NEW STRUCTURES FOR LEGAL PRACTICES AND THE CHALLENGES
THEY BRING FOR REGULATORS

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Introduction and Background

The purpose of this paper is to discuss my experience of regulating incorporated legal practices (ILPs), including multi-disciplinary practices (MDPs), in New South Wales. So far as I am aware, our jurisdiction is the only one in the world to permit the incorporation of MDPs.1 Annexed to this paper is a copy of an earlier paper (Incorporated Legal Practices – A New Era in the Provision of Legal Services in the State of New South Wales) written by my Office. That paper sets out the background to the legislation enabling law firms to incorporate and outlines its key provisions, as well as setting out the arguments for, and against, incorporation. The principal legislation governing the legal profession in New South Wales is the Legal Profession Act 1987 (NSW)3. That Act contains the key provisions governing the operation of ILPs, including the structural requirements of an ILP, and is the source of our power to conduct reviews3 (referred to in this paper as “audits”) of incorporated practices.5

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1 The operation of MDPs in New South Wales has been essentially unfettered since December 1999 following the abolition of the requirements that lawyers retain at least 51% of the net income of the practice and that lawyers retain majority voting rights. It has been argued that the reason behind establishing the somewhat onerous requirements and responsibilities of solicitor directors of ILPs was to address the potential problem of establishing ethical standards for MDPs which included non-lawyers.
3 Referred to hereafter as “the Act”.
4 Section 47P of the Act. While the current Act uses the terminology “review and investigation”, in practice my Office refers to this power as an audit power. The new Act expressly adopts this terminology, and the analogous power in that Act is referred to as a power of “audit”. See footnote 5 below for more information about the new Act.
5 Legal practitioners in New South Wales are also subject to the Legal Profession Regulations 1987 (NSW) and the New South Wales Professional Conduct and Practice Rules. A new Act – the Legal Profession Act 2004 (NSW) - commences on 1 October 2005. The new Act gives me a new power to audit any legal practice, whether incorporated or not, to determine compliance with the new Act, Regulations and Rules (the Rules): see s670, Legal Profession Act 2004 (NSW). This is effectively an extension of my current power to audit any ILP, and audits may be initiated on my own motion. The new Act also gives me additional powers in respect of ILPs. In brief, these include:
- a power to examine particular persons associated with the corporate entity (exercising the same powers as those conferred on the Australian Securities and Investments Commission (ASIC) by Division 2 of Part 3 of the Australian Securities and Investments Commission Act 2001 (Cth) (‘ASIC Act’), with certain modifications) (section 667);
- a power to inspect the books of the ILP, also exercising certain powers under the ASIC Act (section 668); and
- a power to hold hearings for the purposes of an investigation or audit (again, exercising certain powers conferred by the ASIC Act) (section 669).
The annexed paper outlines the legislative provisions governing ILPs in much greater detail than does this one. In summary, the burden of incorporation includes compliance with the Corporations Act\(^6\) and with specific provisions of both the Act\(^7\) and the Legal Profession Regulations\(^8\).

Both the Act and the Regulations provide for additional responsibilities for solicitor directors beyond those responsibilities that partners and employed solicitors have.

The additional responsibilities include:

- A general responsibility on the solicitor director for management of the legal services provided by the incorporated legal practice\(^9\) - this responsibility probably does not extend beyond those general responsibilities that partners have to the general management of their partnership.

- The implementation and maintenance of “appropriate management systems” to enable the provision of legal services in accordance with the professional obligations of solicitors and the other obligations imposed by or under the Act\(^10\). Failure to implement and maintain “appropriate management systems” is declared to be professional misconduct.\(^11\)

- Report to the Law Society Council any conduct of another director of the practice that has resulted in or is likely to result in a contravention of that person’s professional obligations or other obligations imposed by or under the Act\(^12\).

- Report to the Law Society Council any professional misconduct of a solicitor employed by the practice\(^13\).

- An obligation to take all action reasonably available to deal with any professional misconduct or unsatisfactory professional conduct of a solicitor employed by the practice\(^14\).

