FIDUCIARY FAULT LINES: NAVIGATING ETHICAL CONFLICTS IN ARIZONA'S ALTERNATIVE BUSINESS STRUCTURES

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"A trustee is held to something stricter than the morals of the marketplace. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior."[1] The renowned Judge Benjamin N. Cardozo penned this quote, and in it he articulated the high standard to which the law holds trustees (*i.e.* fiduciaries) in representing their principals. The language he used to describe such a relationship borders on the sacred and the inviolable—language people expressing religious fervor or matrimonial commitment use. But his writing was not mere rhetorical flourish. Rather, in his soaring language he expressed a foundational principle of ethics that has gone on to influence the development of the fiduciary duty in corporate law.

While traditionally thought of as a principle of business ethics, the fiduciary duty also arises in the context of a lawyer's representation of her client (*i.e.* legal ethics).[2] This is certainly true in Arizona wherein this duty is recognized, albeit not explicitly, in the legal ethics rules that govern attorneys' behavior. In particular, the notion of a fiduciary duty inheres within the confidentiality and conflict of interest ethics rules.[3] These rules include Ethics Rules ("ERs") 1.1 (Competence), 1.3 (Diligence), 1.6 (Confidentiality of Information), 1.7 (Conflict of Interest: Current Client), 1.8 (Conflict of Interest: Current Client: Specific Rules), and 1.9 (Duties to Former Clients).[4]

Within the last several years, this fiduciary relationship and these ethics rules have taken on greater salience in Arizona's legal community due to the Arizona Supreme Court's ("the Court's") abolition of Rule 5.4.[5] On August 27, 2020, the Court abrogated Rule 5.4 and promulgated Rule 31.1, thereby permitting Alternative Business Structures ("ABSs").[6] Following this change, nonlawyers

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[1] *Meinhard v. Salmon*, 164 N.E. 545, 546 (1928).

[2] *See* Neil Hamilton, *Internalizing a Fiduciary Mindset to Put the Client First*, 24 PRO. LAW. 8 (2017) (stating that "[t]he law of lawyering . . . rests upon each lawyer's internalized fiduciary disposition that the lawyer's responsibilities to the client . . . must be put before the lawyer's self-interest.").

[3] *See* David D. Dodge, *Ethical Rule Violations and Malpractice*, 55 ARIZ. ATT'Y, Oct. 2018, at 8 (stating that the confidentiality and conflict of interest legal ethics rules have their basis in a lawyer's fiduciary duties).

[4] *Id.*

[5] Rule 5.4 previously stated that "a lawyer shall not form a partnership with a nonlawyer if any of the activities of the partnership consist of the practice of law." Ariz. Sup. Ct. R. 42, ER 5.4 (abrogated Aug. 27, 2020, effective Jan. 1, 2021).

[6] *See* Ord. Amending the Ariz. Rules of the Sup. Ct. and the Ariz. Rules of Evidence, Ariz. Sup. Ct. No. R-20-0034 2 (Aug. 27, 2020).

could own law firms.[7] But this change was not met without opposition.[8] After all, the status quo at the time in nearly every state was that only lawyers could own law firms. Many detractors, both in Arizona and in other states, expressed concerns that by allowing nonlawyers to own law firms, ethical tensions would be created between a lawyer's fiduciary duty to his client and the nonlawyer owner's commercial interest in turning a profit.[9]

After three years, the Court itself signaled concerns over the sufficiency of its regulatory scheme surrounding ABSs when it established the Task Force on Alternative Business Structures ("ABS Task Force") and empowered it to investigate concerns related to ABSs.[10] The Court gave the ABS Task Force three mandates: to determine (1) whether the Court should require ABSs to make additional disclosures; (2) whether the Court should allow ABSs to form solely to practice mass tort litigation; and (3) whether the Court should mandate that ABSs provide substantial services to people in Arizona.[11] Several months later, the Court asked the ABS Task Force to review "third-party financing of civil litigation and its ramifications for Alternative Business Structures in Arizona."[12] Through its creation of the ABS Task Force, then, the Court expressed lingering ethical concerns surrounding ABSs.

Notwithstanding these concerns, it remains that Arizona has blazed a trail down which other states now seek to travel. Washington state has recently created a pilot program that allows ABSs.[13] Indiana, too, has begun its journey down this

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[7] Specifically, the Court stated that "[a]n entity that includes nonlawyers who have an economic interest or decision-making authority as defined in ACJA 7-209 may employ, associate with, or engage a lawyer . . . to provide legal services to third parties." *Id.* at 9.

[8] One notable voice of dissent was Chief Judge Peter B. Swann, who served on the task force that advanced the petition to eliminate rule 5.4. He argued that "under this proposal, entities who need not be identified, and individuals who would never pass character and fitness, will be free to call the shots for lawyers without any concern for ethical rules." Hon. Peter B. Swann, *The Case Against the Elimination of ER 5.4*, 56 ARIZ. ATT'Y, Oct. 2020 at 35, 41.

[9] The Board of Governors of Florida, for example, criticized ABSs stating that "[a]llowing nonlawyer ownership or investment in law firms may simply amplify the existing profit motivations in the practice of law and steer investors toward the most potentially profitable cases." Mark A. Behrens & Christopher E. Appel, *Proposals to Allow Nonlawyer Ownership of Law Firms, Fee Splitting Experience Rejection*, WASH. LEGAL FOUND.: LEGAL BACKGROUNDERS (Oct. 13, 2022), https://www.wlf.org/2022/10/13/publishing/proposals-to-allow-nonlawyer-ownership-of-law-firms-fee-splitting-experience-rejection/ [https://perma.cc/Y22A-VNC6].

[10] Ord. for the Establishment of the Task Force on Alt. Bus. Structures and Appointment of Members, Ariz. Sup. Ct. No. 2024-51 1 (Mar. 18, 2024).

[11] *Id.*

[12] Ord. for the Task Force on Alt. Bus. Structures to Evaluate Ramifications of Third-Party Fin., Ariz. Sup. Ct. No. 2024-136 (July 3, 2024).

[13] On December 5, 2024, "the Washington Supreme Court . . . entered an order authorizing . . . companies and nonprofits [*i.e.* nonlawyers] to offer legal services." Sara

path.[14] Furthermore, two other states—California[15] and Florida[16]—have considered allowing ABSs, although neither has moved forward with such a proposal. And finally, Utah and Washington, D.C. have already created programs through which some nonlawyers can own law firms.[17] In total, of the seven jurisdictions in the United States that have considered permitting ABSs, five of them have done so.

Given the increasing number of jurisdictions that are either investigating or permitting ABSs, and given such a trend has the potential to completely transform the delivery of legal services across the country, a thoughtful examination of the state that pioneered that movement is needed. Arizona now has over four years of experience overseeing ABSs, and its experience managing them can serve as a model for other states. To be sure, there are some ethical questions regarding ABSs in Arizona that remain unanswered, but these questions can be answered by reference to Australia's and the UK's experience with ABS-like programs.

Part I will discuss the Court's introduction of ABSs in Arizona. This will include: (1) an examination of the history leading up to the Court's ethics reforms that permitted ABSs; (2) the ethical criticisms ABS opponents initially voiced; (3) the actions the Court took to address these criticisms at the outset; (4) the current

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Niegowski, *Supreme Court Approves a Pilot of Licensing Innovation to Expand Legal Access in Washington*, WASH. STATE BAR ASS'N: MEDIA RELEASE (Dec. 5, 2024), https://wsba.org/news-events/media-center/media-releases/supreme-court-approves-a-pilot-of-licensing-innovation-to-expand-legal-access-in-washington [https://perma.cc/7LG4-K943].

[14] On October 3, 2024, "[t]he Indiana Supreme Court . . . directed a . . . committee to 'develop initial parameters for a legal regulatory sandbox' . . . [that] pointed to Utah, where a program launched in 2020 allow[ed] . . . non-lawyer investment and ownership in law firms." Sara Merken, *Another US State Joins Legal Services Reform Push, Citing Lawyer Shortage*, REUTERS: LEGAL (Oct. 4, 2024, at 11:53 AM MST), https://www.reuters.com/legal/government/another-us-state-joins-legal-services-reform-push-citing-lawyer-shortage-2024-10-04/ [https://perma.cc/B7RG-ECJR].

[15] In 2018, "[t]he State Bar of California[] . . . [began pursuing] proposals [that] would authorize . . . corporations to own law firms . . . [but] AB 2958 . . . [later] guarantee[d] that the bar" could not permit nonlawyer ownership of law firms. Nancy Drabble & Saveena K. Takhar, *New California Law Bans State Bar's Pursuit Of Corporately Owned Law Firms*, ADVOCATE (Nov. 2022), https://www.advocatemagazine.com/article/2022-november/new-california-law-bans-state-bar-s-pursuit-of-corporately-owned-law-firms [https://perma.cc/FJ45-PR4F].

