

## LAWYERS' PROPERTY RIGHTS IN STATE LAW

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### ABSTRACT

The current system of state licensing of lawyers is being challenged by significant changes in the legal profession, including multi-state and multi-disciplinary law firms and the rise of Internet law practice. Conventional client-protection explanations of lawyer licensing are inadequate to meet this challenge. However, lawyer licensing can be best understood in the context of the state competition debate. State licensing has an important overlooked benefit in terms of enabling lawyers' role in the state lawmaking process. Efficient laws make the state an attractive forum for potential litigants to choose at the time of their contract. Lawyer licensing encourages lawyers' involvement in lawmaking by capitalizing the benefits of their law-improvement efforts in the value of the law license. In other words, state licensing gives lawyers a kind of property right in law. This article shows how lawyers' influence over state law may be consistent with social welfare and how giving lawyers property rights in law through state licensing helps produce these effects.

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<b>I. CHALLENGES TO STATE-OF-PRACTICE LICENSING</b>	<b>7</b>
A. CURRENT RESTRICTIONS ON LAWYER COMPETITION	7
B. THE RISE OF INTERSTATE LAW PRACTICE	8
1. Law practice over the Internet	9
2. Multi-state firms	10
C. ALTERNATIVE REGULATORY REGIMES	12
1. Private ordering or self-regulation	13
2. Corporate-type choice of domicile	14
3. Federal licensing and regulation	16
<b>II. LAWYERS' PARTICIPATION IN STATE LAWMAKING</b>	<b>17</b>
<b>III. EFFICIENCY OF LAWYERS' EFFECT ON STATE LAW</b>	<b>18</b>
<b>IV. CREATING LAWYERS' PROPERTY RIGHTS IN LAW</b>	<b>20</b>
A. TYING LAWYERS TO STATES	21
B. TYING THE LAW TO STATES	23
<b>V. TESTING THE HYPOTHESIS</b>	<b>24</b>
A. FACTORS AFFECTING THE LAWYERS' LOBBY	24
1. Direct evidence of lawyers' political action	24
2. Barriers to entry	25
3. Lawyer income	26
4. Percentage of lawyers in the population	27
5. Coordination costs	27
B. CONNECTING LAWYERS' LOBBYING TO STATE LAW EFFICIENCY	28
<b>VI. CONCLUDING REMARKS</b>	<b>31</b>

Law practice is undergoing fundamental changes with the growth of large, national law firms and the move toward multidisciplinary firms that combine lawyers with non-law professionals. The Internet threatens to erase geographical limitations on soliciting legal business and practicing law. Those whose livelihoods are threatened by the changes are resisting them. The American Bar Association has refused to make even a tentative move toward permitting multidisciplinary practice<sup>1</sup> and has done nothing to facilitate solicitation and practice through the Internet. In fact, an ABA commission is moving toward recommending rule changes that would increase the extent to which lawyers can be subject to regulation wherever they practice.<sup>2</sup> But despite the ABA's resistance, powerful forces are moving for change. Many lawyers see the market opportunities in multidisciplinary practice, and clients see the benefits of being able to hire multidisciplinary firms and buy legal services on the Web. Lawyers have been working within the bar to relax restrictions. Lawyers may be forced to accept significant changes in their current regulatory structure.

One potential change would be to eliminate the current system of state licensing of lawyers. State licensing not only blocks the way to national law practice but also seems to have only the same cartel effect as other professional regulation -- that is, keeping the price of legal services high by restricting entry into the profession.<sup>3</sup> Although there is evidence that lawyers have not used licensing laws to raise their incomes,<sup>4</sup> it seems evident that lawyers are resisting wholesale erosion of their perquisites whether or not these changes benefit society.<sup>5</sup> To be sure, lawyer licensing, like professional

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<sup>1</sup> The ABA House of Delegates has twice rejected proposals to consider allowing multidisciplinary practice. For a discussion of the ABA's 1999 rejection of MDPs, see Larry E. Ribstein, *Organized Bar Shouldn't Shield Lawyers From New Competition*, Washington Legal Foundation Legal Opinion Letter, October 15, 1999. At the summer, 2000 meeting, the House of Delegates adopted the so-called MacCrate proposal, Resolution 10F, which provides in part that "[t]he sharing of legal fees with non-lawyers and the ownership and control of the practice of law by nonlawyers and the ownership and control of the practice of law by nonlawyers are inconsistent with the core values of the legal profession." See Geanne Rosenberg, *ABA Resoundingly Rejects MDPs*, *The National Law Journal*, July 12, 2000.

<sup>2</sup> See *infra* text accompanying note 33.

<sup>3</sup> See generally Milton Friedman, *Occupational Licensure*, in CAPITALISM AND FREEDOM (1962); George J. Stigler, *The Theory of Economic Regulation*, 2 *BELL J. ECON.* 3 (1971). See also John R. Lott, Jr., *Licensing and Nontransferable Rents*, 77 *AM. ECON. REV.* 453 (1987) (arguing that non-transferable professional licenses not only involve rent-seeking costs and monopoly rents, but also bar low-cost producers because the license is not an opportunity cost for licensee).

<sup>4</sup> See Dean Lueck, Reed Olsen & Michael Ranson, *Market and Regulatory Forces in the Pricing of Legal Services*, 7 *J. Rev. Econ.* 63 (1995).

<sup>5</sup> The problem may be the inherently complex nature of law. See Gillian K. Hadfield, *The Price of Law: How the Market for Lawyers Distorts the Justice System*, 98 *Mich. L. Rev.* 953 (2000). If so, the cure would be to permit parties to avoid reliance on law where the costs outweigh the benefits. They could do so by privatizing law. See Gillian K. Hadfield, *Privatizing Commercial Law: Lessons from the Middle and the Digital Ages*, Stanford Law School, John M. Olin Program in Law and Economics, Working Paper No. 195 (March 2000) available at [http://papers.ssrn.com/paper.taf?abstract\\_id=220252](http://papers.ssrn.com/paper.taf?abstract_id=220252) (Hadfield, *Privatizing*). The current article considers the effect of lawyer licensing and ethical rules assuming no change in the

licensing generally,<sup>6</sup> can be defended as a way of preventing a lemons market, particularly given the nature of legal services as "credence" goods.<sup>7</sup> Indeed, since lawyers and clients have joint interests in maintaining the quality of legal services, ethics rules also might be viewed as a standard lawyer-client contract that economizes on contracting costs.<sup>8</sup> But, as discussed below in subpart I(C), it is not clear that government regulation offers significant advantages over what could be produced by markets and private ordering alone.

This article shows, however, that state licensing of lawyers has an important benefit relating to lawyers' role in the state lawmaking process that has not previously been taken into account in the policy debate on lawyer licensing. Lawyers internalize costs and benefits of state laws to the extent that efficient laws make the state an attractive forum for potential litigants to choose at the time of their contract. Accordingly, it may make sense to adopt policies that encourage lawyers' involvement in lawmaking.

Lawyers' role in lawmaking is best understood in the context of the state competition debate. State law has been viewed as a kind of "product" that state legislatures in effect manufacture and that competes in a market for laws.<sup>9</sup> This is especially clear regarding corporate law, where the apparent ease of choosing the applicable state law by selecting the state of organization seems to encourage competition, and where there is explicit evidence that at least one state, Delaware, actively competes.

The debate concerns whether state competition is likely to lead to efficient outcomes. Some commentators have argued that the corporate law competition is a "race-to-the-bottom" because managers disregard shareholder interests in choosing the incorporation state,<sup>10</sup> while others have argued that it is a "race to the top" because capital markets discipline jurisdictional choice.<sup>11</sup> Some evidence supports the latter

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demand for conventional legal services.

<sup>6</sup> See generally Hayne E. Leland, *Quacks, Lemons, and Licensing: A Theory of Minimum Quality Standards*, 87 J. POL. ECON. 1328 (1979).

<sup>7</sup> See *infra* text accompanying note 57.

<sup>8</sup> See Jonathan R. Macey & Geoffrey P. Miller, *An Economic Analysis of Conflict of Interest Regulation*, 82 IOWA L. REV. 965 (1998).

<sup>9</sup> See Roberta Romano, *Law as Product: Some Pieces of the Incorporation Puzzle*, 1 J.L. ECON. & ORG. 225 (1985).

<sup>10</sup> See William Cary, *Federalism and Corporate Law: Reflections upon Delaware*, 83 YALE L.J. 663 (1974). For other commentary consistent with this view see Lucian Arye Bebchuk & Allen Ferrell, *Federalism and Takeover Law: The Race to Protect Managers from Takeovers*, 99 COLUMB. REV. 1168 (1999); Lucian Arye Bebchuk, *Federalism and the Corporation: The Desirable Limits on State Competition in Corporate Law*, 105 HARV. L. REV. 1435 (1992).

<sup>11</sup> See Ralph Winter, *State Law, Shareholder Protection, and the Theory of the Corporation*, 6 J. LEGAL STUD. 251 (1977). For other commentary consistent with this view see Frank H. Easterbrook & Daniel R. Fischel, *THE ECONOMIC STRUCTURE OF CORPORATE LAW* (Harvard, 1991); Roberta Romano, *Law as a Product: Some Pieces of the Incorporation Puzzle*, 1 J.L. ECON. & ORG. 225 (1989); Daniel R. Fischel, *The "Race to the Bottom" Revisited: Reflections on Recent Developments in Delaware's Corporation Law*, 76 Nw. U. L. Rev. 913 (1982).

proposition.<sup>12</sup> There is also evidence of welfare-enhancing competition regarding the law governing closely held firms that are not traded in efficient capital markets.<sup>13</sup> More recently, the debate has focused on whether Delaware's competitive advantages, including a sophisticated bar and judiciary, developed case law, convenient location and ability to credibly commit to continuing to supply high-quality law,<sup>14</sup> enable it to dominate the market for state corporate law and thereby prevent the emergence of the optimal legal rules that would prevail in a perfectly competitive market.<sup>15</sup>

One corollary of the imperfect competition view concerns lawyers' role. Lawyers clearly have played an important, role in writing Delaware law.<sup>16</sup> Lawyers might be expected to use their substantial influence to promote legal rules that favor lawyers' interests, as by encouraging excessive litigation. Although a perfectly competitive market for corporate law arguably would constrain such rules, it has been argued that Delaware lawyers can capitalize on Delaware's dominance in the market for corporate law to make Delaware law excessively litigation-intensive.<sup>17</sup> From this perspective, lawyers' main role in state competition seems to be as the beneficiaries of inefficiencies in the market for state law.

But fully understanding lawyers' role in promoting state competition requires a broader perspective. A corporate-type state competition can occur whenever the process of contractually selecting the applicable state law is analogous to that of choosing the state of incorporation.<sup>18</sup> Looking beyond U.S. corporate law raises important questions

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<sup>12</sup> Peter Dodd and Richard Leftwich, *The Market for Corporate Charters: Unhealthy Competition versus Federal Regulation*, 53 J. BUS. 259 (1980); Romano, *supra* note 11.

