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The Role of International Law Firms and Multijural Human Capital in the Harmonization of Legal Regimes

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Abstract

The problem of harmonizing legal rules across multiple overlapping legal orders is, in part, a problem of knowledge. If the public goal of harmonization is to promote value in transactions and dispute resolution, a legal regime needs institutions that facilitate the production of multijural human capital: expertise about how legal rules interact with each other and with the environment in which economic actors design transactions and dispute processing mechanisms. Because much of this expertise is embedded with the actors involved in transactions and disputes, the production of expertise has to be supported by adequate incentives for private actors to invest in the costly production of information and the cost of sharing this information with public bodies such as courts and regulators. As an information asset, multijural human capital is subject to externalities which lead to underinvestment. In this paper I argue that international law firms can internalize some of these externalities to increase the production of multijural human capital. Significant obstacles to the cross-border integration of legal practice, however, interfere with the formation of truly multi-jurisdictional law firms and thus hamper the process of effective harmonization in multijural settings.

The Role of International Law Firms and Multijural Legal Human Capital in the Harmonization of Legal Regimes

I. Introduction: Harmonization and Legal Human Capital

When multiple legal orders co-exist within a single legal regime—whether within a single country, such as Canada, or a cross-country trading regime, such as the E.U.—the potential exists for differences in legal rules to undermine the effort to engage in productive transactions and effective dispute resolution. If parties are completely free to choose the legal regime governing all aspects of their transaction or dispute—including a choice of law clause in a commercial contract or selecting an exclusive state of incorporation, for example—divergent or inconsistent sets of overlapping legal rules do not present much of a problem; indeed a diversity of choices may promote higher value transactions.¹ But in many settings, the rules of multiple legal regimes can attach to a transaction or dispute without regard to the parties' preferences. This generates a need for problem-solving by the parties: how to structure a transaction or a dispute resolution process that responds simultaneously to the environment in which the parties are operating and the multiple legal orders in which this environment is situated? And it generates a need for problem-solving by the legal regimes involved: what to do when presented with a transaction or dispute that has been structured, at least in part, in response to the legal rules from a different legal order and which may be simultaneously subject to the authority of those different legal rules? A legal regime that is uninterested in the impact of the resolution of this puzzle on the value of transactions and the efficiency of dispute resolution may find this an uninteresting problem, but a regime that

¹ This is the hypothesis of the regulatory competition literature. For a discussion of the tradeoffs of harmonization and competition in regulation see Sykes (2000)

recognizes that one of law's functions is to provide an environment in which transactions generate value and disputes are efficiently resolved will see in this a central challenge of its coexistence with other legal regimes.

For a regime that approaches the problem of overlapping legal orders with a view to generating value in transactions and dispute resolution, the problem of harmonization is thus, in part, a problem of knowledge. In particular, it is a problem of knowing how differences in legal rules and environments affect the value of transactions and disputes. This is a more complex version of any legal design question: How will a change in the measure of contract damages affect the quality of deals struck and the likelihood of inefficient breach? Will compulsory licensing of computer software lead to more or less innovation? Will workers be better or worse off (legislative goals promoted or undermined) if safety legislation is interpreted to provide an exemption for small firms? These legal design questions are encountered by regulators and legislators when designing written legal rules *ex ante*, and they are encountered by adjudicators called upon to interpret and implement rules (statutory or common law) *ex post*. In both cases, the social welfare goals of law depend on the level of expertise about the relationships between legal rules, environments and outcomes available to the regulator, legislator or adjudicator. I call this expertise *legal human capital*. (Hadfield 2007). When this expertise includes knowledge of the legal rules of overlapping legal regimes and the particular problems generated by multijuralism, I call this expertise *multijural human capital*.

In this paper I argue that understanding the nature and consequences of legal harmonization in multijural settings requires attention to the availability and quality of

multijural human capital. How are regulators, legislators and adjudicators educated about multiple legal rules, how they interact with each other and with changing transactional and dispute environments, and the impact of various solutions to harmonization problems on the value and efficacy of transactions and disputes? In Hadfield (2007) I develop a model of the accumulation of legal human capital, and its impact on the capacity of a regime for welfare-improving adaptation over time, premised on the idea that much of the knowledge necessary to generate effective legal rules, tailored appropriately to local and changing environments, is embedded. That is, it is known initially and at lowest cost to the parties involved in a particular transaction or dispute, the parties who ‘live’ in the environment and wrestle with the problem of adapting their transactions or dispute resolution processes to the legal rules around them. The problem of rule generation—through *ex ante* legislation or *ex post* interpretation—is then a problem of how embedded information is produced and transmitted so as to raise the level of multijural human capital available to courts, agencies and legislatures. Put differently, private parties need multijural human capital to design their multijural transactions and dispute processes, and public actors need this same multijural human capital to harmonize legal regimes to improve the economic value that private actors can generate.

