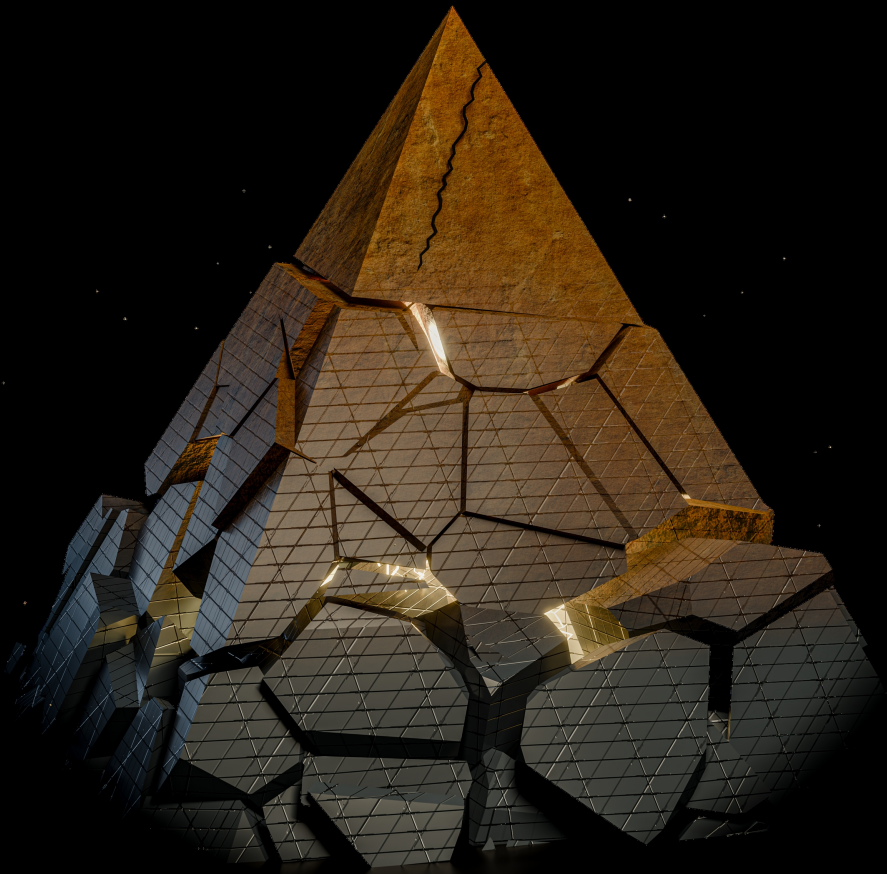


BUILDING AI-NATIVE PROFESSIONAL SERVICES FIRMS

Strategy, Economics, and Execution



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CHAPTER 3

Uncertainty and Structure as Strategy

CHAPTER 3 · MARCH 2026

✓ Prologue · Four Lawyers, One Monday Morning

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Chapter 3: Uncertainty and Structure as Strategy

The future is already here—it's just not evenly distributed.

— William Gibson

Sarah's flight back to San Francisco was delayed two hours at JFK. She did not mind. She sat in the terminal with her laptop open, transcribing notes from cocktail napkins into a proper document. Maya had given her more than she had expected—not just the frameworks, but the vocabulary she would need to speak fluently with investors.

The economics were clearer now. EBITDA margins, revenue multiples, the J-curve of transformation, the value creation bridge that converted \$60 million of enterprise value to \$250 million and beyond.

But understanding the economics was only the beginning. Maya's parting words echoed: *"The founders who raise successfully are the ones who understand the economics as well as the bankers on the other side of the table. And by successfully, I mean the right amount of money under the right conditions. AI is going to create a lot of zombie companies out there that took the wrong amount at the wrong time under the wrong terms."*

Sarah needed capital. Real capital. A seed round to build the platform and prove the model, then a Series A to scale. And that meant she needed to understand not just the economics of her firm, but the broader environment in

which investors would evaluate her—the uncertainties they'd probe, the scenarios they'd stress-test, the structural questions they'd ask.

The dinner with Maya certainly helped but her story and pitch was still very much a work in progress.

Her phone buzzed. A text from Maya:

“Talked to Alex Hawthorne. He’s interested. I’m connecting you via email. He lives in Los Altos. Good luck—he’ll push you hard but he’s fair. And he actually understands professional services.”

This was the meeting Sarah was hoping for—face to face with a top-tier Silicon Valley angel investor. Now it was game on.



Weeks passed before Alex Hawthorne's calendar aligned with Sarah's. In the interim, the technology landscape lurched forward again. A Chinese laboratory had released an open-source reasoning model that rivaled frontier performance at a fraction of the cost, sending tremors through Silicon Valley and reinforcing what Sarah already believed: the capability curve was not flattening. Token prices had cratered such that inference that cost dollars a year ago now cost pennies. The agentic workflows Sarah was exploring such as multi-step reasoning, tool calling, autonomous document analysis had advanced rapidly. It was now more than two years since a large language model had first passed the bar exam and crushed the LSAT, the milestones Sarah always cited when people asked why she had walked away from a partnership track. The technology had changed enormously since that moment. Most of the legal industry had not.

Sarah found herself at the bakery of a Michelin star restaurant in Los Altos, fifteen minutes early as usual. The bakery occupied a spot on State Street, the heart of a town that felt more like a village—boutiques with handlettered signs, restaurants with sidewalk seating, the kind of place where people might actually know their neighbors. The aroma hit her the moment she walked in: butter and caramelized sugar, fresh sourdough, the dark richness of properly roasted coffee.

She'd done her research on Alexander “Alex” Hawthorne. Maya's email introduction had included a brief bio, but Sarah had dug deeper. Former M&A

partner at a prestigious New York firm, specializing in tech deals. Made partner by 35, known as a dealmaker who could navigate regulatory complexity and close billion-dollar transactions. Then, in his mid-40s, he'd walked away from the partnership—burnt out, Maya said, but also transformed by watching a startup client go bankrupt for lack of early funding.

