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PAPER

Innovations in the Provision of Legal Services in the United States

An Overview for Policymakers

Neil Rickman, James M. Anderson

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Preface

This paper discusses the role of innovation in the legal services industry and the unique factors in the legal services industry that affect the production of innovation. The paper also discusses the further research and data infrastructure necessary to aid policymakers in understanding whether existing restrictions on the practice of the law should be altered. The research described here relates to the RAND Corporation's Law, Business, and Regulation division's research agenda on changes in the legal services industry and the way they may affect civil justice. This paper will be of interest to legal scholars and others concerned with the U.S. legal system, practitioners within that system, and policymakers interested in innovation, legal services, and regulation. The research was conducted within the Kauffman-RAND Institute for Entrepreneurship Public Policy.

The Kauffman-RAND Institute for Entrepreneurship Public Policy, which is housed within RAND Law, Business, and Regulation, is dedicated to assessing and improving legal and regulatory policymaking as it relates to small businesses and entrepreneurship in a wide range of settings, including corporate governance, employment law, consumer law, securities regulation, and business ethics. The institute's work is supported by a grant from the Ewing Marion Kauffman Foundation.

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Jim Dertouzos, Director
RAND Law, Business, and Regulation
1776 Main Street, P.O. Box 2138
Santa Monica, CA 90407-2138
310-393-0411 x7476
Email: James_Dertouzos@rand.org

Susan Gates, Director
Kauffman-RAND Institute for
Entrepreneurship Public Policy
1776 Main Street, P.O. Box 2138
Santa Monica, CA 90407-2138
310-393-0411 x7452
Email: Susan_Gates@rand.org

Contents

Preface iii
Figures and Tables vii
Summary ix
Acknowledgments xi

SECTION 1
Introduction 1

SECTION 2
The Existing Legal System in the United States 5
2.1 The Size of the Legal Services Industry 5
2.2 Employment in the U.S. Legal Services Industry 6
2.3 Summary 8

SECTION 3
A Framework for Analyzing Innovation in Legal Services 9
3.1 Characteristics of Legal Services 9
3.2 A Typology of Innovation in Legal Services 11
3.3 Socially Beneficial Innovation 12
3.4 Innovation and Access to the Legal System 14

SECTION 4
The Potential for Innovation in Legal Services: Examples and Research Questions 17
4.1 Unbundling and Outsourcing of Legal Services 17
4.2 Multidisciplinary Partnerships 19
4.3 Alternative Litigation Finance 21
4.4 Billing Arrangements 22
4.5 Information Technology 26
4.6 Regulation and Legal Service Innovation 29

SECTION 5
Conclusions 35

References 37

Figures and Tables

Figures

2.1. Gross Revenues of Legal Services Industry, 1998–2009 6

Tables

2.1. Population per Attorney in Selected Countries 7
2.2. Where Lawyers Are Employed in the United States, 2007 7

Summary

Over the past 20 years, globalization, consolidation, information technology, and litigation financing have begun to change the way that many legal services are provided in the United States. The innovations that have occurred have often been influenced by experiences elsewhere, as in the case of traditional prohibitions on litigation financing, for which the United Kingdom and Australia have led the way in relaxing rules. The same globalization and offshoring of information services that have occurred in accounting, product support, and medical transcription have begun to occur in legal services. Yet numerous restrictions on the provision of legal services—from traditional restrictions on litigation and firm financing to the requirement that a legal provider be a licensed attorney in a particular state—limit the kinds of innovation that are permissible.

In this paper, we present a framework for examining recent and ongoing innovations in legal services in the United States. Our goal is to provide a framework that can aid policymakers in understanding the likely effects of innovations and the role of policy in promoting or deterring innovation, and to provide criteria that policymakers might use to decide whether the advantages of an innovation justify loosening existing restrictions.

Having set out our framework, we then consider a number of recent or potential examples of innovation in legal services. These relate to the way that services may be supplied in the future (in particular to their unbundling and to offshore outsourcing), the onset of multidisciplinary partnerships (linking attorneys to other professional service providers), the potential for new methods of funding both litigation and classes of legal services (through new sources of capital), new pricing strategies, and potential roles for information technology (both to lower production costs and to enhance consumer information). In the process, we provide a series of research questions that we believe would help in understanding these factors as potentially beneficial sources of innovation in legal services. We then end by discussing the role of regulation in promoting or impeding innovation.

Acknowledgments

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SECTION 1

Introduction

The legal system plays a fundamental role in all of our lives. Though not every individual hires an attorney, we all live within the legal system's shadow to the extent that it defines what we can do in relation to others. Thus, when we purchase a product, our rights and obligations are defined by law, and the same is true when we buy a house, are hurt in a car accident, or are hired by an employer.[1] Businesses, of course, also rely on the law—for instance, to uphold the contractual relationships that underpin their production processes, supply chains, and retail activity.

As well as hinting at the variety of situations in which the law is important, these simple examples illustrate that the benefits generated by the legal system are enjoyed not only by those who actively use legal institutions, but by others, too: The law creates an external benefit for others. Legal action develops the common law and thereby clarifies the law; it also deters illegal and injurious activity. In addition, several studies of the value of "well functioning" legal systems have suggested that a country's overall economic performance is correlated with the quality of a country's legal institutions (e.g., Shleifer et al., 2004). The legal system may also, of course, have negative effects—for instance, if it results in unnecessary costs,[2] inefficiently costly precautionary activity (e.g., unnecessary warnings on consumer products or unnecessary medical testing), or insufficient precautionary care. In short, we all have an interest in the operation of the legal system because it affects us both directly and indirectly, whether or not we ever retain an attorney.

While some of the external benefits of a well-functioning legal system accrue to all citizens, others depend on one's ability to obtain legal services. The effect of a product liability lawsuit on reducing manufacturing defects, for example, depends on at least some consumers injured by a product being able to obtain legal representation. More generally, the benefits of law in organizing our rights and our responsibilities to one another may be lost if legal services are not available. It is therefore important to examine the way in which legal services are supplied and whether innovations in their provision could promote social welfare by expanding access to justice.

In the United States, suppliers of legal services include the private bar, lawyers in government employment, and those working for nonprofit organizations. In addition, there are

[1] Evidence suggests that the proportion of those who may have an actionable claim and who pursue the claim by filing a lawsuit is quite small (Hensler, 1991).

[2] While it does not attempt to measure unnecessary costs, Towers Perrin annually publishes a controversial calculation of the costs of the tort/insurance system (Towers Perrin, 2009). Critics note that it counts the administrative costs of insurers and effects on insurers' reserves as costs and does not attempt to measure any of the benefits of the tort system.

many organizations and individuals who work with the law, with lawyers, or as intermediaries. Broadly defined, these stakeholders make up the *legal services industry* (LSI). As such, they constitute the obvious sources of innovation within the LSI, whether through the creation of new products for demanders or the creation of new techniques for suppliers.[3]

Yet the LSI has historically been resistant and even threatened by innovation. Part of this is the economic self-interest one sees in any existing industry—the existing bar is not anxious to foster radical change that would create new competition. And certainly, some forms of innovation (e.g., access to free legal materials on the Internet) may displace conventional legal services and reduce LSI profit. But part of the resistance is cultural, which is perhaps not all that surprising given that the craft is dominated by adherence to precedence.

The resistance to some forms of innovation in legal service provision is related to lawyers' self-conception. Lawyers practice a literally storied profession that emphasizes the independence of the attorney and the status of the occupation as a profession rather than a business. The character of Atticus Finch in *To Kill a Mockingbird* (Lee, 1960) is just one of many hagiographic depictions of the traditional attorney that emphasizes wisdom and independence. Abraham Lincoln is also heroized as a practicing country lawyer who preserved the nation in part through his lawyerly skills of rhetoric and negotiation (Gopnik, 2009). Similarly, U.S. lawyers possess (or talk as if they possess) a shared mindset. They believe that they think in a distinctive legal way about the world, a way unlike that of those untutored in the law, whether the specific area of law is real estate, contracts, or criminal law. The oft-recited pedagogical goal of first-year classes in law schools is to try to teach law students "to think like lawyers."[4] This idea justifies the required general curriculum in law school. The precise content of this shared ideology is difficult to discern, but, if nothing else, it includes a belief that lawyers do in fact possess a particular way, distinct from the ways of other disciplines, of thinking. This cultural tradition includes skepticism of innovation in the provision of legal services or of anything that might challenge the norms of legal professionalism.

Some prominent lawyers are appalled and saddened by innovations in the provision of legal services and the changing role of the lawyer. In *The Lost Lawyer*, Anthony Kronman (a former dean of Yale Law School), lamented the decline of the lawyer-statesman ideal, whose actions were not governed primarily by the marketplace (Kronman, 1993). He attributed this change, in part, to the explosive growth and competitiveness among law firms that have altered the nature of much legal work. Instead of developing long-standing relationships with clients and their range of problems, the modern attorney is often an increasingly expert specialist. Similarly, the enormous growth of law firms has sometimes hindered any attachment of an attorney to a particular firm. While firm profits have increased, these changes have eroded stability and the ideal of the traditional lawyer-statesman, to the detriment of the entire profession.

This tradition still exerts a pull on the imaginations and aspirations of American lawyers. As we discuss in Subsection 4.6, the tradition has given rise to a unique professional culture

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[3] In this paper, we focus primarily on *process* innovations—new ways in which legal services are provided to users. This includes, for example, 1) providing the same amount of service at less cost, 2) providing wider access to legal information, and 3) generating more useful information for decisionmaking, such as developing early case assessment methods in litigation. This is in contrast to *product* innovations, such as the development of the poison pill by Martin Lipton of Wachtell, Lipton, Rosen, and Katz. At times, the boundary between these two is somewhat porous. For example, if alternative billing arrangements result in more-efficient dispute resolution, a process innovation might be closely linked to a product innovation.

[4] See Gantt, 2007, p. 413, for discussion of the origin and murky meaning of the phrase "thinking like a lawyer."

and to the self-regulation of attorneys and the tradition's code of professional responsibility, as well as to restrictions on the ownership of law firms. This tradition has justified opposition to any perceived threat to the attorney's independence; it has also justified a variety of restrictions on who can practice law and how they can do so. Indeed, in other industries, similar restrictions might be considered anticompetitive and illegal. As we discuss below, for good and ill, these restrictions, rooted in this tradition, constitute substantial impediments to innovation.

This cultural resistance to innovation is reinforced by the historical industrial organization of legal services, which has probably slowed the development of innovations compared with other industries. Often the full return in investments in legal services innovation is not provided to the investors. A partner in a law firm may bear the full cost of a current investment in information technology (IT) while the benefits go not only to that partner, but also to all his/her future partners. Similarly, lawyers working on a contingent fee basis will generally directly receive only one-third of the benefit of innovations that increase settlement amounts. Innovations that reduce the number of billable hours necessary to perform a particular piece of legal work may *reduce* firm revenue, at least in the short run. Many legal services are also related to various governments, entities that have their own non-market sets of incentives that may act to discourage innovations.