In Section II of this paper I discuss the deeply local and contextual legal problem-solving that may be required when transactions or relationships cross jurisdictional boundaries using as an example a complex Russian securities offering studied by McBarnet (2002). In Section III I then examine the market failures that may attend the production of the specialized legal human capital necessary to engage in cross-border problem-solving. These market failures arise because, as is the case for most information

assets, multijural human capital is subject to externalities that lead, generally, to underinvestment in production and transmission. Section III therefore also looks at the role of multi-jurisdictional law firms in overcoming some of these failures. Section IV then examines the obstacles to the development of truly multi-jurisdictional law firms posed by the regulation of the legal profession globally. As I discuss here, globalization of trade in legal services lags far behind globalization more generally. This, I argue, poses a major challenge for the long-run production of multijural human capital by private actors and thus the availability of multijural human capital to courts, legislatures and regulators. Obstacles to the creation of multi-jurisdictional law firms thus pose a risk of undermining the integration of legal regimes in multijural settings.

II. Multi-jurisdictional Problem-Solving and the Role of Shared Legal Human Capital in Harmonization

In the 1995 film *Apollo 13*, depicting the near-fatal complications that developed during the American attempt at a third lunar landing, there is a scene in which NASA engineers are presented with a pile of miscellaneous odds and ends of equipment available to the astronauts on the spacecraft and told to come up with a way to convert those random materials into a highly specific fix for the damaged system that keeps the astronauts' level of carbon dioxide below toxic levels. Modern lawyers operating in a multijural environment are often in a similar, if decidedly less dramatic, situation. Their clients have specific legal needs and constraints and face a hodge-podge of alternative mechanisms available to satisfy those needs and constraints. Lawyers who serve their clients well are experts in evaluating the cost and efficacy of alternative solutions to both transactional and litigation challenges, and, if they are particularly effective, imaginative in their efforts to cobble together a structure that promotes the interests of their clients.

Like the NASA engineers, in order to accomplish these tasks, lawyers need to be knowledgeable about the complex ways in which different pieces will fit together and the detailed specifics about the environment in which the solution will be deployed. And they need to know whether and how well the people who will actually implement the solution will be able to carry it out, possibly far away in another world. In the transactional context, Gilson (1984) dubbed lawyers “transaction cost engineers.”

McBarnet (2002) provides a case study of the issuing of securities by a Russian company to foreign investors in the late-1990s that illustrates this phenomenon well in a regulated transactional setting. The securities offering faced several key legal problems in attracting investors. First, much of the regulatory environment that supports securities transactions in developed markets—the markets in which the Russian company hoped to find investors—was then absent in Russia. Under the existing legal framework, for example, ownership of company shares was evidenced exclusively by a list of shareholders maintained or controlled by the company itself; efforts to move to an independent registry system were still incomplete and the risk of having ownership rights simply struck off the books was both ongoing and complex to evaluate. As another example, there was no effective financial reporting regulation in place: there was limited public reporting and what public reporting might be forthcoming was subject to little or no oversight and unreliable. Both problems were solved through contractual terms: the company undertook liability for the accuracy of shareholder information held by the registrar, and undertook to publish audited annual financial statements in accordance with U.S. GAAP accounting rules.

A second major difficulty facing a successful securities offering by this Russian company (40% still owned by the state) presented a classic harmonization problem: divergent regulatory treatment, specifically tax treatment, of the securities in question. The Eurobonds the company sought to issue were at the time attractive to foreign investors in part because they had been constructed in such a way as to avoid withholding tax in the issuing country. Competing for these investors was hampered by the fact that these securities were not exempt from withholding tax in Russia. To overcome this obstacle, lawyers for the Russian company put in place an elaborate structure, dubbed the “passport deal,” to avoid Russian withholding: the company established an Irish subsidiary, which issued the shares (Ireland did not withhold tax); proceeds from the Irish offering were collected by the Luxembourg subsidiary of a German bank, which established a secondary market in the securities; the German bank was then able to (finally) route the money to the Russian company through a commercial loan, which did not attract Russian tax. As described by McBarnet who studied the transaction in detail: “The whole structure involved a network of guarantees, pledges of indebtedness on two levels of priority, certificates of indebtedness, and of course the aforementioned loan agreement, each of these also transnational, between Russian company, Irish company, UK, US, German and Austrian underwriters, German bank and its Luxembourg subsidiary.” (McBarnet notes the irony of a largely state-owned company going through elaborate procedures to avoid its own tax structure.)

McBarnet’s focus is on the design of this transaction and she does not explore the enforcement of the contractual or tax obligations created and avoided by the deal. But it is easy to see the complicated multijuralism implied on the enforcement side. Suppose

the Russian company fails to respect the independence of the share registration, in violation of the contract but not Russian law, or arguably fails to meet its financial disclosure obligations in accordance with US GAAP rules. How will Russian courts interpret the contract and the Russian company's conduct? How will they assess damages? Will they issue an injunctive order to correct the share registration? Will they order a restatement or other disclosure of otherwise private financial records? Are these obligations enforceable in foreign courts? An arbitral forum? Suppose the Russian Federation decided that the complicated structure was not effective in avoiding tax obligations. How would a Russian court interpret the structure and the implications of Russian tax law? Would courts in Germany or Luxembourg or Ireland cooperate in subpoenaing documents or individuals or attaching assets located in their jurisdictions? Would they provide enforcement of the contractual obligations of registration oversight or disclosures? How would they interpret the deal's structure, Russian tax law, the state of Russian company registration and disclosure requirements, and the application of any relevant international treaties for enforcement of foreign court orders?