Now he ran *Juris Dictum Capital*, an angel fund focused on emerging tech. His portfolio included several unicorns, and investor circles called him the “Guardian Angel” for his ability to turn early-stage ideas into industry disruptors. More relevant to Sarah: his background in professional services meant he actually understood the business she was trying to build. He'd seen the inefficiencies, the billable hour treadmill, the resistance to change. And according to Maya, he was actively looking for an AI-native professional services investment—patiently waiting for the right opportunity.

Sarah hoped she was that opportunity.

She joined the line and studied the case: morning buns glistening with orange zest and brown sugar, pain au chocolat with visible layers, croissants that shattered when you looked at them wrong. The bakery was tiny—four small tables, maybe five if you counted the ledge by the window. All occupied. This wasn't a place designed for lingering.

A man in his mid-fifties appeared beside her, wearing a Patagonia vest over a crisp collared shirt—*Juris Dictum Capital* embroidered on his chest opposite the Patagonia logo. He had silver-flecked hair, an easy smile, and the kind of relaxed confidence that came from decades of high-stakes negotiations. On his feet, a pair of wildly colorful, ultra-rare Air Jordans that probably had their own insurance policy.

“Sarah Okonkwo?” He extended his hand. “Alex Hawthorne. Maya speaks highly of you. I hope you don't mind—I took the liberty of ordering for us. The morning buns go fast.”

“Thank you for making time,” Sarah said. “And for the save on the pastries.”

The counter called Alex's name. He returned with a tray: two morning buns still warm from the oven, their caramelized tops catching the light; a Kouign Amann with its impossibly flaky layers of caramelized butter; a wedge of monkey bread, sticky and fragrant with cinnamon; and two chai lattes, the milk frothed



into a fine microfoam with cardamom and black pepper blooming through the steam. Sarah glanced at the occupied tables, then back at Alex.

“I chose this place for a reason,” he said over his shoulder. “Practically no seating. Best pastries in the Bay Area, but nowhere to sit and give me a Power-Point. I’ve already read your deck, by the way. Twice. What I don’t know yet is you.”

He held the door open for her.

“Angel investing is as much a bet on the founder as the idea. Maybe more. I can analyze your market, stress-test your financials, poke holes in your assumptions. What I can’t do from a pitch deck is figure out how you think when you’re not performing. How you handle being thrown off your game.” He smiled. “So we walk.”

They stepped outside into the mild California morning. The street was already alive—couples window-shopping, a busker playing acoustic guitar on the corner, the smell of coffee drifting from every other doorway. Alex handed Sarah a morning bun wrapped in parchment paper and carried the monkey bread between them as they walked, pulling off pieces as they went.

“So,” Alex said, tearing off a piece of his pastry, “before we talk business, tell me something. What made you leave your old firm?”

At least he was direct about it, Sarah thought. No pretense that this was just a casual conversation.

“The short answer is that I see what is coming and the partners at my old firm do not. It is not doom and gloom, however, it is an opportunity—an opportunity I intend to take advantage of ... The longer answer...” She paused, savoring a bite of the morning bun—the orange zest bright against the caramelized sugar, the impossibly tender brioche. “I spent eight years watching brilliant people do repetitive work that machines could do better. Contract review. Document drafting and analysis. Due diligence. Regulatory review. We billed clients hundreds per hour to have associates do work that was tedious, error-prone, and increasingly automatable. And when I suggested we could use AI to do it better and faster, I was told it would cannibalize our revenue.”

“Which it would,” Alex said. “In the short term.”

“Right. But I wasn’t thinking about the next quarter. I was thinking about what the industry would look like in five years. Ten years. The partners with one to ten years to retirement wanted to maximize distributions. I wanted to build something that would still exist when I’m their age.”

They turned onto a quieter side street, past a jewelry store and an art gallery, the buildings giving way to mature oaks shading beautiful homes.

Alex nodded slowly. “And you couldn’t do that from inside a traditional firm.”

“The voting arithmetic doesn’t work. You need a supermajority to approve transformation investments. Partners near retirement have no incentive to fund changes they won’t benefit from. Even the middle cohort—partners who might see the strategic imperative—often lack the votes or the appetite for the J-curve.”

“The J-curve,” Alex repeated. “You’ve done your homework.”

“I had a good teacher. Maya walked me through the economics in painful detail.”

“She’s sharp. One of the best I’ve worked with on professional services deals.” He broke off a piece of the Kouign Amann and handed it to Sarah—the caramelized shell cracking to reveal layer after buttery layer, the kind of pastry that justified its reputation. “Tell me about your firm. Where are you now?”

“Almost a year. Five lawyers including me, plus two full-time operations staff. We are using GPT, Claude and a handful of other frontier models to handle work

that would traditionally require a team like three times our size. The early clients came from my network—a couple general counsel I had worked with who were willing to take a chance on something new. We have just started winning some small amount of work through referrals, which feels like a turning point. But it is still early days.”

“Revenue?”

“Run rate of about \$1 million. Again, still early, but the growth curve is steep and the unit economics are strong. We’re doing roughly 2x–3x the work per lawyer compared to what I could do at my old firm—and that ratio keeps improving as the models get better and we get better at working with the models.”

“And you’re here because you need capital to scale.”

“I am here because Maya said you understand this space in a way most investors do not.” Sarah met his eyes. “I can pitch to a hundred VCs who think professional services is boring and law is a guild that technology cannot touch. Or I can talk to someone who had actually lived inside the industry and seen how it works—and doesn’t work.”

Alex nodded. They had circled back toward the main street, passing a range of speciality shops and high end restaurants, the kind of places that could only exist in a town where people had both money and time. He pulled out his phone and typed a quick message.

“I like what I’m hearing,” he said. “But I want you to meet someone before we go further. My head of due diligence, Rachel. She’s going to push back on everything you’ve told me—that’s her job.” He glanced at his phone as it buzzed. “She’s free now. And she suggested something that might sound unusual.”

Sarah raised an eyebrow.

“There’s a trail that starts about fifteen minutes or so from here. Nice loop through the nature, it takes maybe an hour or so. Rachel and I do our best thinking on the trail. Would you be up for a hike?”

Sarah looked down at her ballet flats, then back at Alex.

“I keep spare trail shoes in my car,” he said. “What size are you?”

“Seven and a half.”

“Perfect. Rachel’s an eight. Close enough.” He gestured toward the parking lot.