<sup>13</sup> See Larry E. Ribstein, *Statutory Forms for Closely Held Firms*, 73 WASH. U. L.Q. 369, 392-94 (1995). See also Bruce H. Kobayashi & Larry E. Ribstein, *Evolution and Uniformity*, 34 ECON. INQUIRY 464 (July, 1996) (showing evidence of evolution of state statutes toward efficient level of uniformity).

<sup>14</sup> These advantages were first discussed by Romano, *supra* note 11.

<sup>15</sup> See Hadfield, *supra* note 5; Marcel Kahan & Ehud Kamar, *Price Discrimination in the Market for Corporate Law*, [http://papers.ssrn.com/paper.taf?abstract\\_id=217849](http://papers.ssrn.com/paper.taf?abstract_id=217849) (2000) (arguing that Delaware uses its market power to charge firms franchise taxes and litigation costs according to the benefits firms gain from using Delaware's law); Ehud Kamar, *A Regulatory Competition Theory of Indeterminacy in Corporate Law*, 98 COLUM. L. REV. 1908 (1998) (arguing that legal indeterminacy helps entrench Delaware's dominance); Michael Klausner, *Corporations, Corporate Law, and Networks of Contracts*, 81 VA. L. REV. 757 (1995) (arguing that network externalities may have "locked in" Delaware law, thereby preventing more efficient standards from developing). The network externalities argument potentially applies whenever there is an existing standard and therefore goes beyond the specific context of Delaware's dominance in corporate law. For evidence contrary to this lock-in view, see Bruce H. Kobayashi & Larry E. Ribstein, *Factors Determining the Success of Business Forms: The Case of LLCs and LLPs*, ms 2000.

<sup>16</sup> See S. Samuel Arsht, *A History of Delaware Corporation Law*, 1 Del. J. Corp. L. 1, 17-21 (1976); Kahan & Kamar, *supra* note 15 at 64.

<sup>17</sup> See Kamar & Kahan, *supra* note 15; Jonathan R. Macey & Geoffrey Miller, *Toward an Interest-Group Theory of Delaware Corporate Law*, 65 TEX. L. REV. 469 (1987).

<sup>18</sup> See Bruce H. Kobayashi & Larry E. Ribstein, *Uniformity, Choice of Law and Software Sales*, 8 GEO. MASON LAW REVIEW 261 (1999); Bruce H. Kobayashi & Larry E. Ribstein, *State Regulation of Consumer Marketing Information* (working paper, 2000); Bruce H. Kobayashi & Larry E. Ribstein,

concerning what drives competition in the absence of significant franchise tax revenues and where the market for state law is not dominated by a single state. In particular, it is not clear what motivates *lawmakers*, as distinguished from *states*, to compete. Legislators, the state's agents in the lawmaking process, seemingly reap inadequate rewards from making a state's law competitive to justify their engaging proactively in law reform,<sup>19</sup> particularly since other jurisdictions can free-ride on their efforts by copying successful innovations.<sup>20</sup> Although taxpayers as a whole may gain from the state's being a leader in the competition, their gain probably is not large enough to overcome significant political coordination costs.<sup>21</sup> Legislators therefore probably would get a higher return from spending time supporting causes promoted by well-coordinated interest groups than from participating in law reform.

Lawyers, by contrast, have a significant incentive to promote the quality of their state's law. As I discussed in a previous article, lawyers therefore can be viewed as the engine that drives efficient state competition.<sup>22</sup> This article explores the mechanisms and conditions that enable lawyers to play this role and looks beyond Delaware. In general, the article suggests that lawyers have a sort of property right in the body of law they are licensed to practice in the sense that other lawyers are excluded from some of the benefits of practicing under that law. This priority gives lawyers an interest in investing resources to influence their state's laws, including political activities, participation in bar functions and legislative drafting. Lawyers' property rights in law drive the supply side of state competition to provide efficient law. In other words, lawmaking can be viewed as a positive externality of law practice.

The benefit of assigning property rights in state law to lawyers should be balanced against the potential costs of state licensing of lawyers, including not only the anti-competitive effects of creating barriers to entry but also the perverse effects of lawyers' political activities. Eliminating state licensing of lawyers might reduce cartel effects of lawyer licensing and agency costs inherent in the lawmaking process, but at the same time might also reduce lawyers' beneficial incentives to participate in state law reform.<sup>23</sup>

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*Contract and Jurisdictional Freedom*, in THE FALL AND RISE OF FREEDOM OF CONTRACT, (F.H. Buckley, ed. Duke, 1999); F.H. Buckley & Larry E. Ribstein, *Calling a Truce in the Marriage Wars*, \_\_ U. ILL. L. REV. \_\_ (2001); Erin A. O'Hara & Larry E. Ribstein, *From Politics to Efficiency in Choice of Law*, \_\_U. Chi. L. Rev.\_\_ (2000); Erin A. O'Hara & Larry E. Ribstein, *Conflict of Laws and Choice of Law*, International Encyclopedia of Law and Economics, Encyclopedia of Law and Economics, Volume V (2000); Larry E. Ribstein, *Choosing Law By Contract*, 18 J. CORP. L. 245 (1993).

<sup>19</sup> See Douglas J. Cumming & Jeffrey G. MacIntosh, *The Role of Interjurisdictional Competition in Shaping Canadian Corporate Law*, 20 Int. Rev. L. & Econ. 141, 144-46 (2000).

<sup>20</sup> See Susan Rose-Ackerman, *Risk Taking and Reelection: Does Federalism Promote Innovation?* 9 J. LEGAL STUD. 593 (1980).

<sup>21</sup> It is important to distinguish taxpayers' lack of incentive to promote proactive competition from particular taxpayer groups' incentives to oppose state regulation that drives industry away. See Kobayashi & Ribstein, *Contract and Jurisdictional Choice*, *supra* note 18.

<sup>22</sup> See Larry E. Ribstein, *Delaware, Lawyers, and Contractual Choice of Law*, 19 Del. J. Corp. L. 999 (1994).

<sup>23</sup> The optimal system might be to privatize lawmaking, or at least commercial lawmaking. See Hadfield, *Privatizing*, *supra* note 5. This would not eliminate the need to incentivize the lawmakers, but it would at least facilitate the development of competing incentive systems. The present article considers the

This article proceeds as follows. Part I places the issue in the context of the appropriate regulatory framework for lawyers and the issues that are bringing the debate over regulating lawyers to a head – law practice over the Internet, multi-disciplinary practice and the ongoing revision of ethical rules. These developments raise substantial questions about the viability of the current framework for regulating lawyers and suggest the need for placing that framework on firmer foundation. Parts II and III show how lawyers' influence on state law may be consistent with social welfare. Part IV shows how lawyers' property rights in law help produce these effects. Part V discusses specific ways in which this link between the efficiency of state law and lawyers' property rights might be established. Part VI contains concluding remarks, including a discussion of some specific implications of the theory.

## I. CHALLENGES TO STATE-OF-PRACTICE LICENSING

State law currently regulates lawyers based on the state in which they practice. As discussed in subpart A, the effect of the current system is to restrict competition among lawyers. Subpart B shows how these restrictions are being challenged by the rise of multi-state and Internet law practice. Subpart C discusses some possible alternative approaches to regulation, many of which seem to make more sense than the current system. This suggests that the current system needs to be placed on a firmer foundation or eliminated, and sets the stage for this article's reevaluation of the current system based on lawyers' property rights in law.

### A. CURRENT RESTRICTIONS ON LAWYER COMPETITION

The current system for regulating lawyers operates in several ways to protect lawyers' income from erosion by competition. First, licensing rules restrict entry into the legal profession by requiring an extensive legal education. This protects lawyers' investments in their training from competition by low-cost suppliers.

Second, ethical rules further protect the lawyers' investments in their licenses by ensuring that lawyers do not compete down the value of legal services. Until prevented from doing so by First Amendment and antitrust laws, ethical rules prohibited lawyers from advertising and bound them to minimum fee schedules.<sup>24</sup> Ethical rules now operate primarily by maintaining lawyers' status as a learned profession rather than merely purveyors of a commodity.<sup>25</sup> They accomplish this objective, among other ways, by protecting lawyers from working for non-lawyer owners<sup>26</sup> and prohibiting lawyers from "commercializing" the profession by imposing non-competition agreements.<sup>27</sup>

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best way of incentivizing lawmakers *assuming* law is publicly provided.

<sup>24</sup> For a historical perspective, *see generally* Richard Abel, *AMERICAN LAWYERS* (1989).

<sup>25</sup> *See* Richard A. Posner, *OVERCOMING LAW* 56 (1995); Ronald D. Rotunda, *Professionalism, Legal Advertising And Free Speech In The Wake Of Florida Bar v. Went For It, Inc.* 49 ARK. L. REV. 703 (1997). Hadfield, *Price of Law*, *supra* note 5 at 992 also notes how lawyers gain from professional nature of law practice, but views this as resulting largely from the "natural" barrier of the scarce availability of the cognitive skills necessary to engage in complex legal reasoning nature of law" rather than from lawyers' rent-seeking. It is possible that both effects are at work.

<sup>26</sup> *See* Model Rules, *supra* note 31, Rule 5.4.

<sup>27</sup> *See id.* Rule 5.6. For a discussion of the professional self-interest basis of these rules, *see* Larry

Third, and most importantly for present purposes, the current system restricts lawyer mobility by bundling lawyers' choice of ethical and licensing regime to some extent with their choice of physical location. This insulates each state sub-market from competition. Lawyers who practice in a state where they are not licensed risk fines and discipline even for high-quality practice both in states in which they practice and in states in which they are licensed.<sup>28</sup> The definition of unauthorized practice is notoriously unclear.<sup>29</sup> Although courts probably will punish only blatant efforts to establish a law practice in a state in which the lawyer is not licensed,<sup>30</sup> careful lawyers must beware the borderline cases, such as where the lawyer must spend a substantial amount of time on behalf of a single client in a state in which the lawyer is not licensed. Obtaining multiple state licenses involves potentially high costs of taking a bar exam or being admitted on motion in each state maintaining those bar memberships through continuing legal education, dues, pro bono work and the like. Finally, lawyers face discipline at least by their licensing state for acts done in other states even if those acts do not amount to unauthorized practice.<sup>31</sup> The ethical rules of the state where the court sits apply to conduct in court proceedings, while the ethical rules of the licensing jurisdiction in which the lawyer "principally practices" apply to transactional work unless the "particular conduct clearly has its predominant effect in another jurisdiction."<sup>32</sup> The "Ethics 2000" commission studying revision of ethical rules is considering permitting even non-licensing states to regulate lawyers based on where their practice occurred.<sup>33</sup>

## B. THE RISE OF INTERSTATE LAW PRACTICE

Fundamental changes in law practice are putting pressure on the current system of lawyer regulation by extending lawyers' ability to compete outside their home states and facilitating competition between lawyers and non-lawyers. As discussed in subsection 1, the Internet creates a new type of market for legal advice and can enable individual lawyers to leverage their legal expertise throughout the country. Subsection 2 shows how multi-state law firms can extend lawyers' reach through contractual arrangements with other lawyers. These developments call into question a regulatory approach that lets each state exert some control over what is essentially a national market. More importantly, they raise the political stakes of changing the rules. The developments therefore may force a reevaluation of and changes in the current system.