Of course the solicitor director and employed solicitors owe the normal duties in relation to professional obligations, trust funds, legal fees and other costs, solicitors fidelity fund and indemnity insurance, and members of the ILP who hold practicing certificates are still subject to the provisions of the Act generally. ILPs, solicitor directors, officers and employees may also be subject to investigation by the Law

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\(^6\) 2001 (Cth), previously known as the “Corporations Law”
\(^7\) Division 2A of Part 3.
\(^8\) 1987 (NSW); referred to hereafter as “the Regulations”. All references in this paper to specific Regulations, eg. Regulation 24, are references to the Regulations.
\(^9\) s47E(2) of the Act.
\(^10\) s47E(3)(a) of the Act.
\(^11\) The term “appropriate management systems” is not defined in the Act. See this paper page 7 ff for a discussion of our approach.
\(^12\) s47E(3)(b) of the Act.
\(^13\) s47E(3)(c) of the Act.
\(^14\) s47E(3)(d) of the Act.
Society Council or by my Office (which is known as the Office of the Legal Services Commissioner (OLSC))\textsuperscript{15}.

In the course of investigation or review, my Office has a power of examination in relation to solicitors and employees of ILPs. Such examination takes place in private and the person being examined may have a lawyer present. A record may be made of the examination\textsuperscript{16}.

My Office has also been granted the power to inspect the books of ILPs. The power is exercised on provision of notice to the ILP and extends to requiring the production of books, the inspection thereof and their subsequent use in any proceedings. Such power may be exercised even with the presence of a lien\textsuperscript{17}.

In the course of investigation or review, my Office has the power to hold hearings, the conduct of such hearings to be at the discretion of my Office and with the power to summon witnesses and take evidence\textsuperscript{18}.

The novel powers outlined above may be exercised both when an investigation pursuant to section 55 of Part 10 of the Act has been commenced or when the Law Society Council or I determine to conduct an audit of the compliance of the ILP with the requirements of the Act.\textsuperscript{19} In practice, it is my Office which has assumed the role of auditing ILPs for compliance with the Act.

This paper is intended to be an update to the annexed paper and will outline the numbers, types and structures of ILPs in New South Wales, and discuss my three years of experience of regulating them. The approach my Office has taken is predominantly an educative one, and my regulation of ILPs turns on a process of self-assessment. This process is discussed in detail later in this paper.

**The current state of play**

At the time of writing, there are 452 ILPs in New South Wales. Of these, approximately 60 are MDPs. The majority of ILPs were previously existing traditionally structured law firms. A significant proportion of these were in fact sole practitioner firms.

Larger firms have, in the main, displayed little interest in incorporation. Incorporation is a less attractive option for larger firms which generally have national (rather than state-based) practices. However, by early 2006, it is anticipated that all states in Australia will have enacted similar legislation to that in force in New South Wales, enabling the incorporation of truly national firms\textsuperscript{20}. I am anecdotally aware of several

\textsuperscript{15} s470 of the Act
\textsuperscript{16} Regulation 33
\textsuperscript{17} Regulation 34
\textsuperscript{18} Regulation 35
\textsuperscript{19} s47P of the Act.
\textsuperscript{20} See page 13 of this paper for a discussion of the model laws which form the basis of the relevant legislation in all Australian jurisdictions.
large commercial firms which intend to revisit the incorporation question once that legislation is in force across all Australian jurisdictions.

There are a number of innovatively structured ILPs in existence. These include franchises, clusters (where individual ILPs join to form a larger, single ILP) and "complete service" firms.

Complete service firms, which are MDPs, operate almost exclusively in the area of real estate and conveyancing, and the provision of financial services. For example, we are aware of one MDP whose members include development managers (who source potential real property acquisitions); marketers (who market the development opportunity to potential investors); real estate agents; financial and tax advisers (who assist clients to structure their investment); finance brokers (who assist the client to obtain the requisite finance) and legal practitioners (who document the whole transaction, including drafting heads of agreement where the investor is a syndicate comprised of a number of natural persons and/or distinct corporate entities). This MDP is a "one stop shop" for high-end investors in commercial and/or industrial property in Australia.

There are a number of smaller MDPs that provide a range of non-legal services to clients. These include partnerships between lawyers and accountants, debt collectors, architects, tax agents, management consultants, corporate trainers, town planners, human resources consultants, financial planners and advisors, and, in one case, an entertainment agent.

There are currently two ILPs that have publicly listed on the Australian Stock Exchange. While they are distinct corporate entities, they have the same directorship.

Public listing, as foreshadowed in my previous paper, poses unique challenges for a regulator of legal services. The approach taken by my Office to resolve the potential conflict between the solicitor director's duty to shareholders and duty to client was to negotiate the inclusion of a clause in the solicitor director's contract of employment and the document governing terms of appointment to the board of the company.