Sarah followed him to his car. Alex had told her exactly what he was doing—no formal pitch, walk and talk, evaluate the founder not the deck. He had been completely transparent about it. And yet, she realized, knowing the game did not make it easier to play. Every answer she’d given on the walk through town, every pause, every bite of pastry—all of it was data now. The evaluation had started the moment he’d said her name at the bakery counter.



The trailhead was tucked behind a residential neighborhood, marked only by a small wooden sign and a dirt parking lot. Rachel was already there, leaning against a Rivian appropriately featuring the El Cap Granite colored paint. She had sharp features, dark hair pulled back, and the kind of focused intensity that Sarah recognized from the best lawyers she had encountered. She was dressed in the sort of ‘athleisure’ style hiking clothes that suggested this was routine.

“Sarah Okonkwo,” Rachel said, extending her hand. “Alex has been texting me your talking points for the last hour. I’m impressed. And skeptical.”

“That’s fair,” Sarah said, lacing up the borrowed trail shoes. “I’d be skeptical too.”

The trail wound uphill through a cathedral of coast redwoods, the morning light filtering through branches a hundred feet overhead. The air smelled of bay laurel and damp earth. They walked three abreast where the path allowed, single file where it narrowed.

“Juris Dictum,” Sarah said as they climbed. “You named your fund after the legal term for statements by a court that aren’t essential to the decision. The non-binding observations. Why?”

Alex glanced at Rachel. “Most founders don’t ask about the name.”

“I’m a lawyer. The name means something.” Sarah steadied herself on a root. “It also tells me something about how you think. You’re interested in the ideas that don’t fit the conventional mold. The observations that might become precedent later, even if they’re not binding now.”

“Go on.”

“That is what I’m building. An AI-native law firm that shouldn’t work according to conventional wisdom. Professional services firms are not supposed to be scalable. They are not supposed to command technology multiples. They are not supposed to be interesting to venture investors.” She paused at a switchback, slightly winded. “But the conventional wisdom is wrong.”

Alex smiled. “Does this firm have a name yet?”

“Candor.”

“Just Candor? Not Okonkwo and Associates?”

“Just Candor. The whole thesis depends on telling clients the truth—what AI can do, what it cannot do, where the human judgment matters, where the verification layer catches what the machine misses. If we’re not radically transparent about that, we’re just another firm with a chatbot and a marketing deck.” She stepped over a root. “Besides, traditional firm names are designed to sound old and permanent. I want a name that sounds like a promise.”

Rachel made a note in her phone. “I like it. Simple. And it’ll look good on a cap table.”

Over the next mile, Sarah walked them through the economics of transformation—the margin expansion from 10% to 36%, the multiple expansion from 1.2x to 5x, the value creation bridge that significantly increased enterprise value. She described the productivity data, the unit economics, the J-curve of investment. The rhythm of the hike helped—ideas flowed more naturally than they would have in a conference room, punctuated by the crunch of footsteps on packed earth.

Rachel interrupted periodically with sharp questions. Alex listened, occasionally stopping to point out a particularly massive redwood or a view through the canopy. His silence, Sarah understood, was its own form of evaluation.

When they reached a clearing with a fallen log that served as a natural bench, Alex suggested they rest. The view opened up—rolling hills, a glimpse of the Bay in the distance.

“Good,” Alex said. “You understand the economics.” He looked at Rachel. “Now let’s talk about the unknowns—both known unknowns and perhaps even some unknown unknowns.”

3.1 UNCERTAINTY, LAYER BY LAYER

“Every pitch I see,” Alex said, “has a five-year projection. Revenue growing at 40% annually. Margins expanding on schedule. Exit at year seven.” He shook his head. “I’ve been doing this for more than a decade. You know how many of those projections come true?”

“Not many,” Sarah said.

“Almost none. Not because the founders are lying—most of them believe their projections. But because the future is genuinely uncertain.” He picked up a stick and cleared a patch of dirt at his feet. “Tell me what you don’t know about the next five years.”

Sarah had expected this. Maya had warned her: *“Alex will test whether you’ve thought about uncertainty. Don’t pretend to know things you can’t know.”*

“Interest rates,” she began. “I don’t know where rates will be in five years. The ZIRP (zero interest rate) era ended, rates rose faster than anyone expected, and now...” She shrugged. “They could stabilize, fall if the economy weakens, rise if inflation persists. Each scenario changes my valuation math.”

Alex scratched “IR” in the dirt. “Keep going.”

“Inflation dynamics. My model assumes labor costs continue rising faster than technology costs—which has been true for decades. But that could change. Immigration policy, union organizing, chip shortages, energy prices—any of these could shift the relative costs of humans versus AI.”

“Technology trajectory,” Rachel added. “How fast will AI capabilities improve?”

Sarah nodded. “That’s the big one. The models available today are significantly more capable than even just eighteen months ago. But I don’t know if that pace continues, accelerates, or hits a plateau. Each scenario implies different strategies.”

“And even if AI works,” Rachel added, “who captures the value? Firms? Clients? Technology vendors? Labor?”

“Exactly.” Sarah turned to Alex. “I could give you projections that assume a specific answer to each of these questions. But that would be false precision. The honest answer is that I’ve built scenarios, not predictions.”

Alex’s expression shifted—not the polished investor smile he’d been wearing since the parking lot, but something closer to genuine interest. He was recalibrating, she could tell, filing her honesty somewhere useful rather than dismissing it. “Good. Most founders try to convince me they can predict the future. You are telling me you can’t and this is far more credible.” He added more scratches to the dirt. “So let’s talk about how you think about these uncertainties.”

3.1.1 Interest Rate Uncertainty

“Walk me through interest rates,” Alex said. “Why does it matter for your business specifically?”

“Valuation is central to everything I’m trying to do,” Sarah replied. “If I’m raising capital, investors like you are pricing future cash flows. If discount rates stay high, the present value of those cash flows is lower. Transformation investments that look attractive at a 5% cost of capital may look marginal at 8%.”

“Give me numbers.”

Sarah had run these calculations so many times she could recite them from memory.

“At a 10% discount rate and 3% perpetual growth, my \$50 million revenue target at 36% margins produces roughly \$180 million in enterprise value. At a 12% discount rate, that drops to \$150 million. At 8%, it rises to \$225 million.”