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E. Ribstein, *Ethical Rules, Agency Costs and Law Firm Structure*, 84 VA. L. REV. 1707 (1998).

<sup>28</sup> For recent discussions of the penalties for unlicensed practice focusing on the specific context of multi-state law practice see Jeffrey L. Rensberger, *Jurisdiction, Choice of Law, and the Multistate Attorney*, 36 S. TEX. L. REV. 799 (1995); Charles W. Wolfram, *Sneaking Around in the Legal Profession: Interjurisdictional Unauthorized Practice by Transactional Lawyers*, 36 S. TEX. L. REV. 666 (1995).

<sup>29</sup> See Wolfram, *supra* note 28 at 694 (noting that "[w]hat we see are very few decisions, a fair amount of pointless rigor in applying the prohibition against unlicensed local law practice, and an apparently high level of judicial confusion over how to delineate permissible and impermissible practice").

<sup>30</sup> *Id.*

<sup>31</sup> Model Rules of Professional Conduct, Rule 8.5(a).

<sup>32</sup> *See id.*

<sup>33</sup> See Ethics 2000 Commission, Proposed Rule 8.5, Public Discussion Draft (April 18, 2000), available at <http://www.abanet.org/cpr/ethics2k.html>.

## 1. Law practice over the Internet

The Internet could revolutionize law practice if freed from the constraints of the current ethics rules. To see this, it is important to see what the Web added to existing technologies. Lawyers long have had the technical capability to advertise nationally.<sup>34</sup> Telephone and email have enabled lawyers to communicate with clients in other states. Books and other media enable lawyers to mass market their advice through books or similar media. Legal software adds interactivity in the sense that purchasers can adapt the advice to their own situations, although only for certain tasks such as drafting wills for simple estates.<sup>35</sup>

The Web adds several important elements to the existing technological mix. First, websites permit significantly increased customization to individual users, thereby bridging the gap between electronic and personal advice. Just as Amazon can tell users what books they are likely to want based on what books they have indicated they wanted, a legal website might be able to tell "clients" what decisions they are likely to want to make by comparing information provided by each user with information provided by the network of users.<sup>36</sup> This resembles what a lawyer does when advising a client based on the lawyer's experience. Although software design also can take prior experience into account, the Web adds the capability of continuous updating.

Second, websites such as *freeadvice.com*, *laws.com*, and *americounsel.com* can convey large quantities of legal information directly to consumers by posting the information itself or providing links to other websites. Although this information is not itself advice, like the Web generally it has the potential for educating consumers enough to reduce their dependence on professional advice. Indeed, many people already use the Web to supplement advice from professionals such as doctors, lawyers and accountants. The Web also can provide information interactively in response to users' questions, rather than merely in static, one-size-fits-all lists. Thus, the Web might narrow lawyers' role as the exclusive middleman between the law and people it affects.

Third, Web services can combine these capabilities with links to individual lawyers in various forms, including face-to-face representation,<sup>37</sup> email and voice consultation all with electronic transfer of relevant documents. The individual user can

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<sup>34</sup> See Catherine J. Lanctot, *Attorney-Client Relationships in Cyberspace: The Peril and the Promise*, 49 DUKE L. J. 147 (1999) (showing how, even before television, national radio raised issues about lawyer solicitation).

<sup>35</sup> Examples include Intuit's Quicken program, and Nolo Press. In 1998, the Texas Unauthorized Practice Committee sued these companies seeking to bar the sale of their products in the state. See *Nolo Press/Folk Law, Inc. et al. v. the Unauthorized Practice of Law Committee*, Cause No. 99-03252, 201st District Court of Travis County, Texas. Although a lower court approved a preliminary injunction against such sales, the Texas legislature passed a law, HB 1507, legalizing such practices in Texas. The Committee subsequently dropped its investigation. See letter to Peter D. Kennedy, September 21, 1999, available at <http://www.nolopress.com/texas/fromUPL.html>.

<sup>36</sup> See *The Legal World's Soothsayer*, THE LAWYER, February 10, 1998 (noting that the Internet will permit online advice as to "simple legal affairs").

<sup>37</sup> For a discussion of a British service, Desktop Lawyer, see Darryl van Duch, *Technology from Hell Challenges Lawyers, Scares ABA*, American Lawyer Media, April 5, 2000 (noting that the firm has 6% of the divorce business in England).

determine the precise form of advice she needs based on the site's other resources.<sup>38</sup>

In general, therefore, the Web might greatly shrink the distinction between individualized and mass-marketed legal advice. This could create individual fortunes and social surplus in the legal market just as the Web has done in books and other markets. Even if the Web does not replace traditional legal advice, it will certainly change the types and sources of the advice. Its main current threat is not to high-end advice or sophisticated litigation, but rather to more routine representation, where lawyers will have to show that they can add value to the automated advice and information people can obtain from the Web. The Web may allow a few lawyers to get rich by packaging legal expertise into "legal information products"<sup>39</sup> while displacing many lawyers just as Amazon is closing small bookstores. The ABA already has seen the threat to existing modes of practice, and at its March, 2000 meeting appointed a committee to study, among other things, possible impact on the "core values" of the profession, and whether the Internet sites violate ethical rules on such matters as client confidentiality and conflicts of interest.<sup>40</sup>

Viewed from this perspective, state regulation of the legal profession appears not only to be restricting competition not only among lawyers, but also between conventional lawyers and other methods of delivering legal advice. Since the business opportunities made available by the Internet are common knowledge, the public and many lawyers may not continue to tolerate impediments to these opportunities imposed by the legal profession. Moreover, Internet law practice offers the potential of providing effective legal assistance on routine matters to a low-income clientele. This makes strong opposition by the ABA politically unattractive, thereby increasing political pressure on state licensing. Responding to this pressure demands a stronger rationale for the current system than is available under the existing analytical framework.

## 2. Multi-state firms

Large law firms can be an efficient substitute for ethical rules. Law firms address lawyer-client agency costs by providing reputations that transcend those of the individual members. These reputations can bond lawyers' promises of ethical behavior. When these promises are breached, the market exacts a penalty scaled to the level of wrongdoing damage by devaluing the firm's reputation, and therefore the premium it can charge for its services.<sup>41</sup>

Reputational bonding has implications for law firms' structure and size. The firm needs, among other things, a compensation mechanism that gives partners incentives for

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<sup>38</sup> The Web also can link lawyers with each other, thereby creating a virtual firm in which lawyers share information as in a real firm only without a real firm's contractual and physical infrastructure.

<sup>39</sup> See *Virtual Justice: The Future of the Legal Profession Lies With IT*, The Financial Times, February 3, 1998.

<sup>40</sup> See van Duch, *supra* note 37.

<sup>41</sup> See Daniel Fischel, *Multidisciplinary Law Firms*, 55 BUS. LAW. 951 (2000); Ribstein, *supra* note 27.

developing the firm's goodwill and not just their own reputations. Non-competition clauses bind the partners to this sharing mechanism rather than leaving them free to leave when they find ex post that can make more elsewhere.<sup>42</sup> With respect to firm size, larger firms can offer larger reputational bonds.<sup>43</sup> In order to grow to its optimal size, a firm that sells legal services may need to leverage its reputation and expertise by spreading out to several states and across multiple specialties and disciplines, including some outside of law.

Given large firms' potential for reducing lawyer-client agency costs, regulation of lawyers should encourage their growth and development. Unfortunately, ethical rules tend to stunt law firm growth.<sup>44</sup> The current approach to regulating lawyers based on where they practice has exacerbated this effect. Since the lawyers in each office of a multi-state firm certainly will be deemed to be practicing law in that state,<sup>45</sup> they would be licensed and regulated by that state. Thus, the internal structure of a multi-state firm must comply with the rules of every state in which the firm has an office. For example, if some states do not allow enforcement of strong non-competition clauses, a nationwide firm might face the choice between providing for the most efficient firm-wide incentive structure and maintaining an office in the regulated state as an affiliate rather than a branch. Complying with multiple structural rules became an issue for the big accounting firms when the states started recognizing limited liability for professional firms through the "limited liability partnership" form. The firms could not become LLPs until this form was at least recognized in all 51 U.S. jurisdictions. Accordingly, they orchestrated a large lobbying effort to bring about this result.<sup>46</sup> Ethical rules present a more daunting problem for law firms.

Ethical restrictions on non-lawyer ownership represent the most important constraint on law firm size and structure. Although current ethical and licensing rules do not prevent law firms from offering non-legal services,<sup>47</sup> they restrict non-lawyers from owning equity shares in law firms.<sup>48</sup> Restricting law firm capitalization has important structural consequences.<sup>49</sup> Among other things, the limitation to lawyer-owners means that the firm will be a less hospitable environment for non-lawyers than one in which the non-lawyer professionals or capital-contributors share ownership.<sup>50</sup> Although law firms

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<sup>42</sup> *Id.*

<sup>43</sup> *Id.*

<sup>44</sup> *Id.*

<sup>45</sup> See *supra* text accompanying notes \_\_\_. Thus, the problems for big firms cannot be solved merely by minor alterations of the definition of local practice as suggested by Wolfram, *supra* note 28.

<sup>46</sup> See Rick Telberg, Big 6 Race into LLPs, *Accounting Today*, Aug. 8, 1994, at 1, 41 n.14.

<sup>47</sup> See Model Rules, *supra* note 31, Rule 5.7 (1996) (implicitly recognizing multi-service firms by providing that legal ethics rules apply to law firms performing non-law services).

<sup>48</sup> See *id.* Rule 5.4.

<sup>49</sup> See Ribstein, *supra* note 27.

<sup>50</sup> *Id.*

might set up multidisciplinary offices in jurisdictions that allow them (currently only D.C.) and then affiliate with these offices, this structure entails significant costs. Affiliated firms cannot provide for firm-wide monitoring and incentives that are necessary for the firm to maintain its reputational bond because professionals in one state's office would have no financial interest in another state's office.

### C. ALTERNATIVE REGULATORY REGIMES

The new forms of law practice described above may put pressure on the current system for regulating lawyers. To be sure, any change would face strong opposition from lawyers and others who have stakes in the current system. Just as the current state licensing rules create problems for new forms of practice, they also make escape difficult. Though a state might try to be the Delaware of lawyer regulation by adopting permissive rules,<sup>51</sup> a single state with a significant market share can block developments nationwide. For example, lawyers who practice in New York would have to comply with New York's ban on multi-disciplinary firms.<sup>52</sup> Moreover, major states' opposition can block efforts to change uniform ethical rules because of uniform lawmakers' incentives to seek broad consensus.<sup>53</sup> These factors played out in the ABA's flat rejection of moderate moves toward multidisciplinary practice.<sup>54</sup>

The status quo nevertheless might break down in the face of the new developments described above. Internet law practice and multi-state law firms are just two of the most visible indicia of the increasing geographic scope of law practice. Intransigent state regulators may increase and make more obvious the costs of a system that regulates law practice as if were still contained within state borders. Lawyers face the threat of competition from non-U.S. law firms, and from accounting and other non-law firms.<sup>55</sup> Smaller firms and individual lawyers, as well as non-law firms, can gain from Internet practice that would leverage their expertise into a huge consumer market. Consumers of legal services can see the benefits of delivery of legal services through the Internet and by multi-state and multidisciplinary firms. These parties may seek federal regulation through new legislation or administrative action, or judicial remedies under the antitrust laws. Moreover, an interstate dynamic may develop where states are pressured to enforce lawyers' contractual choice of regulatory regime.<sup>56</sup>

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<sup>51</sup> City bar associations also may play a role. The Philadelphia bar recently moved to permit 51% lawyer-owned firms. The District of Columbia has the first and only rule permitting multi-disciplinary practices.