[16] In 2022, "[t]he Florida Bar's Board of Governors unanimously opposed the Special Committee's proposals to allow nonlawyer ownership in law firms." Mark A. Behrens, *Fla. Supreme Court Rejects Nonlawyer Ownership of Law Firms, Fee Splitting with Nonlawyers*, FEDSOC BLOG (Mar. 31, 2022), https://fedsoc.org/commentary/fedsoc-blog/fla-supreme-court-rejects-nonlawyer-ownership-of-law-firms-fee-splitting-with-nonlawyers [https://perma.cc/2A8E-ZPKB].

[17] *See* Mike Robinson, *Are Non-Lawyers Allowed to Own a Law Firm?*, CLIO BLOG (Sep. 13, 2024), https://www.clio.com/blog/can-non-lawyer-own-firm/ [https://perma.cc/QVF4-56FF] (discussing how both Utah and Washington, D.C. offer limited nonlawyer ownership of law firms).

efforts the Court is employing to mitigate lingering and newly-emerging ethical concerns related to ABSs; and (5) the remaining ethical questions regarding ABSs that are still unanswered. These open questions will serve as a catalyst for Part II.

Part II will undertake a case study of Australia and the United Kingdom—two foreign jurisdictions that have permitted nonlawyer ownership of law firms for many years—in an effort to answer these questions.[18] For both countries, Part II will examine: (1) the history surrounding their adoption of ABS-like programs; (2) the ethical concerns each country attempted to address at the outset of their programs; (3) the changes each country made to address residual ethical concerns related to their ABS-like programs; and (4) the regulatory approach each country took in response to the rise of third-party litigation funding.

Finally, Part III will articulate which reforms Australia and the UK took that Arizona regulators should investigate to answer the open questions Part I details

I. ARIZONA'S ADOPTION OF ABSS

A. The Introduction of ABSs

On November 21, 2018, the Court established the Task Force on Delivery of Legal Services ("Task Force") to conduct a review of the Court's regulatory regime and determine whether the regime needed to change to keep pace with business and technological advances.[19] Citing its goal of "promoting access to justice," the Court noted that "changes in technology, the legal profession, and the economy call for a reassessment of the delivery of legal services to consumers more broadly."[20] To that end, the Court organized the Task Force and endowed it with several mandates.[21] Most relevantly, the Court asked the Task Force to investigate and "[r]ecommend whether Supreme Court rules should be modified to allow for co-ownership by lawyers and nonlawyers in entities providing legal

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[18] This article studies Australia and the United Kingdom because of their shared common law tradition with the United States. *See* Jennifer G. Hill, *Regulatory Show and Tell: Lessons from International Statutory Regimes*, 33 DEL. J. CORP. L. 819, 819 (2008) (stating that the United States, Australia, and the UK are common law countries).

[19] Ord. for the Establishment of the Task Force on Delivery of Legal Servs. and Appointment of Members, Ariz. Sup. Ct. No. 2018-111 1–2 (Nov. 21, 2018).

[20] *Id.* at 1.

[21] These mandates included: (1) simplifying and clarifying the provisions of Rule 31(d); (2) reviewing the Legal Document Preparers program to recommend revisions to the existing rules and code sections governing this program; (3) examining whether nonlawyers should be allowed to render legal services in a limited capacity; (4) reviewing Supreme Court Rule 42 and ER 1.2 to determine if changes are necessary to incentivize a greater use of limited scope representation services; (5) recommending whether Supreme Court rules should be amended to allow nonlawyers to have ownership in law firms; and (6) recommending other rule changes or pilot programs to further the Court's aim of increasing access to legal services. *Id.* at 2.

services."[22]

Upholding its mandate, the Task Force conducted research, submitted a report, and recommended several changes.[23] Most relevant to this article, the task force recommended that the Court:

> Eliminate Arizona's Rules of Professional Conduct (ER) 5.4 and 5.7 and amend ERs 1.0 through 5.3 to remove the explicit barrier to lawyers and nonlawyers co-owning businesses that engage in the practice of law while preserving the dual goals of ensuring the professional independence of lawyers and protecting the public.[24]

When the Task Force put forth these recommendations, ER 5.4 "prohibit[ed] sharing fees with nonlawyers and forming partnerships with nonlawyers if any part of the partnership's activities include[d] the practice of law."[25] In reviewing the history of ER 5.4, the Task Force concluded that "[t]he prohibition was not rooted in protecting the public but in economic protectionism."[26] Ultimately, "the task force . . . concluded it no longer serve[d] any purpose, and in fact may impede the legal profession's ability to innovate to fill the access-to-civil-justice gap."[27] As such, the Task Force recommended that the Court abrogate ER 5.4 and allow ABSs.[28]

After the Task Force submitted its report, the Court enacted multiple reforms to effectuate several of the Task Force's recommendations.[29] The Court's most salient reforms were its abrogation of ER 5.4, its replacement of Arizona Supreme Court Rule 31, and its amendments to existing ERs that touched upon lawyers' ethical duties to their clients.[30] As noted above, ER 5.4 prohibited the ownership

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[22] *Id.*

[23] Outside of its recommendations regarding ABSs, the Task Force made several other categories of recommendations: (1) modifying the legal advertising rules; (2) promoting education and information to the public on unbundled legal services; (3) clarifying when a law student may practice law under the supervision of a lawyer; (4) restyling Supreme Court Rule 31(d); (5) developing a system to allow nonlawyer legal service providers to render a limited scope of legal services; (6) initiating a pilot program to expand legal services to domestic violence survivors; (7) allowing domestic violence lay advocates to prepare legal documents for victims of domestic violence; (8) increasing the scope of services that Legal Document Preparers can provide to clients; and (9) encouraging local courts to establish programs whereby nonlawyers in the court can provide legal information to *pro se* litigants. TASK FORCE ON THE DELIVERY OF LEGAL SERVS., ARIZ. SUP. CT., REPORT AND RECOMMENDATIONS 3–5 (2019).

[24] *Id.* at 3.

[25] *Id.* at 15.

[26] *Id.*

[27] *Id.*

[28] *Id.* at 3.

[29] Ariz. Sup. Ct. No. R-20-0034, *supra* note 6.

[30] First, in abrogating the old Rule 31, the Court paired the adoption of Rule 31.1 with

of law firms by nonlawyers,[31] and the previous Supreme Court Rule 31 defined the practice of law, outlining who was authorized to engage in it.[32] Relatedly, the other ERs touched upon the relationship between a lawyer and her client.

While Arizona pioneered ABSs with the goal of expanding access to legal services, the key question is whether the initial ethical safeguards were enough to allow non-lawyers to own law firms without negatively impacting lawyers' ability to uphold their fiduciary obligations to their clients. The next section articulates the ethical concerns ABS opponents voiced at the outset and analyzes the changes the Court made to address these concerns.

B. Ethical Concerns Regarding ABSs at the Outset and the Court's Initial Ethics Reforms

Before ABSs entered Arizona's legal marketplace, some lawyers voiced concerns that ABSs would create ethics problems. These concerns stemmed from the belief that nonlawyer owners within ABSs would not understand a lawyer's ethical duty to her client.[33] And as a function of this ignorance, nonlawyers in law firms would bring pressure to bear upon attorneys by strong-arming them into prioritizing profits at the expense of their client's best interest.[34] In other words, ABS opponents expressed concerns that implicated two intertwined categories of legal ethics: conflicts of interest and professional independence. This harkens back to the Court's "twin goals of protecting a lawyer's independent professional judgment and protecting the public."[35] While ABS opponents had legitimate concerns, the Court was aware of these concerns well before lawyers started opining on the ethical dangers of ABSs. In fact, these concerns animated the Court's decision to promulgate a host of new court rules and ethics rules amendments alongside its introduction of ABSs.

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the adoption of a new Rule 31, and it also adopted Rule 31.2 and Rule 31.3. And second, the Court amended several ERs to accommodate ABSs: (1) ER 1.0; (2) ER 1.5; (3) ER 1.6; (4) ER 1.7; (5) ER 1.8; (6) ER 1.10; (7) ER 1.17; (8) ER 5.1; (9) ER 5.3; (10) ER 5.4; (11) ER 5.7; and (12) ER 8.3. *Id.* at 2.

[31] *Id.* at 44.

[32] *Id.* at 9.