For the U.S., Canadian or U.K. investors (the primary purchasers of these securities) seeking to enforce or avoid enforcement of the various contractual and regulatory implications of this complicated arrangement, the problem of overlapping jurisdictions is heightened by the need to understand the operation of and possibly choose between court systems quite different from those that operate in common law jurisdictions. Modes of interpretation differ, rules of evidence differ, discovery and interim relief procedures differ, available remedies differ, the roles played by experts differ, the availability and relevance of legal materials differs, the relationship between

the courts and the state differs, methods of enforcement for court orders differ, the availability of public enforcement tools such as contempt orders differs, and the list goes on. One can also imagine complex enforcement strategies involving actions in multiple jurisdictions. And control over which courts or forms will resolve even contractual matters can be elusive. Efforts to control which court manages a particular transaction or relationship, or to select an international court or arbitral forum, are themselves contractual agreements that one party to the transaction may seek to enforce or avoid in a domestic court.

For the parties to this particular transaction, making its complex design effective—and thus giving the Russian company access to an expanded capital market—requires substantial amounts of detailed, context specific legal expertise about multiple jurisdictions and their overlaps and interaction. More to the point, however, it requires the various courts and regulatory agencies that might play a role in its enforcement—or in its regulation to comport with state law—to have access to substantial expertise about the detailed nature of the transaction, its commercial and regulatory environment and the legal regimes of other jurisdictions. Will the Russian court, for example, be able to understand the intricacies of US GAAP accounting regulations? Allow testimony from U.S. accounting experts? Recognize established precedents from other legal regimes interpreting and applying these obligations? Enforce private registration obligations that go beyond those required by Russian law? Recognize a difference between a commercial loan and intra-company transfer? As defined by Irish, Luxembourg or German law? Pierce the entire structure and impose tax withholding obligations on the company,

leaving the Russian tax authority to enforce these obligations through the Irish, German or Luxembourg courts?

Without substantial multijural human capital on which to draw, the various courts that may play a role in the interpretation, enforcement or regulation of this multijural transaction are unlikely to implement “the” substantive legal rules as designed by the parties to this transaction or the states that regulate the transaction. Nor are they likely to evolve over time to increasingly accurate interpretation and implementation of these legal rules. The private effort to harmonize the regulatory regimes is thus likely to be undermined.

This is still true even if in response to efforts such as this one there are public efforts at harmonization—international treaties about tax treatment for Eurobonds, for example, or the wholesale adoption of US-style accounting regulation by the Russian Federation. Even if legislation is implemented that attempts to direct the legal treatment of arrangements such as this, such legislation still needs interpretation (although perhaps less so) and the evidence, perhaps complex (what do US GAAP rules require? When does a passport deal cross over from legitimate structure to tax evasion?), still needs to be understood in relation to that legislation. As Johnson et al (2000) document with respect to ‘tunneling’ (the removal of assets from a company by controlling shareholders at the expense of minority shareholders,) the development of effective legal rules to control behavior can require detailed knowledge of the myriad ways in which entities respond to the rules in different environments. The enactment of “harmonized” rules by the state is only a first step, not necessarily even a required first step, toward the development of a harmonized multijural regime. The multijural human capital available to individual

courts in those multiple jurisdictions is an important factor in the achievement of harmonization. This implies that the incentives facing private parties to produce and transmit multijural human capital play a significant role in the public process of harmonization.

III. Market Failures in the Production and Distribution of Legal Human Capital and the Role of the Law Firm

Legal human capital is costly. Identifying what knowledge is necessary to resolve a legal issue requires skill and experience, resources and effort; so too does actually producing knowledge to fill identified needs. My premise in Hadfield (2007) is that although the ultimate public value of legal human capital is achieved when it reaches public bodies such as courts, this costly work is, primarily, done privately by lawyers and paid for by their clients. The Russian company and its investors described in Section II both face (different) incentives to expend the considerable resources necessary to develop expertise in how the Russian shareholder registration system is working in practice, Irish securities and tax law, US GAAP rules and their interpretation and application in different settings, German banking law, and so on. These incentives come from the initial incentive to design and evaluate a mutually attractive transaction and from the later incentive to effectively pursue or defend a legal dispute about the transaction's implementation or regulation by the state.

The key observation is that the multijural human capital acquired to promote the private interests of the parties to a transaction or its regulators ultimately must make its way into the legal system as a whole—into courts and other enforcement agencies—in order to improve the quality of the interpretation, application and adaptation of legal rules. Individual legal human capital must become shared legal human capital. Hadfield

(2007) looks at the institutional attributes that can affect the extent to which the sharing of individual legal human capital with courts and other legal professionals occurs. Here I want to focus on a more fundamental question: whether the initial individual incentives to invest in legal human capital are subject to market failures and thus likely to result in underproduction.