“A \$75 million swing based on a variable you can’t control,” Alex observed.

“Right. Which is why I’m not building a strategy that only works in one rate environment. I need a business that’s defensible whether rates stay high, go higher, or come back down.”

3.1.2 *Inflation Dynamics*

“What about inflation?” Rachel asked. “You mentioned relative costs of labor versus technology.”

“AI transformation is fundamentally about substituting capital—technology—for labor. The economics depend on relative inflation rates.” Sarah picked up a small stone, turned it over in her hand. “A lawyer who cost \$300 per hour in 2010 costs \$600 or more today. Compute costs have fallen by an order of magnitude in the same period. That spread has been widening for decades.”

“But it could reverse,” Rachel said.

“It could. Chip shortages, energy prices, data center construction timelines, regulatory constraints on AI compute—all of these could raise technology costs. Meanwhile, labor inflation could slow if immigration policy changes or if there’s a recession.” Sarah met Rachel’s eyes. “I don’t think that’s the most likely scenario. But I’ve modeled it.”

“And?”

“If labor-technology inflation converges, my margin advantage shrinks. I’d still be more efficient than traditional firms, but the gap would be smaller. The business would work, but the returns would be more modest.”

3.1.3 *Technology Trajectory*

Alex sat back down. “Now the big one. Where does AI go from here?”

“Three scenarios.” Sarah had thought about this obsessively. “In the optimistic case, capabilities continue improving at current rates. We see something approaching AGI within a decade. AI systems handle almost a significant amount of the cognitive work that professionals do today. In that world, I need to move aggressively because anyone who waits will be overtaken.”

“Scenario two?”

“Moderate improvement. Significant capabilities added each year, but fundamental limitations persist. AI assists professionals but does not replace complex judgment. This is further buttressed by the fact that buyers remain hesitant

to sign off on complete automation for many tasks—they want someone who they can hold responsible if something goes wrong. In that world, measured transformation makes sense—I build steadily but don’t bet everything on technology that might not materialize.”

“And the pessimistic case?”

“Progress slows. Current capabilities plateau. We’re in an AI winter within five years.” Sarah paused. “In that world, aggressive transformation bets become costly mistakes. Traditional models persist longer than anyone expects.”

“Which scenario do you believe?” Rachel asked.

“I believe the moderate case is most likely. But I’m not certain, and I’m not building a company that fails if I’m wrong.” She let that settle for a moment, then continued. “Here’s what people miss about the pessimistic case. Even if the technology plateaus tomorrow—even if nothing improves from what we have right now—there are already enormous gains sitting on the table. Two years ago, language models were already pretty strong and still most of the profession dismissed it as a parlor trick or an autocomplete machine. Today we have reasoning models that can work through multi-step legal analysis, call external tools, and produce outputs that rival experienced associates.”

“So your argument is that the existing technology is already enough,” Rachel said.

“Enough to build a real business, yes. I personally think some version of the aggressive case is as likely or more likely than the pessimistic case. But we don’t need AGI or whatever to deliver faster turnaround, lower cost, and fewer errors on the work that constitutes the bulk of legal spend. The gains are already there. What an AI-native firm does is actually harvest them—because our economics reward efficiency rather than penalize it. Right now folks in our sector go out of their way to find the shortcomings in AI. They do not really zoom in to find the things that are now already possible with AI. An AI native law firm is going to focus on the ‘art of the possible’ today and identify any emerging capabilities faster than the incumbents because we truly have an incentive to do so.”

Sarah could see Alex turning something over in his mind, so she pressed the point. “And there’s a market-share argument that holds regardless of what the technology does next. Traditional firms aren’t going to wake up one morning

and restructure around capabilities they've been ignoring for years. Organizational inertia is real. Even in the plateau scenario, an AI-native firm takes share simply by doing what incumbents won't."

"What about pure technology plays?" Alex asked. "Legal tech companies that sell directly to clients or in-house teams?"

"Products shift the burden to the buyer. Someone still has to learn the tool, configure it, verify the outputs, integrate it into their workflow. That's friction, and it's substantial. A services firm absorbs all of that complexity. We deliver outcomes, not software licenses. If the technology improves, we bring those improvements to clients faster than a traditional firm can—because our entire operation is built to adopt them. And we deliver them in a form that's more palatable than a product, because the client does not have to change how they work. They just get better results."

Rachel leaned forward. "This is what LPOs (Legal Process Outsourcers) and other ALSPs (Alternative Legal Service Providers) were supposed to do, by the way. The whole premise of that industry was capturing the efficiency gap that law firms left on the table. And some of them built real businesses around it." She paused. "But most of them ended up as body shops. They are selling labor at a lower rate, not fundamentally changing how the work gets done. Oddly enough they are as addicted to headcount as much as the law firms they are supposedly disrupting. Even the ones that talk a good game about technology and who have made some investments at the margins have not really made the sustained investment to truly embed AI into their operations. If you diligence them you will see the tech is more of a marketing story than a structural commitment."

"So why would this be different?" Alex asked.

"Two reasons," Sarah said. "First, we are building the technology into the firm's operating model from day one—not bolting it onto a staffing business after the fact. That's a genuinely different animal. Second, and this is the part people underestimate: buyers matter. The people signing off on outside legal spend are mostly lawyers themselves. General counsel, deputy GCs, senior in-house attorneys. They are comfortable buying from law firms. They understand the professional obligations, the privilege protections, the malpractice coverage. Outsourcers have always carried a stigma with that buyer population—fair or

not, there's a trust deficit. I mean they are called 'alternative' for a reason. An AI-native law firm bridges that gap. You get the efficiency advantages that ALSPs promised but mostly did not deliver, wrapped in a form factor that the actual buyers prefer."

Sarah nodded. "It is the best of both worlds, or at least that is the thesis. The cost structure of an ALSP and technology commitment of a software provider with the professional credibility and client trust of a law firm."

Alex nodded slowly. "Good. Now tell me about the regulatory environment."