<sup>52</sup> See N.Y. St. Bar, Lawyer's Code of Prof. Resp., DR 3-103A.

<sup>53</sup> See Larry E. Ribstein & Bruce H. Kobayashi, *Economic Analysis of Uniform State Laws*, 25 *Journal of Legal Studies* 131 (1996).

<sup>54</sup> See *supra* note 1.

<sup>55</sup> This was made clear by the recent Ernst & Young/McKee & Nelson law/accounting merger. Even some small boutique firms would have potential gains from multidisciplinary practice. See Fischel, *supra* note 41 at 972.

<sup>56</sup> See Bruce H. Kobayashi & Larry E. Ribstein, *Contract and Jurisdictional Freedom*, *supra* note 18.

For present purposes it is enough to note that the future of the current system is at least open to question. This section discusses some theoretical alternatives to the current regime of regulating lawyers based on where they practice. In general, these alternatives all appear to be plausible ways to reduce the anti-competitive effects of the current system. These alternatives' defects appear only from an analysis in Part IV of how adoption of these systems would affect lawyers' property rights in state law.

### 1. Private ordering or self-regulation

One obvious alternative is completely eliminating lawyer licensing and ethical rules. A problem with this alternative is that these rules do serve a valuable function. It is difficult for most individual clients effectively to choose and monitor lawyers because it is inherent in engaging a professional that the professional has expertise the client lacks. A completely reliable evaluation would require the client to have some experience with the lawyer. Thus, legal services are a kind of “credence” good that the client must take on trust.<sup>57</sup> Licensing rules serve to overcome the client evaluation problem in part by providing for minimum qualifications that all lawyers must meet. Thus, a client theoretically knows just from the attorney's bar certificate that the lawyer has certain skills even if the client cannot investigate independently. This may be particularly important for clients who deal only rarely with the legal system, lack independent resources for checking qualifications, or have relatively small or routine matters that do not justify substantial investigation costs.

Licensing rules also help ensure that lawyers adhere to ethical standards that reduce agency costs arising out of legal representation.<sup>58</sup> In general, these are the costs of an owner's delegation of power over her property to a non-owner agent, who faces a conflict between her self-interest and her duty to the principal.<sup>59</sup> In the lawyer-client context, the lawyer may not spend enough time on a client's work, misuse client funds entrusted to the lawyer, or spend more time than is necessary on the client's work in order to inflate her bill or misrepresent her qualifications.<sup>60</sup> Ethical rules have teeth because of the state's power to withdraw the legal right to practice from lawyers who break the rules. The existence of a state-enforced mechanism means that clients need not trust in an individual lawyer's honesty or bond.

In general, without lawyer licensing and ethical rules clients might face a lemons market in which they are unable to distinguish high-quality and low-quality lawyers, so that low-quality producers will predominate. Unless the fundamental nature of legal practice changes to eliminate its credence good characteristic,<sup>61</sup> it seems likely that lemons problems will remain and serve to justify some type of lawyer regulation.

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<sup>57</sup> As to credence goods generally, see Michael R. Darby & Edi Karni, *Free Competition and the Optimal Amount of Fraud*, 16 J.L. & ECON. 67, 69 (1973); Ellen R. Jordan & Paul H. Rubin, *An Economic Analysis of the Law of False Advertising*, 8 J. LEGAL STUD. 527, 530-31 (1979).

<sup>58</sup> See Ribstein, *supra* note 27.

<sup>59</sup> See Michael Jensen & William Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs, and Ownership Structure*, 3 J. FIN. ECON. 305 (1976).

<sup>60</sup> See Ribstein, *supra* note 27.

<sup>61</sup> See Hadfield, *supra* note 5.

But it is important to keep in mind that, even without externally imposed ethical and licensing rules, lawyers would have incentives to signal their quality in order to get business. Although clients may be at a disadvantage in dealing with lawyers, they know this and will seek to minimize their costs by dealing with the most reputable lawyers. One mechanism lawyers might use is large law firms, which offer long-lived reputational bonds that secure the performance of all of the members.<sup>62</sup> Lawyers also might join voluntary contractual associations that expel members or sue for fines in the form of liquidated damages. Or firms might be allowed to opt into or out of legal regulation, so that the public enforcement mechanism would exist only for those who want it. These private alternatives offer the potential for effective regulation without the legally enforced cartel that state licensing and ethical rules make possible.

Even if clients would be adequately protected by a private ordering regime, such a regime might be criticized on the ground that it does not adequately serve the interests of society in general and the judicial system in particular. With respect to society, it is important to distinguish particular third parties who are injured by specific acts in connection with legal representation and broader social concerns. To the extent that clients hire lawyers to harm third parties, this is similar to use of agents in other contexts, where the principal (in this case, the client) is the primarily responsible party. Lawyers also might be constrained by conventional theories of aiding and abetting or direct harm. Or third parties might look to the regulatory system that binds a party's lawyer as a signal of client integrity. Thus, lawyers and their clients would internalize costs of choosing lax or no regulation.

With respect to society as a whole, lawyers have been said to bear responsibilities regarding fair distribution of legal services – that is, for pro bono representation. But these arguments have been said merely to cloak self-interested efforts by the profession to secure special status and to increase the demand for legal services.<sup>63</sup> The question is whether social needs to make legal representation available to the poor must be covered by regulation of the profession rather than by voluntary lawyer efforts or public funding.

Finally, efficient judicial administration involves holding lawyers to rules of conduct while practicing in court. Requiring a license to practice in a state's courts brings the power of license revocation to bear on violations of conduct rules. But licensing is not necessary for this purpose. Lawyers might be barred from practicing in a court or sanctioned in other ways for violations of a court's rules without being subject to an elaborate licensing system. Indeed, lawyers already may practice in a state court for particular cases without being licensed in the state.

In short, the conventional arguments for government licensing of lawyers do not seem convincing. However, as discussed below in this article, the property-rights-in-law argument provides an additional and more convincing rationale.

## **2. Corporate-type choice of domicile**

Lawyers might be regulated under state law but, like corporations, choose to be licensed and regulated by any state and then practice in any other state or states under the

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<sup>62</sup> See generally Ribstein, *supra* note 27. See also Larry E. Ribstein, *Law Partner Expulsion*, 55 *Business Lawyer* 845 (2000) (discussing the expulsion mechanism for enforcing this bond).

<sup>63</sup> See Posner, *supra* note 25 at \_\_\_.

licensing state's law.<sup>64</sup> This, of course, would involve states' adoption of a choice-of-law rule under which they recognize the primacy of the licensing state irrespective of where the lawyer practices. This approach is similar to the private ordering model except that all lawyers would be subject to some state enforcement mechanism and the choice would be among 51 regulatory bodies rather than a potentially much larger number of private organizations.<sup>65</sup>

There are three main differences between this "corporate" model of lawyer regulation and the current approach to choosing the applicable regulatory regime. First, it facilitates competition among ethical rules. Because lawyers need not tie their choice of ethical rule to their place of practice, they can shop among all states for their preferred ethical rule. States would charge lawyers bar-admission fees for using their regulation and the states with the regulations lawyers find most attractive would earn the highest fees. Second, the corporate model would facilitate adaptability of ethical rules to varying types of practice. Lawyers could choose, for example, a Delaware-type set of rules adapted to large firms, or a more rural state's small-firm-type rules. Or states could cater to particular types of law practice, such as multi-disciplinary or Internet-based. Third, the corporate model allows each lawyer to be governed by a single set of ethical rules. For example, all of a lawyer's clients would be subject to the same conflict-of-interest rules. This reduces lawyers' costs of learning the rules and monitoring for violations.

A variation on the corporate system would be letting multi-state law firms choose a single regulatory regime that governs all lawyers in the firm. This is particularly significant with respect to rules that have structural implications for law firms, including rules regarding who may own equity in the firm, non-competition agreements and members' vicarious liability for the firm's debts.<sup>66</sup> Indeed, the costs of subjecting law firms' lawyers to different rules in different states suggest that application of some variation of a corporate-type rule is necessary to sustain non-uniform ethical rules. Moreover, allowing the firm to choose the law would maximize competition among ethical regimes. As in the corporate setting, the largest firms would do the most shopping because they would be able to amortize the shopping cost across a larger number of clients and cases.<sup>67</sup>

In general, a corporate-type system would combine state regulation and

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<sup>64</sup> This approach is discussed in more detail in Erin A. O'Hara & Larry E. Ribstein, *From Politics to Efficiency*, *supra* note 18. A pure version of the choice-of-domicile approach that lets lawyers practice in any court under their chosen rules probably would be unworkable because a court needs to be able to apply a single set of rules to all those who appear before it. Accordingly, courts should be able to enforce their own rules of court administration.

<sup>65</sup> A variation on the corporate alternative would be to let lawyers and individual clients contract for the licensing and ethical rules that apply to particular representations. *Cf.* Conflicts of Interest Task Force, *Conflict of Interest Issues*, 50 BUS. LAW 1381, 1426 (1995) (suggesting that firms include choice-of-law clauses in engagement letters to deal with client conflict issues). This regime would make it harder for states to discipline lawyers and to design or apply rules as coherent bundles. As to the latter problem, *see* O'Hara & Ribstein, *supra* note 18. Also, clients might find it harder to analyze individual rules rather than simply making judgments about entire jurisdictions.

<sup>66</sup> *See* Ribstein, *supra* note 27.

<sup>67</sup> Note that, even without a law explicitly allowing the firm to choose, law firms might require each member individually to choose the firm's preferred domicile.

enforcement with flexibility and competition. The main question is not how it differs from the current regulatory system, but whether it differs significantly from private ordering. First, although the state has unique powers to fine and jail lawyers who do not comply with state law, state punishment mechanisms are rarely used and private associations can levy contractual punishments and withdraw accreditation lawyers need to signal quality.

Second, state laws emerge from a political process, which arguably ensures accountability to non-lawyer interests. However, this does not sharply distinguish them from association rules. Lawyers could be expected to have the most potent political voice in state rules just as they do in private rules. They are well-informed about the rules and well-organized at the state level through state bar associations. Moreover, private organizations such as bar associations also could offer a platform for non-lawyers. Conversely, it is unlikely non-lawyers would play a significant role under a corporate-style system of state regulation. Since attorney ethical rules affect non-attorneys only sporadically, third-party groups probably do not gain enough from political action to outweigh collective action costs to give them much influence over attorney ethical rules. Non-lawyers' ability to internalize the benefits of influencing ethical rules is further reduced by the fact that the rules would affect legal representation wherever lawyers' practice under a state law and not just where the non-lawyers reside. In other words, Illinois consumers would accomplish little by influencing Illinois law if most lawyers in Illinois choose to be governed by Delaware law.