Market failures routinely characterize the production and distribution of information. Information is subject to well-known externalities; it is hard to package and price. It is difficult to exclude others from using information and thus difficult to ensure that all those who value the information pay for it and so are included in the demand that generates production and distribution incentives. Because of these problems, many markets for ideas are supplemented by intellectual property regimes such as patent and copyright law and by public production or subsidy of intellectual endeavors through grants, university funding and so on. The highly specific nature of the legal knowledge that supports particular transactions, however, makes these methods of supporting the production and distribution of legal human capital inadequate. Although a portion of legal human capital clearly can be subsidized by public funding of legal education and law reform efforts, this kind of abstract knowledge takes a lawyer only so far in devising a structure that is adapted to the needs and legal environment in which a client resides. Patent and copyright protections are also ill-suited to the protection of investments in legal human capital at least in part because of the ineffability of much legal knowledge: much of what is valuable in legal work is the exercise of judgment and an appreciation for how multiple considerations work together to recommend a particular course of action or strategy. Some legal products can be encapsulated—in standard contract provisions or

other documents, for example—but much of what can be learned is learned only through shared practice—learning-by-doing, together.

If legal human capital were *completely* specialized to a particular transaction, such that what was learned in one was not valuable to what was needed in another, the difficulties that attend markets in information would be largely inconsequential for legal design. Researching and analyzing a client's legal problem takes lawyers' time and other resources, which *can* be packaged and priced. If of no value to anyone else, the demand for the information and ideas produced by the lawyers who put together and evaluated the Russian securities offering described above would be completely captured by the demand for lawyers' time generated by the Russian company, the prospective investors, the German bank, and so on.

But much of what lawyers learn *in situ* in solving a particular client's problem is of value to others. This is evident in the phenomenon of specialization: I want a lawyer working on my transaction who has done others like it because I anticipate that the experienced lawyer will do a better job of anticipating the problems I face and know the terrain of possible solutions better. Moreover, information displays increasing returns to scope. The value of information about new Russian registration or German banking or EU tax laws, or court procedures, is higher to the lawyer who is already well-informed about the problems faced and solved in putting together the 'passport' deal or steeped in the practical realities of enforcing the deal in various courts.

Because of the accumulated nature of legal expertise, the production and distribution of legal human capital presents problems for legal design. We want lawyers to invest optimally in learning, not merely with a view to the value of that learning for a

particular piece of work done for a particular client, but also with a view to the value of that knowledge for future clients, including state regulators. We want legal human capital to be shared among lawyers, and in multijural settings we want information shared across jurisdictional boundaries so that what one lawyer has learned from her experience in Irish courts can be shared with another who is working on designing a securities offering for a Russian company or contemplating a German challenge to a questionable tax-avoidance structure implemented with the cooperation of a German bank. This means we need to pay attention to the incentives lawyers face to gain and share multijural information with each other.

Beyond professional camaraderie and intellectual curiosity, the incentive for lawyers to invest in and share expertise about transactions is a function of the extent to which they can expect to capture some of the value of those efforts. In the absence of formal intellectual property protections which would allow lawyers to license their expertise in exchange for a royalty or other fee, lawyers need to ensure that they receive some of the fees generated by legal work that makes use of their expertise. They do this by working in collaborative settings: partnerships and firms. Within the confines of a firm, and with established rules about the sharing of income and opportunities that come into the firm, lawyers overcome many of the difficulties of transactions in intellectual work and ideas, particularly knowledge that is difficult to reduce to written form. In a smaller firm, knowledge is shared informally through conversation and feedback on strategies, documents and so on. In a larger firm, more formal mechanisms for exchange also arise: databases of memoranda, model contracts, forms and other writings and established training sessions or even (in multi-locational firms) conferences and

workshops for firm members. In many settings, large and small, overt mentoring relationships are established, with junior lawyers assigned to work with senior lawyers to learn both didactically and by osmosis from exposure to the daily practice of law. Rotation among different offices is often used to expose younger lawyers to the work of more senior lawyers in multiple locations. In all these settings, protection against the distribution of valuable information to those outside the firm is assisted by confidentiality obligations and access restrictions (only firm members can attend a firm luncheon or look through password-protected databases, for example) and by the sheer need to be in frequent and informal contact with experts in order to learn much of what they know.

The function of the law firm as a solution to problems of generating and sharing human capital has been studied by three important contributions. Gilson & Mnookin (1989) and Galanter & Palay (1991) both analyze the value of human capital transfers from experienced to novice practitioners and the role of the law firm in facilitating the sharing of senior lawyers' (partners') human capital with a number of junior lawyers (associates.)² Galanter & Palay in particular emphasize the capacity to maximize the value of senior human capital by overcoming the limit that any individual can only work so many hours; the fact that human capital is non-rival (many can use it at once without reducing its value to any one of them) implies that the value of senior human capital can be expanded by sharing that knowledge with others with a fresh labor supply to exploit it. Gilson & Mnookin (1989) focus on the law firm's investment in the associate's training, paying him or her more than she is worth during the apprenticeship period. Gilson and

² Gilson & Mnookin are more focused on the need to create an incentive for associates to invest in firm-specific human capital, given the risk of firm opportunism later in their careers, taking somewhat for granted that this human capital is provided in training by the senior lawyers in the firm. Galanter & Palay make this point more explicitly.

Mnookin (1985) look to the sharing of law firm profits as a portfolio mechanism to reduce the risk associated with investment in specialized human capital through diversification.