Yet despite this tradition of the law as a distinct profession with its own norms, industrial organization, and way of thinking, and the concomitant resistance to radical innovation, the practice of law is a business. And the increasingly efficient production of whatever product the business sells requires innovation. In most industries, innovation is central to survival (Lafley and Charan, 2008). Successful law firms have used IT to increase their attorneys' productivity and capacities and have dramatically increased in size, permitting additional specialization. Back-office functions have been moved to reduce overhead costs. Such trends are acknowledged in both the trade press and scholarly output; for instance, such authors as Richard Suskind have written widely on innovation within legal services, and the *Financial Times* has published four annual *Innovative Lawyers* magazines that, among other things, rank law firms for their innovative activity.[5]

Further innovations appear likely. The American Bar Association's (ABA's) Ethics 20/20 Commission is reconsidering the basic ethical structures governing the profession in light of technology and increasing globalization (Podgers, 2010). Among other changes, the commission is charged with revisiting the long-standing disapproval of multidisciplinary partnerships. Presently, Rule 5.4 of the Model Rules of Professional Conduct (American Bar Association, 2010) prohibits partnerships or fee sharing with nonlawyers.[6] In England and Australia, two nations with common-law traditions similar to those of the United States, historic restrictions on the ownership structure of law firms have been relaxed, leading to publicly owned law firms and paving the way for multidisciplinary partnerships. As we discuss below, these changes have implications for the industrial organization of the provision of legal services.

Given the reluctance of the profession itself to embrace change (which is partly attributable to culture, partly to self-interest), how should policymakers generally view innovation in

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[5] It is instructive to note that these have tended to focus on similar topics, perhaps suggesting areas that lawyers believe are fertile for innovation. They include approaches to dispute resolution, billing, client service, and managing resources within the law firm.

[6] The Model Rules of Professional Conduct are created by the ABA. While they are not binding on the states, every state but California models its rules of professional responsibility on them.

the provision of legal services? Should innovation be encouraged as a route to better services at lower prices, thereby expanding access to justice, or discouraged as undermining the unique role of attorneys in mitigating the conflicts of our diverse, energetic, and contentious society? What are the likely effects of specific legal innovations? Are there policies or principles that could be recognized to guide innovation in the provision of legal services and the rules that govern them? While these are difficult issues, our goal is to describe a research agenda that can ultimately aid policymakers in addressing them.

Arguably, the stakes are high. Not only is the provision of legal services a multibillion-dollar industry, but innovations in the provision of legal services can shape the very law itself. The content and existence of binding legal opinions are shaped by the cases that are presented—and not presented—for litigation to courts (Priest and Klein, 1984). If an innovation in legal services permits a different category of plaintiffs to bring claims or a different type of claim to be brought, the law itself may change. Similarly, Hadfield (2008) has speculated that entirely new forms of private conflict resolution mechanisms may develop once legal services are freed from their traditional restrictions and monopoly by lawyers. On the other hand, leaders of the American bar point to the unique independent role of the attorney in U.S. society and the independent generalist judiciary as the envy of the world, and therefore are understandably reluctant to accept innovation that might unsettle this role.

To begin addressing these questions, we first sketch the size of the existing LSI in the United States. This can be measured in a number of ways; we chose to look at the economic impact in terms of revenue-profit generation and employment, and (despite some familiar data problems) at the scope and scale of the types of issues with which the U.S. legal system deals.

Next, we set out a basic framework for researching innovation within the LSI. First, we categorize a number of legal services in terms of key characteristics in order to indicate the variety of ways in which they can differ and the scope for innovation that may exist. We then suggest a simple framework for evaluating innovation that compares the costs and benefits of these innovations to consumers and producers of legal services.

In the remainder of the paper, we then employ our framework to examine several areas of potential innovation in legal services as case studies. In each case, we set out a number of questions that could form the basis of a research agenda going forward. The areas we chose are multidisciplinary practices, barriers to entry in the LSI, outsourcing of services, billing, and the use of IT to provide information to potential users of legal services. Our goal was to frame the issues in order to establish a basic research agenda for future work that could inform policymakers and regulators in promoting effective innovation. We are conscious that our work is not exhaustive, but we believe that our research framework is general enough to accommodate other ideas in the future.

We focused principally on legal services in the United States. However, we do discuss examples of innovation elsewhere to anticipate innovations that might occur in the United States and to learn from other countries' experiences with innovations in legal services.

SECTION 2

The Existing Legal System in the United States

2.1 The Size of the Legal Services Industry

One way to understand the importance of legal services in the United States is simply to measure it as we might any other industry— in terms of the revenues it generates. While the practice of law takes place in a variety of forms and venues, the one that is most conducive to measurement in terms of revenues is lawyers in private practice. The U.S. Department of Commerce's Bureau of Economic Analysis estimates that in 2009, the LSI generated $281,687,000,000 in output (see Figure 2.1). This is substantially larger than accounting ($151,352,000,000) and management consulting ($158,904,000,000) (Bureau of Economic Analysis, undated-a).

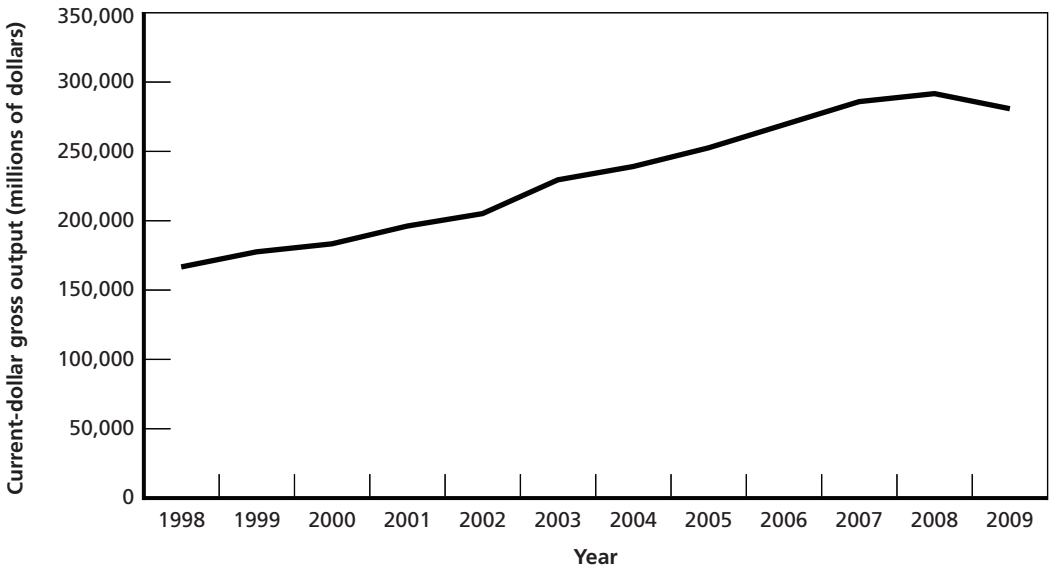
To the extent that private practice excludes many of the other circumstances in which law is practiced in the United States, this figure of almost $3 billion is a clear underestimate of the LSI's contribution to economic activity.

Of course, gross revenues are not the same as profits—maybe law firms have very high costs. This is an important point in itself, but is especially so when considering innovation, because profits (rather than revenues) are conventionally a major source of funding for investment and innovation. In fact, the U.S. Census Bureau estimates that law firms earned gross *profits* of $51 billion in 2003, which is a profit rate of 40 percent compared with revenues. Again, this outperforms many other professional services: profits of $13 billion (32 percent profit rate) for certified public accountants and $9 billion (12 percent profit rate) for management consultants (U.S. Census Bureau, 2005, pp. 82, 88).[1]

The legal industry is a net contributor to the U.S.'s balance of trade (later in the paper, we discuss trends in the globalization of law). The Bureau of Economic Analysis estimates that U.S. law firms produced $5 billion of invisible exports in 2006, while invisible imports of legal services were $1 billion, yielding a positive net contribution of $4 billion to the U.S. balance of trade (Bureau of Economic Analysis, undated-b).

[1] These figures are not calculated in line with usual accounting standards and, as such, are not directly comparable with other public companies' performance. Application of Generally Accepted Accounting Principles would reduce the profits reported here, lowering relative performance against public companies but not against the other professional services we have reported.

Figure 2.1
Gross Revenues of Legal Services Industry, 1998–2009



SOURCE: Bureau of Economic Analysis, undated-a.
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2.2 Employment in the U.S. Legal Services Industry

A different way to gauge the significance of legal services in the United States is to look at the numbers employed in the industry. The number of lawyers practicing in the United States in 2007 has been estimated to be between 760,000 and 1,100,000 (the first figure is from the U.S. Department of Labor's Bureau of Labor Statistics [BLS]; the second is from the ABA) (Harvard Law School Program on the Legal Profession, undated).[2] The BLS data suggest roughly one lawyer per 300 people and one lawyer per 140 employed people in the United States. Table 2.1 provides comparable figures for other nations.

How does this break down across the various sectors that employ lawyers? Private lawyers are employed by some 180,000 law offices across the United States, though, as one would expect, the distribution of employment is skewed toward larger firms.

Table 2.2 shows the skewed distribution of employment toward larger firms (in the American Lawyer top 50 and the National Law Journal 250. Some 250 firms (out of approximately

[2] The Harvard Law School Program on the Legal Profession suggests that the difference stems from the BLS counting only lawyers earning an income from legal practice, and the ABA adopting a wider measure based on the Martindale-Hubbell International Law Directory. There is some evidence of higher *total* employment in the LSI: High Beam's market report on legal services quotes a BLS estimate of 1,043,680 "jobs" in the LSI in 2001, with 496,710 relating to occupations "specifically legal in nature." (High Beam Business, undated).

Table 2.1
Population per Attorney in Selected Countries

Nation	Number of Attorneys[a]	Population (in millions)[b]	Population per Attorney
U.S.	760,000–1,100,000	315	414–286
UK	155,323	62	399
Sweden	4,503	9	1,999
The Netherlands	14,882	17	1,142
France	47,765	62	1,298
Germany	146,910	82	558

[a] Figures for European Union nations are from the Council of Bars and Law Societies of Europe, 2008.

[b] Population figures are from the United Nations Department of Economic and Social Affairs Population Division, 2009.

180,000) account for 15 percent of lawyers.[3] Working down the table, the split of government lawyers is roughly equal between federal, state, and local government. Lawyers in business include in-house counsel (i.e., those employed in commercial firms other than private law practices), with insurance being the most heavily populated (11,000), as might be expected given that many legal matters involve insurance claims. Investment banks, manufacturing, and commercial banks each employ about 4,000 lawyers. As with private practice, the spread of in-house counsel is uneven: The top 200 corporate law departments in U.S. companies employed around 27,700 lawyers in 2006, with both Citigroup and GE employing over 1,000 each (Harvard Law School Program on the Legal Profession, undated). The numbers in education include over 10,000 law teachers reported by the American Association of Law Schools (undated), while those for public interest organizations include lawyers involved in charities, social assistance organizations, etc.

Although it is reasonable to use employed lawyers as a measure of the human capital available to supply legal services in the United States, it results in an underestimate, both because many law school graduates do not practice as attorneys and because many nonlawyers could provide legal services. For example, a number of U.S. law schools require their students

Table 2.2
Where Lawyers Are Employed in the United States, 2007

Employment	Number	Percentage
American Lawyer top 50	43,000	6.0
Remaining National Law Journal top 250	70,000	9.0
Other law firms (2+ lawyers)	182,000	24.0
Sole practitioners	271,000	35.0
Government	120,000	16.0
Business	65,000	8.0
Education	13,000	2.0
Interest groups	3,300	0.4
Public interest organizations	2,400	0.3

SOURCE: Data are extracted from Harvard Law School Program on the Legal Profession, undated. Figures are approximate and percentages involve rounding.