Third, clients might be better able to choose lawyers based on a limited number of state licensing organizations as distinguished from a potentially unlimited number of private associations. However, whether clients would be able effectively to choose lawyers based on their licensing state depends, as with private regulation, on clients' ability, either individually or through the market, to evaluate competing regimes. Corporate-style lawyer regulation may not be strictly comparable to state regulation of corporations because the market for legal services does not have a device comparable to the securities markets for enabling price to accurately reflect quality.<sup>68</sup> Although the number of potential state licensing regimes is limited, as a practical matter only a limited number of private organizations would emerge as prominent and have signaling value for lawyers. Accordingly, there may be little practical difference between the two regimes in terms of clients' practical ability to make informed choices.

Thus, moving to a corporate-style choice of domicile system for state licensing of lawyers raises issues similar to those raised by moving to a private-regulation system. As discussed below, the justification for either approach must be sought in a theory of lawyer's property rights in law.

### **3. Federal licensing and regulation**

There are increasing questions whether a system that lets individual states exclude or impose restrictions on lawyers licensed and based elsewhere makes sense in the context of national law firms and the global Internet. These questions ultimately may lead to federal licensing and regulation of lawyers. Federal regulation might benefit both lawyers and consumers who would gain from national law practice.

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<sup>68</sup> See Ralph Winter, *State Law, Shareholder Protection, and the Theory of the Corporation*, 6 J. LEGAL STUD. 251 (1977).

Congress theoretically could require federal licensing at least as to practice in federally dominated areas such as bankruptcy, patent, antitrust and securities law.<sup>69</sup> Congress' Commerce Clause power probably extends beyond those areas, and at least to clearly interstate issues such as Internet law practice. But significant encroachment into a traditionally state-dominated area may not be politically feasible.<sup>70</sup> Federal licensing is also questionable policy. To the extent that federal licensing empowers consumer and other interest groups instead of lawyers, it is unclear a priori which groups would promote more efficient legislation.<sup>71</sup> Moreover, federal regulation would replace variety among and competition between licensing and ethical regimes that is inherent in regulation by 51 jurisdictions with a one-size-fits-all set of rules.

Despite these problems, some sort of federal licensing scheme might seem to be a plausible alternative to the unwillingness of state regulators to accommodate the needs of modern law practice. The ultimate conclusion, however, depends on the analysis in the remainder of this article of lawyers' property rights in state law under the current approach to lawyer licensing.

## II. LAWYERS' PARTICIPATION IN STATE LAWMAKING

The analysis of lawyers' property rights in law begins with lawyers' role in lawmaking. This Part discusses lawyers' effectiveness in lobbying for state law. Part III considers whether lawyers' influence is consistent with social welfare. Part IV shows how this beneficial role of lawyers depends on legal rules that give lawyers property rights in state law.

Lawyers have the inherent lobbying advantages over non-lawyer groups. First, they already have expertise about the law that their rivals must acquire in order to be able to lobby successfully.<sup>72</sup>

Second, lawyers may be better able than other groups to overcome collective action or free rider problems inherent in political activity. One way for a group to overcome collective action problems is by undertaking political activity as a byproduct of its other functions.<sup>73</sup> Bar associations not only engage in political activity, but also facilitate information exchange and networking among lawyers.<sup>74</sup> Moreover, engaging in law reform benefits lawyers beyond any advantages they might gain from specific laws.

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<sup>69</sup> Congress is not subject to the limitation that applies to some state legislatures based on courts' inherent powers to regulate the bar. *See, e.g.,* *First Bank & Trust Co. v. Zagoria*, 302 S.E.2d 674, 676 (Ga. 1983).

<sup>70</sup> *See* Jonathan R. Macey, *Federal Deference to Local Regulators and the Economic Theory of Regulation: Toward A Public-Choice Explanation of Federalism*, 76 VA. L. REV. 265 (1990).

<sup>71</sup> *See* Wolfram, *supra* note 28 at \_\_\_.

<sup>72</sup> *See* Macey & Miller, *supra* note 17 at 508-9.

<sup>73</sup> *See* Mancur Olson, *THE LOGIC OF COLLECTIVE ACTION* (1965).

<sup>74</sup> *See* Paul H. Rubin & Martin J. Bailey, *the Role of Lawyers in Changing the Law*, 23 J. LEGAL STUD. 807 (1994).

Lawyers as a group acquire an aura of professionalism from these activities.<sup>75</sup> Individual lawyers can enhance their personal reputations for expertise by participating in law reform and by advertising their efforts through such activities as continuing legal education lectures. Recent moves toward permitting advertising and solicitation may give lawyers even more incentive to participate in lawmaking. These changes reduce lawyers' property rights in clients. This forces them to spend more time and energy getting business, as through reputation-enhancing lawmaking activities. At the same time, lawyers' greater ability to advertise for name recognition does not reduce their need to promote their specific expertise, as through involvement in law reform.

Third, lawyers can influence their state's law other than by directly participating in lawmaking. They can earn money and reputational benefits by writing forms, manuals, and treatises. These materials have been characterized as part of a "network" that increases the value of a state's law.<sup>76</sup>

Fourth, law firms may help lawyers act collectively. Firms can specialize functions by allocating more politically skilled members to political activities and can internalize the reputational benefits of members' participation.<sup>77</sup> Lawyers who practice alone or in small firms may have less flexibility in allocating their time to non-billable activities.

For the reasons discussed below in Part IV, licensing lawyers to practice in a particular state ensures that benefits from that state's body of law will benefit a particular group of lawyers. This, in turn, encourages lawyers to act collectively in the ways just described to bring about the desired changes in state law.

### III. EFFICIENCY OF LAWYERS' EFFECT ON STATE LAW

This Part shows why lawyers' participation in lawmaking may be efficient. Although lawyers, like other interest groups, will pursue their private interests, these interests may mesh with social welfare.

Lawyers might seek legal rules that maximize the demand for lawyers.<sup>78</sup> This may cause lawyers to advocate rules that are contrary to social welfare. First, lawyers may seek rules that increase the need for and cost of litigation.<sup>79</sup> These might include fact intensive standards that judges must apply in specific cases.<sup>80</sup> Second, lawyers may advocate rules that increase the need for legal advice. For example, laws that render

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<sup>75</sup> See Posner, *supra* note 25 at \_\_\_.

<sup>76</sup> See Klausner, *supra* note 15.

<sup>77</sup> Firms will play this role only if they can protect the reputational capital they create in the process, as through enforceable non-competition agreements that encourage lawyers to contribute to the firm's reputation rather than their own client-building activities. See Ribstein, *supra* note 27.

<sup>78</sup> See, e.g., Rubin & Bailey, *supra* note 74.

<sup>79</sup> See Fischel, *supra* note 41 at 969, n. 57; Macey & Miller, *supra* note 17 at 504.

<sup>80</sup> See Kamar & Kahan, *supra* note 15 (noting these and other factors that increase Delaware corporate litigation).

certain types of agreements or terms unenforceable, make the amount of tax liability contingent on particular terms, or impose formalities as a condition of enforceability, may deter business people from writing their own agreements. Third, lawyers may seek complex rules that increase the costs of legal advice.<sup>81</sup> Fourth, lawyers may benefit from frequent changes in laws that force parties to seek legal advice in connection with rewriting their agreements to conform to the new law.<sup>82</sup>

This analysis must be qualified by the fact that lawyers have an interest not only in increasing the demand for lawyers generally, but also in increasing the use of the state law in which they have a property right. Whether this incentive leads to efficient laws depends partly on the applicable choice-of-law rule. If the plaintiff can decide where to sue at the time of litigation, as in many tort cases, lawyers can be expected to attempt to secure plaintiff-friendly laws in order to maximize litigation in their jurisdictions. This would be inefficient because the rules would take into account only the interests of one party to the suit.

On the other hand, where the contracting parties choose the law at the time of entering into their contracts rather than at the time of suit, they operate behind a veil of ignorance as to ultimate consequences and therefore presumably will choose the law that maximizes their joint social welfare.<sup>83</sup> Accordingly, lawyers can gain benefits under this rule only by drafting efficient laws rather than those that favor a single interest group. This contrasts with non-lawyer interest groups that seek wealth transfers from competing groups. Accordingly, enhancing lawyers' incentives to participate in lawmaking might lead to adoption of more efficient laws than under a regime where lawyers do not have these incentives.

Under *ex ante* choice of law, lawyers would have incentives not only to adopt efficient laws, but also to maintain the efficiency of these laws in light of ongoing developments and to protect contracting parties from wealth-transferring changes in the law.<sup>84</sup> As Roberta Romano has pointed out, states can compete with other states in the law market by offering a reputational bond that other states cannot easily replicate.<sup>85</sup> The bond is, in effect, a promise secured by the state's reputation that it will maintain its law and not seek to make wealth-transferring changes.<sup>86</sup> This theory seems to apply only in

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<sup>81</sup> It has been argued that government-supplied law is inherently complex and costly, and arguably cuts low-income clients with small transactions out of the system. See Hadfield, *supra* note 5. But even given a particular supply of government-supplied law, increasing lawyers' role arguably might cause law to be more complex and costly than it otherwise would be.

<sup>82</sup> See Larry E. Ribstein, *Changing Statutory Forms*, 1 J. Sm. & Em. Bus. L. 11 (1997), reprinted in 39 Corp. Prac. Comm. 703 (1998).

<sup>83</sup> See O'Hara & Ribstein, *supra* note 18. The effectiveness of the choice-of-law clause can be enhanced by a choice-of-forum clause because courts are likely to apply local law. See Kobayashi & Ribstein, *Contract and Jurisdictional Freedom*, *supra* note 18.

<sup>84</sup> See Ribstein, *supra* note 82 (discussing the tradeoff between change and stability).

<sup>85</sup> See Romano, *supra* note 11.

<sup>86</sup> As to reputational bonds and penalties generally, see Benjamin Klein & Keith B. Leffler, *The Role of Market Forces in Assuring Contractual Performance*, 89 J. POL. ECON. 615 (1981); Benjamin Klein et al., *Vertical Integration, Appropriable Rents, and the Competitive Contracting Process*, 21 J.L. &

the unique case of Delaware corporate law where circumstances such as the small size of the state enable Delaware to bond itself through its reliance on franchise taxes. But states in other circumstances may be able to offer similar bonds if their lawyers can demonstrate a commitment to maintaining the stability and currency of all or part of the state's law. For example, the state's lawyers might have committed substantial resources to specializing in representing particular types of clients, such as high-tech companies. This commitment may bond the bar to maintain the law relating to the needs of those industries.

This analysis works even if state competition is imperfect and lawyers' interests do not mesh perfectly with those of society. As discussed above,<sup>87</sup> Delaware lawyers may be able to exploit for their benefit the state's competitive advantage in the market for corporate law. But even if lawyers can extract private gains from their state's laws, society still might be better off if lawyers are better motivated than the non-lawyer interest groups that would prevail if lawyers had less influence.