All of these contributions are specifically interested in the growth of the large multi-specialty American law firm and the changing patterns of partnership decisions. In the global context, however, it is the basic formation of shared practices among lawyers (not necessarily large, multi-specialty or patterned on the American model) that, I argue, proves critical to understanding the role of international law firms in generating the multijural human capital needed to support the expansion of cross-border interaction and the generation of the shared legal human capital necessary for public bodies such as courts and regulators to harmonize law in multijural settings. Indeed, in the global context the creation of multi-jurisdictional legal practices and the facilitation of cross-border exchange of legal human capital is a fundamental legal design question, one that has by and large not been well understood in the ongoing efforts to develop the legal structures needed to support globalization and multijuralism.

The embedded, local and often ineffable knowledge necessary to design, evaluate and regulate transactions takes on dramatic proportions in the multijural context. The sheer volume of what must be known to effectively evaluate alternatives increases several-fold over what is required in the domestic context. What this implies for multijuralism is a substantial need for multijural human capital not only about the particular transaction or relationship at stake, but also about the law, norms and practices of the jurisdictions potentially relevant to the transaction or relationship. Some of this legal human capital—the practices of contract law and enforcement in Irish or Russian

courts, for example—will be available to domestic lawyers practicing in particular jurisdictions. Accessing that expertise is possible through the retention of the services of domestic lawyers in the process of putting together the transaction. The very nature of the cross-border setting, however, suggests the need for lawyers from all relevant jurisdictions involved in the transaction. How are these services to be combined?

A simple answer would be to separately retain the services of attorneys possessing the requisite expertise. These services could be retained by each of the transacting parties, or by the primary attorneys responsible for the transaction. The difficulty here, however, is the one we have already explored, namely the economic difficulties of contracting over information. We are concerned not only with accomplishing a particular transaction or regulating a particular relationship, but also with the ongoing capacity of global legal systems to generate investments in multijural human capital, the value of which transcends the gains in a particular transaction. What incentive is there for the domestic Russian lawyer, for example, to invest in legal human capital about U.S. accounting law and practices and how they interact with Russian law and practices beyond what is needed to carry out a specific transaction? To assist in devising a transactional structure that will reduce reliance on Russian legal mechanisms (and hence Russian legal advice) where this is cost-effective? What incentive is there to share expertise in Russian law or legal norms with foreign lawyers—such as those putting together similar deals in other emerging market economies lacking developed registration or disclosure regulation? What incentive do U.S., Canadian or U.K. lawyers have to share their expertise in evaluating these transactions for their investor clients with European lawyers seeking to advise their investor clients? If the legal relationships are

limited to separate contracting arrangements, the problems of generating appropriate incentives for the production and distribution of appropriable information lead to underinvestment in trans-border legal expertise and inadequate sharing of global legal human capital.

To support and regulate the multijural transaction or relationship, then, it is important to have in place mechanisms that support the investment in and sharing of the legal human capital specific to such transactions and relationships. This brings us back to the importance of law firms. The law firm, as we have seen, is an organizational structure that helps to overcome the individual disincentive to invest in and share appropriable and generalizable legal human capital. When transactions move across jurisdictional boundaries and the expertise and legal innovation necessary to support them include issues unique to the multijural setting, then the law firm as a solution to the underinvestment problem must also transcend borders. The multi-jurisdictional law firm captures the returns to both generating expertise in multijural transactions and relationships and sharing legal human capital between lawyers situated in different jurisdictions. It is not necessary for a specific lawyer—Russian, Irish, German, or American in McBarnet’s securities example—to anticipate repeat business of this type; it is now sufficient for the firm as a whole to anticipate repeat business to generate incentives for efforts to be made to learn more about the issues at stake and their more general characteristics, and to invest in mechanisms for transferring that information to other lawyers in the firm. If the Russian and U.S. and European lawyers are in the same firm, jointly benefiting from future revenues, the incentive to hoard expertise in domestic

legal knowledge is alleviated and the incentive to invest in sharing that information is generated.

The sharing of legal human capital across jurisdictions is particularly important in the multijural context because of the likelihood that lawyers, steeped in their domestic jurisdiction, will fail to appreciate the subtle ways in which legal and non-legal mechanisms operate in foreign environments. This is knowledge that it is difficult to access in the abstract. Indeed, like the proverbial fish that knows nothing of the sea in which it swims, it is likely that the domestic lawyer is oblivious to many of the features of the domestic jurisdiction that make particular transactional solutions or regulatory approaches effective. Yet such knowledge is essential to the ongoing effort to facilitate global interaction. Thus Russian, German, Irish, Luxembourg and American, British or Canadian lawyers are each likely to exercise poor judgment about transactional design or enforcement in the absence of being educated by the other, in an ongoing and embedded way, about the way in which different mechanisms are likely to function in the effort to integrate U.S. accounting practices, common-law contract interpretation, Irish securities law, German and Luxembourg banking procedures and Russian tax and company laws with enforcement in any one (and probably many) of these individual jurisdictions.