[3] This skewed distribution reflects the position across U.S. employment more generally, with about half of workers employed in companies with over 500 employees (and a majority of these in companies with over 2,500).

to undertake pro bono work, and wider organizations (such as the media, bloggers, and online advice services) all offer legally oriented employment (and services).[4] In addition, many who receive law degrees do not choose to work as lawyers (see Bikson et al., 2003).

The picture that emerges from these data is of the LSI as economically powerful, playing an important role in economic activity and employment at home and abroad, in private practice, in commercial organizations, and elsewhere. In some sectors, such factors as self-employment, high profits, and global competition may be regarded as strong drivers of innovation. Later, we discuss whether this is true of the U.S. LSI, along with some of the consequences.

2.3 Summary

This section has reviewed the size of legal services in the U.S. economy. Whether measured by employment or revenue and profits, the industry is large compared with many other professional service sectors. In terms of its impact on individual lives, the snapshot provided above indicates that the law is a potentially wide-ranging component of U.S. life, in terms of both the breadth of circumstances it can affect (and shape) and the number of times it appears to be called upon to do this.

For these reasons, the LSI's efficiency and effectiveness are important to national economic well-being. In theory, innovation in the provision of legal services can play a vital role in improving their delivery. Yet the variety and complexities illustrated above can make it difficult to analyze the circumstances in which successful innovation can take place. Thus, we now set out a framework for thinking about the possible sources and impacts of, and possible impediments to, innovation within legal services.

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[4] As examples of pro bono work among law students, Columbia Law School first required its students to undertake 40 hours of pro bono work over two years in 1996, and New York University's students have pledged 95 hours of such work over their three years.

SECTION 3

A Framework for Analyzing Innovation in Legal Services

We have shown that legal services come in all shapes and sizes. This can make it difficult to devise policy toward them: Should one size fit all, or are there issues pertinent to some more than others? In particular, what types of legal services might be prone to what kinds of innovation? And what should policymakers look out for when seeking to evaluate such activity? We begin by offering a brief list of the characteristics that describe legal services. These are useful in identifying the types of innovation that may take place within the legal system, which we then discuss before introducing a framework for evaluating socially beneficial innovation. They are also useful in understanding the types of innovation observed, in so far as they allow one to see how particular influences appear to be present in what, at first glance, may seem to be quite different settings.

3.1 Characteristics of Legal Services

Here, we identify several key characteristics of legal services that are likely to influence modes of demand and delivery in different settings—hiring lawyers, developing in-house counsel, investment in search costs, international competition, etc. In turn, these characteristics may influence the opportunities for, and evaluations of, innovation.[1]

- *Complexity and rules*: Most legal services involve the interpretation and application of rules. But particular areas of the law can vary widely in complexity and this, in turn, can affect the opportunities for innovation. So, for example, the more complex the rules in a particular area of law, the more specialized the knowledge likely to be required to provide competent legal advice. In contrast, the analysis and application of less-complex areas of the law will involve more application of "codified knowledge" and can be performed by less-experienced providers.[2]
- *Information asymmetry*: When complex services are involved, it may be difficult to judge their quality in advance. This means that it is difficult to know in advance what may be required or, once the service has been delivered, whether it was of satisfactory quality. In the language of economists, most legal services are "experience" goods (i.e., goods whose quality can only be confirmed after use) or "credence" goods (i.e., goods whose quality

[1] Lancaster (1966) first presented the idea that products varied according to the characteristics they possessed. In the current setting, our point is that different legal services can be seen as a particular collection of characteristics, such as those we list (e.g., some are more complex than others but involve fewer repeat purchasers).

[2] We are indebted to Milton Regan for sharing this observation.

may still be unclear after use). In such settings, word-of-mouth recommendations may assist demanders when making their decisions about what, and from whom, to purchase, and suppliers may seek to invest in reputations for desirable elements of service provision (such as speed or overall quality). The less information asymmetry there is, the easier it will be for clients to devise metrics to measure the quality of the legal services and the greater the possibility of fee arrangements that more closely align the quality of the legal services with payment.

- *Risk*: Some legal cases involve considerable risk, risk that the lawyer, as well as the client, may face. A well-functioning market could create arrangements that transferred these risks to those most willing to bear them (perhaps through the fees charged by the lawyer).[3]
- *Repeat purchase*: Some of the above issues are alleviated when the buyer is a repeat purchaser (as might be the case for an automobile insurer). In such circumstances, the buyer will be familiar with what is required and, indeed, may have a long-term relationship with the supplier (or may integrate with a supplier to form an in-house team). Clients with recurring risks of a particular type will be in a better position to estimate the aggregate likelihood of those risks.
- *Jurisdiction*: Some legal services involve the interpretation and application of rules from other jurisdictions, perhaps from abroad or from other U.S. states. This requires additional expertise and may encourage specialization by certain suppliers. It means that the competitive pressures faced by some firms must be gauged in the context of the international (or intranational) market, not their local position. Other legal services involve highly localized expertise. The degree to which the production of legal services depends on local expertise or knowledge may affect the geographic size of the competitive market. For example, if clients perceive that local relationships between, say, lawyers and courts matter, this will limit the geographic extent of their search for suitable lawyers.
- *Commercial or noncommercial*: Some legal services involve businesses ("commercial"), and others involve individuals ("noncommercial"). These services may relate to a number of the dimensions listed above—e.g., commercial firms may be repeat players, international, or better suited to risk bearing than are individuals.
- *Government involvement*: Some cases involve the government, either as the party seeking to enforce legal rights or as the party defending itself against others seeking to do so. Thus, government agencies may, for example, pursue unpaid tax liabilities, defend requests for possible overpayments, or sue contractors (or be sued by them) for breach of contract.[4]
- *Inputs*: Some legal services may require the aggregation of a relatively discrete body of legal information and its application to a discrete body of facts. Other legal services might require much broader sets of inputs, in terms of either the legal knowledge required or the extent of facts that must be organized. The size and nature of inputs required for the legal services affect the kinds of innovations that are possible.
- *Collaboration*: Some legal services are conducted with more or less required collaboration with the client or even other legal services providers. The extent to which the provided

[3] The risks involved in legal cases are sometimes highlighted by insurance companies when seeking to sell legal expenses insurance. For example, Sonoma Insurance recently sought to encourage demand with the phrase "because even good cases don't always win at trial."

[4] Of course, the government is also a party in criminal prosecutions.

legal services can be aided by collaboration shapes the kinds of innovations that are possible and most productive.

3.2 A Typology of Innovation in Legal Services

Economists view innovation as a process with several stages (Stoneman, 2002), the first of which (where ideas are formed and prototypes developed) is typically referred to as the invention stage. Next is the adoption stage, where the innovation is taken up by a select group, or "champions," before it is eventually diffused (if successful) across the sector in question.[5] We might then consider a number of sources of such innovation and the unique obstacles to this model in the legal setting.

To begin, at a broad level, we can distinguish between product and process innovation:

- *Product innovation*: This relates to the production and delivery of new (or improved) legal services by suppliers. For this to be successful, it must be possible to identify potential demanders who will buy the new service at a price that covers its costs of development and production.
- *Process innovation*: This relates to the way in which legal services are produced and the incentives that suppliers have to seek more efficient ways to achieve this. An example of such innovation in legal services is the use of IT by providers of legal services to increase productivity.

Both of these can be accomplished by introducing specific products or processes within a particular law firm. They can also be achieved by reorganizing the firm (or several firms), which might bring together a new set of skills in order to offer a new service or to capitalize on economies of scale and/or scope to lower costs. Thus, beneath the broad notions of product and process innovation, we have

- *Organizational innovation*: A form of innovation that involves existing legal service providers seeking efficiencies and opportunities to deliver new services through reorganization. Examples observed recently include mergers of law firms (including multinational ones) and offshore outsourcing of some legal practices. Looking to the future, plans for multidisciplinary law firms constitute another potential example.
- *Entry innovation*: Organizational innovation may take place at the level of the existing firm but may also result in new entry—of existing firms into new areas or of new firms created "from scratch" (i.e., not from reorganization of an existing firm or firms). Innovation may provide opportunities for this, via the supply of new products or the use of new delivery methods. New entry may also involve the emergence of nonlaw firms that provide legal services, such as the intermediaries described in Subsection 4.5.

[5] For convenience, we assumed that we need not distinguish between these stages, an assumption that future research should examine.

While the preceding examples of innovation are common to many industries (and examples can be found in the LSI), we can find several that are more closely related to some of the service characteristics we set out earlier.[6]

- *Price innovation*: Price is an important means by which suppliers of any good/service compete. As we have seen, however, the nature of the product on offer can be difficult to assess in the service sector. In turn, this can make price an awkward signal for potential clients to read—an attractive price for a high-quality legal service may be an unacceptable one for a low-quality alternative. Thus, innovative practitioners may seek to gain a market advantage by altering the nature of their billing—i.e., by finding ways to price their services that give clients some potential reassurance on quality (e.g., they might cap the price as a commitment to supplying an efficient service, or they might agree to charging higher prices only if pre-established performance criteria are met. In addition, the riskiness of many legal services creates another task for prices to perform: the allocation of risk between lawyer and client. Once again, innovative suppliers may find ways to redistribute risk that are attractive to clients (and to themselves) given their respective appetites for risk.[7]
- *Informational innovation*: Any market with information asymmetries raises the potential for existing suppliers to seek to overcome such problems (e.g., by establishing a reputation) or for intermediaries to enter and help transfer information from sellers to buyers (perhaps through collaboration with existing suppliers). This may be simple locational or price information, more-detailed quality and performance information, or advice on the service that is required. Developments in IT make this a natural opportunity for innovation in legal services.
- *Regulation-induced innovation*: In most industries, much innovation takes place in a decentralized fashion, with individual suppliers seeking to gain competitive advantage by offering innovative products, services, or modes of delivery. Yet the wider legal context in which this happens may also exhibit innovation. Thus, a particular state might experiment with permitting a particularly attractive form of legal organization in an effort to attract legal services providers from its neighbors. More ambitiously, it might hope to develop a dispute resolution regime more congenial to economic activity and thereby improve the welfare of its citizens. It is helpful, therefore, to distinguish this from other (more decentralized) innovation processes, because it is the direct result of policymakers' interventions and may affect the whole legal system.