The above analysis implies that the efficiency of lawyers' property rights in law depends on the type of law practice. Since transactional lawyers operate mostly under efficiency-enhancing contractual choice of law rules, lawyers' property rights would make them the engines of efficiency. On the other hand, litigators' influence would focus on the less efficient sort of law that plaintiffs select unilaterally and ex post, at the time of dispute. Under this regime, lawyers would be the engines of inefficiency. Lawyers' role in this regard is not, however, likely to depend on the applicable licensing law. Litigators have inherent advantages over out-of-state lawyers based on their proximity to the courts and relationships with local judges and legislators. They are therefore likely to try to make their residence state's law pro-litigation even if the law gives them no more access than out-of-state lawyers to their state's courts. In any event, the states would be unlikely ever to relinquish their power to regulate lawyers practicing in their own courts, given the inefficiency of judges' having to apply different procedural rules in each case.<sup>88</sup>

#### IV. CREATING LAWYERS' PROPERTY RIGHTS IN LAW

Assuming that lawyers may contribute to the efficiency of state law, the question is how lawyers' incentives to make such contributions might be maximized. Whether lawyers will invest resources in developing their state's laws depends on the extent to which they can protect these investments from free-riders. In other words, lawyers need to have a kind of property right in the law of a particular state. Lawyer licensing laws create such a property right by, in effect, giving lawyers licensed in a state priority access to the state's law through the exclusive rights to represent clients in the state and to practice in the state's courts.<sup>89</sup> Because of these exclusive rights, the value of a state's law

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ECON. 297 (1978).

<sup>87</sup> See *supra* text accompanying note 17.

<sup>88</sup> See O'Hara & Ribstein, *supra* note 18.

<sup>89</sup> Property rights technically involve not only rights to use a resource and exclude others, but also a right of alienability. See Harold Demsetz, *Property Rights*, 3 NEW PALGRAVE DICTIONARY OF ECONOMICS AND THE LAW, 144, 145 (P. Newman, ed. 1998). Law licenses differ from the standard definition of property because they are inalienable. As discussed above, inalienability relates to the efficiency of lawyer licensing. See *supra* note 3. Moreover, inalienability may reduce lawyers' incentive to improve state law by reducing their ability to capitalize on the improvement. However, it is determinative

comprises part of the value of the law licenses the state issues.

Lawyer licensing therefore can be shown to serve a beneficial purpose rather than simply maintaining a lawyer cartel.<sup>90</sup> However, it does not necessarily follow that the current system of lawyer licensing is efficient. Creating property rights in a state's law through law licenses may be analogized to the government's selling a right to harvest timber off of its land. Neither the buyer of the right nor the government agents selling it may sufficiently internalize all costs and benefits to make efficient decisions concerning resource use.<sup>91</sup> It may be more efficient to allow private parties to own the land and the timber. Similarly, a more efficient approach to lawmaking might be to enable the formation of competing private lawmaking systems whose owners would have high-powered incentives to efficiently delegate rights in lawmaking. The present paper simply shows why lawyer licensing makes sense given a public lawmaking system.

This Part discusses two conditions for the creation of lawyers' property right. First, as discussed in Section A, lawyers must be tied to the courts and dients located in particular states. This can be accomplished by requiring lawyers to obtain costly licenses to practice law in particular states. Second, as discussed in Section B, it is necessary to have choice-of-law, jurisdiction and forum rules that te application of a state's law to the enacting state.

#### **A. TYING LAWYERS TO STATES**

Lawyers have an interest in maintaining the law of the state in which they practice only if they can restrict entry into the state or its courts by lawyers who did not pay the entrance fee. Barriers to entry by unlicensed lawyers encourage lawyers to invest in a state's law by protecting these investments from free-riders.

Barriers to entry include states' licensing requirements and standards of admission to practice. Every state requires a bar exam. Taking the bar exam usually requires months of study and the risk of embarrassing failure. In all states a very high percentage of applicants pass if they take the exam enough times.<sup>92</sup> This suggests that the bar exam is more a price of admission than a device that effectively screens out unqualified applicants. The states' passage rates vary widely but are generally high.<sup>93</sup> Only four states have bar passage rates lower than 60%. These include Louisiana, which has an idiosyncratic civil law system; the District of Columbia, which is unique in admitting

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for present purposes that inalienability does not necessarily eliminate this incentive.

The ability to create property rights in law reduces the public good nature of law, at least in the sense of the non-excludability aspect of public goods. Law would still have the public good quality of non-rivalrousness in the sense that the use of law by some does not reduce its value to others. These two aspects of public goods are distinguished in J.G. Head, *Public Goods and Public Policy*, 17 PUBLIC FINANCE 197 (1962).

<sup>90</sup> See *supra* text accompanying note 3.

<sup>91</sup> See Demsetz, *supra* note 89.

<sup>92</sup> See George M. Crow, *So You Passed the Bar. Big Deal*, The Recorder/California law, [www.law.com](http://www.law.com), May 1, 2000.

<sup>93</sup> See Table.

lawyers on motion without prior experience elsewhere;<sup>94</sup> and California, which uses its bar exam to screen graduates of unaccredited California schools. Only in Delaware does a low passage rate appear to be used as a restriction on entry. Since Delaware is the most prominent example of a state where lawyers have played an important role in maintaining the state's law, this provides some anecdotal evidence of the role of state licensing in creating lawyer property rights in law.

Most states permit admission on motion by lawyers who have practiced in other states, albeit subject to qualifications such as years-of-practice requirements.<sup>95</sup> Many states also have a reciprocity requirement whereby state A admits on motion only lawyers licensed in states that admit state A lawyers under the same terms.<sup>96</sup> Once admitted, lawyers must still maintain their bar memberships by paying annual fees and complying with continuing legal education, pro bono, and other requirements.<sup>97</sup> These requirements make it hard to maintain licenses in many states, and therefore tie lawyers to particular states.<sup>98</sup>

Paying the cost of bar admission buys several privileges. The most important is the right to make court appearances in that state's courts. While this right may seem less important than the lucrative business of advising the client, planning the transaction, and advising on litigation strategy, it may be significant. Local counsel, through their regular and exclusive access to the courts, learn the system, have reciprocal relationships with judges and other counsel, and develop reputations for fair play. Through law firms, non-litigators can share with litigators the benefits of barring out-of-state lawyers from their state's courts. Clients may want to have the same firms handle both litigation and planning work in order to reduce search costs and realize economies of scope, particularly from information-sharing among lawyers and across cases. Whether or not they handle both facets of given clients' business, firms that combine litigation and planning can distribute benefits of their caseload as a whole between litigators and planners.

The second privilege state licensing confers is the exclusive right to practice on behalf of clients located in the state. This is important because physical proximity with the client matters. Even with the Web, email and telephone, clients still get some advantage from being able to meet personally with their lawyers. A business client therefore would want to hire legal advisors and planners whose offices are near the firm's headquarters or other major location. If these lawyers consult regularly with the company at a particular place they will be deemed to be practicing law in that place and therefore

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<sup>94</sup> *Id.*

<sup>95</sup> *Id.*

<sup>96</sup> *Id.* California is a notable exception, although it recently passed a law providing for study of a move to a reciprocity system. [cite] As already noted, California permits graduates of unaccredited law schools to sit for its bar, which increases the importance of the bar exam screen. This complicates the issue of admitting graduates of non-California schools who have not taken the California bar.

<sup>97</sup> *Id.* (listing state continuing legal education requirements).

<sup>98</sup> Commentators have suggested other ulterior motives for pro bono requirements. See Posner, *supra* note 25 at 61 (noting that pro bono requirements increase demand for legal services); Jonathan R. Macey, *Mandatory Pro Bono: Comfort for the Poor or Welfare for the Rich*, 77 CORNELL L. REV. 1115 (1992) (noting that pro bono requirements helps large firms by reducing competition from smaller firms).

will have to be licensed there.<sup>99</sup> A licensing requirement therefore protects lawyers from competition for transactional work by out-of-state lawyers.

The effect of the privileges conferred by licensing becomes clearer by comparing the current system of lawyer regulation with the alternative approaches discussed above in subpart I(C). If legal advisors need not obtain any license to practice law, they would have to compete with anyone in the world who chose to give legal advice on the Internet or elsewhere. Anyone who sought to invest in a state's law therefore would face many free-riders. A federal licensing system would limit who could give legal advice but would not address free-rider problems with respect to investments in the law of a particular state. Investments in federal law also would involve serious collective action problems because of the size of the national bar. Finally, under a system that permitted lawyers to contract for the applicable regulatory system irrespective of their place of practice, lawyers would associate with particular states but could represent clients anywhere else. Once again, investments in a state's law would face free-rider problems.

## B. TYING THE LAW TO STATES

Tying lawyers to particular states gives them an interest in the legal system of that state, but not necessarily in that state's law because any lawyer can advise on the law of any state. Indeed, as between the lawyer licensed to practice in state A and the lawyer in state B who has the contact with a client who seeks advice under state A's law, the State B lawyer may have the advantage in getting the client's business.<sup>100</sup> It follows that a lawyer licensed in state B would have no more reason to invest in state B than in state A law. Thus, in order to create property rights in law, a lawyer's license to practice in a particular state must give that lawyer preferred access to that state's law. This requires tying the law to its enacting state.

This is done in several ways. First, state judges applying modern approaches to choice-of-law tend to apply their own state's law.<sup>101</sup> Thus, while an Idaho lawyer can become a recognized expert in Delaware law, the lawyer may still have to litigate in Delaware courts, and therefore affiliate with a Delaware lawyer, in order to be able to count on litigating cases under Delaware law.<sup>102</sup> It follows that an Idaho lawyer would want her clients to choose to be governed by Idaho law, and therefore would have an incentive to invest in Idaho rather than in Delaware law.

Second, state law is tied to the enacting state to some extent by the *forum non conveniens* doctrine, under which courts refuse to hear cases that are more conveniently

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<sup>99</sup> See the articles cited in *supra* note 28.

<sup>100</sup> See Macey & Miller, *supra* note 17 at 493-94.

<sup>101</sup> For studies showing pro-plaintiff, pro-resident and pro-forum biases see Patrick Borchers, *The Choice of Law Revolution: An Empirical Study*, 49 WASH. & LEE L. REV. 357 (1992); Michael E. Solimine, *An Economic and Empirical Analysis of Choice of Law*, 24 GA. L. REV. 49, 81-89 (1989); Stuart Thiel, *Choice of Law and the Home Court Advantage: Evidence*, \_\_\_ AMER. L. & ECON. REV. \_\_\_ (2000).

<sup>102</sup> The Delaware courts may themselves offer advantages regardless of which state's law they apply. See Romano, *supra* note 9. However, this relates to investments in the court system, rather than in the law.

heard elsewhere, including because they require application of another state's law.<sup>103</sup> Judges might apply *forum non conveniens* because they hope that other courts will reciprocate, so the courts of each state retain control over that state's law, or because they gain little reward from the effort expended in deciding precedents under another state's law.