In the absence of a truly multi-jurisdictional law firm in which lawyers from different countries share in firm profits, lawyers have an incentive to hoard information about their respective expertise in order to preserve the value of their services in future transactions. Lawyers also have a disincentive to devote effort to identifying transactional, regulatory or enforcement solutions that reduce reliance on the legal environment in which they are expert. Both actions increase their bargaining power in

the distribution of the rents generated in any given transaction or litigation that requires their input. Relatedly, in the absence of future profit-sharing, individual lawyers in separate jurisdictions have little incentive to innovate costly solutions for cross-border transactions and relationships if they do not have reliable access to the other jurisdiction in the future. The truly multi-jurisdictional law firm, in which all members of the firm reliably share in the increased present and future value created by improved information-sharing and innovation, can help to alleviate these sub-optimal incentives.

As those who have studied the economic function of law firms have emphasized, however, in order for the sharing of future revenues to support current collaborative efforts such as information-sharing and transactional innovation, it is important for the law firms' 'hold' on the value of the information to persist. This means that the risk that lawyers in the firm will opportunistically defect in the future, taking with them the value created by their joint efforts, has to be effectively reduced in order for the firm to serve its function. Both Gilson & Mnookin (1989) and Galanter & Palay (1991) look at the risk that junior associates will abscond with the value of the mentorship and training they have received from senior partners or degrade the value of the investment by shirking; this risk, they argue, is managed by the partnership decision, which holds out a large partnership prize for the associate who remains loyal, hard-working and productive through a probationary period. Gilson & Mnookin (1985) looks at the risk that the lawyers whose specialties turn out to be profitable will abandon the lawyers whose specialties turn out to be unprofitable, or threaten to leave if they are not given a greater share of firm revenues, thus undoing the value of diversification that they suggest motivates the creation of large multi-specialty firms. This risk, they claim, is reduced by

the law firm's creation of a valuable set of clients who are bonded to the law firm rather than particular lawyers and the establishment of a firm-level reputation, reducing the value to a given lawyer of defecting.

In order for the multi-jurisdictional law firm to support the sharing of information and investments in innovative cross-border transactional solutions, then, it is important for the law firm to effectively share profits among lawyers from different jurisdictions (to prevent hoarding and shirking), and to be largely protected against hold-up and abandonment threats by lawyers from different jurisdictions.

IV. Global Regulation of Legal Services and the Obstacles to Multi-jurisdictional Law Practice

The globalization of the legal services market lags substantially behind the globalization of other goods and services, with an arcane web of barriers to the creation and stability of the truly multi-jurisdictional law firm. Barriers to the sharing of law firm profits among a multi-jurisdictional set of lawyers abound in the form of restrictions on the formation of business relationships such as partnerships, or even employment relations, between lawyers from different jurisdictions. Restrictions on the creation of firm reputation, as a bonding mechanism for the firm, are widespread, particularly for multi-jurisdictional firms. And most critically, the legal profession in most countries, organized as a self-governing body often considered beyond the reach of state regulation, operates a tight cartel over access to the provision of legal services that either rely on the country's law or are provided to the country's residents. The hold-up threat created by these cartels effectively thwarts efforts to form an enduring commitment between lawyers from multiple jurisdictions to share the profits generated by sharing expertise and innovating new solutions for cross-border transactions and relationships.

In the domestic context, the capacity of bar associations (directly or through their influence on statutes regulating the legal professions) to restrict entry into the practice is well-documented. Restrictions adopted in different jurisdictions include numerical quotas (particularly with respect to notaries, who generally hold a territorial monopoly on the preparation of certain documents), control over bar exam passage rates and the accreditation of law schools, limits on advertising, ranging from complete bans on any form of advertising to prohibitions on the content, form or medium of advertising and price controls.³ Moreover, most jurisdictions control the organizational form of law practice. In most countries, for example, law firms must operate as partnerships among lawyers; some jurisdictions now allow law practice to be organized as a limited liability corporation but continue to require that the corporation be owned exclusively by lawyers and limited to the provision of legal services (excluding combinations with other services providers such as management consultants and accountants).⁴ In major European countries such as Germany (Paterson et al 2003), as well as in Asian countries such as Japan (Kelemen and Sibbitt 2002) and transition countries such as Slovakia⁵, law firms may not operate multiple offices. “Almost everywhere” in the OECD countries, lawyers are subject to local presence requirements (OECD 2000), meaning that lawyers cannot provide legal services (electronically, by telephone, etc.) without setting up shop in the country. In the U.K. lawyers with authority to appear in court (barristers) must work as self-employed solo practitioners and may not enter into practice arrangements with

³ Minimum fee schedules for lawyers persist in the EU, for example, in Germany, Italy and Austria. Notaries are subject to minimum and/or maximum fee schedules in Austria, Belgium, France, Germany, Greece, Italy, Netherlands and Spain. (EC 2004)

⁴ The capacity of the legal profession to restrict the formation of multi-disciplinary partnerships—between lawyers and accountants, for example—was recently upheld by the European Court of Justice against an attack under the EU competition laws in the *Wouters* case (C-309/99.)

⁵ Parliamentary Act No. 132/90 Coll. On Advocacy.

solicitors; in some countries such as Slovakia, lawyers may not be employed by other lawyers, limiting the potential for law firms to grow through the use of associates prior to partnership. In many jurisdictions throughout the world, lawyers are prohibited from presenting themselves to the market as specialists in particular areas of law. Many of these regulations are of dubious value to the welfare of domestic markets, although they are all generally defended as being necessary to protect the independence of the legal profession and protect the consumers of legal services. Of greatest concern for the development of multijural transactions and relationships, however, are the restrictions these domestic regulations place on foreign lawyers and the emergence of multi-jurisdictional law firms.