This clause made explicit what is already provided by the Act: that, in the event of a conflict between the terms of the Corporations Act and the Act, the solicitor director's obligations under the Act prevail. The clause went further, by stating that the company cannot require the solicitor director to do anything which would cause him (in this case) to be in breach of his obligations under the Act, the Regulations or the Rules. It also provides that the solicitor director is himself the sole arbiter of whether a proposed course of action by the company would result in such a breach.

Of the first tranche of 300 ILPs, approximately 100 are no longer incorporated entities. In part, a lack of planning, an incomplete understanding of the requirements of incorporation and an erroneous belief that incorporation is a panacea for those

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21 Section 478(1) of the Act states that, "the provisions of this Act or the regulations that apply to or in respect of any incorporated legal practice prevail, to the extent of any inconsistency, over the applicable corporate law".
traditionally structured firms experiencing cash flow problems can explain these failures. It is not a panacea, and those firms which are not already cash flow positive are unlikely to become so simply via the process of incorporation. However, in many cases, practitioners simply experienced that a corporate structure did not deliver the financial and other benefits hoped for, and a decision was made to return to a traditional structure.

We have also witnessed several collapses where lawyers went into partnership with other service providers who were the principal financiers of the conglomerate. One such example involved a partnership between a real estate agency, an accounting firm and a legal practice.

The accounting firm was the principal provider of funds for the start-up ILP. The intention was that the ILP would provide cut-price legal advice and conveyancing services to the real estate arm of the business. It was also envisaged that the ILP would provide legal services external to the group, thus generating further profit for the group. In practice, however, it soon became apparent to the solicitor director of the ILP that, in order to provide legal services to the real estate agency, he had to lower his fees to commercially unviable levels as he had to compete with the licensed conveyancers which the real estate agency had hitherto engaged.

Moreover, the start-up funds provided to the legal practice by the accountancy firm were insufficient to implement the “appropriate management systems” required by the Act and the Regulations. This funds shortage extended even to an inability on the part of the ILP to purchase a filing system, and when we audited the practice, the files were literally piled on top of each other in corridors.

Needless to say, we were receiving consumer complaints on an almost daily basis about a failure on the part of the legal practitioners to action files, return telephone calls, or to facilitate the transfer of files when inevitably disgruntled clients decided to take their business elsewhere. Additionally, the trust account inspectors, when conducting their first inspection (a routine matter when a new firm is established), became concerned at the chaotic manner in which it appeared the practice was conducting business, and formally expressed their concerns to my Office.

It was against this backdrop that my Office conducted its first audit of the ILP. We met with the solicitor director and a number of his staff, and discussed what the implementation of “appropriate management systems” might mean in the context of his firm.

Over a two month period, we worked very closely with the solicitor director to assist him to put in place “appropriate management systems”. A filing system storage system was installed, enabling the ILP’s files to be easily located and, perhaps more importantly, to be segregated from the files of the real estate and accountancy arms of the business; policies relating to the timely transfer of files were implemented and a policy in relation to the raising of invoices was established. The net result was that

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22 See this paper pages 7 ff for a discussion of our educative approach to “appropriate management systems”.
billings of the practice increased by 40% and the solicitor director was very appreciative of our intervention.

However, it was clear to my Office, and the solicitor director himself, that more work was required in order for the ILP to meet its legislative responsibilities. In particular, there was a pressing need for trust accounting software to be purchased as the ad hoc manner in which trust funds were dealt with was creating a high-risk situation for the practice. While the solicitor director acknowledged this need, the funds required for the purchase of suitable software were not forthcoming from the accountancy firm.

It was at this point that the accountancy arm of the group called in the loan to the legal practice. With no means to repay the loan as well as funding the significant outlay required to purchase a software system to enable it to meet its legislative responsibilities with respect to trust accounting, the ILP was unable to comply with the requirement to implement and maintain “appropriate management systems”. The solicitor director had his practising certificate cancelled because he was constrained financially by the accountancy arm of the practice from delivering his obligations under the Act. This ultimately resulted in the failure of the entire group as the ILP could not continue to operate without a solicitor director.

This proved a valuable example of the importance of solicitor directors having both management and some measure of financial control over the ILP, as well as offering a dire warning to lawyers intending to go into business with non-lawyers who have an incomplete understanding of the vitality of “appropriate management systems” to the survival of the ILP, and/or do not appreciate the complexities inherent in the often competing duties a solicitor director owes to both client and shareholder.

We have also encountered several examples of a phenomenon which has been dubbed by my Office "phoenix ILPs".