3.3 Socially Beneficial Innovation

Any innovation must generate benefits to suppliers of legal services (profits) or to those who use them (consumer surplus) or it will quickly wither, since there will be no incentive to supply or consume the new service or employ the new technique. Innovation itself is costly (there are design and implementation costs, possible reorganization costs, etc.). These benefits and costs are *private*, but there may also be *external* benefits and costs that are derived or borne, respec-

6 This is not to suggest that other services and products do not exhibit elements of these.

7 In Subsection 4.4, we discuss how alternative billing arrangements often attempt to perform precisely these tasks.

tively, by others not directly producing or using the innovation. For example, we have seen that some legal services are adversarial, so an innovation that encourages their use will generate costs and benefits for the third party involved. We have also seen that people who are not using the legal system may enjoy the general benefits (deterrence of wrongdoing, clarification of rights and duties) because of its use by others. The costs and benefits (private and external) will be incurred over the lifetime of the innovation. The following are some of the criteria that policymakers can use to evaluate different kinds of innovations:

- *Internalized services*: If the innovation produces no (or, perhaps more realistically, very limited) external costs and benefits, the private market for legal services will be sufficient for examining whether the innovation is socially beneficial. This may be the case for niche legal services used by relatively few individuals.
- *Partial innovation*: If the innovation takes place in specific parts of the legal system, with no appreciable spillovers, socially beneficial innovation can be evaluated with reference to those parts alone. This may be the case for innovations in specific areas—say, the practice of medical malpractice law, where services are often specialized (so the effects of innovations may be restricted largely to the particular service in question).
- *Systemwide innovation*: If the whole legal system is affected by an innovation, one must account for all the potential private and external costs and benefits of the innovation, including its direct and indirect effects, in order to determine whether it is socially beneficial. This may be the case for a change to the structure or practice within the court services or to professional licensing for lawyers.[8]
- *Winners and losers*: Not everyone will gain from an innovation. The buyers of one service may gain while the buyers of another lose, private benefits may increase while external benefits decline, and firms may gain while consumers lose. This does not necessarily mean that the innovation is undesirable.[9]
- *Relative costs and benefits*: In principle, an innovation that generates, say, small changes in benefits can still be socially beneficial if it also generates small changes in costs. In some situations (for example, if policymakers are themselves leading the innovation and face an overall budget constraint), it may not be possible to implement all socially beneficial innovations. In this case, it may be reasonable to rank innovations according to the largest change in net social benefit that they produce—i.e., innovation X may be preferred to innovation Y if X produces more social benefits.
- *Time lags*: If an innovation is likely to take place over a long time or to last for a long time, the costs and benefits over the whole of that time period should be estimated.

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[8] To the extent that they are the result of regulatory reforms, these may be regarded as regulatory innovations. We argue below (in Subsection 4.2, for example) that these innovations may encourage innovations by legal service providers, perhaps in specific areas. Thus, in the language of the current section, systemwide innovation may stimulate partial innovation.

[9] Under some decision criteria (e.g., Pareto), only innovations that make someone better off and no one worse off should be accepted. Other criteria (e.g., Kaldor-Hicks) would permit change if those who are made better off by the change gain more than is lost by those who are made worse off by the change.

3.4 Innovation and Access to the Legal System

An important component when evaluating innovation is the change in consumer surplus that it generates. A problem with estimating consumer surplus is that it is derived from the demand for legal services, something about which little is known. For instance, little is known about how responsive the demand for many legal services is to their price, or about the range of factors that prevent would-be users of the legal system from using it. In terms of the characteristics of legal services set out in Subsection 3.1, we might expect these factors to be influenced by the complexity of the legal service required, the riskiness of any potential case outcome, the existence of asymmetric information between lawyer and client, a potential consumer not being a repeat player, etc.

In principle, innovation might be expected to increase access to the legal system through, say, helping to lower prices or generating new methods of service provision that attract new users. There are many concrete examples to illustrate this, but we have chosen to provide just one. The introduction of new ways to bill clients (which we discuss below) may encourage new users of legal services through effects on price and on the client's ability to offload risk to an attorney. Without information on the *potential* demand for legal services, however, it is difficult to measure the possible effects these innovations may have.

Of course, once we take the broader perspective (see Subsection 3.3), expanded legal services may not be socially desirable, because external costs (and benefits) may also arise. It is not clear that it is socially beneficial for every viable legal claim to be litigated. Nor is it clear that the current regime, which generally conditions access to the formal legal system on either existing wealth or a claim of a particular value and type, is socially optimal either. Clearly, however, it is important for regulators (and suppliers) to understand the extent of the *potential* demand in order to gauge the potential for innovations that reduce the costs of legal services or increase their variety and to evaluate their importance and the social welfare gain (or loss) they might bring.[10]

Thus, we can pose our first research questions:

1. ***What is the size of the potential U.S. market for legal services?***
2. ***To what extent are there legal needs that the existing LSI is currently failing to satisfy?***
3. ***How do these vary by type of problem, gender, age, and socioeconomic status?***[11]

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[10] For example, the introduction of new ways to bill clients may encourage new users of legal services, perhaps because services are cheaper or because they share risk better. Proponents would laud this as offering more people access to the legal system; detractors would criticize the potential for excessive levels of, say, litigation and the unfairness and costly investments in over-deterrence it may cause. Ideally, it would be possible to measure whether current access to the legal system is "too high" or "too low." However, in the absence of such abstract knowledge, it is helpful to understand just how large the potential problem of "hidden demand" actually is.

[11] By definition, the type of demand we are considering is not observable, so uncovering it requires an approach that seeks to find out when people and businesses think they may have had need for legal services but chose not to follow through. It is also important to understand the reasons for this non-action and whether its extent varies across the dimensions of legal services, as described above. Thus, we favor approaching this issue via survey work, possibly on the back of omnibus survey instruments with filter questions asking whether interviewees have experienced potential "justiciable" problems and, if so, how they dealt with them, and why they did nothing (if that was the case). The Legal Services Commission in England and Wales has been running a bespoke survey of this type for several years, thereby building up a view of trends (Legal Services Research Centre, undated). Arguably, however, a larger survey would uncover a sufficiently large number of justiciable problems and be able to drill down with more statistical significance.

4. ***How price sensitive are potential demanders of legal services—i.e., what is the price-elasticity of demand for legal services?***

SECTION 4

The Potential for Innovation in Legal Services: Examples and Research Questions

We now turn to a number of areas in which innovation can be observed or might be expected in the (reasonably near) future. Since it is not feasible to cover all possibilities, we restrict our treatment here to a small number of examples that illustrate the sorts of considerations set out in Section 3. Thus, for example, the areas of innovation that we consider cover different sets of the characteristics described in Subsection 3.1, with different degrees of innovation sometimes being observed in, say, corporate or complex consumer-orientated activities. The areas also span potential systemwide innovation (e.g., change to such legal rules as champerty), instances of partial innovation, and, indeed, some cases where the former may promote the latter (thus, liberalizing champerty rules may encourage funding for certain types of cases). Moreover, the examples have received considerable attention in the trade press, so they are likely to have reasonably wide resonance with numerous LSI stakeholders.

Additionally, because little is known about the effects of recent or impending innovation, we sketch some reasonably high-level research questions whose answers might provide a better understanding of the conditions for successful innovation in legal services. The areas we cover are

- unbundling and outsourcing of legal services
- multidisciplinary partnerships
- alternative litigation finance
- billing arrangements
- use of IT.

We then end the section by discussing how regulation can influence the level of innovation. Again, we observe that this possible systemwide reform could stimulate partial innovations, such as the promotion of attorney information websites.

4.1 Unbundling and Outsourcing of Legal Services

Some have argued that the cost of legal services is too high and that many clients do not wish to pay for the customized (or bespoke) service that lawyers have traditionally offered. Instead, they suggest that innovative firms will seek to unbundle their products (see Suskind, 2008, and Hadfield, 2008)—i.e., to divide them into component parts and offer each in the most efficient way. Thus, rather than legal services consisting of the undivided time of a single lawyer who

provides the full panoply of protections involved in the lawyer-client relationship and seeks to offer customized solutions to a specific client, they will be subdivided, with some elements perhaps being produced simultaneously for more than one client in order to reap economies of scale. These unbundled services will also be marketed in a more decentralized way and sold in ways similar to such services as tax preparation or document processing.

Some services will be more amenable to unbundling than others—i.e., the types of services involved may depend on the characteristics of the services in question, so the framework in Section 3 may help in identifying candidate areas for such innovation. For example, while clients may be keen to receive lower-cost services, they may be skeptical about the perceived additional uncertainty, risk, and information asymmetry that could be created by more than one lawyer being involved. In turn, this could mean that a single point of client contact (and hence a single point of contact with the overall product being delivered) may be required. In other settings (perhaps repeat-player commercial firms with experienced in-house teams to keep overall watch over the work being done), unbundling may be an attractive opportunity. Similarly, it seems plausible that it would be easier to unbundle relatively routine services. In contrast, work that involves numerous complex links or personal issues (e.g., a delicate divorce case) might require more conventional, bundled services.

A number of these issues are evident in a particular example of unbundling: the case of legal process outsourcing (LPO), a practice that is becoming increasingly prevalent (among commercial law firms and large corporations).[1] Here, the work on a case is unbundled, and the more-routinized components (such as document review work) are sent to companies specializing in handling these components at lower costs (driven largely by lower local labor costs) (Timmons, 2010). India has seen significant expansion as a home of LPO providers and now houses three of the world's largest suppliers of these services: Integreon, Pangea3, and CPA Global. The industry was recently forecast to grow to $4 billion of legal work by 2015, and the major participants have plans for significant expansion over the next two years. Such blue chip law firms and companies as Clifford Chance, Allen & Overy, Microsoft, Canon, and Rio Tinto all have contracts with LPO firms.[2] More recently, LPO firms have been conducting less-routinized work, including legal research. Microsoft recently announced an agreement with CPA Global to outsource legal support work, including legal research, to India (Aldridge, 2010).

Our framework (see Section 3) is helpful when trying to better understand the foregoing developments and in thinking about the future. While it is perhaps intuitive that routine tasks can easily be outsourced, this may initially be less true with more case-specific tasks (such as legal research). As we discuss below (in Subsection 4.5), the onset of IT and search engines removed locational impediments to outsourcing research services, while the content of such research itself (or at least its implications) can be reported back to the client by the contact attorney. At the same time, the evaluation framework suggested in Subsection 3.3 teaches us to be mindful of the costs as well as the benefits associated with innovation. For instance, policymakers may have to give careful consideration to issues of client confidentiality if highly sensi-

[1] Of course, to the extent that the law firm retains the LPO in a way that is invisible to the client, this process need not affect the attorney-client relationship. In that sense, the unbundling in question is akin to arrangements that maintain a single point of contact for the client, as just mentioned.

[2] Dean (2010) reports that many law firms do not disclose their links with LPO firms. Perhaps mischievously, he wonders whether they "don't want their clients to know that they are trying to save money when serving them with their next bill."

tive information is being disseminated to other entities, particularly if this is occurring without the client's express knowledge and permission. Similarly, potentially difficult issues may arise with respect to waiving legal privileges.[3]

Unbundling and LPO raise a number of interesting questions from the perspective of innovation within the LSI, some of which are as follows:

1. ***What is the extent of "routine activity" in legal services that may be amenable to unbundling and/or outsourcing? Can this amount reasonably be quantified (perhaps for specific areas of law)?***
2. ***What reductions in the cost of the supply of legal services are attributable to LPO firms, and what quality of work is achieved? What governs the terms of the contracts between clients and LPO firms?***
3. ***What is the limit (in terms of service characteristics) on the extent of this outsourcing, and could it ultimately involve mergers between LPO firms and law firms? To what extent can LPO providers be organized to benefit firms that represent individuals as well as commercial clients?***
4. ***What controls are placed on LPO providers, especially those who may find themselves working for both sides of a case?***[4] ***Also, how do (or how should) LPO providers overcome the entry barriers discussed in Subsection 4.2?***
5. ***If a law firm contracts with an LPO provider that is venture capital funded, is the firm enjoying benefits of outside capital that it would be denied by domestic regulation?***[5] ***(Both this question and question 4, above, effectively relate to questions about how the LPO market is regulated.)***

4.2 Multidisciplinary Partnerships

While some economies may be available from splitting up legal services, others may be available from the scale and scope economies inherent in combining activities. Once again, the characteristics of the service (and the nature of its production process) play a central role here, so our framework is relevant for indicating the potential for innovation and research in these settings. One particularly interesting example is the possibility for law firms to merge with providers of other services in what are known as multidisciplinary practices (MDPs). Law firm participation in such mergers is currently prohibited in the United States, but it is interesting to consider whether this ban should be relaxed, as well as some of the possible outcomes of doing so—not least because such a debate is taking place in the United States (and has taken place elsewhere). To consider these issues, we begin by briefly describing the current position in the United States.

