

# Innovations in Regulation—Responding to a Changing Legal Services Market

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Since July 1, 2001 law firms in New South Wales have been permitted to incorporate their practices and provide legal services either alone or alongside other legal service providers who may, or may not be, “legal practitioners.”<sup>1</sup> The implementation of a comparable system in the United Kingdom signifies an international trend that is gathering steam, one that is subject to a sustained critique from within sections of the profession concerned about a prospective diminution of ethical standards. Ultimately, though, opening the doors in one jurisdiction signatory to the General Agreement on the Trade in Services (GATS) may short-circuit the debate in those countries yet to adopt these reforms. This article will examine the regulatory regime in New South Wales, the implications of incorporation for legal professional standards, and the obligations of legal practitioners that have been reinforced through that scheme. The article will then address the New South Wales experience of incorporation using specific examples of how firms have met, or failed to meet, the associated opportunities and challenges. The article demonstrates how the commoditisation of law can effectively be overcome by a responsive regulatory regime which promotes ethical practice.

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1. The generic term of “legal practitioner” or “lawyer” is used in Australia to refer to either a barrister or solicitor, such persons being akin to “attorneys” in the United States.

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## I. INTRODUCTION

It is for the more *laissez faire* amongst us a fascinating prospect that in a modern capitalist society an analysis of anti-competitive behavior in a market could lead to more complex regulation of legal services. Given Australia's relatively high level of bureaucratization, though, this was the entirely predictable result of the 1998 National Competition Policy Review conducted by the Federal Government.<sup>2</sup> The Review found the partnership model, the most common form of business structure for law firms in NSW, to be anti-competitive.<sup>3</sup> Consequently New South Wales passed legislation in 2001 permitting the creation of incorporated legal practices (ILPs), which could also include multidisciplinary practices (MDPs). The combination of increased public scrutiny of corporate behavior and the continuing preeminence of legal professional standards, legislators argued, ensured that legal firms could have their cake and eat it too. Legislators sought to overcome the most significant argument against incorporation: ethical concerns regarding potential conflicts of interest<sup>4</sup> resulting from the removal of the higher level of protection partnership provides through the joint and several, unlimited liability of partners for the debts of the partnership.<sup>5</sup> Nonetheless, the concerns raised have continuing relevance and point to emerging issues with the observance by firms of their ethical and legislative obligations.

While the rationale for legislative change may be supportable on particular public policy grounds (assuming for the moment that we agree that competition is a good thing *per se*, and that this type of regulatory system is a good way to achieve it), the decision to move from the traditional partnership business structure to incorporation is complex. The complexity is heightened considerably in publicly listing.<sup>6</sup>

Incorporation brings with it both benefits and challenges to law firms.<sup>7</sup> In contrast to partnerships, incorporation protects directors of a firm through the

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2. Attorney General's Department of NSW, *National Competition Policy Review of the Legal Profession Act 1987, 1988*, available at [http://www.lawlink.nsw.gov.au/report%5C1pd\\_reports.nsf/pages/ncpf\\_toc](http://www.lawlink.nsw.gov.au/report%5C1pd_reports.nsf/pages/ncpf_toc) (last visited Mar. 20, 2009).

3. The National Competition Policy Review found that partnership management and decision-making is antiquated by contemporary standards, particularly given the realities of dispersed, multi-location practice. The potential growth of partnerships was considered hamstrung by their inability to raise capital from the public. Transparency, it was argued, could be increased through the introduction of corporate structures that were required by law to subject themselves to greater public scrutiny. *See id.*

4. *See, e.g.*, Parliament of New South Wales, Legislative Council Hansard, June 23, 2000 at 7624, available at <http://www.parliament.nsw.gov.au/prod/lc/lcpaper.nsf/0/705B216DA5D7246DCA256907002C1F62>.

5. Jeff Shaw QC MLC, *Incorporation of Legal Practices Under the Corporations Law*, 68 L. Soc'y J. 67, 68 (1999) (NSW).

6. Philip King, *Legal Practice: Should Your Firm Incorporate?*, 39(2) L. Soc'y J. 44, 44-46 (2001) (NSW).

7. Steve Mark, NSW Legal Comm'r, Notes on the issue of listing of law firms in New South Wales and the incorporation of law firms, address at the Joint NOBC, APRL and ABA Centre for Professional Responsibility Program, *Brave New World: The Changing Face of Law Firms and the Practice of Law from a Professional*

benefit of limited liability, grants the drafters of the company constitution flexibility regarding ownership, control and distribution of profits and could constitute a profitable investment for shareholders.<sup>8</sup> Share transferability gives owners and other shareholders, who may be non-lawyers, greater flexibility compared to partnerships in their financial relationship to the firm. Non-lawyer directors may make valuable contributions to the operations of a company, providing specialty expertise. Incorporated legal practices avoid the requirement of partnerships to reconstitute themselves on the death, retirement or withdrawal of a partner. In addition, while underperforming partners may be removed, in an ILP they need only be voted off the board. Incorporation provides greater flexibility to reward productive employees, which may contribute to a greater corporate camaraderie.