The term "phoenix ILP" refers to those ILPs which do not survive initial incorporation, primarily through a failure to implement “appropriate management systems”. In such cases, the initial ILP will close its doors and shortly thereafter a new ILP will emerge, like the proverbial phoenix rising from the ashes, with the same solicitor directorship, the same staff, the same premises and often an eerily similar trading name to that of the defunct ILP.

My Office has no direct control over the incorporation process and therefore cannot intervene to prevent the creation of the new corporate entity. A firm wishing to incorporate must liaise with ASIC and comply with that organisation’s requirements to create a corporate vehicle. It must also notify the Law Society of New South Wales (the Law Society) of its intention to commence trading as an ILP.

While the Law Society provides general information to the potential ILP about the advantages and disadvantages of incorporation, this does not extend to any firm specific due diligence. The Law Society role extends only to ensuring that certain documentation (including a certificate of incorporation, a certificate of insurance and a company search which reveals the appointment of at least one solicitor director with an unrestricted practising certificate) is produced. No analysis of the appropriateness
of any particular firm incorporating is undertaken, either by the Law Society or my Office (which assumes a role in the regulatory regime only after the ILP is approved by the Law Society), and this may require legislative amendment in the future.

This deficiency notwithstanding, my Office has worked closely with the Law Society, LawCover, the provider of professional indemnity insurance in New South Wales, and the College of Law, the largest provider of continuing legal education in New South Wales, to develop an educative programme to assist solicitor directors to comply with their professional responsibilities.

As previously mentioned, my Office has, in practice, by agreement with the Law Society, assumed the role of auditing ILPs for compliance with the Act and Regulations. The test for compliance is found in s47E (3)(a) of the Act which stipulates that it is professional misconduct if a solicitor director does not ensure that “appropriate management systems” are implemented and maintained by the ILP to ensure that legal services are provided by solicitors in accordance with the Act.

As previously stated, the Act does not define “appropriate management systems.” Accordingly, my Office has collaborated with the Law Society, the College of Law and LawCover to determine the objectives to be met to help ascertain whether an ILP has “appropriate management systems” in place. The approach formulated is an “education towards compliance” strategy in which ILPs must show that they have procedures in place which evidence compliance with what my Office considers to be the ten objectives of a sound legal practice.

The ten objectives or “ten commandments” as they have become known, are as follows:

1. Competent work practices to avoid negligence
2. Effective, timely and courteous communication
3. Timely delivery, review and follow up of legal services to avoid instances of delay
4. Acceptable processes for liens and file transfers
5. Shared understanding and appropriate documentation from commencement through to termination of retainer covering costs disclosure, billing practices and termination of retainer
6. Timely identification and resolution of the many different incarnations of conflicts of interest including when acting for both parties to a transaction or acting against previous clients as well as potential conflicts which may arise in relationships with debt collectors and mercantile agencies or conducting another business, referral fees and commissions etc.
7. Records management which includes minimising the likelihood of loss or destruction of correspondence and documents through appropriate document retention, filing, archiving etc and providing for compliance with requirements as regards registers of files, safe custody, financial interests
8. Undertakings to be given with authority, monitoring of compliance and timely compliance with notices, orders, rulings, directions or other
requirements of regulatory authorities such as the OLSC, Law Society, courts or costs assessors

9. Supervision of the practice and staff
10. Avoiding failure to account and breaches of s61 of the Act in relation to trust accounts.

To enable solicitor directors to assess their management systems, a standard "self-assessment" document has been developed and is sent to all solicitor directors as part of the impending ILP review programme. It is acknowledged that since ILPs vary in terms of size, work practices and nature of operations, an approach of "one size fits all," requiring the fulfillment of uniform criteria, would be inappropriate.

Instead, the self-assessment document contains concepts to consider when addressing each of the ten objectives and then examples of what an ILP may do to evidence compliance with each of the objectives. For example, under the objective of maintaining "competent work practices to avoid negligence," a concept to consider is that, "fee earners practise only in areas where they have appropriate competence and expertise." The self-assessment document then suggests that an example of a procedure that will evidence compliance is that there is "a written statement setting out the types of matters in which the practice will accept instructions and that instructions will not be accepted in any other types of matters." The self-assessment document also contains a column within which the solicitor director can rate the ILP's compliance with each of the ten objectives as either "Compliant," "Non-Compliant" or "Partially Compliant."

The ten objectives and the self-assessment document were extensively tested both within a forum of interested parties and with over twenty practising law firms before being sent out to incorporated practices at large.