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[3] In addition, there are some interesting conflicts with other regulatory policies, which are highlighted elsewhere in this paper and are in research questions 3 and 4 on this page.

[4] Dean (2010) reports that LPO providers tend to divide themselves into "shared service teams" and "client specific" teams in an effort to address the conflict-of-interest issue.

[5] It is interesting to note that this may be a way for firms to overcome restrictions on investment in law firms, as discussed in Subsection 4.3.

The ABA Model Rules of Professional Conduct[6] prohibit lawyers or law firms from sharing legal fees with nonlawyers (American Bar Association, 2010, Model Rule 5.4). This includes forming partnerships with nonlawyers or practicing law in a corporation in which a nonlawyer is a director or "a nonlawyer has the right to direct or control the professional judgment of the lawyer."[7] The Comment on the Rule explains its justification as follows: "The provisions of this Rule express traditional limitations on sharing fees. These limitations are to protect the lawyers' professional independence of judgment" (American Bar Association, 2010, Comment on Rule 5.4).[8]

Some have argued that whatever the ostensible justification for the ABA rule, the real reason it survives is to preserve the existing structure of the bar (and, perhaps, higher prices). Adam and Matheson (1998, p. 8), for example, argued that the rule was maintained in 1981 partly because of "fear of Sears"—i.e., concern that competition with large corporations would drive out the solo or small-firm practitioners making up the bulk of the legal profession.

Yet access to capital may benefit some of these smaller firms. In other industries, a tiny startup with an innovative idea can receive outside capital from angel investors, venture capital firms, and, eventually, an initial public offering (and evidence from other fields suggests that such new entry can be an important engine for innovation). In the law, however, no such outside investment is permitted, and only the comparatively well-capitalized, larger firms can take advantage of legal business opportunities that require capital. This restriction on capital has probably contributed to the existing structure of the legal profession today and the striking pattern of large law firm growth over the past 40 years. Clearly, as emphasized in Section 3, the costs and benefits of relaxing restraints on this type of innovation must be carefully assessed.

Our framework suggests that the different characteristics of services provided by a supplier may influence the prospects for innovative activity. Some firms will favor a merger to gain access to capital, perhaps to fund expansion into a particularly risky area of work.[9] Others will seek to merge with services that complement their existing portfolio; for example, if they specialize in family law and residential real estate, it may make sense to offer clients a "one-stop-shop" opportunity involving, say, banking services and personal accountancy facilities. Thus, the structure of the legal services industry could be significantly affected by MDPs, but in different ways for different types of services.

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6 The Model Rules of Professional Conduct (American Bar Association, 2010) serve as a model for the states' rules of professional conduct. Only California has adopted rules that do not closely follow the ABA Model Rules.

7 The District of Columbia is the only jurisdiction in the United States that has employed a substantially different rule on this point. There, a nonlawyer may hold a financial or managerial interest in a partnership with an attorney. But the nonlawyer must perform "professional services which assist the organization in providing legal services . . ." (DC Bar, 2007, R. 5.4(b)). This prohibits passive outside investment in the law firm. And the firm can only offer other services if they are directly linked to the legal services being provided to the client.

8 In 1981, the ABA briefly considered permitting nonattorney ownership of law firms (Adams and Matheson, 1998, p. 8). Again in 2000, the ABA Commission on Multidisciplinary Practice recommended that the Model Rules of Professional Conduct be amended so that attorneys could jointly practice and share fees with nonlawyer professionals, but this call was ultimately unsuccessful (Podgers, 2009, p. 65). Just last year, ABA President Carolyn Lamm announced the creation of an Ethics 20/20 Commission to examine this issue of multidisciplinary practice and, more generally, how the U.S. legal profession is regulated (Podgers, 2009, p. 65). The passage of the Legal Services Act of 2007 in the UK and similar developments in Australia that permit multidisciplinary practice and outright investment in law firms have put some pressure on the ABA to revisit the traditional prohibition (Podgers, 2009, p. 66).

9 Garber (2010) reports a degree of loan finance provided to law firms by third parties. It is interesting to speculate on how this activity relates to the codes discussed above and the extent to which this might relax some of their effects.

With no clear evidence on which to base an evaluation of the possible effects of allowing outside investment and/or MDPs, we feel that answering some baseline research questions would help policymakers in this area:

1. ***What is the range of MDPs that might emerge, and how does this link to a law firm's existing portfolio of services?***
2. ***What factors would lead a firm in search of capital to merge or borrow funds? (This is akin to the corporate finance question of whether firms should seek equity or debt finance.)***
3. ***What are the likely costs and benefits of the different types of MDPs that may be uncovered by question 1, above? Can mechanisms be established to minimize threats to independence of legal advice? How will the competitive effects differ among different types of MDPs? Do clients perceive benefits from potential MDPs?***
4. ***Are there any examples of related practice that could help to evaluate the effects of MDPs? (For example, loan finance arrangements mentioned by Garber (2010) or the experiences of in-house counsel.)***

4.3 Alternative Litigation Finance[10]

The restriction on capital investments in law firms identified above is related to the topical issue of litigation financing. Recent years have seen the development of innovative activity on the part of lawyers and financiers when looking to fund large (mainly commercial) claims, including some class actions. Effectively, these activities involve the provision of venture capital to fund claims in return for a sufficient slice of any damages achieved. This capital can then be used to fund the case. Such practices can be attractive to clients with insufficient funds (or, in the case of class actions, clients for whom the return on the case may not justify the expenditure), but they may also be attractive to others if they free funds for other activities. Such practices have grown in popularity in Australia and have also become accepted in England and Wales—Jackson (2009), for example, has endorsed them (in principle). Others have invested directly in law firms, either by purchasing equity stakes in firms where permitted (e.g., Australia) or by loaning money to law firms.[11] They are also developing in the United States (see Garber, 2010; see also Waye, 2008, and Mulheron and Cashman, 2008, for, respectively, Australian and English perspectives).

As Garber (2010) points out, there are, in fact, several types of alternative litigation finance (ALF). These range from the provision of venture capital-style investment in multimillion-dollar claims, to the funding of law firms themselves by outsiders, to the provision of nonrecourse loans to individuals to fund their claims. He goes on to show that each of these raises different questions, many related to the characteristics of the claim in question. Thus, for example, investment in a multimillion-dollar claim requires substantial investment expertise, legal input, and return in order to cover potentially substantial costs. By contrast, investment in an individual's claim still requires evaluation expertise; but to the extent that it

[10] This topic is also known as third-party litigation finance.

[11] If the law firms are functionally investing in legal claims (e.g., via contingency fee arrangements), then the functional effect of an outside investment in a law firm is a partial investment in the claims that the law firm is pursuing.

can be done in bulk, there is more scope for pooling of risk and therefore fewer claim-specific loan arrangements.

Garber (2010) also considers the potential for ALF to develop in the United States. From our perspective, several things are interesting and can be linked back to our framework. First, as already pointed out, the characteristics of the types of cases in question will play a role in the emergence of this finance. Thus, to the extent that large gross returns are necessary to offset the risk of meeting substantial costs, we might not expect to see venture-capital-style investment in relatively small claims or in claims that are extremely complex or uncertain. Second, any evaluation of ALF must bear in mind social and private costs, as well as benefits. For example, in principle, additional means of finance raise the specter of excessive litigation (though Garber is skeptical here), while the relationships that develop between funders, lawyers, and clients could lead to difficulties in processing cases and achieving the best outcome for the client. Third, confidentiality issues are raised by the disclosure of information that a potential funder might need to evaluate the value of a case.[12] Fourth, the link between regulation and ALF is important. This is not just a direct link (whereby courts agree to allow specific funding arrangements), but can also involve indirect links, such as the professional regulations surrounding multidisciplinary partnerships or the courts' attitudes toward champerty and maintenance. In each of these situations, relaxing one regulatory rule could stimulate innovation in ALF, as has arguably been the case in Australia and the UK.

Like Garber, we think that the research agenda surrounding ALF is fertile. Some of the related key research questions are

1. ***Is it possible for venture-capital-style ALF to compete with other methods of financing lower-value litigation, thereby affecting access to justice for lower-value claims? What would be the social welfare consequences of this outcome?***
2. ***What is the optimal way to regulate ALF? What type of data and analysis would a regulatory system need? How do other instances of venture capital finance in law impinge on this? What role may be played by MDPs?***

4.4 Billing Arrangements

Fee arrangements can address a number of issues arising between lawyer and client that are related to the characteristics of the service being provided. Fee arrangements can share risk between the parties, can help to incentivize cost-reducing efforts by the lawyer, can provide both the lawyer and the client with incentives to expend effort on the case, and can stimulate competition by aiding transparency and enabling firms to offer a wide menu of choices to potential clients in order to address their particular needs. Optimal risk-distribution and principal-agent theory predicts that one would expect to see different arrangements emerging in different circumstances depending on the characteristics (such as those in Section 3) of the legal issues in question.

[12] In *Leader Technologies v. Facebook, Inc.*, D. Del., Civ. NO. 08-862-JJF, 6/24/10, the U.S. District Court for Delaware held that disclosure of information to possible funders waived the attorney-client privilege. As a result, the information that was shared with the funder had to be turned over to the party's opponent. This decision may hinder efforts to secure outside financing.

For the past 30 years, the dominant means of billing corporate legal services has been the billable hour.[13] To maximize revenue, the law firm generally has an incentive to bill as many hours as possible, subject to the constraints imposed by the price elasticity of demand. One common way to accomplish this is to staff cases with relatively inexperienced associates. From the law firm's perspective, this pays a double bonus. First, relatively inexperienced associates require more hours to complete tasks and thus permit the law firm to potentially bill the client more (so long as it does not drive the client elsewhere) without engaging in fraudulent inflation of attorney hours. Second, the experience helps train the younger associates (Van Zandt, 2009, p. 1130).

The dominance of the billable hour also reduces incentives for firms to invest in innovations to increase attorney productivity. An innovation that permits attorneys to produce the same legal product with 25 percent less labor might simply result in less revenue for the firm. Despite regular calls by critics to end the billable hour as the principal means of billing, a large proportion of corporate legal work in the United States continues to be funded this way (Glater, 2009).[14]

By contrast to corporate cases, the billing strategy for noncorporate work has traditionally depended on whether monetary amounts are at stake and whether the case is amenable to notions of winning and losing. Tort litigation satisfies both of these criteria, but a cooperative arrangement of child custody terms does not. In the case of tort litigation, a contingent fee has been the traditional means of paying lawyers in the United States (for reasons we list below), while other means (billable hours or variants on the themes below) would be relevant to noncontentious business.