[33] Among others, one lawyer argued that nonlawyer owners would fail to understand a lawyer's fiduciary duty, stating that "[l]awyers . . . have an entrenched, foundational, and deep-rooted appreciation of their fiduciary duty to act in the client's best interests at all times. Will or can a non-lawyer owner attain the same appreciation?" Benjamin Gottlieb, *New Ethical Rule Changes: Greater Access to Justice or Diminishment in Integrity of the Legal Profession? The Jury is Still Out*, ATT'Y L. MAG. (Sep. 4, 2020), https://attorneyatlawmagazine.com/legal/legal-news/ethical-rule-changes-access-to-justice-or-diminishment-standards-legal-profession-jury-out [https://perma.cc/5X2V-4XVX].

[34] Gottlieb expressed this concern, positing that in ABSs "tension and conflict [may] exist between the attorney-employee's efforts to implement ethically sound—albeit non-profitable policies—and the nonlawyer owner's efforts to churn out greater profit." *Id.*

[35] TASK FORCE ON THE DELIVERY OF LEGAL SERVS., *supra* note 23, at 13.

To accompany the allowance of ABSs, the Court replaced Supreme Court Rule 31 with Rules 31,[36] 31.1, 31.2, and 31.3.[37] First, the new Rule 31 gave the Court jurisdiction over licensed ABSs,[38] thereby allowing the Court to oversee nonlawyers' activities. Second, Rule 31.1 required ABSs to "employ[] at least one person . . . who supervises the practice of law."[39] This rule prohibited nonlawyers from supervising lawyers, thereby eliminating a source of ethical pressure within ABSs. Third, Supreme Court Rule 31.2 extended existing ethical protections against the unauthorized practice of law to ABSs by prohibiting the unauthorized use of the designation "Alternative Business Structure."[40] And finally, Rule 31.3 created exceptions to Rule 31.2.[41] In sum, these rules brought ABSs under the ethical supervision of the Court as a first line of defense against ethical tensions created by nonlawyer ownership of law firms.

In addition to replacing Rule 31, the Court adopted Rule 33.1,[42] thereby creating the Committee on Alternative Business Structures ("CABS"). The Court tasked CABS with reviewing ABS applications and recommending whether the Court should grant applicants a license.[43] After receiving a recommendation, the Court could approve the application, deny it, or approve it with modifications.[44] Rule 33.1 also empowered the Court to revoke an ABS license if the applicant engaged in "fraud or material misrepresentation in the procurement [of] the ABS's license."[45] At bottom, this rule created a gatekeeping system to address the conflict of interest and professional independence concerns within an ABS. If an applicant showed they had sufficient safeguards in place to address these ethical concerns, the Court would grant them a license. If not, the Court would deny their application or require them to make changes to address these concerns before granting them a license. And if after the Court granted a license it discovered that an ABS misrepresented their ethical constraints, the Court could revoke their license.

Separate from promulgating new rules, the Court amended several ERs to

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[36] This was a new Rule 31.

[37] Ariz. Sup. Ct. No. R-20-0034, *supra* note 6, at 1–2.

[38] *Id.* at 9.

[39] *Id.*

[40] *Id.* at 10.

[41] Most relevant to this article, an ABS whose license the Court has suspended may render some legal services, but this is subject to the judgment or order of the Court, a disciplinary judge, or a hearing panel. These exceptions are outlined in subsections (b) through (e) under Rule 31.3. *Id.* at 10–15.

[42] Rule 33.1 contained many procedural elements regarding CABS, such as the number of members sitting on the committee (*i.e.* eleven), the length of their term of office (*i.e.* three years), and the ability of the Court to remove any member at any time. *Id.* at 17.

[43] In addition to Rule 33.1, the Court subjected CABS to oversight under the Arizona Code of Judicial Administration ("ACJA") § 7-209, which provided a framework for how CABS should conduct its review of ABS applicants. *See generally* ARIZ. CODE OF JUD. ADMIN. § 7-209 (West, Westlaw with amendments received through Dec. 1, 2024).

[44] Ariz. Sup. Ct. No. R-20-0034, *supra* note 6, at 17.

[45] *Id.* at 18–19.

address the ethical concerns ABSs created.[46] First, the Court amended ER 1.6 to permit lawyers to share client information with nonlawyer owners on the condition that "[a]ny such shared information shall be subject to requirements of confidentiality."[47] Second, the Court amended ER 1.7 to bar a lawyer from representing a client when the adverse party's firm is owned, in part, by a nonlawyer who also possesses an ownership interest in the lawyer's firm.[48] Third, the Court amended ER 1.8 to require lawyers in ABSs to disclose to their client the inherent conflict the lawyer possesses when they operate as both advisor and participant in a transaction with the client.[49] Fourth, the Court amended ER 1.10, which previously required firms to screen conflicted lawyers out of a client's representation, to extend screening requirements to nonlawyers in ABSs.[50] Fifth, the Court amended ER 5.1 to extend a supervisory lawyer's duty of ethical oversight to encompass nonlawyers within an ABS.[51] Sixth, the Court amended ER 5.3 to require ABSs to charge one of its lawyers with creating and enforcing policies and procedures to ensure nonlawyer owners adhere to legal ethics rules.[52] Seventh, the Court amended ER 8.3 to place a duty on lawyers in an ABS to report nonlawyer owners if and when they violate legal ethics rules.[53]

The Court's amendments were aimed at alleviating the primary ethical tensions created by ABSs: conflicts of interest, confidentiality concerns, and professional independence. First, amended ER 1.6 addressed confidentiality and professional independence concerns within ABSs by allowing lawyers to withhold information from nonlawyer owners when sharing such information would eliminate confidentiality.[54] Second, amended ER 1.7 addressed conflict of interest concerns within ABSs by preventing lawyers from representing clients when doing so would diminish the zeal with which lawyers represent their clients.[55] Third, amended ER 1.8 addressed the inherent conflict of interest concerns when lawyers are both legal advisers and participants in the transaction.[56] Fourth, amended ER 1.10 addressed self-evident conflict of interest concerns that arise when nonlawyer

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[46] *Id.* at 2. Because ER 1.17 is only tangentially related to ABSs core ethical concerns, this subsection omits a discussion of it.

[47] *Id.* at 27.

[48] Absent the client's written informed consent, if the same nonlawyer owns 10% or more of both the lawyer's firm and the firm against whom the lawyer is arguing, the lawyer may not represent the client. *Id.* at 28.

[49] Comment [1] to ER 1.8 states that lawyers must disclose the risks of this dual relationship to their client, "including when lawyers refer clients for nonlegal services provided in the firm by either the lawyer or nonlawyer." In theory, this covers ABSs that contain other professional services such as accounting services. *Id.* at 31.

[50] *Id.* at 32.

[51] *Id.* at 38.

[52] *Id.* at 41–42.

[53] *Id.* at 49.

[54] *Id.* at 27.

[55] *Id.* at 28–29.

[56] *Id.* at 30–31.

owners have personal interests that conflict with the representation of a new client.[57] And fifth, amended ERs 5.1 and 5.3 addressed all three categories of ethical tensions by creating an internal auditing system whereby designated lawyers monitored nonlawyer owners to ensure they did not run afoul of legal ethics rules.[58]

Aside from these amendments, the Court promulgated ACJA § 7-209 to provide a broad ethical check on ABSs. First, this section required ABSs to submit signed indemnification and conflict of interest statements.[59] The former provided assurance that the ABS would compensate a client harmed by the ABS, and the latter provided assurance that the ABS would avoid representing a client when doing so would create a conflict of interest. Second, § 7-209 required ABSs to certify that the ABS is covered by professional liability insurance.[60] This ensured that the ABS had sufficient financial resources to cover liabilities arising out of the ABS' representation of their clients. Third, § 7-209 required ABSs to have a designated compliance lawyer on staff who "[e]nsure[s] compliance with the ethical and professional responsibilities of lawyers" and "authorized person[s]."[61] To that end, compliance attorneys had to promptly notify the state bar when they reasonably believed that a person within an ABS violated § 7-209 or the legal ethical rules.[62] If a compliance attorney failed to do so, the penalties were severe: "in addition to other possible sanctions, [the compliance attorney] may be suspended [from the practice of law]."[63] Fourth, § 7-209 subjected lawyers and nonlawyers within an ABS to an additional, separate code of conduct.[64] In total, § 7-209 created a system of punishment for ethical failures within ABSs and a pathway for clients to secure remuneration when ABSs run afoul of ethical constraints.

C. Current Efforts to Address Ethical Concerns Regarding ABSs

1. The CABS Reporting System

Section 7-209 also requires CABS to publish annual reports on ABSs, and the information in these reports has informed several administrative changes that have facilitated the Court's oversight of ABSs. According to CABS' 2020 report, the Court granted two ABS licenses.[65] This increased to fifteen licenses in 2021,[66]

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[57] *Id.* at 32–33.