Law firms considering the shift to incorporation must however also consider the impact of the relatively rigorous reporting requirements of the Corporations Act and the rules of the Australian Stock Exchange (ASX).<sup>9</sup> They must also consider that a breakout of increased industrial democracy, which may result from the creation of a more vertical structure, will diffuse decision-making and that remuneration may follow merit rather than disproportionately reward seniority. Further, law firms must consider that through the process of incorporation, they may cede authority for the ownership and management of the practice. The competing obligations of a listed legal practice to its clients and to shareholders presents a tension that will test the sufficiency of the legal regime. The financial advantages of incorporating for potential directors and shareholders heighten this tension.<sup>10</sup>

The additional considerations and completing obligations brought about by the 2001 legislation has presented the Office of the Legal Services Commissioner (OLSC)<sup>11</sup> with new regulatory challenges. As the regulator of legal practices in NSW, the OLSC has thus been forced to revise its role as the legal services

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*Responsibility Perspective*, (Aug. 10, 2007) available at [http://www.lawlink.nsw.gov.au/lawlink/olsc/ll\\_olsc.nsf/pages/OLSC\\_speeches](http://www.lawlink.nsw.gov.au/lawlink/olsc/ll_olsc.nsf/pages/OLSC_speeches).

8. *Id.*; see also Steve Mark, *The Corporatisation of Law Firms—Conflicts of Interest for Publicly Listed Firms*, Address at the Australian Lawyers Alliance National Conference 2007, (Oct. 11-13, 2007) available at [http://www.lawlink.nsw.gov.au/lawlink/olsc/ii\\_olsc.nsf/pages/OLSC\\_publications\\_resources](http://www.lawlink.nsw.gov.au/lawlink/olsc/ii_olsc.nsf/pages/OLSC_publications_resources).

9. See Australian Stock Exchange, Rules, Guidance Notes and Waivers, available at [http://www.asx.com.au/supervision/rules\\_guidance/index.htm](http://www.asx.com.au/supervision/rules_guidance/index.htm) (last visited Mar. 5, 2009).

10. Steve Mark, NSW Legal Comm'r. A short paper and notes on the issue of listing of law firms in New South Wales, Paper for the Joint NOBC, APRL and ABA Centre for Professional Responsibility Panel, pp. 9-10 (2007), available at [lawlink.nsw.gov.au/lawlink/olsc/ll\\_olsc.nsf/vwFiles/Notes\\_for\\_Joint\\_NOBC\\_APRL\\_ABA\\_Panel.pdf/\\$file/Notes\\_for\\_Joint\\_NOBC\\_APRL\\_ABA\\_Panel.pdf](http://www.lawlink.nsw.gov.au/lawlink/olsc/ll_olsc.nsf/vwFiles/Notes_for_Joint_NOBC_APRL_ABA_Panel.pdf/$file/Notes_for_Joint_NOBC_APRL_ABA_Panel.pdf).

11. The Office of the Legal Services Commissioner ("OLSC") receives complaints about solicitors and barristers in NSW. The OLSC works as part of a co-regulatory system, together with the Law Society of NSW (professional body for solicitors) and the NSW Bar Association (professional body for barristers) to resolve disputes and investigate complaints about professional conduct. The OLSC's main role is to ensure that legal practitioners abide by their ethical and other professional obligations when providing services to the public. The OLSC can take disciplinary action against legal practitioners and help resolve problems between practitioners

marketplace undergoes dramatic structural changes in the commoditisation of law. This has meant that the OLSC has had to focus on entrenching and promoting ethical behavior above profit and encouraging the profession to remain a true profession as well as a business.

Part II.A of this article discusses the regime permitting incorporation in New South Wales, including how ILPs are regulated by the OLSC. Part II.B sets out how the OLSC has had to alter its regulatory role in relation to the emergence of a changing legal market in New South Wales. Part III provides an overview of the ILP marketplace and discusses how firms have coped with transforming their practices into ILPs. This part also evaluates how ILPs are responding to the new regulatory regime. Part IV considers the emergence of alternative legal practice structures focusing on those firms that have publicly listed their firms on the Australian stock market. Part V discusses the resistance to change, and examines why many jurisdictions have not enacted similar legislation permitting alternate business structures. Part VI discusses the consequences of commoditising a legal practice. It outlines the challenges and benefits of public listing and discusses how the OLSC has assisted in responding to the challenges. Part VII then discusses the profit verses ethics conundrum. The article concludes that the side-effects of the commoditisation of law can effectively be overcome by a responsive regulatory regime which promotes ethical practice.