3.2 THE REGULATORY CHESSBOARD

"I assume you know the basics," Sarah said. "Modern ABS started in the UK under reforms to the Legal Services Act. The idea eventually made it here to the US. For example, Arizona has Alternative Business Structure authorization (Arizona Supreme Court 2020)—I can have non-lawyer ownership of the law firm itself. By contrast, California just passed AB 931 (California State Legislature 2025), freezing any ABS consideration for four years. New York hasn't moved. Most states still follow Model Rule 5.4."

 ABA MODEL RULE OF PROFESSIONAL CONDUCT 5.4

Rule 5.4 of the ABA Model Rules of Professional Conduct provides, in relevant part:

“(b) A lawyer shall not form a partnership with a nonlawyer if any of the activities of the partnership consist of the practice of law.”

“(d) A lawyer shall not practice with or in the form of a professional corporation or association authorized to practice law for a profit, if: (1) a nonlawyer owns any interest therein ... (2) a nonlawyer is a corporate director or officer thereof or occupies a position of similar responsibility ... (3) a nonlawyer has the right to direct or control the professional judgment of a lawyer.”

Adopted by the ABA in 1983 and carried forward from earlier prohibitions, Rule 5.4 has been the single most consequential structural constraint on law firm development. By prohibiting non-lawyer ownership and fee-sharing, the rule effectively bars law firms from accessing equity capital markets, venture funding, or private equity investment—capital sources that have fueled growth and innovation in virtually every other professional services sector.

“I’m aware,” Alex said. “I’ve been tracking this closely. What I want to know is how you’re thinking about it.”

“The market is bifurcating, not converging.” Sarah traced a mental map of the country. “Arizona liberalizes. California restricts. Texas just blessed MSO structures in Ethics Opinion 706 (Texas Committee on Professional Ethics 2025). The UK, which pioneered ABS, has seen several high-profile failures. The EU essentially closed the door with the Halmer decision (Court of Justice of the European Union 2024).”

“So you can’t assume the regulatory environment will get easier.”

“No. I have to plan for a world where different jurisdictions move in different directions. That affects my structural choices, my market access, my capital strategy—everything.”

Alex turned to Rachel. “What are your concerns about regulatory risk?”

Rachel frowned. “Concentration. If you base in Arizona and Arizona changes its rules, you’re exposed. California’s move was defensive—a response to KPMG entering Arizona. What happens if other states follow California’s lead?”

“That’s real,” Sarah acknowledged. “Arizona could change direction. It’s a political risk I can’t eliminate. What I can do is structure for optionality—build the capability to operate through MSO structures if I need to, maintain relationships in multiple jurisdictions, don’t put all my eggs in one regulatory basket.”

“And this is where Texas matters,” Alex said. “Texas is the number one state in the country for population growth, business relocations, and corporate activity. Houston, Dallas, Austin—these are massive legal markets, and they’re only getting bigger. The fact that Texas blessed MSO structures in Ethics Opinion 706 is not a footnote. It means you have a viable path into what may be the most important growth market in the country without needing ABS. If Arizona is your foundation, Texas through an MSO is your expansion story. That’s the kind of thing I want to see in a deck.”

“You’d still take a hit if Arizona closed,” Rachel said.

“Yes. But I wouldn’t be dead. The technology, the data, the client relationships—those would survive. I’d restructure and keep going. The firms that died in some of the UK ABS failures weren’t killed by regulatory change. They were killed by overextension and compliance failures.”

3.3 PLAYING IN ALL NINE SQUARES

Alex picked up his stick again and smoothed a larger patch of dirt. He scratched out a 3x3 grid.

“Let’s structure this. There are three broad technology scenarios—fast, moderate, slow improvement. There are three broad regulatory scenarios—liberalization, stability, deeper restriction.” He labeled the rows and columns. “Nine possible futures. Walk me through the corners and the center.”

	AI Rapidly Advances	AI Improves Steadily	AI Plateau
Regulation Liberalizes	AI-native dominates; 80% of routine work automated; ABS spreads to 15+ states; traditional mid-market firms face existential pressure	Gradual shift; AI-native firms capture 10–15% of addressable market; traditional firms adapt slowly	Modest efficiency gains without structural change; ABS available but limited AI advantage
Regulation Stable	Technology leads, structure follows; MSO workarounds proliferate; early movers build durable advantages	<i>Base case:</i> Measured transformation; traditional firms adopt AI tools; AI-native firms compete on efficiency and cost	Traditional model persists with bolt-on AI tools; limited disruption; incumbents retain market position
Regulation Retrenches	Underground innovation; tech licensing models emerge; regulatory arbitrage across jurisdictions	Slow transformation; compliance costs dampen adoption; reform pressure builds	Traditional dominates; AI-native firms remain niche; transformation thesis premature

Table 3.1: Scenario matrix: nine futures for AI-native professional services. The intersection of technology trajectory and regulatory environment defines the competitive landscape. The center cell represents the base case around which Candor’s strategy is built.

Sarah took a breath. This was the framework Maya had taught her, but applied to her specific situation.

“Top left: technology accelerates, regulation liberalizes. That’s the best case. AI handles a significant percentage of routine legal work by 2030 (or enough of components thereof to be consequential). ABS spreads to fifteen states. I’m positioned as an early mover with compounding advantages—data, talent, client relationships. Traditional firms face existential pressure.”

“Center: technology improves moderately, regulation stays stable. That’s the base case I’m planning for. AI significantly assists professional work but does not replace judgment. Arizona remains an outlier; most states don’t liberalize. AI-native firms capture 10–15% of addressable market. Traditional firms adapt but don’t disappear. I build a successful company but don’t dominate the industry.”

“Bottom right: technology stalls, regulation restricts. That’s the worst case. AI hasn’t advanced meaningfully beyond today’s capabilities. California’s freeze spreads. AI-native firms remain niche. Traditional models dominate.” Sarah paused. “In that world, my aggressive bet looks like a mistake.”

“How do you win in the worst case?” Alex asked.

“I don’t win big. But I survive and you receive a reasonable return on your capital. The technology still provides efficiency gains, even if they’re modest. I can operate as a high-efficiency traditional firm if I have to. I haven’t burned the boats so completely that I can’t sail back to shore.”

“Resilience over optimization,” Alex said. It wasn’t a question.