[58] *Id.* at 38–43.

[59] ARIZ. CODE OF JUD. ADMIN. § 7-209(G)(1)(b) (West, Westlaw with amendments received through Dec. 1, 2024).

[60] § 7-209(G)(1)(j) (Westlaw).

[61] § 7-209(G)(3)(a)-(b) (Westlaw).

[62] § 7-209(G)(3)(b)(4) (Westlaw).

[63] § 7-209(G)(3)(c) (Westlaw).

[64] *See* § 7-209(K) (Westlaw).

[65] COMM. ON ALT. BUS. STRUCTURES, 2020 ANN. REP. 5 (2021).

[66] COMM. ON ALT. BUS. STRUCTURES, 2021 ANN. REP. 4 (2022).

and to twenty-five licenses in both 2022[67] and 2023.[68] Perhaps in response to the 2020 report, the Certification and Licensing Division ("CLD") of the Court enhanced ABS reporting requirements.[69] In particular, CLD started transmitting the contact information of ABS compliance lawyers to the State Bar once the Court granted a license to an ABS.[70] A year later, the CLD started sending a list of all Authorized Persons within an ABS (*i.e.* owners of ABSs) to the State Bar.[71] These changes were designed to streamline the State Bar's investigation of complaints filed against ABSs, which likely proved useful in 2023 when the State Bar received twenty-four charges of misconduct against four ABSs.[72] While these procedural changes were helpful, they lacked the force necessary to address lingering and newly emerging ethical concerns regarding ABSs.

2. The Task Force on Alternative Business Structures

To substantively address that gap, the Court created the ABS Task Force to investigate what changes the ABS program needed to stay abreast of ethical concerns. On March 18, 2024, the Court promulgated an order, stating that "[t]o date, 67 Alternative Business Structures have been approved. . . . Given the interest level, evaluation of the program is warranted . . . to determine if any adjustments need to be made to the governing code."[73] To that end, the Court established the ABS Task Force, empowering it with a general mandate to "evaluate the program . . . and propose amendments to the Administrative Code of Judicial Administration and court rules as appropriate."[74] Under this rubric, the Court gave the ABS Task Force three specific mandates: (1) determining whether the Court should require ABSs to disclose information about persons funding an ABS; (2) determining whether ABSs could operate solely to solicit mass tort business; and (3) determining whether the Court should require ABSs to provide "substantial services to people in Arizona."[75] After the ABS Task Force started its investigation, it became clear that there was one additional concern that it should investigate: the ethical ramifications of third-party litigation funding. In response, the Court empowered the ABS Task Force to investigate this concern in an order the Court promulgated on July 3rd, 2024.[76]

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[67] COMM. ON ALT. BUS. STRUCTURES, 2022 ANN. REP. 4 (2023).

[68] CT. COMM. ON ALT. BUS. STRUCTURES, 2023 ANN. REP. 2 (2024).

[69] *See generally* COMM. ON ALT. BUS. STRUCTURES, *supra* note 66, at 4 (detailing "[s]everal improvements" to the ABS reporting process).

[70] *Id.*

[71] COMM. ON ALT. BUS. STRUCTURES, *supra* note 67, at 4.

[72] As the division noted, "A *charge* is an allegation of wrongdoing," and while people filed multiple charges against ABSs in 2023, the State Bar did not initiate any complaints against ABSs that year. COMM. ON ALT. BUS. STRUCTURES, *supra* note 68, at 4–5.

[73] Admin. Ord. Ariz. Sup. Ct. No. 2024-51, *supra* note 10, at 1.

[74] *Id.*

[75] *Id.*

[76] Ariz. Sup. Ct. No. 2024-136, *supra* note 12.

On November 12, 2024, the ABS Task Force published a report in which it identified several lingering ethical concerns within ABSs and recommended several changes to the program.[77] Most relevantly, the ABS Task Force identified that third-party litigation funding posed the ethical risk of "potential third-party control over litigation strategy."[78] To address this risk, the ABS Task Force recommended limited initial disclosure when a party uses third-party funding in litigation.[79] According to the ABS Task Force, this disclosure would consist of (1) the existence of third-party funding and (2) the identity of the funder.[80] The ABS Task Force also recommended that in some circumstances, the court should perform an in camera review of the funding agreement to determine if there were any conflicts present, such as control rights.[81] Outside of these minor recommendations, the ABS Task Force did "not perceive any problems with the current approach" to ABSs.[82] It noted that third-party litigation funding is not unique to ABSs, and that due to the enhanced level of screening ABSs go through during their application process, "existing ethics rules can address most issues related to third-party funding."[83]

3. Remaining Ethical Concerns

True enough, third-party litigation funding is not unique to ABSs; but an open concern within ABSs remains: Might a nonlawyer owner influence litigation funding in ways not captured by the funding agreement or the ethics rules? After all, a majority of ABSs are majority nonlawyer owned,[84] and many of these owners are litigation funders and private equity firms.[85] Given their involvement in the

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[77] ARIZ. SUP. CT. TASK FORCE ON ALT. BUS. STRUCTURES, REPORT AND RECOMMENDATIONS (2024).

[78] *Id.* at 3.

[79] *Id.*

[80] *Id.*

[81] Control rights refer to terms in a litigation funding agreement that entitle the funder to dictate important decisions such as whether to settle a case or proceed to trial. *Id.* at 19.

[82] *Id.* at 23.

[83] *Id.* at 3.

[84] In 2021, nine of the fifteen ABSs (*i.e.* 60%) were majority nonlawyer owned. ARIZONA SUPREME COURT COMMITTEE ON ALTERNATIVE BUSINESS STRUCTURES, *supra* note 66, at 5. In 2022, twenty-seven of the thirty-nine ABSs (*i.e.* about 70%) were majority nonlawyer owned. ARIZONA SUPREME COURT COMMITTEE ON ALTERNATIVE BUSINESS STRUCTURES, *supra* note 67, at 5. The 2023 report does not contain information on the breakdown of lawyer to nonlawyer ownership.

[85] According to the public law library, private equity funds with ownership stakes in ABSs include Melody Capital Management and Kayne Anderson, and litigation funders with ownership stakes in ABSs include Pravati Capital and Virage Capital Management. *Arizona's Legal Landscape Transformed: Private Equity and Litigation Funders Seize Opportunities in Law Firm Ownership*, PUB. L. LIBR. (June 28, 2024), https://publiclawlibrary.org/arizonas-legal-landscape-transformed-private-equity-and-

world of finance, these firms are likely the ones either providing or arranging third-party financing. And their ability to influence the course of litigation may not be completely captured by a funding agreement or the ethics rules. For example, as a part of the investment agreement between a private equity firm and an ABS, the former may acquire veto rights over major business decisions of the latter such as decisions whether to settle or continue litigation. As such, questions remain: If a nonlawyer owner arranges litigation financing, is the client receiving the most competitive and fair terms possible? If a litigation funder is part-owner of an ABS, will that funder exert undue influence over litigation strategy? What other ethical concerns regarding ABSs are yet in their formative phase of development? If other concerns are currently germinating, can prophylactic measures be taken to prevent these concerns from emerging?

Given these open questions, it is useful to examine how other countries with ABS-like models have answered them. Australia and the UK are good case studies, as both have adopted regulatory frameworks similar to ABSs. The next section explores both countries in detail.

II. FOREIGN JURISDICTIONS' APPROACH TO REGULATING ABS-LIKE ENTITIES

A. Australia

1. Australia's Adoption of Multidisciplinary Partnerships ("MDPs")

Starting in 1993, Australian states began permitting nonlawyer ownership of law firms through Multidisciplinary Partnerships ("MDPs"). New South Wales ("NSW") pioneered this change when its legislators passed the Legal Professions Reform Act ("the NSW Act").[86] Over a decade later, the states of Victoria, Queensland, and Western Australia adopted similar reforms.[87] Victoria began permitting MDPs in 2004,[88] Queensland did so in 2007,[89] and Western Australia did so in 2008.[90] At the outset, MDP dissenters voiced concerns that these business structures would create ethical problems for lawyers. And just as in Arizona, these

litigation-funders-seize-opportunities-in-law-firm-ownership/ [https://perma.cc/X5H2-JASQ]. In addition, an author publishing in Bloomberg noted that "[o]f the 76 applications that have been approved for so-called alternative business structures (ABS) since 2020, at least 15 have involvement from private equity or litigation finance." Emily R. Siegel, *Private Equity Goes to Arizona for National Tort Firms*, BL: BUS. & PRAC. (July 2, 2024, at 11:09 AM), https://www.bloomberglaw.com/bloomberglawnews/business-and-practice/X1K10AJ8000000 [https://perma.cc/SP7A-KKQ9].