We have also seen, on three occasions, solicitor directors (in all cases, young lawyers with limited practising experience) who lost their practising certificates when they purported to delegate their responsibilities to the non-legal members of the ILP (who are often the sole providers of capital, which they may use to exert financial pressure on the solicitor director). This purported delegation is, of course, ineffective and it is important to note that, additionally, the solicitor director is, at least to an extent, vicariously liable for the acts or omissions of the other legal staff of the ILP. Should the ILP fail to meet its legislative responsibilities, the solicitor director may lose his or her practising certificate and the ILP may be wound up.

One of the most spectacular examples involved a non-lawyer who owned a conveyancing business. He was in a romantic relationship with a young lawyer from a respected middle size firm which provided legal advice to the conveyancing business. The non-lawyer decided to establish an ILP, thus providing legal services at low cost to his own conveyancing business. He convinced the young lawyer to join him as solicitor director, but at no stage did she have any control over, or access to information in relation to, the management of the ILP. The lawyer failed to appreciate that her professional responsibilities as solicitor director of the ILP were non-delegable.
The non-lawyer failed to turn up for work one day, and it subsequently emerged that he had left the country on an "extended holiday" financed with monies from the ILP trust account. When questioned, the solicitor director tearfully explained that she trusted him. It was not enough to save her practising certificate, and she narrowly escaped fraud charges. Her former lover has since been arrested and the client monies recovered.

The Process and Philosophy of Regulation

The perceived benefits and disadvantages of incorporation have been the subject of many papers (including my earlier paper titled “Incorporated Legal Practices,” a copy of which is annexed to this paper), and I do not propose to go into them again.

Encouragingly, however, we are increasingly seeing improved management practices cited as the rationale for incorporation, over and above perceived taxation and other financial advantages. Our regulatory role with regard to ILPs is, primarily, to ensure that ILPs adopt and maintain “appropriate management systems”. As you are aware, this is achieved via the process of self-assessment discussed above.

300 self-assessment packages (containing general information, the self-assessment document and the “ten commandments”) were sent out to the first tranche of ILPs and, to my astonishment, an impressive 294 were ultimately completed and returned. Many solicitor directors commented that the process of self-assessment had been a valuable one. Those ILPs which did not return the self-assessment document were audited by my Office. Four of the six firms audited achieved compliance; the remaining two ILPs did not and their solicitor directors had their practising certificates cancelled.

In my Office, we sometimes, tongue in cheek, refer to the “appropriate management systems” regime as “management by stealth”. The legal profession is traditionally well-versed in meeting its legislative responsibilities but often resistant to management principles and practices. The ILP provisions have provided my Office with a unique opportunity to introduce, oversee and enforce management systems within the legal profession, at least within those firms which are incorporated.

This approach sits well within my general philosophy of regulation at the OLSC in which I strongly believe that a regulator has three prime functions:

1. to ensure compliance with the relevant laws, rules and regulations;

2. to consistently questions those laws, rules and regulations both for relevance, and in assessing their impact upon both the profession and the community at large, and to make appropriate recommendations for change or improvement; and

3. to educate the profession and consumers of legal services with the goal of creating a culture within the profession whereby compliance itself becomes cultural. Once such a culture is achieved, it follows that there will be a reduction in the number of complaints received by my Office. In fact, it has
been a long standing stated aim of my Office to reduce the number of complaints about lawyers.

Already, in New South Wales, we are seeing a fall in the number of complaints about legal practitioners. For the last three years, complaints have fallen at the rate of approximately 5% per annum.

At the end of the day, it is not the regulator but the regulated who must achieve compliance, thereby reducing complaints. I can only provide support and assistance for a journey solicitor directors must ultimately make themselves.

The process is an individual one. Not only in the sense that the appropriateness of certain management systems will be particular to each firm, but in the sense that the responsibility lies, ultimately, with the individual rather than the corporate entity.

I believe, following the series of spectacular corporate collapses globally, including in Australia, we are witnessing a decline in the realist philosophy which tells us that a corporate entity is akin to a natural person, with the same rights and responsibilities. Perhaps this is best illustrated by the collapse of Enron in the United States of America. That company purportedly operated within an ethical framework, with a series of sophisticated and elaborate checks and balances in place. And yet it resulted in the largest corporate collapse in history, perhaps because it lacked ethical people, and its systems lacked truly ethical content.