“Exactly. I’m not trying to find the strategy that maximizes returns in one scenario. I’m trying to find the strategy that works reasonably well across all of them.”

3.4 STRUCTURE AS STRATEGY

Rachel leaned forward. “Let’s talk structure. Because this is the part where most people’s eyes glaze over, and it’s the part that actually matters. You’re telling us you want to build an AI-native law firm. But in almost every state in the country, a non-lawyer can’t own a law firm. So how does any of this work?”

“Start with why the rule exists,” Alex said. “I want to hear how you think about it, not just how you plan to engineer around it.”

Sarah nodded. “Model Rule 5.4. The ABA adopted it decades ago, and nearly every state follows some version. The core idea is that non-lawyer ownership of a law firm creates a risk that business interests will override professional judgment—that an investor will pressure a lawyer to cut corners, settle a case too cheaply, or prioritize revenue over the client’s interests. It is theoretically about protecting the independence of professional judgment.”

“And you think that concern is outdated?” Rachel asked.

“I think the concern is legitimate but the remedy is blunt. Rule 5.4 doesn’t just prohibit interference with professional judgment—which would be reasonable. It prohibits the ownership structure entirely. It says the only way to protect against the risk is to make sure non-lawyers can never have an economic stake in a law practice. That made more sense in an era when the main threat was an accounting firm pressuring its captive law practice. It makes less sense when the

question is whether a technology company can invest in building better tools for delivering legal services.”

They had started walking again, the trail now descending through a grove of bay laurels.

“But the rule is what it is,” Alex said. “Listen it might be (is) pure protectionism masquerading as virtue, but it is the current reality in many locations. So walk me through the structural options in light of the reality.”

“There are really three models, and they exist on a spectrum from most permissive to most conservative.” Sarah had rehearsed this part, but the conversation made it feel less like a pitch and more like a planning session. “The first is Alternative Business Structure—what I’m doing. Arizona eliminated its version of Rule 5.4 in 2020. Utah created a regulatory sandbox. DC has long permitted non-lawyer ownership in limited forms. Puerto Rico allows it as well. In an ABS jurisdiction, I can form a single entity that is both a law firm and a technology company. Non-lawyers—including venture capitalists—can own equity directly. They sit on the board. They share in the profits. The entity itself holds the law licenses through its employed attorneys, and it’s regulated by the state bar just like any other firm.”

“So in Arizona, your fund would own shares in the same entity that represents clients,” Alex said. “Clean cap table. Standard preferred stock. Normal VC mechanics.”

“Exactly. The term sheet looks like any other startup investment. You get equity, liquidation preferences, board seats, information rights—all of it. The only additional layer is bar oversight. Arizona requires ABS entities to report annually, maintain professional liability insurance, and ensure that lawyers within the firm retain independent professional judgment regardless of what ownership wants. But there’s no structural barrier to the investment itself.”

Rachel crossed her arms. “That’s Arizona. What about the other forty-nine states?”

“That’s where it gets interesting. Under certain circumstances, a lawyer licensed in California can work for an Arizona ABS and serve California clients. The firm is regulated in Arizona; the lawyer is regulated by the California bar. Again, this is all dependent upon specifics—but it is possible. Lawyers at the

Big Four accounting firms, at legal tech companies, at ALSPs—they've been practicing under structures that aren't traditional law firms for years. The key distinction arguably is where the entity is organized and regulated, not where the individual lawyers are barred."

"Has that theory been tested?" Alex asked.

"Not definitively in a courtroom. But it's how every national law firm essentially operates today. Kirkland & Ellis is an Illinois limited partnership, but its lawyers practice in every state. Nobody argues that Kirkland can't serve clients in New York because it's organized in Illinois. An Arizona ABS extends the same logic—the firm is organized and regulated in Arizona, and its lawyers are individually licensed wherever they practice."

"The risk," Rachel said, "is that a state bar decides to make an example of someone. California didn't freeze ABS consideration for no reason. They see Arizona as a threat."

"They do. And I take that seriously. Which brings us to the second model—the Management Services Organization." Sarah picked up a small branch and traced two circles in the dirt, side by side. "In an MSO structure, you have two entities. On the left, a traditional law firm. Lawyer-owned, Rule 5.4 compliant, licensed to practice in any state. On the right, a management services company. The MSO provides the law firm with technology, back-office operations, marketing, human resources, billing infrastructure—everything except the actual practice of law. Investors own the MSO."

"How does the money flow?" Alex asked. This was the question he always asked—Sarah could tell it was reflexive.

"The law firm pays the MSO a management fee. To be safest, the fee should not be a direct percentage of revenue but could be some combination of flat fee plus some sort of utilization fee on top of it. In terms of percentage of revenue, it might be something like 15 to 30 percent or more. The precise number would depend upon exactly how much of the firm's operational infrastructure the MSO provides. The law firm retains enough revenue to pay its lawyers and cover its malpractice insurance. The majority of net revenue ultimately flows through the management fee to the MSO, where your equity sits."

“So as an investor, I don’t own a piece of the law firm. I own a piece of the company that the law firm can’t function without.”

“Right. And the MSO owns the technology platform, the client data infrastructure, the AI systems—all of the intellectual property that makes the firm AI-native. The law firm is, in a sense, the regulated professional shell. The MSO is where the enterprise value accumulates.”

Rachel nodded slowly. “This is exactly how it works in healthcare. Physicians can’t be employed by corporations in most states—corporate practice of medicine doctrine (Rooke-Ley et al. 2025). So private equity rolls up physician practices through MSOs. The doctors own the practice, the PE fund owns the MSO, and a management services agreement ties them together (Schlafly 2024). It’s a well-trodden path. Hundreds of billions of dollars have been deployed through MSO structures in healthcare (Commonwealth Fund 2023).”

“The legal version is newer,” Sarah said, “but the mechanics are somewhat the same. Texas blessed it explicitly in Ethics Opinion 706. Several other state bars have issued informal guidance suggesting that properly structured MSOs don’t violate Rule 5.4, because the non-lawyer entity isn’t practicing law or sharing legal fees—it’s providing management services for a contractually agreed price.”

“What’s the catch?” Alex asked.

