

*Private Firm***State Ban on Nonlawyer Stake in Law Firms Meets Constitutional Standards, SDNY Says**

Jacoby & Meyers's constitutional challenges to New York laws and regulations that stop nonlawyers from obtaining equity stakes in law firms are "entirely without merit," the U.S. District Court for the Southern District of New York declared July 15 (*Jacoby & Meyers, LLP v. Presiding Justices*, 2015 BL 226485, S.D.N.Y., No. 11 Civ. 3387 (LAK), 7/15/15, on remand of 488 F. App'x 526, 28 Law. Man. Prof. Conduct 732).

In something of a coda to recent state bar resolutions opposing nonlawyer ownership of law firms, Judge Lewis Kaplan held that New York's legal barriers to nonlawyer equity investment in law firms don't violate firms' rights to free speech and freedom of association, the dormant commerce clause, substantive due process or equal protection.

"Whether or not J&M receives a financial boost from non-lawyer equity investors will have no constitutionally problematic impact on the public's right of access to courts."

JUDGE LEWIS A. KAPLAN

Kaplan's strongly worded 40-page decision ends a putative class action New York-based personal injury firm Jacoby & Meyers LLP started in 2011. The judge wholly rejected the firm's arguments, calling some "frivolous" and saying others "misstate[] the law," reflect "a fundamental misunderstanding" of constitutional doctrine or rest on a "woefully misguided premise."

However, the Second Circuit will likely have a say on the issue, as the firm says it's planning to appeal.

"While we are disappointed with the decision, we look forward to the Second Circuit's review of the District Court's ruling," Todd S. Garber, one of the lawyers representing Jacoby & Meyers in this litigation, told Bloomberg BNA via e-mail. He is a partner with Finkel-

stein, Blankinship, Frei-Pearson & Garber LLP in White Plains, N.Y.

The ruling follows other setbacks for proponents of measures to open up law firms to nonlawyer ownership, as has been done in England and Australia. See 31 Law. Man. Prof. Conduct 97.

In a key blow to proponents in 2012, the ABA Commission on Ethics 20/20 ditched the idea of recommending any changes to the ABA's existing policy against nonlawyer owners or investors in law firms. See 28 Law. Man. Prof. Conduct 250. The New York State Bar Association subsequently adopted a resolution reaffirming its opposition to nonlawyer ownership of law firms. See 28 Law. Man. Prof. Conduct 747.

At present only two U.S. jurisdictions—the District of Columbia and Washington state—allow firms to include nonlawyer owners under limited circumstances. See 31 Law. Man. Prof. Conduct 187.

'Very Well Reasoned.' The opinion is sure to gladden the hearts of those opposed to allowing nonlawyer investment in law practices.

"I am delighted with the decision. It's very well reasoned," John E. Thies of Webber & Thies P.C. in Urbana, Ill., said in an interview with Bloomberg BNA.

Thies was president of the Illinois State Bar Association in 2012 when the nation's largest voluntary bar reaffirmed its opposition to nonlawyer ownership during the ABA Ethics 20/20 Commission's consideration of the idea. He is also past president of the National Caucus of State Bar Associations.

Thies said that beyond assessing the challenge to New York Rule of Professional Conduct 5.4 and related statutes, the court articulated why the rule is important in the first place, starting with the significant state function of regulating those who are authorized to practice law. The opinion highlights the extremely important interest in maintaining and assuring the professional conduct of attorneys, he said.

Related to that, Thies said, the opinion recognizes the value of maintaining lawyers' independence of judgment and the importance of minimizing situations in which lawyers are motivated by economic incentives as opposed to their client's best interests.

Thies also said he appreciates Kaplan's effort to debunk the law firm's arguments that modifying or eliminating Rule 5.4 is necessary to reach underserved populations, obtain needed capital and improve competition. These are all points that have been made by those who want to weaken Rule 5.4, he said.

Context Makes Case Important. In comments he sent to Bloomberg BNA, University of Arizona law professor Ted Schneyer, who was on the Ethics 20/20 Commission, said Kaplan's opinion is likely to have an impact in the United States, given that virtually every U.S. jurisdiction has the same ban as New York on nonlawyer ownership.

On the other hand, Schneyer said, "similar bans that have long existed outside the U.S. have recently been abrogated in other common law countries, notably Australia and England and Wales, on the grounds that replacing the bans with rules that limit non-lawyer ownership will increase access to legal services and stimulate more innovation and competition in the legal services market."

Moreover, abrogation of the ban is now under serious consideration in Canada, and considerable scholarship favoring the change, both here and abroad, has recently appeared, he noted.