I believe that as a society we are realising that companies are not the guardians of ethical standards - people are. The corporate entity is not distinct from the people who constitute it, except by way of its legal status. Our approach to the regulation of ILPs - self-assessment based on the “ten commandments” - is essentially a systematisation of ethical conduct. Each of the “ten commandments” refers to certain behaviours which, if followed, will result in an ethical outcome. In this way, the management systems we oversee and enforce are themselves value-based, and can be distinguished from those professional standards which seem to have existed in a vacuum in companies like Enron. Such standards were empty, because they did not result in ethical conduct. Our approach is based on ethics, and it is from ethics that our standards are drawn. The “ten commandments”, if followed, will lead to ethical behaviour in the profession and, in this way, cultural change is effected.

The oft-made distinction between ethics and profit is, I believe, an illusory one. Many lawyers tell me that they feel they must choose between acting ethically and practising profitably. If legal practitioners abandon ethical standards, there will no longer be any point of differentiation between the legal profession and anyone else providing the same or similar services. Ethics are essential to the legal profession’s very survival in an increasingly competitive market. Moreover, if the profession, with the supporting structures my Office provides in the form of “appropriate management systems” as based on the “ten commandments”, does in fact achieve the ultimate goal of cultural change, then the issue falls away. If all lawyers behave ethically, then there is no one for a client seeking unethical advice or services to approach.
My scepticism about how the incorporation of legal practices would play out in New South Wales has been overborne by the benefits which sound management principles can bring to legal practice. Law can, and should, be regarded as both a profession and a business and in ILPs we witness the overt merger of the two roles. The perceived clash between duty to shareholder and duty to client has not, at this stage, given rise to the problems that such a duality might be expected to present. In fact, it seems to me that the commercial pressure brought to bear upon practitioners in a traditionally structured firm by large corporate clients to provide potentially ethically bankrupt advice in fact exceeds the pressure exerted by shareholders in search of the almighty dollar upon solicitor directors.

I say this because, with the introduction of “appropriate management systems”, we have a codification of certain ethical and business principles. There will always be ethical and unethical people. What is now explicit is that “appropriate management systems” provide the framework for ethical behaviour, and they can also be enforced. In this way, it is clear that a solicitor director's duty to shareholders to return profit is in fact contingent upon the lawyer's professional duties to his or her client. Put another way, in an ILP, “appropriate management systems” (and the ethical and legislative responsibilities they encompass) can be seen as a derivative director's duty, much like occupational health and safety requirements and environmental responsibilities have come to be regarded in companies at large.

If a solicitor director does not adopt and maintain “appropriate management systems”, he or she can lose her practising certificate and the ILP can be wound up. There can be no greater detriment to the interests of the shareholder than that.

**Lessons Learnt**

Whilst acknowledging the fact that a significant number of those firms which incorporated in the first tranche are no longer operating as incorporated entities, I am nevertheless prepared to cautiously label the grand experiment of incorporation for legal practices in New South Wales a success. Despite my concerns, incorporation, at least at this point in time, has not resulted in the sacrifice of professional ethics on the altar of profitability and (most particularly in the case of those firms listed on the Australian Stock Exchange) shareholder accountability. On the contrary, legal practitioners employed by ILPs are slightly less likely to be the subject of consumer complaints than their colleagues in traditionally structured firms.

While we do not have any data on why this is so, it does seem (and we believe) that, to some extent, the implementation of “appropriate management systems” is responsible for the decreased likelihood of consumer complaints. The imposition of a management methodology upon the delivery of legal services has enabled ILPs to provide a quality service efficiently and cost effectively, without compromising their professional responsibilities.

Indeed, many ILPs have embraced written cost disclosure (mandatory for all legal practitioners in New South Wales) as an opportunity to differentiate their services from those of other firms, whether incorporated or not. The cost agreement has become a marketing tool, with many ILPs including service delivery guarantees (such
as the return of telephone calls within three hours by an appropriately qualified employee, personal representation at court rather than the use of agents and capped fees at various stages of proceedings). Convoluted “legalese” documents which many lawyers would have difficulty deciphering, let alone consumers, are slowly being replaced by Plain English cost agreements.

Regulation 24 requires an ILP, by its solicitor director, or any solicitor providing legal services, to disclose to any client in connection with the provision of legal services:
- a description of the legal services to be provided to the client;
- advice that the provision of legal services is regulated by the Act;
- a description of non-legal services (if any) to be provided to the client; and
- advice that the Act does not regulate the provision of those non-legal services.

The disclosure must be made before any legal services are provided and is to be made on each occasion that the client retains the ILP to provide legal services.

These requirements were among the most fiercely resisted provisions of the ILP regime, with many practitioners arguing that it was not practicable to make disclosure in this way each time services were provided, the more so because the delineation of legal and non-legal services was problematic. Additionally, practitioners argued that while it was usually possible to define, in a broad sense, the scope of legal services to be provided, it was much more difficult to foresee the range of non-legal services which may be provided incidental to the legal work.