[86] *Legal Profession Reform Act 1993* (NSW) (Austl.).

[87] Other Australian states have followed suit, but a discussion of these states' programs would be largely duplicative.

[88] *Legal Profession Act 2004* (Vic) s 2.7.37 (Austl.).

[89] *Legal Profession Act 2007* (Qld) s 145 (Austl.).

[90] *Legal Profession Act 2008* (WA) s 132 (Austl.).

states promulgated rules to accompany the entrance of MDPs into the Australian market to address these concerns.

2. Ethical Concerns Regarding MDPs at the Outset

At the outset, lawyers in these Australian states articulated the same primary ethical concerns that Arizonan lawyers articulated about ABSs many years later: (1) confidentiality risks;[91] (2) conflicts of interest concerns;[92] and (3) professional independence concerns.[93]

Regarding confidentiality, some lawyers were concerned that nonlawyer owners would engage in business practices that would eliminate the privilege that attaches to communications between a lawyer and his client.[94] In Australia, to qualify as privileged, "a communication must have been made confidentially. . . . [W]here a communication is made in front of a third party, privilege will likely not apply."[95] With the advent of MDPs, lawyers were concerned that nonlawyer owners would qualify as "a third party," thereby causing lawyers to forfeit the privilege that would otherwise attach to their communications with clients.

Regarding conflicts of interest, some lawyers were concerned that nonlawyer owners within MDPs would create tension between the fiduciary duties lawyers owe to their clients and the business (*i.e.* profit) interests of the firm. To be sure, this concern existed in non-MDP law firms as well, and the Australian Solicitor's Conduct Rules addressed such a problem.[96] But some lawyers argued that MDPs created a wrinkle that non-MDP firms did not possess: namely, that "non-lawyer participants . . . may not be bound by the same stringent fiduciary duty."[97]

Regarding professional independence, lawyers' concerns in this domain mirrored those in the arena of conflicts of interests. Namely, some lawyers were concerned that the introduction of nonlawyer ownership of law firms would

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[91] *National Competition Policy Review of the Legal Profession Act 1987* (Final Report August 1998) ch 10 (Austl.).

[92] *Id.*

[93] *Id.*

[94] *Id.*

[95] Johnathan Quilty, Patrick Joyce, & Kate Rietdyk, *Legal Professional Privilege under Australian Law*, LANDER & ROGERS (Dec. 2017), https://www.landers.com.au/legal-insights-news/legal-professional-privilege-under-australian-law [https://perma.cc/R2VY-778P] (citing the Evidence Acts of Australia as the source of such privilege).

[96] Rule 2.12.2, for example, states that "[a] solicitor must not do anything . . . calculated to dispose a client . . . to confer on the solicitor . . . any benefit in excess of the solicitor's fair and reasonable remuneration for legal services provided to the client." L. Soc'y of N.S.W., *ACT Legal Profession (Solicitors) Conduct Rules 2015* (at 7 January 2015) r. 2.12 (Austl.).

[97] Nicolee Dixon, 'Legal Profession Reform in Queensland: Multi-Disciplinary Practices (MDP's)', (Research Brief No 03, Parliamentary Library, Parliament of Queensland, February 2003) 5 (Austl.), https://documents.parliament.qld.gov.au/explore/ResearchPublications/ResearchBriefs/2003/200303.pdf [https://perma.cc/K4AA-A7BQ].

prevent lawyers from exercising their own professional judgment in servicing their clients. Some lawyers acknowledged this concern as legitimate but stated that "the independence of legal advice and ethical practices will depend upon the personal integrity of individual lawyers in the MDP, rather than the type of business entity."[98]

3. Ethical Safeguards NSW Constructed Around MDPs at the Outset[99]

To address these concerns, NSW updated its solicitors' rules (*i.e.* lawyers' rules) to accompany the newly minted MDP structure.[100] Three rules in particular stand out: Rules 2.1.1, 2.1.3, and 2.1.6. First, Rule 2.1.1 mandated that member solicitors in an MDP retain majority voting rights in directing the affairs of the partnership, likely to preserve the professional independence of solicitors.[101] Second, Rule 2.1.3 mandated that the partnership and its members avoid conflicts of interest between the partnership's clients and "any other interest which a member of the partnership may have or be required to serve."[102] Finally, Rule 2.1.6 required MDPs to maintain indemnification insurance to provide remuneration for clients harmed by the firm's actions.[103] While it is clear that NSW (and other Australian states) affirmatively addressed the ethical concerns surrounding MDPs from the start, the question is whether these states have been effective at preventing such ethics violations.

4. Were These Ethical Safeguards Enough?

The question as to whether these ethical safeguards were enough remains partially unanswered, although further research could yield some insight. Relative to other countries permitting ABS-like law firms, there appear to be few MDPs in Australia. This lack of data makes it difficult to empirically determine whether Australian states have successfully managed the ethical concerns described above. Nonetheless, as of 2021, there were thirty MDPs licensed in NSW,[104] and in that same year, the Office of the Legal Services Commissioner (*i.e.* the body

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[98] *Id.* at 11.

[99] Because each of the Australian states shared the same ethical concerns, and because New South Wales was the first to permit MDPs, the following sections focus solely on New South Wales. An analysis of the other states would be largely duplicative.

[100] According to the Law Society of New South Wales, the rules went into effect on July 1, 1994. L. SOC'Y OF NSW., 'Professional Conduct and Practice Rule', *Gov't Gazette of the State of NSW.,* (Syd., June 10, 1994) 2806 (Austl.).

[101] *Id.* at 2812.

[102] *Id.*

[103] *Id.*

[104] The Law Society's Ethics Committee, *Multi-Disciplinary Practices: What are the Ethical Boundaries?*, L. SOC'Y NSW J.: LSJ (Nov. 1, 2021, at 08:30 AM AEDT), https://lsj.com.au/articles/multi-disciplinary-practices-what-are-the-ethical-boundaries/ [https://perma.cc/ZUP9-2UDE].

responsible for handling ethics complaints against legal practitioners in NSW) received 2,714 written complaints.[105] Unfortunately, the Office of the Legal Services Commissioner did not categorize the complaints based on whether the lawyer against whom the complaint was filed worked for a traditional law firm or an MDP. As such, one would need to conduct research on the complaint-level data to understand whether MDPs are over-contributing to the number of legal ethics complaints in NSW.[106]

While answers to the question noted in title of subsection 4 cannot be discerned from NSW's legal ethics complaints data, NSW's efforts at reforming its MDP system may provide an answer, at least in part. Years after the NSW Act was passed, NSW commissioned a review of its MDP system. After this review was completed, NSW eliminated its initial regulation that required lawyers within MDPs to hold majority voting rights.[107] At the same time, NSW empowered the disciplinary tribunal that handles ethics complaints to regulate nonlawyers by declaring them "not fit and proper to be a partner" if their behavior warranted such a designation.[108] In tandem, these two changes create a nuanced picture of NSW's MDP reforms. On the one hand, by eliminating the requirement that lawyers within MPDs hold majority voting rights, NSW loosened ethical restrictions. On the other hand, by empowering disciplinary tribunals to discipline nonlawyers within MDPs, NSW tightened ethical restrictions. Conflicting reforms aside, it appears that the legal regulators in NSW believed that to some degree, their initial MDP ethical safeguards were not enough, and such a determination led to these reforms.

5. In the Wake of Reform, What Ethical Concerns Remain?

In the wake of these reforms, two primary concerns with MDPs remained: (1) confidentiality concerns brought about by law firms' inability to fully cordon off privileged information from the eyes of nonlawyer partners; and (2) conflicts of interest concerns created when MDPs make internal referrals.

An Australian researcher, Adrian Evans, articulated the confidentiality concern in a law review article wherein he provided a recommendation on how to handle the concern. Evans began by recognizing the concern, stating that while

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[105] Jennifer Shaw, *Complaints and Discipline—Ethics Check for Lawyers Series*, MONDAQ (June 30, 2022), https://www.mondaq.com/australia/human-resource-management-/1207462/complaints-and-discipline---ethics-check-for-lawyers-series [https://perma.cc/P8L2-RKYE].

[106] Such research is beyond the scope of this article but may yield important insights for regulatory bodies regarding ABS-like programs.

[107] *See* Jayne R. Reardon, *Alternative Business Structures: Good for the Public, Good for the Lawyers*, 7 ST. MARY'S J. LEGAL MALPRACTICE & ETHICS 304, 327 (2017) (noting that the rule requiring majority ownership of MDPs by lawyers was eliminated in 2001).