Third, under interest analysis or related approaches to choice of law that many courts apply, choice of law depends to some extent on the party's contacts with the state. Although interstate companies may be subject to the laws of various states in which they operate, and may seek to contract for the law of a particular state whether they operate there or not, they can expect the law of their headquarters state to be particularly important. Moreover, if a firm has a special reason to avoid the law of a particular state, it may need to avoid contacts with that state that would be sufficient to bring the firm into court there. It follows that states with business-friendly laws will attract firms.<sup>104</sup> As discussed above, these firms, in turn, will tend to seek legal advice from local lawyers. Thus, the value of the advantage a law license confers in representing clients based in the licensing state is tied to the quality of the law of that state. This gives a lawyer an incentive to invest in improving the law of a state in which she is licensed.

## V. TESTING THE HYPOTHESIS

This Part considers how to test this article's hypothesis that lawyers influence the efficiency of state law. It shows that the limited data on this issue that has been produced provides some support for this paper's hypothesis. However, it also indicates the difficulty of producing more definitive support. Subpart A develops measures of lawyers' influence, while subpart B examines whether state-to-state differences in lawyer influence correlate with the efficiency of state lawmaking.

### A. FACTORS AFFECTING THE LAWYERS' LOBBY

Lawyers' political influence theoretically is reflected in several factors discussed in this section: the ratio of lawyers in the state population; lawyers' income as compared with other groups; availability of low-marginal-cost coordinating mechanisms; lawyers' ability to capture benefits from political action; and evidence of lawyers' political activities. Some of these factors are direct measures of influence, while others indirectly measure political influence by showing its effects.

#### 1. Direct evidence of lawyers' political action

The clearest way to show lawyers' political impact is evidence of their political activity in promoting lawyers' interests as such. Evidence might include amounts budgeted by state bar associations for lobbying activities, bar participation in drafting

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<sup>103</sup> See, e.g., *Rogers v. Guaranty Trust Co.*, 288 U.S. 123, 130 (1933). For a discussion of the relevance of *forum non conveniens* to Delaware lawyers' interest in Delaware law, see Macey & Miller, *supra* note 17 at 97-98. Note that the applicable law is only one factor considered in *forum non conveniens*. See R. WEINTRAUB, COMMENTARY ON THE CONFLICT OF LAWS 218-9 (3d ed. 1986); *Koster v. (American) Lumbermens Mut. Casualty Co.*, 330 U.S. 518, 527-28 (1947); 15 C. WRIGHT, A. MILLER & E. COOPER, § 3828 (2d ed. 1986).

<sup>104</sup> For a discussion of this point in the context of pressures leading states toward efficiency, see Kobayashi & Ribstein, *Contract and Jurisdictional Freedom*, *supra* note 18.

legislation, and the bar's political contributions as compared with those of other groups in the same state. Because it is hard to obtain comparable data from bar associations, it may be necessary to resort to the less direct measures of influence discussed below.

## 2. Barriers to entry

As discussed in Part I, lawyers' property rights depend on their ability to exclude non-lawyers and out-of-staters from sharing the benefits of their lawmaking efforts. This turns to some extent on entry barriers such as the difficulty of the bar exam for lawyers who are not licensed in other states, and the requirements for admitting lawyers previously licensed in other states, which determines lawyers' ability to practice in several states. Important variations on the latter requirements include whether lawyers can be admitted on motion without having to requalify in each state, whether admission of lawyers requires that they pass a special written lawyers' exam,<sup>105</sup> and whether admission depends on whether their licensing states admit lawyers on similar terms or on whether lawyers must have practiced law in another state for a period of time.<sup>106</sup>

The costs of maintaining bar membership in a given state matter because they determine how hard it is for lawyers to maintain multiple bar memberships. For example, to the extent that mandatory continuing legal education (CLE) requirements can be satisfied by taking out-of-state courses, the CLE requirement increases a lawyer's marginal costs of being licensed in an additional state only if the lawyer's original state of admission does not have a CLE requirement. Since about one fourth of the states do not have CLE requirements,<sup>107</sup> a significant fraction of lawyers will need to incur additional costs in order to maintain bar membership in another state that does require CLE. Also, some states impose pro bono requirements that might constrain multiple bar memberships.<sup>108</sup>

The problem with drawing conclusions about lawyers' political power from barriers to entry alone is that the height of the barriers may reflect the relative benefits of entry restrictions to lawyers in various states rather than lawyers' relative political power. This depends not only on the quality of the state's laws, but also on the state's geographical and demographic characteristics. Thus, independently of lawyers' political influence, one would expect to see lower barriers to enter in a farm state that has a relatively low demand for lawyers than, say, in a Sunbelt state where lawyers are seeking

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<sup>105</sup> Many states also require the objective MPRE exam. However, since this exam need be taken only once and is required for admission in every state but Michigan, Maryland, Pennsylvania, Virginia and Washington, and its scores used in many states, it does not impose a constraint on multiple licenses comparable to that imposed by a written exam.

<sup>106</sup> See Table. DC is the only jurisdiction that does not require some kind of prior legal experience for admission on motion. The states vary slightly regarding what is defined as "practice." Only Virginia requires the actual practice of law as distinguished from law teaching or working as in-house counsel or a government lawyer. California is studying the requirements for admitting lawyers with a view to eliminating or modifying the requirement that lawyers admitted elsewhere take the California bar. See *supra* note 96.

<sup>107</sup> See Table.

<sup>108</sup> [Cites]

to retire or a state like New Jersey that risks an influx of lawyers from its neighbor.<sup>109</sup> Indeed, if the barriers to entry in a high-demand state were only slightly higher than in a low demand state, this might indicate that the bar in the high demand state has less political power than that in the low demand state.

### 3. Lawyer income

It follows from the preceding subsection that the important indicator of lawyer's property rights is not whether there are barriers to entry, but whether these barriers correlate with the perquisites of political power, particularly including lawyer income or the price of legal services. If so, lawyers have earned rents from restricting entry that may reflect the value of the law of the licensing state. This income or price effect would be consistent with the cartel theory of lawyer licensing according to which lawyers use political influence to impose barriers to entry and thereby to produce income greater than under free competition.<sup>110</sup>

Lueck, Olsen and Ransom attempted to isolate the supposed cartel effect of lawyer licensing by correlating lawyers' income and the price of legal services with barriers to entry as indicated by such factors as bar passage rates and residency requirements for admission.<sup>111</sup> They concluded that lawyers' income and prices correlated less with barriers to entry than with market variables such as population density, growth, per capita income and employment, with human capital variables such as lawyers' experience and schooling, and with specific factors reflecting demand for legal services such as the divorce rate. This data indicate that lawyers are earning rents from their personal characteristics and their place of practice rather than from regulation. The rents from place of practice are notable since it is not clear why the supply of lawyers in a particular place would not rise over time to meet the demand. Indeed, the study found no significant relationship between barriers to entry and lawyer density. Instead, lawyer density appeared to relate to the demand for lawyers as indicated by the correlation between lawyer density in the population and employment in industries that tend to generate law business -- finance, insurance and real estate.

The solution may lie in one of the study's findings that the authors noted but did not stress. The regulatory variables testing state restrictions on admission to the bar were *jointly* important to *lawyer earnings*. There was no significant correlation with the *price* of legal services to clients and the hourly rates charged by firms for individual lawyers' services. But it would seem that only lawyer earnings would measure accurately the cartel effect, since prices depend partly on the cost of living in each locale. There was also no significant correlation between *some* individual regulatory variables and lawyer earnings. But in assessing whether state regulation restricts entry the rules should be viewed as a package, with harsher restrictions in some areas substituting for laxer restrictions in others.

The Lueck, Olsen and Ransom data may simply indicate that licensing laws filter out less skilled lawyers, so that higher earnings reflect human capital variables rather than the quality of a state's law. But the correlation between overall regulation and lawyers'

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<sup>109</sup> See Wolfram, *supra* note 28 at 681.

<sup>110</sup> See *supra* note 3 and accompanying text.

<sup>111</sup> See Lueck, Olsen & Ransom, *supra* note 4.

earnings is significant for present purposes because it suggests that licensing may have the effect of restricting entry, and therefore potentially addresses the free-rider problem inherent in law reform. The data therefore are consistent with the hypothesis that licensing creates lawyers' property rights in law.

#### 4. Percentage of lawyers in the population

As noted in the preceding subsection, lawyer density could be expected to relate inversely to lawyers' political influence under the cartel theory, since it indicates that a state's lawyers have been unable to bar competition. Lueck, Olsen and Ransom concluded that their failure to find this inverse correlation argued against the cartel theory. However, the result was inconclusive because it is unclear what the density would be without regulation. As discussed above, barriers to entry need to be high where the demand for lawyers is also high. In states where lawyers are not greatly in demand, there is little need to restrict entry.

In any event, whether lawyers have managed to restrict entry is only one implication of lawyer density. The critical question for present purposes is whether lawyers use their political power to shape state law so that it serves lawyers' interests. From this perspective lawyers' density might itself increase lawyers' income. Other things equal, a higher proportion of lawyers means more votes and campaign contributions for legislators who support the lawyers' agenda. In other words, each additional lawyer admitted might simultaneously reduce existing lawyers' share of the pie but increase lawyers' political clout and thereby increase the size of the pie. The density factor may, therefore, be a direct indicator of political influence rather than an artifact of the exercise of influence. This perspective on lawyer density is supported by the Lueck, Olsen and Ransom finding discussed above that, even with high lawyer density, restricting entry was correlated with higher lawyer income.<sup>112</sup>

#### 5. Coordination costs

In order to wield influence, lawyers also need to be able to coordinate and eliminate free rider problems. As discussed in Part I, two significant coordinating mechanisms are bar associations and law firms. Since bar association membership correlates with lawyer licensing, it would not provide a basis for interesting state-to-state comparisons. The extent to which practice in a given state is organized into large law firms may be a more interesting variable. Law firms are significant in two ways. First, as discussed above,<sup>113</sup> large law firms are better able to devote resources to political activity than are sole practitioners or lawyers in very small firms.

Second, large law firms may have different interests in a state's law than smaller firms. Big firms' clients are likely to be larger on average than those of smaller firms because it is the larger clients that generate the sort of multifaceted legal business that requires a bigger firm.<sup>114</sup> These clients, in turn, are likely to be the ones employing

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<sup>112</sup> See *supra* text accompanying note \_\_\_\_.

<sup>113</sup> See *supra* text accompanying note 77.

<sup>114</sup> See Ribstein, *supra* note 27 at \_\_\_\_.

contractual choice of law clauses<sup>115</sup> and that are otherwise most sensitive to the choice-of-law ramifications of location decisions. Thus, large law firms will have an interest in making the state's law attractive to parties that choose law by contract, rather than ex post at the time of litigation. By contrast, smaller firms' clients may either be entirely local and not particularly sensitive to choice-of-law, or plaintiffs' firms that are concerned with ex post choice of forum at the time of trial.<sup>116</sup> This distinction is important because of the conclusion in Part III, above, that lawyers' participation in law that is chosen ex ante is more likely to be efficient than their participation in law that is chosen ex post.