In most jurisdictions, conventional authorization to practice law in the country—being physically present in the country and providing legal services to foreign or domestic clients, or providing services to clients located within the country from outside the country—is limited to those who have been admitted to practice by that country. The requirements for admission to practice generally include completion of a law degree (often within the country itself), passing an examination (usually administered only in the language of the country), meeting various moral standing criteria (such as the absence of a criminal record and evidence of good moral character), and, in many places, completion of a period of apprenticeship with practicing lawyers in the country. Historically, there have been citizenship and residence requirements imposed on would-be practitioners; some countries (such as Greece) continue to impose this requirement. Effectively, these requirements make it very difficult for foreign lawyers to gain admission to practice in a jurisdiction other than their own.

In the European Union, various directives and court decisions have attempted to reduce the barriers to practice between Member States. Member States are not, for example, allowed to impose citizenship or residency requirements on lawyers seeking to gain admission to the bar in a given State. Member States are also obligated to recognize the law degrees offered by other Member States as fulfilling the education requirement, subject to the requirement that the prospective lawyer pass an aptitude test or undertake a period of adaptation to local practice. Most recently, the 1998 Lawyers' Establishment Directive has exempted applicants from the requirement of completing an aptitude test or an adaptation period if he or she has "effectively and regularly pursued for a period of at least three years an activity in the host Member State in the law of that State, including Community law." These provisions apply only to Member States, however: lawyers from non-Member States are generally subject to the much more stringent requirements of admission to practice described above.

Many countries allow some legal practice by foreign lawyers who do not gain admission to the local bar (often called foreign legal consultants), generally under the restriction that the practice is limited to advice on matters of the foreign law or international law, although some (such as Greece, Luxembourg, and Denmark (CCBE 2006)) prohibit any practice by foreign lawyers. In China foreign lawyers are restricted to providing advice exclusively on foreign law, prohibited from opening more than one office or entering into any partnerships with domestic firms; in Japan, foreign lawyers are required to maintain residency in Japan and in Korea no foreign lawyer has ever been granted authority to engage in even the limited assistance to Korean lawyers allowed by statute. (Kim 2006) Other countries (such as Germany) require the foreign lawyer to

work in collaboration with a lawyer admitted to practice in the host country (OECD 2000 (1996 data)); others (such as Japan, Mexico, France, Turkey) prohibit foreign law firms from employing local lawyers (OECD 2000 (1996 data), Kelemen and Sibbitt 2002). In some countries (such as Russia and Indonesia), foreign firms are prohibited from practicing under their home name and required instead “to practice under the aegis of a local client, a local firm, or simply to list their resident foreign lawyers.” (Abel 1994) In the United States, where the legal profession is regulated at the state level, only half of the states recognize foreign legal consultants; requirements differ state-by-state but generally restrict the foreign legal consultant to advising on matters of his or her home country’s law; some also allow advice on international law or third-country law. (Silver 2005) Some require the foreign legal consultant to practice alongside a local lawyer; some do not. (Hill 2006). Most allow foreign legal consultants to be employed by or enter into partnership with lawyers in the host state; some (such as North Carolina) do not. (Silver 2005)

The most liberal regime for foreign lawyers exists in the European Union, where lawyers from one Member State are permitted to practice law in another Member State under their home professional title, expressed in the language of their home country.⁶ While such lawyers may give advice on the law of either their home country or the host country, they may be required by the host country to practice in conjunction with a lawyer in the host country for the purposes of representing a client before the host country’s courts.⁷ They may also be restricted from engaging in activities reserved to

⁶ The European Court of Justice recently held that registration with a member state could not be conditioned on a demonstration of proficiency in the language of the host country. *Commission of the European Communities v Grand Duchy of Luxembourg*, C-193/05 (19 Sept 2006).

⁷ Article 5(3) of Directive 98/5.

notaries (such as preparing deeds, administering estates and conveyancing.)

Furthermore, lawyers from Member States are permitted to form partnerships with or be employed by lawyers in the host country, if these practice arrangements are available to lawyers admitted to practice in the host country.

Efforts to reduce barriers to cross-national legal services are apparent in the General Agreement on Trade in Services (GATS) governing WTO Member States, but it is clear that the impact of GATS is still slight. GATS requires Member States to engage in negotiations to reduce trade barriers in services, including legal services, and to establish disciplines governing the licensing of services with a view to ensuring that licensing requirements are based on objective criteria and not overly burdensome as a restriction on the supply of the service. (Terry 2004) Lawyers, however, have had little trouble in the international context, as they have had little trouble in the domestic context, defending limitations on practice as justified by the independence of the profession and the need to protect the consumers of legal services. By and large, the impact of GATS is to require that Member States allow lawyers from other Member States to gain access to the legal profession on the same terms as their own citizens, that is, to satisfy the same requirements of legal education, training, language, form of practice etc. as their citizens must satisfy. Much deference to the local regulation of legal practice by lawyers therefore continues.