[108] *See The Council of the Law Society of New South Wales v FZK* [2023] NSWCATOD 154 (Austl.) (holding that the conduct described in the facts of the case "rendered [the lawyer] . . . not a fit and proper person to be employed or paid in connection with the practice of law").

communications between a lawyer and her client are protected by confidentiality, this protection is arguably removed when a nonlawyer acquires an ownership interest in the firm.[109] But, he argued that a solution may exist, stating that while "[t]he intimate knowledge of one partner as to their client's affairs is presumed to be the intimate knowledge of all other partners . . . a sufficiently credible 'Chinese Wall'" could render this concern moot.[110] However, Evans was doubtful that a Chinese Wall would handle such confidentiality concerns, because such a wall did not have the capacity to prevent inadvertent disclosures of information during, for example, a social or celebratory occasion.[111]

Another Australian researcher, Nicolee Dixon, articulated a conflict-of-interest concern that MDPs pose, and she provided a recommendation on how to address this concern. Dixon noted that if MDPs contain multiple types of professionals, there "is the possibility that a referral might be made [by a lawyer] to another part of the MDP where an outside professional would be more appropriate."[112] Citing an Issues Paper, Dixon recommended that to address this concern, "full disclosure should be made to the client, at the time of the referral, of the possible benefit that could be derived by the solicitor, and the availability of external services of the same type."[113]

While these solutions sound feasible, it is unclear whether Australian states have implemented them; regardless, Australia's experience managing the ethical concerns MDPs create can help answer some of the questions Part I posed. Specifically, given the Court recently granted KPMG an ABS license,[114] the danger of inappropriate internal referrals identified by Dixon is now in its formative phase of development in Arizona. Dixon's recommendation to address this danger may provide a prophylactic regulation that could prevent the seeds of such ethical concerns from blooming into a fully formed problem.[115] Part III of this article will explore this subject in more detail.

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[109] Adrian Evans, 'Multidisciplinary Practices', [2000] 74(11) *L. Institute J.* 25, 25 (Austl.).

[110] *Id.*; Chinese Walls are "a[n] organisational [sic] contrivance . . . designed to prevent the flow of confidential information to or from a part or parts of that enterprise. Lee Aitken, ''Chinese Walls' and Conflicts of Interest', (1992) 18 *Monash Univ. L. Rev.* 91, 92 (Austl.).

[111] Evans, *supra* note 109, at 25.

[112] Dixon, *supra* note 97, at 5.

[113] *Id.*

[114] *See* Alt. Bus. Structure Application of KPMG L. US, LLC, Ariz. Sup. Ct. No. 2025-43 (Feb. 27, 2025).

[115] To be sure, the American Bar Association's legal ethics rules, which Arizona's legal ethics rules closely track, do refer to these types of referrals, but they do so tangentially in the comments to some of the rules. *See, e.g.*, MODEL RULES PRO. CONDUCT r. 1.7 cmt. 10 (A.B.A. 1983) (*"*[A] lawyer may not allow related business interests to affect representation, for example, by referring clients to an enterprise in which the lawyer has an undisclosed financial interest.").

6. Third-Party Funded Litigation in Australia

As with its experience with ABS-like programs, Australia preceded Arizona by over a decade in its notice of and response to third-party litigation funding. In June of 2011, the Law Council of Australia ("LCA") released a paper that analyzed the proliferation of third-party funded litigation and the ethical problems therein.[116] According to the paper, starting in 1995, Australian regulators began accepting third-party litigation funding as an exception to Australia's common law prohibition against maintenance and champerty.[117] Since then, third-party litigation funding has expanded largely to fund class actions and large single-plaintiff suits.[118] While the LCA believed that third-party litigation funding helped increase Australians' access to justice, it also believed that third-party litigation funding created ethical concerns that needed to be addressed, namely: (1) conflicts of interest; and (2) professional independence.[119]

To address these concerns, the LCA put forth several pieces of guidance. First, the LCA recommended that legal regulators bar litigation funders from performing legal work on behalf of their clients to avoid conflicts of interest.[120] Second, the LCA recommended that regulators place some limits on a funder's control rights to prevent the funder from pressuring lawyers to violate the fiduciary duty they owe to their client.[121] Third, the LCA argued that courts should have to approve settlement agreements when litigation is funded as a check on a funder's possible overreach.[122] And fourth, the LCA recommended that regulators require litigation funding agreements to contain mandatory default terms. These terms included cooling-off periods (*i.e.,* the client's ability to cancel the contract for a full refund within a certain period of time) and provisions allowing the funded party to seek independent legal advice as to the propriety of the funding agreement.[123]

While these recommendations appear sound, regulatory bodies within Australian states and territories have adopted few, if any, of them. In fact, "[t]here are no specific professional or ethical conduct rules that apply to the role of legal professionals in advising clients in relation to third-party litigation funding or in

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[116] The Law Council wrote the paper "to set out areas in which regulation may be required for consumer protection, to minimise [sic] conflicts of interest and put an end to expensive satellite litigation over the propriety of litigation funding agreements." 'Regulation of Third Party Litigation Funding in Australia' (Position Paper, Law Council of Australia, June 2011) 3 (Austl.).

[117] *Id.* at 4.

[118] These class actions and single-plaintiff suits tend to be in the areas of products liability, cartel activity, securities fraud, and companies' negligent conduct in overcharging for products and services. *Id.* at 5.

[119] *Id.* at 3, 16.

[120] *Id.* at 17.

[121] *Id.*

[122] *Id.* at 19.

[123] *Id.* (making other recommendations as well).

funded proceedings."[124] That said, a tradition in Australia has emerged in which litigation funders who fund class actions give lead plaintiffs the opportunity to obtain independent legal advice regarding the propriety of the funding arrangement. Additionally, federal and state rules regarding class actions now require courts to approve settlements.[125] So, while Australian regulators did not codify the LCA's recommendations in formal ethics rules, they nonetheless adopted some of them through either informal practice or court rule regimes.

As with MDPs, Australia's experience managing ethical concerns related to third-party funded litigation can help answer some of the questions Part I posed. In particular, given that several ABSs in Arizona are owned in part by litigation funders, the danger of ABSs settling litigation when it is not in the best interest of the client is quite salient. To address this danger, the Court could adopt several of the LCA's recommendations. Namely, it could (1) require that courts approve settlements when third-parties fund litigation; (2) require mandatory default terms in litigation funding agreements; and (3) require litigation funders to inform plaintiffs that they have the right to seek independent advice as to the propriety of the funding agreement. Part III examines these recommendations in greater depth.

B. United Kingdom

1. The UK's Adoption of ABSs

On October 30, 2007, the United Kingdom ("UK") passed the Legal Services Act ("LSA"), which permitted the formation of ABSs.[126] Legislators hoped that this change would increase competition in the legal field by eliminating trade barriers that restricted nonlawyers from owning law firms. This, they hoped, would decrease the cost of legal services while maintaining fidelity to ethical principles within the legal field.[127] To that end, the LSA outlined the scope of what business an ABS could conduct under what it called "reserved legal activities." These activities included "(a) the exercise of a right of audience; (b) the conduct of litigation; (c) reserved instrument activities; (d) probate activities; (e) notarial activities; [and] (f) the administration of oaths."[128]

Prior to the passage of the LSA, Sir David Clementi articulated the same three ethical concerns that Arizona lawyers articulated regarding ABSs: (1)

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[124] Piper Alderman, Amelia Atkinson, Greg Whyte, Kate Sambrook, Martin Gallego, & Millie Byrnes Howe, *At a Glance: Regulation of Litigation Funding in Australia*, LEXOLOGY (Nov. 21, 2023), https://www.lexology.com/library/detail.aspx?g=e133b4b8-75d6-47e0-a385-d7b8e625f106 [https://perma.cc/NF2L-FNV5].

[125] *Id.*

[126] *See* Legal Services Act 2007, c. 29 (UK).

[127] *See* Myles V. Lynk, *Implications of the UK Legal Services Act 2007 for US Law Practice and Legal Ethics*, 23 PRO. LAW. 26, 30 (2015) (stating that two of the regulatory objectives of the Legal Services Act 2007 was to improve access to justice and promote competition in the provision of legal services).

[128] Legal Services Act 2007 s 5 (UK).

confidentiality risks; (2) conflict of interest concerns; and (3) professional independence concerns.[129] Because these concerns largely mirror those discussed in both Part I and subsection A of Part II, this section omits a discussion of them here and instead focuses on how the UK addressed these concerns at the outset.