## B. CONNECTING LAWYERS' LOBBYING TO STATE LAW EFFICIENCY

The important question for purposes of this article is not simply whether lawyers are able to exercise political power, or whether they use this power to help themselves, but whether lawyers' political power is associated with more efficient lawmaking. If it is, then the current system of licensing on which lawyers' interest in improving state law is based should be retained.

One strategy is to look at particular types of laws. Prior studies have examined state-by-state adoption of corporate innovations<sup>117</sup> and limited liability company statutes.<sup>118</sup> The MBCA study shows that the promulgation of the Model Business Corporation Act spearheaded adoption of innovations included in that Act. The LLC study similarly looks at adoption of uniform and model LLC acts. It shows that the Uniform Limited Liability Company Act had relatively little impact on state LLC statutes in the first few years after its promulgation. This article's theory predicts that states where lawyers have stronger property rights in lawmaking engage in more lawmaking. Because business association statutes are the type that are adopted ex ante by contracting parties, this theory also predicts that lawyers' involvement in this type of lawmaking will produce more efficient laws.

One way to measure these effects is to examine the order in which states adopted particular laws or amendments to these laws and whether this order is associated with differences across states relating to lawyers' property rights. For example, the study might consider when LLC statutes were first adopted in each state,<sup>119</sup> or when states adopted critical amendments to these statutes, including those reflecting tax developments or that broadened the statute's liability shield. Adoption of LLC statutes is a clearer measure because there is less ambiguity as to whether this move was efficient. As discussed at length elsewhere,<sup>120</sup> LLC statutes remove technical, and primarily tax-driven, barriers to limited liability that increased planning and litigation costs with no

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<sup>115</sup> See Ribstein, *Choosing*, *supra* note 18 at \_\_\_.

<sup>116</sup> Lawyers' membership in trial lawyers' associations also might indicate their power in particular states to promote plaintiff-favoring laws that are chosen ex post, at the time of litigation.

<sup>117</sup> See Carney, *supra* note 75.

<sup>118</sup> See Bruce H. Kobayashi & Larry E. Ribstein, *Uniform Laws, Model Laws and ULLCA*, 66 COLO. L. REV. 947 (1995).

<sup>119</sup> See Table.

<sup>120</sup> See Ribstein, *supra* note 13.

corresponding benefit.<sup>121</sup> Lawyers played a role in this area, pushing for changes that might otherwise not have occurred.<sup>122</sup> The states that reacted most quickly to this development therefore arguably are the states where lawyers have the most influence in lawmaking.

Conversely, certain types of state statutes might be said to be inefficient. It may be possible to demonstrate lawyers' impact on the efficiency of state law by showing a negative correlation between states' adoptions of the statute with lawyers' power in each state. One example of an inefficient state law is regulations imposing constraints on franchise contracts. These constraints make little sense in theory, and there is data indicating their inefficiency.<sup>123</sup> Lawyers engaged in advising and planning might oppose these statutes because they deter franchisors from locating in enacting states<sup>124</sup> and thereby reduce lawyers' potential for representing the franchisors. This suggests that a state's failure to adopt such a statute might be attributable to lawyers' opposition.

Focusing on particular laws may, however, be misleading because adoption may be influenced by factors specific to the type of law rather than to the general role of lawyers. With respect to corporate law, states may be acceding to Delaware's clear domination<sup>125</sup> and seeking only to limit the extent to which Delaware siphons off corporate formations. States may do so not by actively competing but by adopting the Model Act, which provides sophisticated drafting and a network of case law that enables states to retain small and medium-sized corporations. Proactive competition might play a larger role in the market for unincorporated firms that Delaware does not dominate to the same extent.<sup>126</sup> These are generally closely held firms and therefore have high relative costs of operating outside the formation state. But they are also more mobile than corporations in terms of the low decision-making costs of changing their state of organization in response to inefficient legal rules.<sup>127</sup>

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<sup>121</sup> See Larry E. Ribstein, *The Deregulation of Limited Liability and the Death of Partnership*, 70 WASH. U. L. Q. 417 (1992).

<sup>122</sup> See Kobayashi & Ribstein, *Contract and Jurisdictional Freedom*, *supra* note 18.

<sup>123</sup> See Timothy Muris and Howard Beales, *State Regulation of Franchise Contracts*, Working Paper, GMU Law School (1994); James A. Brickley, Frederick H. Dark, and Michael S. Weisbach, *The Economic Effects of Franchise Termination Laws*, 34 J. L. & ECON. 101, 115-6 (1991); Richard L. Smith II, *Franchise Regulation: An Economic Analysis of State Restrictions on Automobile Distribution*, 25 J. L. & ECON. 125 (1982).

<sup>124</sup> See Kobayashi & Ribstein, *Contract and Jurisdictional Freedom*, *supra* note 18.

<sup>125</sup> See *supra* text accompanying note 15.

<sup>126</sup> However, it is significant that Delaware, despite its small size, is second only to California in LLC formations. See Kobayashi & Ribstein, *supra* note 15. This indicates that Delaware may be competing for large unincorporated firms just as it does for large corporations.

<sup>127</sup> Roberta Romano has argued that reincorporation costs limit state competition, so that firms reincorporate mainly when they are contemplating a transaction that is facilitated in the new jurisdiction. See Roberta Romano, *The State Competition Debate in Corporate Law*, 8 CARD. L. REV. 709 (1987). This arguably supports a more active market for closely held than for publicly held firms because of the lower reincorporation costs in the former context. But Romano later argued that there is relatively little competition for such firms because the transaction cost benefits of closely held firm statutes are relatively

Second, states' adoption of, or failure to adopt, certain laws may reflect the importance of particular interest groups in the state. For example, trial lawyer or creditor groups may have greater ability to block expansion of limited liability in some states than in others. Also, groups with specific business interests might be particularly strong in some states. Thus, for example, franchisee or franchisor groups may have varying ability across states to secure adoption of franchise legislation.

Third, states may differ in terms of their ability to compete along dimensions other than the supply of law. For example, more urbanized states can offer firms the ability to locate in a major business center or access to many consumers. This enables them to attract firms while extracting wealth from them through taxation and regulation.

Because of these differences it may be instructive to look at entire categories of laws. One possibility is to consider states' adoption of all kinds of uniform law proposals and not simply those relating to business associations. Lawyers' unwillingness to invest resources in customized drafting, as indicated by the state's adoption of a uniform law, suggests that lawyers cannot protect investments in state lawmaking from appropriation by free riders. Thus, a state's tendency to adopt uniform law proposals arguably indicates that lawyers in the state lack property rights in the state's law.

A state's rank in adopting uniform law proposals, while it may indicate how active the bar is in a particular state, may not be a clear test of the efficiency of lawyers' involvement because uniformity is efficient in some circumstances and inefficient in others. In particular, the benefits of uniformity are relatively low for laws relating to long-term contracts because parties can solve most problems of state-to-state variation by contracting for the application of a particular law. The benefits therefore probably do not outweigh the costs of uniformity in terms of reduced variation and competition.<sup>128</sup> Although states have tended toward uniformity where it is efficient, they have not clearly avoided uniformity as to the category of laws where uniformity is least efficient.<sup>129</sup> It might be instructive to determine whether the states that have moved toward inefficient uniformity are those in which lawyers are weak.

A problem with this obtaining this data, however, states widely vary in the extent to which they copy the uniform law proposals promulgated by the National Conference of Commissioners on Uniform State Laws. Some states adopt proposals in name, but only after making significant variations. Just as uniformity is efficient with respect to certain types of laws, so it is efficient with respect to certain provisions within a law. For example, uniformity may be efficient in provisions concerning third-party creditors, such as restrictions on dividends, because firms cannot contract for the application of a particular provision without their creditors' consent. On the other hand, uniformity is less efficient with respect to provisions applying solely between the firm's owners because customized contracting is desirable and practicable in this context.<sup>130</sup> In general, states have spontaneously moved toward efficient uniformity in with respect to limited liability company statutes. It might be instructive to determine whether variations in the degree of

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low. See Roberta Romano, *State Competition for Close Corporation Charters: A Commentary*, 70 Wash. U. L.Q. 409, 413 (1992). For a response to this argument, see Ribstein, *supra* note 13.

<sup>128</sup> See Ribstein & Kobayashi, *supra* note 53.

<sup>129</sup> See *id* (showing mixed sign and significance in long-term category).

<sup>130</sup> See Kobayashi & Ribstein, *supra* note 13.

adoption of a *given proposal* across the states correlate with lawyers' role in lawmaking, but this would raise the problems discussed immediately above of sorting out variables relating to particular laws.

## VI. CONCLUDING REMARKS

This article shows that, although the national scope of the legal profession is increasing, thereby seemingly rendering obsolete the current system of state licensing of lawyers, there are potential problems associated with abandoning this system. Lawyers have been an important force for efficiency in state lawmaking. Cutting lawyers' ties to the laws of specific states would weaken their role in lawmaking with potentially negative effects on the efficiency of state law.

A problem with this hypothesis is that it will be very difficult to establish empirically, as shown in Part V. The data in the Lueck, Olson and Ransom study suggests a possible link between lawyer regulation and lawyer income that arguably supports the property rights theory. However, more work needs to be done before the property rights hypothesis can be used as a major rationale for maintaining the current system. Nevertheless, the hypothesis is sufficiently plausible that it should at least be considered as one of many reasons to hesitate before abandoning state licensing.

TABLE

state	motion	recip	atty exam	CLE	rat pass
AL	0			1	0.7
AK	1	1		0	0.66
AZ	0			1	0.76
AR	0			1	0.66
CA	0		1	1	0.52
CO	1	0		1	0.74
CT	1	1		0	0.79
DE	0			1	0.61
DC	1	0		0	0.57
FL	0			1	0.77
GA	0		1	1	0.75
HI	0			0	0.75
ID	0		1	1	0.76
IL	1	1		0	0.78
IN	1	0		1	0.87
IA	1	0		1	0.82
KS	1			1	0.85
KY	1	1		1	0.77
LA	0			1	0.61
ME	0		1	0	0.68
MD	0		1	0	0.68
MA	1	0		0	0.73
MI	1	0		0	0.78
MN	1	0		1	0.84
MS	0		1	1	0.81
MO	1	1		0	0.81
MT	0		1	1	0.89
NE	1	0		0	0.86
NV	1			1	0.6
NH	0			1	0.71
NJ	1			1	0.68
NM	0			1	0.87
NY	1	1		1	0.7
NC	1	1		1	0.74
ND	1	0		1	0.82
OH	1	0	1	1	0.71
OK	1	1		1	0.84
OR	0			1	0.65
PA	1	1		1	0.7
RI	0			1	0.63
SC	1	0		1	0.78
SD	0			0	0.87
TN	1	0	1	1	0.72
TX	1	0		1	0.77
UT	0			1	0.93
VT	1	0		1	0.71
VA	1	1		1	0.68
WA	0			1	0.68
WV	1	1		1	0.77
WI	1	1		1	0.85
WY	1	1	1	1	0.66