Yet perhaps as the result of the recession of 2008–09, more large law firms are attempting to work under alternative fee arrangements.[15] The managing partner of Cravath, Swaine & Moore, one of the most influential law firms in the country, recently called for using fixed-fee billing arrangements to replace the billable hour (Chesler, 2009). Other major law firms—O'Melveney & Myers; Mayer Brown; Reed Smith—have implemented or are planning fixed-fee plans for corporate clients (Neil, 2009; Weiss, 2009; Koppel and Jones, 2009).[16] Similarly, such major corporate clients as Pfizer and Cisco Systems have shifted or plan to shift to fixed-fee arrangements (Koppel and Jones, 2009). According to BTI Consulting Group, spending on

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[13] The billable hour itself was an innovation in the provision of legal services. Prior to the early 1970s, many bar associations circulated official fee schedules that listed prices for various services. These fee schedules came under increasing scrutiny as possible violations of antitrust laws. In *Goldfarb et al. v. Virginia State Bar*, 421 U.S. 773 (1975), the U.S. Supreme Court unanimously held that such fee schedules and their enforcement by the state bar association constitute price fixing under the Sherman Act. While some law firms had been keeping track of attorney time, the end of fee schedules made the billable hour the most popular fee arrangement.

[14] Even as far back as 1994, 73 percent of California attorneys agreed that "[c]lients will increasingly demand alternatives to hourly billing for legal services" (Hensler and Reddy, 1994, p. 10).

[15] See Newing, 2009. Examples mentioned include loyalty card schemes, fixing fees to avoid currency fluctuations, and fee deferrals. It appears that in-house counsel are playing an active role in encouraging such developments.

[16] Some have suggested that the move to fixed fees is overstated. The managing partner of a major Philadelphia law firm stated to the *ABA Journal* that "the billable hour is an overblown issue" and that "clients remain transfixed by asking for discounts on hourly rates" (Zahorsky, 2009).

fixed-fee arrangements increased by 50 percent, to $13.1 billion in the first half of 2009, from $8.6 billion in the first half of 2008 (Koppel and Jones, 2009, p. A1).[17]

A number of commentators have begun to encourage (corporate) clients to request alternative billing arrangements. Some of the options are as follows:

- *Fixed fee*: A fixed fee can be estimated based on past billing history for comparable services. An advantage of such a billing system is that it provides appropriate incentives for the legal service provider to economize and conduct the relevant work as efficiently as possible. It also permits the client to budget more easily. A potential disadvantage is that it requires the scope of work to be outlined very precisely at the outset. Similarly, if conditions change in ways that require additional work, further communication between firm and client is needed to precisely specify what additional work is necessary.[18] We might expect to see such fees in fairly routine cases, in those in which clients are poor at controlling lawyer's inputs, or in those in which the prospect of repeat business allows the lawyer and client to enjoy the "swings and roundabouts" of gains and losses under the fixed charge.
- *Capped fee*: A capped fee is based on hourly bills but includes an agreed-upon maximum amount. Some variations provide for over/under fee arrangement. When fees are over budget, the client pays a discounted rate for additional time; when fees are under budget, the client pays the firm a bonus. Like other alternative fee arrangements, capped fees require rigorous scoping of the proposed work. They are a hybrid between conventional hourly billing practices and fixed-fee systems that partially align client and firm interests. Even conventional hourly billing may include an implicit cap on the amount of time the firm can bill for particular services and hope to retain the client for future matters. Given this description, the characteristics of the legal services for which such fees might be expected to emerge can be inferred from the discussion of fixed fees: Effectively, by allowing the lawyer to make a charge based on hours worked, capped fees reallocate a degree of risk back toward the client (who still benefits from not bearing the full risk of an unfettered hourly bill).
- *Retainer billing*: Under such an arrangement, the client pays a fixed retainer for an agreed-upon set of services over a particular period. This can be accompanied with a supplemental hourly charge for specific matters billed, or it can be a fixed amount. The exact scope of matters covered under the retainer agreement must be agreed on at the outset. Once again, the "fixed" nature of the fee suggests that firms would be unwilling to undertake work on this basis unless the amount of work were reasonably predictable or the prospects of future business made such "loss leadership" worthwhile in the long run.
- *Contingent fee*: Under this arrangement, the payment of the fee is tied to obtaining particular results. It is distinguished from a "success fee" by the fact that the firm receives little or nothing if the desired result is not achieved. The traditional U.S.-style contingent

[17] Jeff Carr, general counsel at FMC Technologies, colorfully analogized alternative billing arrangements to teenage sex: "There are more people talking about it than doing it, and those that are doing it don't know what they're doing" (Elison, 2007, p. 2).

[18] As a variation, an "event charge" is a kind of fixed fee that is tied to specific events during the course of the larger legal effort provided (e.g., litigation, transaction, filing). It shares the advantages and disadvantages of fixed-fee billing systems.

fee is found in monetary claims in which the lawyer is rewarded with a prespecified percentage of damages if the case is won (in a fashion similar to some of the ALF arrangements described above). As such, this arrangement is suited to monetary claims. Other result-contingent billing methods are available, however. For example, the conditional fee in England and Wales permits the lawyer to charge the usual hourly fee if the case is won, along with a prespecified markup; nothing is charged in the event of defeat. Contingent fees are often lauded as aligning the lawyer's incentives with the clients in circumstances where complexity, inexperience, or ignorance prevents effective client monitoring. For this reason, it is perhaps not surprising that contingent fees (of either style) are the dominant means of funding noncommercial litigation in the United States and the UK. By allowing the client to avoid fees if the case is lost, there are also potential access-to-justice benefits.[19]

- *Equity compensation*: Under this arrangement, the law firm is compensated for legal services by an equity stake in the company that receives legal services.
- *Success fee*: Here, the client pays a prespecified percentage markup on the lawyer's hourly rate if the case is successful, and a prespecified downward adjustment if the case fails.[20]
- *Blended rates*: Blended rates compute an average across the hourly rates of the lawyers who will be working on the case. In some sense, they commit the law firm to using these resources (since a different combination would warrant a different blended rate).
- *Budgets*: Sometimes, outside counsel will present in-house counsel with a budget for the forthcoming work; the in-house team will then have to approve and monitor use of the budget.

Clearly, these alternatives present the parties with different combinations of risk sharing and incentives, with demand being based on such factors as the complexity, risk, and asymmetric information involved in the case.[21] They raise a number of interesting questions about how innovative law firms have become in their fee setting, several of which are

1. ***How prevalent are the types of fees described in this subsection in U.S. commercial litigation? Can any differences be explained with reference to differences in regulations across U.S. states? Is there more variation in the more "entrepreneurial" states (using Sobel's [2008] index of entrepreneurship across U.S. states)?***
2. ***What are the theoretical properties of these billing arrangements, and what are the testable implications?*** [22] ***(This question can relate to the effects of billing on litigation, on the numbers of claims brought, and on other areas of law—e.g., family matters.)***
3. ***How do billing arrangements vary between commercial and noncommercial law firms?***

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[19] A substantial theoretical and empirical literature debates these propositions. See Rickman, 1994, and Fenn and Rickman, 2011, for surveys.

[20] Conditional fees in England and Wales are a specific example of this arrangement, with a 100 percent markdown for failed cases.

[21] There may also be interesting questions with respect to billing and more generally, legal cost accounting, raised by unbundling and MDPs. If the provision of "legal services" are broken down to constituent parts, it will be necessary to cost and price these subunits – if only for internal law firm accounting. A variety of risk-sharing arrangements might be imagined between not only the lawyer and client but also the lawyer and subcontractors.

[22] For example, Fenn, Gray and Rickman (2007) produce testable hypotheses about the effects of fixed fees on lawyer input levels and then test these against data from legally aided criminal cases in England and Wales.

4. ***How do clients and firms define the relevant legal outcomes for the purposes of alternative billing arrangements?***

4.5 Information Technology

Rather than being an innovation in legal services in and of itself, IT enables a variety of other innovations in the provision of legal services. IT can allow more translocation of legal services, permit the use of artificial intelligence applications, enable more consumer self-help, and decentralize legal knowledge.[23]

We first note that the use of IT may similarly affect the supply of legal services to corporate and noncorporate clients in a number of respects. By increasing the opportunities for communication across jurisdictions, IT may permit a more national or international market for the provision of legal services, though this may to some extent be hindered by the existing requirement that legal services be provided by those who have passed the bar in a particular state (see Subsection 4.6). IT has massively reduced the cost of transporting information (documents, voice, video) over great distances to nearly zero. This might permit the development of an international market in legal services—or the LPO described earlier (and see below). One could imagine that a consumer's will, for example, might be drafted anywhere in the world. In our framework, such complex, rule-based services as trusts and estates, tax law, and small business contracting may be directly affected by this dynamic. In contrast, in some areas of the law, direct meetings with an attorney will remain important and, at least until social norms further evolve, are unlikely to be wholly replaced by telephone calls or videoconferencing.

The reduced cost of moving data may also permit secondary markets in legal services to develop. A lawyer could interact with the client while invisibly outsourcing document drafting, legal research, and other legal tasks historically performed in the law office.[24] Interestingly, such developments may assist lawyers in marketing as well as "lawyering": Total Attorneys is a company that has used IT to sell customer relationship management services to small law offices. The service enables a potential client's phone call to be returned almost instantly by an employee of Total Attorneys, who collects relevant information and acts as a representative of the attorney. This is designed to enable a sole practitioner to appear very responsive to the potential client and increase the chance that the client will be retained. The company also provides marketing services that permit lawyers to pay Total Attorneys for providing their name to individuals who are looking for lawyers on the Internet in a particular geographic area.

IT of this kind will also likely continue to increase the productivity of lawyers. Smartphones enable on-the-fly legal research and faster response to clients. More important, IT

[23] IT use in electronic discovery during litigation is another important IT use (Dertouzos, Pace, and Anderson, 2008). We do not discuss this form of use here, because it is not primarily an innovation in the provision of legal services, though it has implications for the cost of certain categories of legal services.

[24] To some limited extent, computer-aided legal research has already done this. Lexis and Westlaw research services have obviated the need to spend hours in law libraries; and in many ways, lawyers who rely upon these services are relying on employees of Lexis/Nexis and Westlaw to correctly categorize the law. We have also seen, in Subsection 4.1, that outsourcing of some legal services is beginning to take place.

enables the dissemination and searching of vast amounts of legal data, far more than was possible only a short time ago.[25]

This searching ability enabled by IT may also reduce the need for lawyers and encourage self-representation. Historically, access to legal knowledge was restricted. Conventional case law research in a law library required specialized skills, and computer-aided law research required different but nearly equally specialized skills. Google has recently begun to place the texts of opinions in fields freely accessible in Google Scholar, and more and more legal materials are available for free online. At the very least, the diffusion of knowledge that IT enables will likely continue to reduce the knowledge barriers to self-representation in a variety of fields, particularly those whose characteristics involve relatively uncomplicated legal problems and relatively low-risk outcomes for the consumer.[26]

On the other hand, IT may so increase trained lawyers' productivity that the gap between the self-represented and those represented by a lawyer will actually grow, raising access-to-justice issues. Whereas pre-IT, a lawyer might know the handful of relevant cases, he or she will now quickly access hundreds of published and unpublished opinions and more easily keep track of a wider range of relevant legal knowledge. Although pro se litigants will, in theory, also have this ability, they may lack the training and skill needed to process the wealth of legal information that is instantaneously available.[27] Similarly, it is possible that the potential breadth of resources available will increase the value of an individual who is able to rapidly process and organize large amounts of legal information.

Continued formal legal restrictions on the provision of legal services are likely to slow these trends. Legal-knowledge workers in low-cost regions (of either the country or the world) are not permitted to provide legal services unless there is a member of the relevant bar involved. Paralegals can only assist members of the public with immigration or bankruptcy document preparation if an attorney-client relationship has been forged with a licensed member of the bar to supervise the paralegal, even if no such supervision is necessary.