Try It. Schneyer said he viewed Jacoby & Meyers's constitutional challenges as long-shots from the outset, and "as a matter of constitutional law, I find very little to quibble with in Judge Kaplan's rejection of those challenges."

Yet Schneyer said he supports—at least as an experiment—suspending or abrogating the ban on non-lawyer equity investments in favor of rules that permit but regulate such investments.

Some points in the opinion "do not begin to justify the [nonlawyer ownership] ban as a matter of public policy."

PROFESSOR TED SCHNEYER
UNIVERSITY OF ARIZONA

Some points in Kaplan's opinion "do not begin to justify the ban as a matter of public policy," Schneyer said. For example, he said, the opinion states that New York's ban promotes the lawyers' independence by "preventing non-lawyers from controlling how lawyers practice law" and by "minimiz[ing] the number of situations in which lawyers will be motivated by economic incentives rather than by their client's best interests."

However, "economic incentives and the pursuit of client interests often go hand-in-hand," Schneyer stated. And as a policy matter, he said, "this point seems fatuous in view of all the other forces that give lawyers economic incentives that might clash with client interests but are now treated as entirely acceptable—e.g., influence on law practices by malpractice insurers, by banks that make substantial loans to law firms but with conditions attached, and by group legal services plans in which lawyers participate."

The opinion also asserts, Schneyer noted, that whether or not Jacoby & Meyers "receives a financial boost from non-lawyer equity investors will have no constitutionally problematic impact on the public's right of access to the courts."

But there may be a deleterious impact on access even if there isn't a "constitutionally problematic impact," and lack of access is arguably a more fundamental problem today than ever before, Schneyer said.

'Pretty Persuasive' but 'Wait and See.' "The opinion is pretty persuasive," and it comes from a highly respected judge, longtime New York lawyer and ethics expert Philip Schaeffer said in an interview with Bloomberg BNA.

But "we'll have to wait and see what the Second Circuit has to say," Schaeffer said, noting that the Second Circuit already disagreed with Kaplan on an earlier appeal in this case. Nevertheless, Schaeffer said, "I don't think the way to outside ownership of law firms is going to depend on judicial action in the form of lawsuits."

During the Ethics 20/20 Commission's work Schaeffer served as liaison to the commission from the ABA Standing Committee on Ethics and Professional Responsibility. He is deputy general counsel with White & Case, New York.

Schaeffer pointed out that back offices of law firms are increasingly being financed by nonlawyer institutions, which means that lawyers already have to satisfy lenders. In that regard, there's no difference between equity and debt, Schaeffer posited.

As a practical matter, he said, "one needs financing to be an active lawyer or law firm." The disapproval of having nonlawyer investors in law firms is outdated and ignores the financial reality of modern law practice, in his view.

Schaeffer also said he believes allowing equity investment in law firms is important for access to justice. Not having a sophisticated attitude about how lawyers have to finance their law offices results in many ordinary citizens not having access to lawyers and paves the way for entities such as LegalZoom to become successful as a substitute, he said.

State's Strong Interest. In its putative class action, Jacoby & Meyers challenged the constitutionality of New York Rule of Professional Conduct 5.4, which forbids lawyers to practice in a for-profit law firm if a nonlawyer owns any interest in the firm, along with other provisions of New York law that prevent lawyers from obtaining equity investments in their practices from non-lawyers.

The firm also challenged the constitutionality of a number of New York statutes that restrict ownership of entities engaged in law practice.

Kaplan previously threw out the suit, concluding for technical reasons that it was not justiciable. 27 Law. Man. Prof. Conduct 382. However, the Second Circuit revived the case and sent it back, saying that Jacoby &

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Meyers could amend its complaint so that the district court could reach the merits of the constitutional challenge. See 28 Law. Man. Prof. Conduct 143.

Kaplan noted that state laws regulating the conduct of lawyers are entitled to a strong presumption of constitutionality due to the important state obligation to regulate those who are authorized to practice law.

The state's strong interest in regulating lawyer conduct was a recurring theme in Kaplan's opinion. He cited it repeatedly in explaining his conclusion that the Constitution does not forbid state laws that preclude lawyers from accepting nonlawyer equity investors.

First Amendment Not Implicated. One by one Kaplan shot down J&M's constitutional arguments, which he characterized as a facial—not an as-applied—challenge.

On the First Amendment claims Kaplan concluded the disputed laws regulate nonexpressive commercial conduct and do not violate J&M's freedom of speech.