However, three years on, we are seeing a number of ILPs using the mandatory disclosure regime to showcase the range of non-legal services the ILP offers. A number of firms have reported that this approach to disclosure has increased the uptake by clients of ancillary (non-legal) services offered by the ILP, thus increasing profitability and in many cases allowing the ILP to undercut traditional firms on price for legal services, because of this additional income stream.

Regulation 22 defines “non-legal services” as “services provided by an incorporated legal practice that are not legal services, but does not include clerical or administrative services (such as typing, filing and photocopying) that are provided in connection with legal services.” The term “legal services” as used in Regulation 24 is not defined, however, in Section 48E(1) of the Act, “general legal work” is defined.

The Act defines “general legal work” as “the work involved in drawing, filling up or preparing an instrument or other document that:
- a) is a will or other testamentary instrument, or
- b) creates, regulates or affects rights between parties (or purports to do so), or
- c) affects real or personal property, or
- d) relates to a legal proceeding.”

Most significantly, the Act does not specifically refer to the provision of legal advice or the appearance as an advocate before a court.

The Law Council of Australia and the Standing Committee of Attorneys-General (SCAG) undertook, over several years, a project known as the “SCAG Model Laws Project”. The outcome of this project was the development of a set of model laws relating to the regulation of the legal profession, which is now a national profession.
The model laws, which have received the assent of all Attorneys-General in Australia, adopt a very broad and generalised approach to the resolution of the conundrum of defining legal work by including a provision which prohibits a person from engaging in legal practice for fee or reward when not so entitled. “Engaging in legal work” is not defined. The model laws also contain core provisions allowing incorporation of legal practices in all jurisdictions in Australia, on terms identical to the New South Wales model.

The new Act, which comes into force on 1 October 2005, in accordance with the model laws, adopts an identical provision, establishing a prohibition on engaging in legal work when not so entitled, but again without defining legal practice. Thus, the new Act’s definition of “legal work” is an essentially circular one, basically defining “legal work” as work which is undertaken by a legal practitioner.

Despite the definition of “general legal work,” there are some areas of the law in which there is no guidance as to whether such work should only be provided by a lawyer, and which areas of work may be performed by either a lawyer or non-lawyer. The issue regarding the distinction between “legal work” or “legal services” and “non-legal services” arose in respect of multi-disciplinary partnerships and, in view of Regulation 24, is again the focus of debate.

While the development of a comprehensive definition would no doubt be very difficult, it has been suggested that, to the extent that “legal work” can be identified, it should be done by lawyers, for the protection of the consumer. However, in an evolving market for professional services it is very difficult to restrict the interpretation of tax law, the provision of financial services or the compliance aspects of migration law, to lawyers, while prohibiting tax accountants, financial planners and migration agents from interpreting the law and performing such work. While this issue has not been resolved, what is certain from the Act is that persons who are not qualified lawyers but who provide legal advice or services in NSW are not regulated by my Office.

My Office is aware that a significant number of multidisciplinary incorporated legal practices are actually providing financial services as defined by the Financial Services Reform Act.

In a hypothetical multidisciplinary incorporated legal practice we might have a solicitor, an accountant, a tax agent and a financial adviser. A hypothetical client approaches the practice for some assistance in estate planning. The client is fairly wealthy and wishes to leave her estate to three of her children equally divided between them, but the client wishes to ensure that her eldest child, who has become an heroin addict, receive nothing from the estate.

Whereas it is possible that the advice that the hypothetical client receives from any of

23 This took place in July 2004.
24 See footnote 5 above.
25 2001 (Cth)
the stated members of the practice could be the same, what if it were not? An accountant may be nothing more than a holder of an accountancy degree. If he or she had become a Certified Public Accountant or a Chartered Accountant then he or she would have had to do additional educational work and be subject to forms of regulation greater than someone who simply held a degree, but still arguably not as extensive as that which applies to legal practitioners. Taxation advisers and financial advisers may or may not be licensed and the question of whether they carry any professional indemnity insurance would need to be explored.

In this example, the question of whether or not the advice given or the service provided is actually legal advice or a legal service is left up in the air. Is the service or advice legal if it is given by the lawyer and not so if given by one of the non-lawyers? Is all of the advice or service provided made “legal” by the fact that it is given by a lawyer, or can a lawyer give non-legal advice or services within such a practice?

