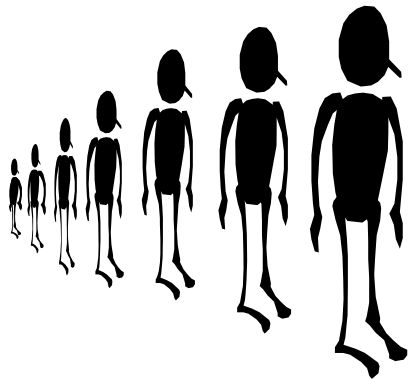
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1999 German Statistics:



- There were 97,791 lawyers (*RA*), of which:
 - 593 were also auditors /CPA (*WP*)
 - 517 were also sworn auditors (*vBP*)
 - 1573 were also a tax advisor (*StBer & StBeVollm*)(this number is approximate)
- 9,611 certified public accountants- *WP*
- 4,295 sworn auditors- *vBP*
- 59,626 tax advisors- *StBer*
- 3,833 tax assistants-*StBVollm*
- **Unclear what percent of lawyers practice in MDPs**
- **No statistics about MDP sizes**
- **Limited Liability Groups**
 - 78 Anwalts (Lawyer) GmbH- 50% increase since 98; decreased in 2000)
 - 5,748 StBer (tax advisor) GmbH
 - 1,759 WP (auditor) GmbH (of which 169 have lawyers as leaders)

Largest Firms Include MDPs



- **All of the 10 largest firms are now MDPs:**
 - Oppenhoff (40 of 293)
 - Pünder (18 of 223)
 - Haarman (81 of 222)
 - Also: Feddersen (4), Bruckhaus (1), Gaederz (2), Bosebeck (2), Wessing (5), CMS Hasche (7), BBLP (6)
 - Non-MDPs may have a tax arm (see Beiten previously)
- **Large MDPs are lawyer-dominated**

Big 5 developed late in Germany

- 1998: Several Big 5-related firms emerged; later than elsewhere in Europe
- Some have grown quite fast: *e.g.* the PwC-affiliated firm went from 5 to 40 lawyers in less than 1 year
- They have attracted some leading lawyers
- They are now among the 10 largest German firms
- Organized as Model 4 not Model 5



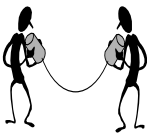
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German Laws Regulating MDPs

- **Forms of Association Provisions:**
 - Model 5 (fully integrated) MDPs are permitted but only with a very few professions (e.g. auditors, tax advisors, patent lawyers) [BRAO §59a]
 - New 1999 limited liability (GmbH) law requires lawyer majority ownership of an MDP in order to limit liability
 - BORA §31, which prohibits interlocking partnerships, is both unclear and under a cloud
 - **Scope of Practice Limits:**
 - There is no ban on performing audit & legal services for the same client
 - **Functional Ethics Rules:**
 - Lawyers must ensure that non-lawyers use lawyer rules [BORA §30]
 - **Substantive Ethics Rules:**
 - in Model 5 MDPs, as in U.S. law firms, confidential information may be shared within the entire MDP; there are no automatic screens
 - in Model 5 MDPs, there is MDP- wide imputation of conflicts of interest (*But German conflict of interest standards differ from US standards*)
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Interview Results

- **Threshold:** a standard comment was “MDPs are no problem because the rules for lawyers & auditors are the same”
 - **Form of Association:** Except in Big 5, Model 5 MDPs are widely used; Big 5 firms use Model 4 & the new lawyer-control GmbH law
 - **Scope of Practice Limits:** the voluntary legal-audit ban described by a German lawyer appears to be an anomaly
 - **Functional Ethics:** The MDPs I interviewed had not institutionalized nonlawyer use of lawyer rules under §30
 - **Substantive Ethics:** in Model 5 MDPs, there is firm-wide imputation; in the Model 4, Big 5-affiliated firms, MDP-wide imputation is viewed as a business decision, rather than a legal requirement
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Lessons to Learn from Germany?



- Germany's MDPs are dominated by lawyers & the Big 5 arrived late
 - The OECD was premature to rely on Germany to show that Big 5 MDPs are acceptable
 - But evidence doesn't show MDPs are NOT acceptable
 - German ethics rules about MDPs are quite new, not understood, & are being challenged
 - Experiences & issues are still useful
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Part 2: German Rules Worth Emulating



- **Form of Association:**
 - I endorse Germany's rule permitting fully-integrated, nonlawyer- controlled MDPs
 - I reject the rule limiting acceptable MDP partners (German cases show the difficulty of line-drawing)
 - **Scope of Practice:**
 - I endorse an audit-legal ban even though its use in Germany is not widespread
 - **Functional Ethics:**
 - My interviews showed a need for more precise rules & education about nonlawyers' use of legal ethics
 - **Substantive Ethics:**
 - I endorse MDP-wide imputation, as in Germany
 - There is a need for rules about independence beyond Germany's rules
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Conclusion

- This is a rapidly developing area
- The MDP phenomenon may be inevitable
- Some key disagreements are whether to require lawyer control or MDP certification & audit
- Some key philosophical differences are who has the burden, can MDP lawyers be trusted, and enforcement viability
- The ABA MDP Commission now seems focused on “whether” to permit MDPs not “how”
- U.S. lawyers need to react if they want to set the conditions of MDPs in the U.S.

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To read more about it:

- <http://www.abanet.org/cpr/mdp/> [*The ABA MDP Commission Homepage contains links to all of its reports, information & testimony*]
- <http://www.abanet.org/cpr/mdp/multicomshed399.html> [*Terry Appendices B1-B7, which are the last links on this page, are the charts that summarize all pre-report testimony to the ABA Commission*]
- Laurel S. Terry, *A Primer on MDPs*, **72 Temple Law Rev. 869 (1999)**
- Laurel S. Terry, *German MDPs: Lessons To Learn*, **84 Minnesota Law Rev. 1547 (2000)**