“Complexity, control, and fragility. The management services agreement has to be carefully drafted. If the fee structure looks too much like profit-sharing, a state bar could recharacterize it as a fee split and find a Rule 5.4 violation. If the MSO exercises too much control over the lawyers’ professional judgment—dictating how cases are handled, overriding legal recommendations, setting unreasonable productivity targets—that’s a problem. The whole structure depends on maintaining a genuine separation between business operations and professional practice, even though in reality they are deeply intertwined.”

“And from my side,” Alex said, “I’m one step removed from the revenue-generating entity. If the lawyer who nominally owns the law firm decides to walk away, or the management services agreement gets challenged, my investment is at risk.”

“That’s the tension. VCs generally don’t like MSO structures because the control is indirect. You can put protections in the MSA—long terms, termination penalties, non-competes (to the extent allowed)—but it’s never as clean as direct equity ownership. Private equity firms are more comfortable with it because they’re used to complex deal structures and longer hold periods. They’ve spent decades doing exactly this in healthcare.”

“Third option?” Rachel asked.

“Traditional law firm plus a separate technology licensing company. The law firm is entirely conventional—lawyer-owned, Rule 5.4 compliant in every jurisdiction, nothing unusual about it. Separately, you form a technology company that builds the AI platform and licenses it to the law firm. Investors fund the technology company. The law firm pays licensing fees.” Sarah shrugged. “Maximum regulatory safety. No bar in the country can object to a law firm licensing software. But the economics are split in a way that’s hard to reassemble. The law firm’s lawyers capture the professional services margin. The technology company captures the licensing revenue. Nobody captures the integrated value of an AI-native practice—the compounding returns that come from the technology and the professional service being optimized together.”

“It’s also the model that every legal tech company already uses,” Alex said. “And we just spent ten minutes talking about why pure technology plays shift too much burden to the buyer. If you go this route, you’re a legal tech startup with a captive customer, not an AI-native law firm.”

“Exactly. That’s why I chose ABS.”

“Why ABS over MSO specifically?” Rachel asked. “Given the jurisdictional concentration risk, why not start with an MSO and keep your options open?”

“Two reasons. First, I’m raising venture capital, and VCs want clean equity. You saw Alex’s reaction to the MSO economics—one step removed, indirect control, fragile agreements. For a seed round and a Series A, I need a cap table that looks like a technology company’s cap table. ABS gives me that. Second, the MSO structure optimizes for regulatory safety at the cost of organizational coherence. I don’t want a wall between my technology team and my legal team. I don’t want management services agreements governing how they collaborate. I want one company, one culture, one set of incentives. The whole point of being

AI-native is that the technology and the professional practice are inseparable. An MSO, by design, separates them.”

Alex was quiet for a moment. “And if Arizona changes its rules?”

“Then I restructure into an MSO. It’s painful—legal fees, renegotiated agreements, a period of uncertainty. But the underlying assets survive. The technology, the talent, the client relationships, the data. I’d lose the structural elegance, not the business. And I’m building the MSO capability now—documenting processes, separating intellectual property into licensable modules, structuring employment agreements with portability in mind. If I ever need to make the switch, I can do it in months, not years.”

“You’re building the escape hatch before you need it,” Rachel said.

“I recognize that you cannot perfectly prepare for all contingencies but I am building optionality. It seems like these outdated rules will eventually give way to an alternative set of rules because if anything they are harming practicing lawyers by forcing them into a business model which cannot adequately take stock of developments in the technical world. So I’m choosing the structure that’s optimal for my current needs—ABS for venture capital—while maintaining the ability to migrate to the structure that’s optimal for a different regulatory environment. The cost of that optionality is some additional legal and organizational complexity today. The benefit is that no single regulatory change is to likely kill the company.”

3.5 FINANCING THE LEAP—CAPITAL AND CONTROL

Alex checked his watch. They’d been talking for nearly two hours.

“Let’s get specific. How much are you raising and what’s it for?”

“Seed round of \$3 million. That gets me at least eighteen months of runway (and perhaps even longer) to build out the AI platform, hire three to four engineers and perhaps one more senior lawyer, and scale the client base. Target is \$5 million revenue with a growing percentage of ARR by the end of the period with EBITDA margins approaching 35%.”

“Valuation?”

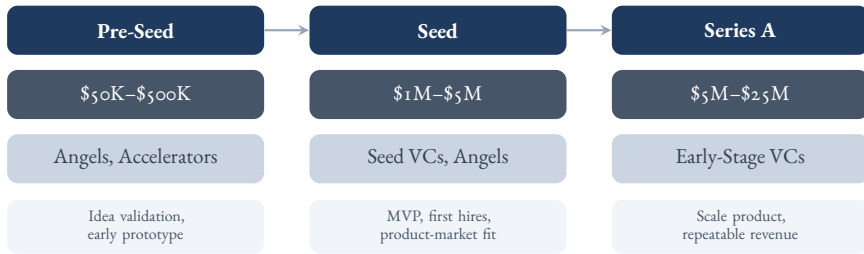


Figure 3.1: The early fundraising progression. Each stage brings larger capital, higher valuations, and different investor profiles.

“I’m looking for \$12 million pre-money. I know that’s aggressive for a professional services company, but—”

“It’s not aggressive if the economics work,” Alex interrupted. “A path to technology-company margins and technology-company growth. I’ve seen worse.”

“And after the seed?”

“Series A of \$15 million or more. By then, I need to have proven the unit economics at scale, expanded to twenty or more clients, and demonstrated that the AI platform can handle modestly to decently complex work, not just mundane legal tasks.”

Alex looked at Rachel. Some silent communication passed between them.

“Sarah,” Alex said, “I have one more question. What happens if you are wrong?”

“About what specifically?”

“About all of it. The technology trajectory, the regulatory environment and in particular, your ability to acquire clients. What if the moderate scenario you’re planning for turns out to be the pessimistic scenario? What if AI-native legal services just... doesn’t work?”

This was the second time Alex had essentially asked the same question but it was also the question Sarah had asked herself many times. The answer was uncomfortable but honest.

“If I’m completely wrong—if AI-native professional services turns out to be a dead end—your downside is capped at the seed investment. But even in that scenario, the assets we’ve built have residual value. The technology platform is licensable. The client relationships are at least potentially salvageable. The data we’ve accumulated has standalone worth. You’re not writing a check that goes to zero—you’re buying a portfolio of options, and several of them pay off even if the central thesis doesn’t.”