There appears to be serious consequences following from the choice of adviser by our hypothetical client. Working with the lawyer would attract the operation of his or her mandatory professional indemnity insurance should an issue of negligence arise, as long as the work performed was “legal work”. Were the lawyer to misappropriate the client’s money, the Fidelity Fund which applies only to legal practitioners would compensate the loss dollar for dollar. Can the same be said of negligent advice or unlawful activities by the non-lawyer members of the incorporated legal practice? Perhaps most importantly, the difficulties in “writing someone out of a will” in the face of the possibility of a claim under the Family Provision Act26 would be well known to lawyers, but not necessarily to our other hypothetical professionals. What is certain is that it is only the lawyer who has an ethical obligation to inform his client of the potential claim upon the estate, and to explain that such a claim is more likely than not to involve lengthy and expensive litigation, perhaps significantly reducing the corpus of the estate.

This hypothetical situation (with its potentially serious implications for the client) raises, for me, an ethical concern: if the ethical basis of the legal profession is sound and a desirable thing, should not the regulation of those ethics apply to the work itself, whomever it is performed by, rather than simply to the lawyers who struggle to define those parts of their work which are, and are not, legal work?

The Financial Services Reform Act requires that financial advisers now be licensed. Legal practitioners argued strenuously at its introduction that legal practitioners providing financial advice need not be licensed as the regulatory regime within which they work provides sufficient consumer protection to render licensing unnecessary. The lawyers were, at least partially, successful in this argument, securing an exemption to the extent that they provide financial advice. This exemption does not extend to their involvement in tax and superannuation schemes.

This has necessarily resulted in a move away from ASIC supervision of legal practitioners providing financial advice, to supervision by my Office. In this respect, it should be noted that my Office can exercise all of ASIC’s powers as provided by the

26 1982 (NSW)
Corporations Act in respect of ILPs. However, with the increasing numbers of multidisciplinary incorporated legal practices which are providing financial services, this argument or debate may well be re-ignited.

Conclusion

I believe that we are experiencing a subtle but enormously significant shift in the focus of regulation. Regulatory response now goes beyond addressing individual complaints to effecting cultural change within the profession as a whole as the development of “appropriate management systems” illustrates, and regulation of the legal services industry is moving from regulation of the profession itself to regulation of the provision of legal services. The new Act which commences on 1 October 2005 effectively extends my power of audit to all law practices, whether incorporated or not, so I believe that this movement will gain, rather than lose, momentum in the coming years.

Our approach to regulating ILPs – self-assessment of compliance with “appropriate management systems” as based on the “ten commandments” – represents a systematisation of ethical conduct. Each of the “ten commandments” refers to a behaviour or set of behaviours and, if followed, the result is ethical conduct. In this way, we are contributing to and witnessing cultural change in the profession.

Moreover, with the enacting of legislation permitting incorporation of legal practices in all Australian jurisdictions by early 2006, I believe we will see an increase in the number of firms, particularly larger firms, electing to incorporate. This is so because, in New South Wales, the larger commercial firms tend to be national, and have thus far been prevented from taking up the ILP model as they are financially merged in Australia-wide partnerships. The removal of this barrier via the enactment of identical legislation in all Australian jurisdictions will, I believe, make incorporation an attractive option to many of the larger national firms.

As discussed, I anticipate that we will continue to experience growth in the numbers of firms electing to incorporate in New South Wales, most particularly MDPs. The availability of new business and legal structures to legal practitioners in New South Wales has given us cause to revisit the issues of what is, and what is not, legal work, and the experience of regulating ILPs, including MDPs, has strengthened my belief that we must, ultimately, extend the regulatory and ethical regime which applies to legal practitioners to all those who perform legal work (whether or not they are possessed of a current practising certificate). This will, I believe, lessen some of the tension experienced by those lawyers who operate ILPs and MDPs together with non-lawyers. Most importantly, it will provide an increased level of consumer protection, something the community both demands and deserves.

As the massive corporate collapses which have occurred globally over the last five years or so illustrate, a company cannot itself be the guardian of ethical standards. Ethical standards are upheld by people, by individuals, and in the case of ILPs, my Office looks to the solicitor director to embody and defend those standards. “Appropriate management systems” in New South Wales have provided a benchmark for legal practitioners within ILPs, but they are equally useful to and, I believe,
necessary in, traditionally structured firms. The experiment of incorporation for legal practices in New South Wales has been a success, and, I hope, an example to the profession as a whole of the success that the implementation of “appropriate management systems”, based on the ethical behaviours codified in the “ten commandments”, can bring.