Having pointed to a number of similarities in the effects of IT on corporate and non-corporate legal services, we now consider a potential difference relating to clients' ability to judge their need for legal services and to judge the quality of lawyers if they decide to use one (as suggested by Section 3). Here, corporate repeat players (perhaps with in-house counsel) are less likely to suffer information asymmetries than are one-shot players, such as individual middle-class clients. IT may restore this symmetry and provide more information to consumers through the growth of lawyer rating systems. AVVO, Best Lawyers, Lawdragon, Martindale-Hubbell, and Super Lawyers all offer lawyer rating services that are accessible by Internet and are designed to appeal to individuals, small businesses, and, if necessary, larger corporate clients.

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[25] Currently, this is somewhat restricted by limits on access to some published opinions and other legal materials. But as these restrictions fall, as seems likely, additional productivity gains are likely. LoPucki (2009) sketches one possible result: a world in which everyone has access to all legal materials and arguments ever filed. Since filed legal pleadings are not subject to copyright, one could imagine a world in which even the most remote solo practitioner would instantly have access to a "pleading bank" of every legal pleading ever filed in a case by the most-sophisticated legal practitioners.

[26] One testable hypothesis is whether the percentage of pro se litigants has increased or decreased. This is a highly imperfect measure of self-directed legal activities, but might be one visible indicator.

[27] One possible implication is that online advice opportunities could arise, subject to professional entry barriers. We discuss intermediaries below.

This development is not without controversy. In 2007, one of the services, AVVO, was sued by a lawyer who filed a class-action lawsuit questioning the company's methodology. The suit was dismissed, the judge concluding that rating lawyers is protected by the First Amendment (American Bar Association, 2009). Some lawyers have also complained that they have been unfairly rated (Ward, 2010)[28]—a potential external cost of such services. In an interesting example of how regulations can stifle innovation,[29] some lawyer rating services have run afoul of state bar rules. Florida, for example, generally prohibits the use of testimonials in lawyer advertising. Florida lawyer Joel Rothman's rating on the AVVO site included several clients who recommended him and their comments about him. After Rothman sought an advisory opinion from the Florida Bar, it indicated that such comments violated the ban on testimonials in lawyer advertising, though it would not independently initiate action against him (Ward, 2010).[30] Similarly, in South Carolina, the bar ethics board ruled that all content of rating websites was subject to state bar rules on advertising, but it also indicated that "this opinion does not take into consideration any constitutional law issues regarding lawyer advertising" (Ward, 2010, p. 5).

In short, some state bars have interpreted their regulation of attorney advertising in a way that restricts the use of feedback and comments by clients. This could potentially diminish the usefulness of public client rating of attorneys. This is an example of a state regulation hindering an innovation that has the potential to increase consumer welfare.

On the subject of legal advice, IT intermediaries are emerging to provide legal advice websites. These offer a wide range of services, from legal directories (to help those who believe they understand their legal problem well enough to identify suitable practitioners to enable its pursuit[31]) to information repositories (to help people identify their problem).[32] Other websites may assist people in undertaking basic legal tasks (such as will writing or do-it-yourself conveyancing).

While the proliferation of these websites and services makes them difficult to research, they are clearly a potentially important addition to the market for legal services, and one that is only likely to grow. In other aspects of life, such as health care, they offer an important way of empowering individuals and making efficiency savings for public- or private-sector suppli-

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[28] As one marketing consultant put it: "Traditionally, law firms and what their client interactions are like have been cloaked in mystery and nobody really knows how good their service is. That's obviously disadvantageous to clients. People are spending large sums of money on legal assistance, and they want to know what they're getting." (Ward, 2010, p. 4).

[29] Another would be the ABA's rules on outside investment in law firms, as discussed in Subsection 4.3.

[30] Rothman ultimately filed suit against the Florida Bar in federal district court, alleging that the professional conduct rule banning testimonial advertising, case results, and statements about the quality of work violated both lawyers' and clients' rights under the First Amendment.

[31] In England and Wales, such practices now go beyond the passive provision of names, addresses, and specialties by sometimes offering to refer potential clients on to a "panel" solicitor who is associated with the given referral scheme. These are also controversial, partly as a result of mis-selling around ten years ago, and partly because they charge referral fees that are considered unethical by many lawyers and judges. Jackson's recently published review of legal costs in England and Wales has proposed the abolition of these fees (Jackson, 2009).

[32] In principle, they could also include law blogs that might be aimed at academics, practitioners, and other media but may offer additional (or implicit) advice to would-be clients. In other areas (such as political debate), these have become extremely influential, and it would be interesting to evaluate their roles (and worth) in the legal context. Nonetheless, we exclude them from the current paper for reasons of tractability. Within the space of web-based products, they are perhaps more tangential to our core interests than those we now discuss.

ers. At the same time, however, when the services concerned are important, dangers are posed by low-quality advice, and some companies may see these services as a competitive threat (to be undermined by, say, saturating the market and reducing the scope for objective information provision). We are not aware of existing evaluations of legal advice websites, but there are numerous published criteria for such evaluations,[33] and there are models for undertaking them in other sectors (such as health care; see RAND Health, 2001) that may serve as a model for evaluating legal advice sites.

Answering the following research questions would aid policymakers in further understanding the relationship between IT and innovation in legal services:

1. ***What are the range and scope of sites offering lawyer ratings and legal advice in the United States? Is there variation across states, and do different states' (including bar associations') regulations affect the availability of these services?***
2. ***How effective are these sites?***[34]
3. ***The future: How might legal advice sites affect the practice and delivery of law in the future? Will do-it-yourself practices grow? Is it possible to imagine litigation being undertaken online? How will/should law firms respond to these changes?***
4. ***How are legal advice websites funded, and what potential issues does their funding raise? Given that they may be funded by user charge, subscription, advertising, or referral fee, and that some may be for profit while others are not for profit, do these various business models raise ethical and economic issues, and can existing sites be evaluated to assess the extent of these?***

4.6 Regulation and Legal Service Innovation

Having discussed some individual examples of ongoing and potential innovations, we now discuss the ways in which the regulation of legal services—broadly defined to include court rules, case law, and legislation—impacts legal services:

- *Professional bodies and state supreme courts* regulate who can provide these services—the skills they require, the amount of training they need, and in which geographic jurisdictions they are allowed to practice law. The professional bodies have economic incentives to limit innovations in the provision of legal services that threaten the economic interest of their membership, such as the provision of legal services by nonlawyers. As discussed in Section 1, this resistance is partly economic and partly cultural.
- *Courts* directly regulate some of the kinds of services that need to be supplied and some of the ways in which this should happen by setting standards for legal malpractice or the ineffective assistance of counsel.

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[33] See, for example, "Evaluation of Information Sources" (World-Wide Web Virtual Library, 2011) or "Tips for Evaluating Legal Websites" (Electronic Legal Aid Newsletter, 2009).

[34] Here, two approaches are possible. In one approach, the public and practitioners could be surveyed in general to gain insight into awareness, usage, and value of sites in general. This may be a suitable first step in the research. Surveys could be designed against accepted criteria for evaluating legal advice sites. In the other approach, a particular site (or policy initiative) could be selected, and users and contributors could be surveyed about the specific costs and benefits of the site.

- *States* ultimately regulate elements of both of the above by, for example, recognizing the professional bodies and producing legislation that encourages some services and reduces (or removes) the demand for others.[35] For example, a law that liberalizes divorce is likely to create more legal activity of a particular type. Similarly, states compete in developing law that might attract beneficial economic activity. For example, most corporations are chartered under Delaware law because of the perception that doing so provides advantages.

The behavior of these regulators can, in itself, be innovative (as in the Delaware example just mentioned) or it can encourage or discourage innovation. In Subsection 4.3, we discussed the role of the courts in encouraging ALF through altered attitudes toward champerty. Following the discussion in Subsection 3.3, it is also important to understand that regulation that limits innovation can be socially beneficial: The externalities inherent in legal services mean that changes (to practice, services, suppliers) can impact others in unforeseen ways, and regulators can help to internalize these. Similarly, information asymmetries can lead to difficulties in choosing a sufficiently able lawyer for the task at hand (as we shall see below). At the same time, however, regulation can limit innovation, and we end this section by considering one area in which the arguments about the effects of regulation are particularly strong: licensing and entry barriers. While it is clear that at some level, such regulation is in the public interest, we note several examples in which innovative activity could be harmed as a result and in which some degree of liberalization may stimulate such activity.

Entry Barriers and Professional Licensing. Many innovative activities can generate potential gains for consumers by making goods and services cheaper to produce and, in a competitive market, cheaper for a consumer to purchase. In reality, however, while cost reductions may take place, producers will appropriate the gains unless they are forced to pass on some fraction of the cost savings in the form of lower prices. Perhaps the most effective way to achieve this is through supply-side competition. Such competition may also have an additional benefit in that it encourages suppliers to seek new products (as well as processes) and to attract new customers to them. Thus, when assessing the potential for innovation in legal services, it is important to discuss the regulatory context governing suppliers, as this may either stimulate or retard competition.[36]

There is an important caveat to the above. As mentioned in Section 3, many legal services are complex, placing the client at a disadvantage in assessing the quality of the service being purchased. This can act as a deterrent to using such services, with consequent implications for access to justice and efficiency. Thus, as in other professional settings, it may be necessary to ensure that suppliers have minimum levels of competence in order to reassure an otherwise wary public. Occupational licensing has sometimes been justified in this way (Leland, 1979). In short, asymmetric information means that we should not expect legal services to be supplied under the same competitive conditions as, say, clothes or groceries.[37] In the terminology

[35] In some states, the legislative branch may be limited by state constitutional separation-of-power provisions that the state supreme courts may interpret to preclude legislation that directly regulates the practice of law.

[36] As discussed in Subsection 3.3, regulatory innovation may be a precursor to partial (or other systemwide) innovation.

[37] In itself, this discussion raises an interesting question: Are there some legal services whose dimensions are sufficiently straightforward that only minimal licensing is required? This, for example, was the view taken about conveyancing in England and Wales when licensed conveyancers were allowed to compete with fully qualified lawyers in this market in 1988. There is some evidence that the price of conveyancing services dropped as a result (see Stephen et al., 1993).

of Subsection 3.3, reducing regulation can create social and private costs as well as benefits. As a result, evaluating the social welfare benefits of any given reform is complex.

For this reason, our presentation here does not seek to answer the ultimate question of whether reducing entry barriers is a "good thing." Neither, for reasons of space, can we possibly cover all entry regulations. We do, however, set out some examples of rather wide-ranging barriers that have come in for notable criticism, where careful scrutiny may therefore be warranted in terms of the calculus set out in Subsection 3.3, and perhaps especially in light of some of the innovations that might occur if these barriers were lifted.

A number of regulations currently restrict the supply of legal services in the United States. These include 1) the requirement that one have a law license from a particular state jurisdiction in order to practice law in the jurisdiction 2) the requirement that lawyers be graduates of accredited law schools, and 3) the restrictions that the rules of ethics place on the actions of attorneys, including the prohibition of lawyers partnering with nonlawyers. While each of these categories of restriction has its own nuances and particular justifications, they are generally all part of the effort to define the practice of law as a particular, distinct profession with its own professional norms and self-governance. We focus on the first two of these restrictions (noting that the third appeared in Subsection 4.2).