"To the extent that the contested provisions of New York law incidentally affect expression—if indeed they do at all—J&M's effort to cast itself and other law firms like it as victims of a heavy-handed, outmoded regulatory regime 'plainly overstates the expressive nature of their activity and the impact of the [New York laws] on it, while exaggerating the reach of [the Supreme Court's] First Amendment precedents,'" Kaplan said, quoting a Supreme Court case.

As for freedom of association, Kaplan said J&M's proposed professional alliance with nonlawyer equity investors would be nonexpressive commercial conduct outside the scope of the First Amendment.

And even if the proposed association were constitutionally protected, the laws in question would not violate the First Amendment, Kaplan said.

"In the last analysis, New York's 'especially great' interest in regulating lawyer conduct—an interest that is unrelated to the suppression of expression—justifies any incidental impact that application of these laws may have on J&M's associational freedoms," Kaplan said.

J&M cited cases recognizing the right to associate for purpose of access to courts, but Kaplan found them of little value in this context.

"Whether or not J&M receives a financial boost from non-lawyer equity investors will have no constitutionally problematic impact on the public's right of access to courts," he said.

If anything, he said, the challenged regulations protect the public by preventing nonlawyers from controlling how lawyers practice law and by attempting to minimize the number of situations in which lawyers will be motivated by economic incentives rather than by their client's best interests.

Dormant Commerce Clause Not Violated. Kaplan also concluded that the challenged laws and regulations don't offend the dormant commerce clause, which blocks states from enacting legislation to favor in-state economic activity while burdening outsiders.

The laws at issue here are not facially discriminatory, the judge said, because they do not give New York firms or lawyers special treatment but rather treat all commercial entities equally, without regard to in-state or out-of-state status.

Kaplan said the challenged regulations are even-handed laws that have only an incidental effect on in-

terstate commerce. They must be upheld, he said, because J&M's complaint does not allege facts that, if proved, would show that the burden on interstate commerce is clearly excessive relative to the benefits for New York.

These laws serve New York's "extremely important interest" in maintaining the professional conduct of attorneys, the judge reiterated.

Fourteenth Amendment Not Trampled. Kaplan gave short shrift to J&M's argument that New York's laws against nonlawyer equity investment in law firms abridge a fundamental right in violation of substantive due process. The challenged laws do not interfere with fundamental rights and are rationally related to a legitimate state interest, he said.

Kaplan also shot down J&M's claim that the laws violate equal protection by drawing an arbitrary distinction between lawyers, who are forbidden to accept nonlawyer equity stakes, and investment bankers, who are not subject to such constraints.

Whatever the similarities in their day-to-day work, Kaplan said, investment bankers do not play the same essential role as lawyers do in the administration of justice. The challenged laws preventing nonlawyers from investing in law practices are rationally related to New York's legitimate and "extremely important" interest in ensuring professional conduct by its licensed attorneys, he said.

Fate of Companion Suits. When Jacoby & Meyers filed its lawsuit challenging New York's Rule 5.4 in the Southern District of New York, it also lodged nearly identical complaints in federal district court in New Jersey and Connecticut, challenging those states' similar rules against nonlawyer owners. One case has been dismissed; the other is still pending but apparently on hold.

In the New Jersey case (*Jacoby & Meyers Law Offices LLP v. Justices of the N.J. Supreme Court*, D.N.J., No. 11-2866 (PGS)), the court denied the defendants' motion to dismiss in 2012, but stayed the case so that the New Jersey Supreme Court could consider the application of Rule 5.4. However, the case was voluntarily dismissed at the plaintiffs' request in July 2014.

In the Connecticut case (*Jacoby & Meyers Law Offices LLP v. Judges of the Conn. Superior Court*, D. Conn., No. 3:11-cv-00817 (RNC)), the defendants' motion to dismiss was argued March 19, 2012. The court has not yet issued a decision on the motion, presumably because it is awaiting Kaplan's decision in the New York suit.

Jacoby & Meyers was represented by Todd S. Garber, D. Greg Blankinship and Jeremiah Frei-Pearson of Finkelstein, Blankinship, Frei-Pearson & Garber LLP, White Plains, N.Y., along with David J. Meiselman of Meiselman, Packman, Nealon, Scialabba & Baker P.C., White Plains.

The defendants were represented by New York Attorney General Eric T. Schneiderman, Special Litigation Counsel Daniel A. Schulze and Assistant Attorney General Michael J. Siudzinski.

BY JOAN C. ROGERS

Full text at http://www.bloomberglaw.com/public/document/Jacoby_Meyers_v_Presiding_Justices_of_the_First_Dept_No_11_Civ_3.