2. *The Ethical Safeguards the UK Constructed Around ABSs at the Outset*

To address these concerns at the outset, the LSA contained several major regulatory reforms, the first of which was the creation of a single regulatory agency to oversee all legal service providers, known as the Legal Services Board (the "Board").[130] The LSA designed the Board to be independent of both the government and the legal profession,[131] a change that marked a major departure from how the UK regulated the legal profession in times past.[132] But importantly, the Board did not regulate the bar itself. Rather, the Board oversaw approved regulators who, in turn, regulated the bar.[133] If approved regulators were not properly carrying out their mandates, the LSA allowed the Board to intervene and impose corrective measures on those regulators.[134] Separate from regulation, the Board possessed the power to directly license ABSs.[135] In sum, the LSA established the Board as the highest authority over the legal profession, endowed it with the ability to regulate the legal regulators, and empowered it to license ABSs directly. By doing so, the LSA enabled the Board to manage the confidentiality, conflict of interest, and professional independence concerns ABSs created.

The second major reform the LSA introduced was the creation of a process whereby ABSs would be licensed through one of several approved licensing authorities.[136] These licensing authorities could function solely as licensing

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[129] David Clementi, 'Review of the Regulatory Framework for Legal Services in England and Wales', (Final Report 2004) 21 (UK).

[130] Lynk, *supra* note 127, at 29.

[131] The Board's independence comes from "the Act [which] requires that the chairman of the Board and a majority of its members not be lawyers." *Id.*

[132] Prior to the Act, front-line practitioner bodies were responsible for regulating lawyers. These bodies included the Law Society, the Bar Council, the Institute of Legal Executives, the Chartered Institute of Patent Agents, and the Institute of Trade Mark Attorneys. This system was one of self-regulation. Clementi, *supra* note 129, at 4.

[133] Lynk, *supra* note 127, at 29.

[134] These measures include target-setting, censure, financial penalties, direct intervention in the regulation of the approved regulator's regulation of its members, and the ability to recommend to the Lord Chancellor that the approved regulator's designation be cancelled. Legal Services Act, *supra* note 126, at 16–27.

[135] *Id.* The Act intended, however, that licensing authorities that the Board approved would be the primary bodies to review ABS applications and approve or deny them.

[136] Under § 73 of the Act, "'licensing authority' means—(a) the Board, or (b) an approved regulator which is designated as a licensing authority . . . and whose licensing rules are approved for the purposes of this Act." Legal Services Act ss 43–44.

authorities or as both licensing authorities and approved regulators.[137] In their capacity as licensing authorities, these bodies retained the power to create their own licensing rules to which ABS applicants would have to adhere.[138] The LSA mandated that the licensing rules promulgated by a licensing authority contain several minimum provisions: (1) a list of licensing qualifications the authority would use to determine whether to grant a license; (2) a provision outlining how the licensing authority would take account of the Act's regulatory objectives when approving ABS applicants; (3) a requirement that regulators use appropriate arrangements to regulate approved ABSs, such as conduct rules; and (4) a requirement that the licensing authority forge appropriate indemnification and compensation arrangements with approved ABSs.[139] In sum, the LSA empowered these licensing authorities to act as prophylactic regulators, preventing unqualified and unethical ABS applicants from securing a license.

The third major reform the LSA introduced was the creation of an independent Office of Legal Complaints ("OLC"), which was tasked with handling all legal complaints against lawyers in the UK.[140] The OLC removed the approved regulators' former power to handle complaints and placed that authority in the hands of a Chief Ombudsman.[141] Such a change was justified, according to Sir David Clement, because the previous complaint system suffered from several issues: (1) it had a poor record of handling complaints; (2) it lacked public confidence in the independence and impartiality of the system; (3) it was inconsistent and unclear in its dispensation of corrective measures; and (4) it possessed significant and unnecessary redundancy.[142] The OLC, then, centralized and streamlined the legal ethics complaint system, thereby increasing the scrutiny under which ABSs (and other law firms) would operate.

While these reforms are enlightening, because the UK regulates ABSs on a national level now, such reforms provide a diminished level of probative value to Arizona researchers investigating reforms to Arizona's ABS system. The most informative of these reforms is the conduct rules to which licensing authorities require ABSs to adhere. Analysis of these conduct rules is beyond the scope of this article, but such rules may prove to be fertile grounds for future research.

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[137] The Solicitors Regulatory Authority, the Council for Licensed Conveyancers, the Intellectual Property Regulation Board, and the Institute of Chartered Accountants in England and Wales are among those approved regulators who also function as licensing authorities. Lynk, *supra* note 127, at 29.

[138] Under § 83(3) of the Act, "licensing rules made by an approved regulator have effect only at a time when the approved regulator is a licensing authority." Legal Services Act 2007 s 83 sub-s 3 (UK).

[139] *Id.* at s 83 sub-s 5.

[140] *See generally Id.* at 64–85, ss 118–160.

[141] *See generally Id.* at 65–66, 71, ss 122–124, 134–135.

[142] *See generally* Clementi, *supra* note 129, at 57–63.

3. Third-Party Funded Litigation in the UK

As with its experience regulating ABSs, the UK preceded Arizona by over a decade in its notice of and response to third-party funded litigation. In 2011, in line with the rise of third-party funded litigation, regulators in the UK formed the Association of Litigation Funders ("ALF").[143] These regulators formed the ALF to achieve several goals: (1) to provide protection for funded clients; (2) to provide protection for funded defendants; and (3) to ensure the public had a positive perception of the industry.[144] To achieve those ends, legal regulators organized the ALF as a self-regulatory body with the power to oversee litigation funders who joined the organization.[145] The ALF exercised this oversight in two primary ways: (1) through a code of conduct; and (2) through a complaints procedure.

The initial ALF code of conduct contained several provisions designed to protect consumers (*i.e.* funded parties) and lawyers. The first provision the ALF designed ensured that funded parties received independent advice as to the terms of the funding agreement before its execution.[146] The protection inherent in this provision is self-evident. A second provision of the code of conduct sought to protect the lawyer who represented a funded party from being influenced by the funder to corrupt the professional duties the lawyer owed to his client.[147] The ALF designed this provision to alleviate conflicts of interest and professional independence concerns. A third provision dealt with control rights and noted that a funder may "not seek to influence the Funded Party's [lawyer] to cede control or conduct of the dispute to the Funder."[148] As with the second provision, the ALF designed this provision to alleviate professional independence concerns. And finally, a fourth provision of the code of conduct required that litigation funders maintain adequate capital reserves to account for their litigation funding obligations.[149] Presumably, the ALF designed this provision to ensure that litigation funders' clients would not be left in a position wherein their funder went bankrupt during litigation, thereby requiring the client to dismiss their complaint.

As with ABSs, the UK's experience managing third-party funded litigation and its ethical concerns can help answer some of the questions Part I posed. In

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[143] Rachael Mulheron, *A Review of Litigation Funding in England and Wales*, (Queen Mary University of London 2024) 49 (UK).

[144] *Id.* at 50.

[145] *Id.*

[146] Rule 9.1 contains this provision, which states that the litigation funder must "take reasonable steps to ensure that the Funded Party shall have received independent advice on the terms of the LFA prior to its execution." *Code of Conduct for Litigation Funders* (Association of Litigation Funders of England and Wales 2018) r 9.1(UK).

[147] *See id.* r 9.2 (stating that the litigation funder will "not take any steps that cause or are likely to cause the Funded Party's solicitor or barrister to act in breach of their professional duties.").

[148] *Id.* r 9.3.

[149] *See id.* r 9.4 (stating that a litigation funder will "[m]aintain at all times access to adequate financial resources to meet the obligations of the Funder.").

particular, given that third-party litigation funders maintain partial ownership of several ABSs in Arizona, there is a danger that clients may not be getting the best funding terms possible. To address this danger, the Court could adopt a separate code of conduct to which litigation funders must subscribe and through which ABS clients could file complaints. Part III will explore this recommendation in more detail.

The case studies of Australia and the UK highlight regulatory mechanisms that could help Arizona address lingering concerns regarding ABSs. To be sure, it is unclear how impactful the ethical changes have been since these countries have made changes to their ABS-like programs. A researcher would have to analyze empirical data—such as complaints against ABSs both before and after these jurisdictions implemented their regulatory changes—to understand if those changes resulted in reduced ethical concerns. But even absent this empirical evidence, Arizona could experiment with these changes on a trial basis. After all, its adoption of ABSs was itself an experiment. So, in the spirit of experimentation, the next section explores potential regulatory solutions derived from Australia's and the UK's experience to answer the questions Section I posed.

III. IMPLEMENTING LEARNINGS FROM AUSTRALIA AND THE UK

After exploring Australia's and the UK's experience with ABS-like programs and third-party litigation funding, this article now addresses the questions Part I posed. The first two questions offer solutions to litigation financing concerns. The third question articulates an ethical concern within ABSs that the Court has largely not had the occasion to address but will likely need to given KPMG's entrance into Arizona's legal market. And the fourth question articulates a potential solution to this emerging concern. If Arizona regulators were interested in implementing any of these solutions, they would need to commission an investigative body to conduct empirical research on these solutions to ensure their efficacy. This research could be accomplished by reviewing complaint data in the UK and Australia, both before and after their respective solutions were implemented.

