An MDP Primer

ABA Annual Meeting - Presidential Showcase

May It Please the Court…I am from Arthur Price & Deloitte: MDPs, Should Trial Lawyers Care?

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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
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)**

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
### Global Responses to MDPs

<table>
<thead>
<tr>
<th>Countries with a large MDP presence:</th>
<th>Bar &amp; regulatory responses:</th>
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<tbody>
<tr>
<td>Australia</td>
<td>CCBE</td>
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<tr>
<td>Brazil</td>
<td>International Bar Ass. (IBA)</td>
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<tr>
<td>England</td>
<td>Union Int’l de Avocats (UIA)</td>
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<tr>
<td>France</td>
<td>Australia</td>
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<tr>
<td>Germany</td>
<td>Canada</td>
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<tr>
<td>Netherlands</td>
<td>Dutch case before the ECJ</td>
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<tr>
<td>Spain</td>
<td>England</td>
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<tr>
<td></td>
<td>France</td>
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<td></td>
<td>U.S. (ABA held 3 hearings</td>
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<td>before issuing its 6/99 report)</td>
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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**
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

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?
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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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
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

May 2000: The ABA Asks Whether not How

• OVERVIEW:
  – 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
## The US Consensus & My Recommendation

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

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

1999 German Statistics:

- There were 97,791 lawyers (RA), of which:
  - 593 were also auditors /CPA (WP)
  - 517 were also sworn auditors (vBP)
  - 1,573 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
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)*

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
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

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
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.

To read more about it:

• [http://www.abanet.org/cpr/mdp/](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/multicom sched3 99.html](http://www.abanet.org/cpr/mdp/multicom sched3 99.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, *German MDPs: Lessons To Learn*, 84 *Minnesota Law Rev.* **1547** (2000)