She paused.

“And in the realistic downside—not the catastrophic one, but the one where growth is slower than projected—you still have a profitable legal services business generating real cash flow. The margins may be lower than my projections, but they’ll be higher than any traditional firm. That’s not a failure. That’s a floor.”

Alex was quiet for a long moment. They had reached the end of the loop, the trail opening onto a meadow with a view of the distant hills. Rachel had walked ahead, giving them space—whether by instinct or signal, Sarah couldn’t tell.

“I’ll be honest with you,” Alex said, stopping at a wooden fence post that marked the property line. “I’ve been looking for an investment in this space for two years. Seen a lot of pitches. Some were too early—founders who didn’t understand the economics. Some were too late—trying to retrofit AI onto some sort of a staffing business. Some were too aggressive—betting everything on scenarios that might not materialize.”

“And me?”

“You understand the economics. You have thought seriously about uncertainty. You are not pretending to predict the future, but you’re not paralyzed by not knowing it either. You have chosen a structure that matches your capital needs. And you have got the background to actually do the work.”

He extended his hand.

“I’m in for \$500,000. I’ll introduce you to two other angels who should take another \$500,000 between them. That gets you to a million. For the rest, I’ll connect you with a seed fund that understands professional services. Tell them I’m leading the round.”

Sarah shook his hand, trying to keep her expression professional even as her heart raced.

“Thank you. I won’t let you down.”

“You might,” Alex said. “Most startups fail. But you’ll fail for the right reasons—because the market wasn’t ready, or the technology didn’t work, or the clients didn’t come. Not because you didn’t understand what you were trying to do.”

Rachel rejoined them as they walked back toward the parking lot.

“One more thing. Build your compliance infrastructure early. Invest at least 2% of revenue in it. The ABS is a regulated industry and I have just seen across my investments too many times where compliance couldn’t keep pace with growth. Don’t let that be you.”

“I won’t.”

“Good.” He smiled. “Welcome to Juris Dictum Capital. Let’s see if we can turn your obiter dicta into ratio decidendi.”

Rachel fell into step beside Sarah as they walked back toward the cars, letting Alex drift a few paces ahead.

“Can I give you one piece of unsolicited advice?” Rachel said quietly.

“Please.”

“You’ve spent today talking about economics, regulation, structure, capital. All important. But the thing that will actually determine whether this works?” She glanced at Sarah. “It’s whether you can find lawyers who are willing to work in a completely different way. Not lawyers who say they are interested in AI over cocktails at a bar conference. Lawyers who will actually sit down and refactor how they do the work, every day, from the ground up. That talent pool is smaller than you think and finding them is going to be one of the hardest things you do.”

Sarah nodded slowly. She had been so focused on the macro questions—the market, the structure, the capital—that she had not spent enough time thinking about the micro one: how the work would actually get produced.

“I’ll keep that in mind.”

“Keep it more than in mind,” Rachel said. “Tattoo it on your arm.”



Sarah drove back to San Francisco in a daze. The morning bun and Kouign Amann felt like days ago; the hike through the beautiful Northern California foothills, the conversation that had somehow covered everything from interest rates to regulatory strategy, the handshake at the trailhead—it all blurred together.

She had made real progress toward committed capital. Committed does not equal closed but it was progress nevertheless. She had a lead investor who understood her business. She would receive introductions to other funders—this time with the wind at her back.

She also had a clearer sense of what she didn’t know, and why that mattered. Alex hadn’t asked her to predict the future. He’d asked her to think rigorously about multiple futures, to build a strategy that worked across scenarios, to preserve optionality while still moving decisively.

The frameworks he’d tested her on—scenario planning, resilience over optimization, regulatory analysis, structural choice—these weren’t academic exercises. They were the tools she’d need to navigate the uncertainty ahead.

But Rachel’s parting words nagged at her. The entire day had been about strategy, structure, and capital—the architecture of the business. Nobody had asked her the most basic operational question: *how are you actually going to do the work?* She had a technology thesis and a handful of early engagements, but she did not have a production system. She did not have defined workflows, quality controls, or a repeatable process that could scale beyond her personal oversight. The gap between “promising AI experiment” and “firm that reliably serves clients” was enormous, and she had not yet figured out how to cross it.

She pulled off at a rest stop near San Jose and pulled out her phone. A text to Maya first:

“Alex is in. \$500K committed, introductions to fill out the round. Thank you for the connection—and for teaching me enough about finance to survive the conversation.”

Maya's reply came quickly:

"Told you he was fair. Now the real work begins. Don't forget: right amount, right terms, right conditions. And call me when you need help with the Series A."

Sarah smiled and merged back onto 101 North. She had a pitch deck to refine, a round to close, and a company to build.

The uncertainty hadn't gone away. Interest rates, inflation, technology trajectory, regulatory evolution, competitive dynamics—all of it was still unknown. But she had a framework for thinking about it, a structure that matched her strategy, and capital to pursue her vision.

Somewhere south of Palo Alto, the weight of it settled on her. Until today, Candor had been her and her team's risk—their savings, their reputations, their careers. Now it was other people's money. Alex's money. The angels he would introduce her to. Eventually, a fund's money. She was no longer just a founder with a thesis. She was a fiduciary with obligations, and the distance between those two things was greater than she had appreciated from the outside.

She thought about what Rachel had said at the parking lot. *Find lawyers who will refactor how they do the work.* She thought about what Alex had said on the trail. *Most startups fail.* She thought about Maya's text, still glowing on her phone. *Now the real work begins.*

That would have to be enough for now. It was more than most founders had but still way less than she would need before it was all over.

COMING NEXT WEEK

Chapter 4
Craft, Process, and Scale

The capital is committed but the real work is just beginning. Sarah returns to Phoenix and confronts the question Rachel posed on the trail: how does the work actually get produced? Chapter 4 introduces David Park—a process engineer from healthcare with zero legal background—who helps Sarah transform chaotic, improvised workflows into the 4S framework: Standardize, Supplement, Specialize, Stop. It is the operational engine that turns conviction into a firm that can deliver at scale.

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