A. If a nonlawyer owner within an ABS arranges litigation financing, either through its own funds or through a third-party's funds, is the client receiving the most competitive and fair terms possible?

Australia's experience regulating third-party litigation funding, specifically through its use of mandatory default terms and independent advice requirements, provides a potential answer to this question. As to the mandatory default terms, the LCA recommended that litigation funding agreements contain a provision for a cooling-off period,[150] which would allow clients to cancel the funding agreement for a full refund within a certain period of time.[151] As to the independent advice

[150] LAW COUNCIL OF AUSTRALIA, *supra* note 116, at 19.
[151] *Id.*

requirement, the LCA recommended that litigation funding agreements contain a provision that permits the funded party to seek independent legal advice regarding the propriety of the funding agreement.[152] In Arizona, if the Court required a cooling-off period provision in funding agreements, an ABS client would have recourse if they later concluded that the agreement was not in their best interest. And if the Court required an independent advice provision, this would level the playing field between the sophistication of the litigation funder and that of the client, thereby maximizing the chances that the agreement is competitive and fair.

B. If a litigation funder is part-owner of an ABS, will that funder exert undue influence over litigation strategy to the detriment of an ABS client?

Australia's experience requiring lawyers to hold majority voting rights in MDPs and requiring courts to approve settlement agreements, and the UK's experience with the ALF's separate code of conduct all provide potential answers to this question. First, regarding Australia's experience with majority voting rights, NSW initially required lawyers within MDPs to hold majority voting rights over their nonlawyer counterparts.[153] In Arizona, if the Court required lawyers to hold majority voting rights in ABSs, this could ensure that the voting power within an ABS would be concentrated in the hands of partners who understand the ethical obligations lawyers owe to their clients.[154] This could prevent an ABS from developing a general business policy of settling litigation sooner than what would be in the best interest of clients. Second, regarding Australia's experience with court approved settlement agreements, court rules in some Australian states require courts to approve settlement agreements when a litigant utilizes third-party funding.[155] Here, if the Court required Arizona courts to approve settlement agreements when a litigant uses litigation funding, this would ensure that the settlement is truly in the best interest of the client. And third, regarding the UK's experience, the ALF promulgated a code of conduct and a separate complaints process to which litigation funders were subject.[156] In Arizona, if the Court promulgated a separate code of conduct to which litigation funders were subject, this could create the incentive structure necessary for litigation funders to refrain from exerting undue influence over litigation strategy.

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[152] *Id.*

[153] Law Society of New South Wales, *supra* note 100, at 2812.

[154] Importantly, while this change would require lawyers in ABSs to hold majority voting rights, that does not necessarily mean that lawyers would have to maintain majority ownership of the law firm. Law Society of New South Wales, *supra* note 100, at 2812.

[155] Alderman, Atkinson, Whyte, Sambrook, Gallego, & Byrnes Howe, *supra* note 124.

[156] Mulheron, *supra* note 143, at 49.

C. What other ethical concerns regarding ABSs are yet in their formative phase of development?

Australia's experience regulating MDPs, particularly relating to inappropriate internal referrals, provides a potential answer to this question. In commenting on the ethical concerns MDPs create, one Australian researcher noted that there "is the possibility that a referral might be made [by a lawyer] to another part of the MDP where an outside professional would be more appropriate."[157] Australian MDPs frequently feature multiple professionals working within the same firm, such as a lawyer and an accountant. In such a case, this concern would manifest when a lawyer becomes privy to the fact that her client needs tax advice and refers that client to the MDP's own accountant, even when it is not in the client's best interest. That concern may very well be germinating in Arizona right now, given the Court recently granted KPMG an ABS license.[158] And now that KPMG has entered Arizona's legal marketplace, other large professional services firms—including Deloitte, PwC, and EY—will likely do the same. If they do, the volume of internal referrals within ABSs will likely skyrocket. The potential for inappropriate internal referrals within ABSs, then, is an ethical concern that has the potential to increase in prominence in the coming years.

D. If other concerns are currently germinating, can prophylactic measures be taken to prevent these concerns from emerging?

Australia's experience regulating third-party funded litigation and Arizona's own experience requiring a compliance lawyer to work within an ABS provide potential answers to this question. As to Australia's experience, the LCA recommended that litigation funding agreements contain a provision that permits the funded party to seek independent legal advice regarding the propriety of the funding agreement.[159] Applied to Arizona, the Court could require that ABSs inform their clients of their ability to seek independent advice as to the propriety of an internal referral. As to Arizona's own experience requiring a compliance lawyer, Arizona could empower this lawyer to oversee all internal referrals within the ABS. This oversight could act as a check against inappropriate internal referrals. And because compliance lawyers are already under a duty to report ethical breaches to state regulatory authorities, there would be clear consequences to inappropriate internal referrals.

CONCLUSION

"[C]ourts . . . must be trusted . . . to incrementally define the contours of the law . . . over time. Difficult and perplexing distinctions will have to be made, and

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[157] Dixon, *supra* note 97, at 5.
[158] *See* Alt. Bus. Structure Application of KPMG L. US, LLC, *supra* note 114.
[159] LAW COUNCIL OF AUSTRALIA, *supra* note 116, at 19.

lines will have to be drawn. But that is precisely the business of our judicial system . . . [thereby] leading law to constantly evolve."[160] This quote was penned by Connecticut Superior Court Judge Douglas S. Lavine, who articulated a self-evident proposition: the law must evolve as our understanding of the issues the law is meant to address increases. While Judge Lavine aimed this proposition at a substantive area of law, it applies with equal force to the regulation of the legal profession. Applied here, after four years of experience regulating ABSs, the Court's understanding of the issues underlying their regulation has increased. As such, the Court has modified the regulatory scheme under which ABSs operate to great effect. But with the increase in the number of third-party litigation funders who own ABSs, and with KPMG's entrance into the ABS marketplace, Arizona must address new ethical issues that have arisen within its ABS program.

Thankfully, Australia and the UK have blazed a regulatory trail in this space that offers insights into how Arizona can address these newly emerging concerns. This article's case study of both jurisdictions shows that Arizona regulators should consider investigating the following reforms: (1) requiring that lawyers within ABSs hold majority voting rights; (2) requiring that litigation funding agreements contain mandatory cooling-off period and independent advice provisions; (3) requiring litigation funders to subscribe to a separate code of conduct and complaints process; (4) requiring courts to approve settlements when an ABS litigant uses third-party funding; and (5) requiring ABSs to inform their clients of the ability to seek independent advice when an ABS makes an internal referral.

If adopted, these reforms have the potential to curb ethical concerns without overly restricting the practice of law within ABSs, and achieving this balance could result in a proliferation of ABSs and a legal renaissance. If lawyers within ABSs hold majority voting rights, the general policy of ABSs will continue to be one in which the client's best interest is prioritized over the firm's economic success. If litigation financing agreements are subject to cooling-off periods and independent advice provisions, a transparent and efficient finance market will be created, leading to an increase in Arizonans' ability to access justice. If courts must approve settlement agreements when litigants use litigation funding, the judiciary can back-stop any improper influence litigation funders attempt to exert over funded parties. If litigation funders subscribe to a separate code of conduct and complaints process that the Court oversees, there will be little opportunity for fraud to abound, as it has in other finance markets (*e.g.* the subprime mortgage market of the early 2000s). Finally, if inappropriate internal referrals are curbed, the cost of professional services, including legal services, will likely decrease because more competition will be introduced into the fray. Those who see these regulatory changes as an opportunity rather than a burden will spin up an ABS practice, compete for professional services business, and help usher in a new era of business development in the legal field. In sum, Arizona has the potential to become the leading legal jurisdiction in the United States as its ABS program is poised to

[160] Ercole v. Cuomo, No. CV 93-0456963S, 1994 WL 363361, at *9 (Conn. Super. Ct. June 15, 1994).

disrupt the professional services market, and these reforms can help bring that result to fruition.

Relatedly, Arizona has itself blazed a regulatory trail in its allowance of ABSs in the United States even with the lingering ethical concerns that exist, and other states can avail themselves of vicarious knowledge through Arizona's experience. States that have recently adopted ABS programs can look to Arizona as they craft their own reforms. And states that are currently investigating the viability of ABS programs can use Arizona as a model jurisdiction to follow as they consider permitting nonlawyer ownership of law firms. As with any market, the first movers (*i.e.* the states at the vanguard of innovation) stand to benefit most from adopting ABSs.