Every state requires that in order to practice law, a person must pass the bar of the state. The "practice of law" is broadly defined and, in most states, it is a criminal offense to practice law without a license, though there are relatively few prosecutions.[38] Under the language of most statutes, nonlawyers can provide general legal advice but are prohibited from providing individualized counsel (Rhode, 2004, p. 87). In 2002, an ABA task force proposed a model definition: "the practice of law is the application of legal principles and judgment with regard to the circumstances or objectives of a person that require the knowledge and skill of a person trained in the law" (Turner, 2003). Under the proposed definition, the practice of law is presumed when a person is acting on behalf of another in 1) giving advice or counsel to persons as to their legal rights or responsibilities or to those of others; 2) selecting, drafting, or completing legal documents or agreements that affect the legal rights of a person; 3) representing a person before an adjudicative body, including, but not limited to, preparing or filing documents or conducting discovery; or 4) negotiating legal rights or responsibilities on behalf of a person.

This definition of the practice of law is quite broad.[39] And the states have adopted an even broader set of definitions of what constitutes the practice of law (Fountaine, 2002, pp. 152–158). Even the publication of legal self-help books and computer software has been found to violate the practice-of-law prohibitions.[40] Similarly, the legal document preparation company LegalZoom was sued for the unlawful practice of law (Weiss, 2010). These restrictions obviously substantially inhibit competition in the market for legal services from nonlawyers and lawyers who are licensed in other jurisdictions.

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[38] Between 1985 and 2000, the practice of law in Arizona was not regulated by statute or court rule. See Rose, 2002.

[39] The ABA ultimately adopted a resolution that left the precise definition up to the states, but urged each state to include "the basic premise that the practice of law is the application of legal principles and judgment to the circumstances or objectives of another person or entity" (American Bar Association, 2003).

[40] See In Re NOLO Press/Folk Law, Inc, 991 S.W.2d 768 (1999) (Texas Bar Association opened unauthorized practice of law proceedings against publisher of self-help legal books); *Unauthorized Practice of Law Committee v. Parsons Technology Inc.*, 1999 WL 47235 (N.D. Tex. 1999) (granting Unauthorized Practice of Law Committee summary judgment to enjoin the sale of legal assistance software); and Fountaine, 2002.

State bar associations justify these prohibitions as being necessary to ensure that those providing legal services are familiar with the relevant state and local laws and to protect ignorant consumers of legal services from exploitation (Rhode, 2004, p. 88). By restricting the practice of law to attorneys, states guarantee that consumers of legal services receive the benefits of the attorney-client relationship, which includes the duty of loyalty (which includes a duty to identify and avoid conflicts of interests), of confidentiality, and of competence, which nonattorneys lack. Hadfield (2008) analogizes these to mandatory terms in the contract for legal services.

However, academic commentators[41] and the public itself are skeptical (Hadfield, 2008, p. 1690). One prominent law professor argued: "Legal self-regulation displays the typical self-interested behavior of a cartel without any of the concomitant benefits" (Macey, 2005, p. 1096). In a survey conducted by the ABA, over four-fifths of the public thought that many matters could be "done as well and less expensively by non-lawyers" (Rhode, 2004, p. 89). Hadfield (2008) argued that these mandatory contract terms are particularly inappropriate and unnecessary for sophisticated corporations that do not need paternalistic protections to ensure that they obtain appropriate legal services. Even a study completed for the ABA-affiliated American Bar Foundation concluded that prohibitions against the unauthorized practice of law were no longer justified (Christensen, 1980).

Hadfield (2008) also leveled a more fundamental critique of the effects of these restrictions, arguing that the prohibition on the unauthorized practice of law has stymied the development of innovations in the law and led to a situation in which the legal system requires "enormous complexity and quantity of legal effort to achieve the transactional and dispute-resolution goals of business entities" (p. 1695). She suggests that the restrictions have prevented the invention of new mechanisms for efficient resolution of conflict and have hobbled even the intellectual development of new paradigms of conflict resolution.

Similarly, the training that lawyers undergo is standardized. Currently, the ABA imposes numerous requirements on law schools that want to become ABA accredited, and ABA accreditation is critical to a law school's graduates being admitted to practice law in most states. The ABA governs admissions, the number of hours that must be taught physically at the law school (as opposed to remote teaching), the classes that must be taught by full-time faculty (as opposed to practitioners or adjuncts), bar passage rates, materials that must be physically possessed by the law school's library, maximum faculty-to-student ratios, and a host of other requirements (American Bar Association Section of Legal Education and Admissions to the Bar, 2007). The result has been a highly standardized law school curriculum modeled after the one developed by Langdell at Harvard in the 1870s (Gordon, 2007, p. 340).

The one-size-fits-all requirement that everyone who practices any kind of law must pass the bar exam and receive training in a wide variety of areas of the law also restricts those who provide legal services and may, arguably, restrict innovative ways of looking at the law. As the practice of law has grown more specialized, the justification for requiring that those providing legal services receive training in all areas of the law lessens. Perhaps at one time, when most lawyers were general practitioners, it made more sense to ensure that all those offering legal services were generally familiar with most areas of the law. But today, it is not clear that a specialist in real-estate transactions, for example, must be trained in criminal procedure. From an

[41] See, e.g., Rhode, 1981; Rhode, 2004; Abel, 1989; Auerbach, 1976; Simon, 1978; Gordon, 1988.

economic perspective, it would seem more sensible to permit firms providing legal services and their clients to determine what qualifications are necessary.

More radically, Hadfield (2008) suggests that if lawyers were not involved by mandate, disputes might be resolved completely outside the law. She envisions a jointly retained firm that might resolve disputes between two organizations without recourse to formal law and suggests that the system that might develop may not resemble conventional "contract law" (p. 1711; and Hadfield, 2004). At the very least, she argues, the standardization of legal training reduces the likelihood of radical innovation in dispute resolution.[42]

It is fairly rare for an individual to hire someone to assist with legal claims, but this is particularly true for middle- and low-income citizens. It is expensive and often intimidating, and there is little knowledge about the quality of the services offered. This is partly a result of the restrictions on the practice of law, which generally require that a relatively expensive licensed attorney be directly involved in the provision of legal services. Moreover, the contractual terms by which the attorney is involved include a variety of additional restrictions (duties of loyalty, confidentiality, avoiding conflict of interest) that can further increase the cost of legal services.

Often, the legal services available to the working class are restricted to law school clinics where the legal services are primarily provided by law students or as charity. The legal profession often emphasizes the importance of the charitable contribution of legal services, pro bono. On most accounts, the need for low and middle-income legal services far outstrips the supply from pro bono volunteer efforts and law clinics. Nearly every lawyer and law student in the United States has been exhorted to volunteer more pro bono hours in an effort to meet this need.[43]

This might be the wrong approach. Rather than perpetuate rules that restrict the supply of legal services, increase their expense, and try to provide legal services to the working class through charitable efforts, it might make more sense to make legal services more affordable.

To be sure, there are risks with loosening restrictions on legal services to encourage more low-cost options. Defenders of the status quo have argued that the American legal system is the envy of the world and that it should be altered with great caution. Lower-cost legal services may enable more litigation that could have important negative externalities—litigiousness is not generally considered a virtue. It may be that the existing restrictions on the practice of law are set at the socially optimal minimum.

But at the very least, we should seriously examine whether innovations in providing legal services, including the liberalization of the restrictions on providing legal services, could promote social welfare. From the perspective of innovation, the real question is how much innovation could be encouraged by liberalizing entry into the U.S. legal profession, and would the gains from such innovations outweigh the losses—precisely the calculus set out in Section 3. While this is an extremely complex question to answer, we suggest that case studies of liberalization in other jurisdictions and in other professional services (such as health and accountancy)

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[42] But see the Uniform Collaborative Law Act (National Conference of Commissioners on Uniform State Laws, 2009). This is an effort to develop a framework for collaborative lawyers to resolve disputes without formal intervention by a tribunal and demonstrates a willingness by lawyers to explore alternative models for dispute resolution.

[43] The ABA has a Standing Committee on Pro Bono and Public Service, whose mission "includes fostering the development of pro bono programs and activities by law firms, bar associations, corporate legal departments, law schools, government attorney offices, and others" (American Bar Association Standing Committee on Pro Bono and Public Service and the Center for Pro Bono, 2006).

might help to identify some important lessons. Thus, we end by suggesting some research questions that would further understanding in this area and ultimately aid policymakers:

1. ***Can other examples of liberalization be identified in other jurisdictions and professional services, and can the lessons learned be applied to U.S. legal services? (Case studies and literature reviews may be the best means of addressing this at first instance.)***
2. ***What specific types of innovation are most stifled by the restrictions on the provision of legal services? (As described above, legal advice websites, ownership opportunities, and billing arrangements all appear to have been curtailed, to some extent, in this way.)***

SECTION 5

Conclusions

Despite its often traditional image—often fostered by lawyers themselves—the LSI has seen, and appears likely to continue seeing, a good deal of innovation. For some, like Suskind, the pace is too slow (though the end game is inevitable); to others, like some state bar associations, the pace is too fast, or could become that way. Such contradictory views are not surprising, since as we have shown, legal services are important and wide ranging. Moreover, they can be distinguished by different characteristics that make some more amenable to innovation than others, and a rational evaluation of given innovations should be designed to recognize costs as well as benefits arising from innovation. Although these are high-level observations, they should still be helpful to policymakers, who often find themselves under pressure from both sides of the innovation debate.[1]

We have provided examples of innovation in legal services and shown how they may vary with the characteristics of the products in question. Each example raises an interesting and important research agenda that may help evaluate particular innovations and provide insights into others. We are particularly aware that comparisons of experiences across states and countries may be beneficial here. Perhaps one of the most powerful insights arising from our discussion in Section 4 relates to the degree of overlap between the "partial" innovations we have described—for example, innovations in IT that are likely to benefit innovations in LPO. A particular example of such a link relates to the ways in which systemwide regulatory innovation may encourage subsequent partial innovation—as in the case of multidisciplinary practices and ALF, or reduced entry barriers and lawyer rating services. While these overlaps make the policymaker's job harder, it is still important to understand them when considering particular innovations.

We have indicated some possible avenues for further research in discussing innovations in Section 4. There are, of course, many relevant research questions here, but our research agenda recognizes the general lack of information about legal services innovation and, in many cases, seeks to establish baseline information about the prevalence and outcomes of the innovations. Future research would surely drill down into the areas this baseline analysis found to be most fruitful and would help quantify some of the components of our evaluation framework (see Section 3). Indeed, that framework would also benefit from additional research, including perhaps a more detailed typology of the characteristics of legal services and their implications for

[1] Reform may be politically very difficult. The relevant policymakers themselves are often attorneys, either in the state legislatures or in the state bar associations. In the legislature, they may be influenced by attorney-donors. Often a state bar association's explicit function is, in part, to protect the economic interests of its members. This function may create substantial conflict with a goal of regulating legal services in a way that maximizes social welfare. Would-be legal service innovators are likely to wield much less political power.

innovation. A large body of literature exists on estimating the extent of innovation in different industries, and we think it would be fruitful to examine how readily these techniques could be brought to bear on the LSI in order to quantify its level of "innovativeness" and to help draw comparisons with other industries. Finally, it would be useful to try to understand the conditions that appear to give rise to innovations in the production of legal services—i.e., what the legal "ecology" necessary to give rise to such innovations is.

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