Both the OECD and the European Commission have recently devoted substantial attention to reviewing the control of the legal (and other professions) by self-governing bodies under competition law (OECD 2000, EC 2004), however little progress has been made in shifting the balance of regulation. The Council of Bars and Law Societies of

Europe (CCBE) and the International Bar Association (IBA) both have adopted strong positions defending the bulk of self-governance of the legal profession, seeking to establish as a core principle the uniqueness of the legal profession and the need for deference to its special status among the professions.⁸ The legal professions throughout the world largely share the view that the legal professions and only the legal professions can determine appropriate regulation of the practice of law; and that, indeed, given its essential independence from the state, the legal profession falls outside of the purview of government. As articulated by the Canadian Bar Association: “Our view is that the legal profession should not have to prove the ‘necessity’ of rules which it is convinced are required to preserve its integrity and protect the public.” (Paton 2003)

All told, the web of continuing regulation of individual country legal markets imposes tremendous barriers to the creation of multi-jurisdictional law firms, particularly expanding beyond the EU, and thus to the resolution of the disincentives facing lawyers to invest in the global legal human capital necessary to support globalized exchange and the development of multijuralism. Overt restrictions on the formation of partnerships and other business relationships clearly limit the growth of multi-jurisdictional law firms. Mere collaboration or networks of independent firms cannot substitute for the internalization of incentives that occurs with the creation of a business entity that shares profits among lawyers in multiple jurisdictions. Even where such profit-sharing arrangements are possible, by making it so difficult for out-of-country lawyers to provide

⁸ The International Bar Association, for example, has adopted a resolution on ‘core values’ in the legal profession that requires a recognition that the legal profession is different from other services, fulfilling a special function, and that no deregulation of the profession should occur which fails to observe the principle that “preservation of an independent legal profession is vital and indispensable for guaranteeing human rights, access to justice, the rule of law and a free and democratic society.” IBA, Resolution on Deregulating the Legal Profession, available at www.ibanet.org/aboutiba/resolutions.asp. The CCBE also emphasizes the uniqueness of the legal profession and advocates only minimal changes in the existing regime of self-governance. CCBE (1998)

legal services, the existing state of regulation undermines the capacity for multi-jurisdictional law firms to avoid the risk of hold-up that destabilizes cooperative agreements to share information and innovate cross-border transactional and regulatory solutions. The stability of a multi-jurisdictional law firm depends on the capacity of the firm to retain sufficient independent access to individual jurisdictions (and the clients resident there) in order to make the profits available from continuing in the firm greater than the profits available from defection for lawyers from the separate jurisdictions. Access to clients and business has to be a firm asset, not an individual lawyer asset, in order to stabilize the firm and thus generate the benefits of shared information and innovation. Much of the regulation of the global profession, however, prevents exactly this.

Surveys of international law practice confirm that the incentives for truly collaborative multi-jurisdictional practice are weak. Silver (2003) concludes that U.S. law firms, which still dominate lists of multi-jurisdictional law firms, are increasingly “going global by going local,” that is, by staffing foreign offices with lawyers who are foreign-trained and who practice the law of the host country. She sees in this strategy a segregation of U.S. and foreign practice, and thus limited opportunities for shared practice and collaborative work. Abel (1994), documenting the number and nature of international law practices around the globe in the late 1980s, emphasizes that foreign firms face the risk that by expanding their services in a given country they will restrict the referrals they receive from local lawyers. In light of the regulatory structure in most countries, which makes access to locally admitted lawyers essential for some of the services that a law firm might need to provide in a given transaction or litigated dispute,

we can understand the limited extent to which local and foreign lawyers are likely to collaborate. The local monopoly gives the local bar substantial hold-up power to extract sunk investments in collaboration and innovative legal work, including the work to develop reputation and a network of client referrals.

V. Conclusion

Both private and public harmonization efforts depend ultimately on courts and other adjudication bodies. The legal rules that are written into statutes, treaties and guidelines are not static and self-effectuating; they are dynamic and in need of interpretation, application and adaptation to local and changing circumstances. Courts therefore need access to grounded problem-specific knowledge in order for harmonization to be effective across multiple jurisdictions. My claim is that the principal source of this multijural human capital—expertise about the interaction of legal rules and their impact on transactions and dispute resolution—is the legal human capital generated by lawyers for clients and shared with courts in the process of transactional design and dispute resolution. For courts and regulators to become expert, sufficiently so as to promote economic value in transactions by resolving the harmonization problems of overlapping legal orders—private parties and their lawyers must invest in generating this expertise and sharing it with public bodies.

The global markets in which lawyers' investments in multijural human capital take place are thus important not merely for how well they serve the interests of particular clients but, more fundamentally, for how well they work to generate the multijural human capital that ultimately feeds into the quality of the harmonization work of courts. These global legal markets, however, are characterized by both market failure

and monopoly restrictions. Market failures arise because of the externalities that attend the production and distribution of information, externalities that in other settings are mitigated through the use of intellectual property protection, public subsidy and so on. Law firms are an important organizational form for overcoming legal human capital market failures. In the multijural setting, however, extensive jurisdiction-specific monopolies over the provision of legal services inhibit the development of truly multi-jurisdictional law firms. Reducing the barriers to multi-jurisdictional legal practice is thus an important policy step in the direction of promoting the harmonization of law in a multijural world.

VI. References

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