## II. INCORPORATION IN NEW SOUTH WALES

### A. THE LEGAL REGIME GOVERNING ILPS

The principal legislation governing the legal profession in New South Wales are the Legal Profession Act 2004 (NSW) (the LPA 2004)<sup>12</sup> and the Legal Profession Regulations 2005.<sup>13</sup> The legislation permits legal service providers to register as a company with the Australian Securities and Investments Commission (ASIC), the agency responsible for ensuring compliance with the *Federal Corporations Act 2001* (Cth) (Corporations Act).<sup>14</sup> Once so incorporated, the company is obliged to abide by its constitution, the Legal Profession Act 2004 and the Legal Profession Regulations 2005 and the Corporations Act.

A legal service provider may incorporate and provide legal services either

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and other members of the community. The OLSC is an independent statutory body and its decisions, can only be challenged through the normal process of administrative law.

12. Legal Profession Act, No. 112 (2004) (N.S.W.Stat.), available at [http://www.austlii.edu.au/au/legis/nsw/consol\\_act/lpa2004179/](http://www.austlii.edu.au/au/legis/nsw/consol_act/lpa2004179/) (hereinafter "LPA 2004").

13. Legal Profession Regulation 2005 (Austl.—N.S.W.), available at [http://www.austlii.edu.au/au/legis/nsw/consol\\_reg/lpr2005270/](http://www.austlii.edu.au/au/legis/nsw/consol_reg/lpr2005270/).

14. On 1 July 2001 the Legal Profession (*Incorporated Legal Practices*) Act 2000 ('2000 Act') and the Legal Profession (*Incorporated Legal Practices*) Regulation 2001 came into force in New South Wales amending the LPA 1987. The 2000 Act and Regulations amended the 1987 Act to enable providers of legal services in NSW to incorporate by registering a company with the Australian Securities & Investment Commission (ASIC).

alone or alongside other legal service providers who may, or may not be “legal practitioners.” At least one legal practitioner director must be appointed.<sup>15</sup> A legal practitioner director is defined as a director of an incorporated legal practice who is an Australian legal practitioner holding an unrestricted practicing certificate. The legal practitioner director is generally responsible for the management of the legal services provided in NSW by the ILP.<sup>16</sup> It is an offence if an incorporated legal practice does not have any legal practitioner directors for a period exceeding seven days.<sup>17</sup>

The rationale for imposing a requirement that the ILP have at least one legal practitioner director stems from a rule that existed in NSW known as the “51% rule.” The 51% rule was introduced in 1994 legislative amendments that liberalized MDPs. The rule stipulated that lawyers were required to retain at least 51% of the net income of the partnership, thereby limiting the income of non-lawyers to 49% of the net income earned by the MDP. In addition, the 51% rule also retained the ethical structure of the practice as a legal practice. This rule was abandoned in 1999 in response to the Federal Government’s competition policy review.<sup>18</sup>

The usual professional obligations that complement the privileges enjoyed by Australian legal practitioners bind those practitioner employees and officers delivering legal services on behalf of an ILP.<sup>19</sup> These responsibilities are, however, extended in the case of legal practitioner directors of an ILP. Legal practitioner directors also have a general responsibility to manage the legal services provided by the incorporated legal practice<sup>20</sup> and implement and maintain “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 section 140(2) and (3) of the LPA 2004.<sup>21</sup> Failure to implement and maintain “appropriate management systems” is declared to be professional misconduct.<sup>22</sup>

Legal practitioner directors also must report to the Law Society any conduct of another director of the practice that has resulted in or is likely to result in a

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15. LPA 2004 § 140(1).

16. *Id.* § 140(2).

17. *Id.* § 142(1).

18. In 1998 the Federal Government published a report on national competition review. The report entitled the “National Competition Policy Review of the Legal Profession Act” (National Competition Policy Review) determined that the rules governing MDPs were anti-competitive and should be repealed. As a result, in December 1999 the rules were amended to provide that lawyers no longer had to retain the majority voting rights in an MDP. The amendments further provided that the net income of the MDP could be shared by lawyers and non-lawyers without any restrictions. These amendments meant that the operation of MDPs has essentially been unfettered since December 1999. *See* Attorney General’s Department of NSW, *supra* note 2.

19. LPA 2004 § 143.

20. *Id.* § 140(2).

21. *Id.* § 140(3)(a).

22. *Id.* § 140(5).

contravention of that person's professional obligations or other obligations imposed by or under the Act.<sup>23</sup> Legal practitioner director's must also report to the Law Society any professional misconduct of a solicitor employed by the practice. Legal practitioner directors must also take all action reasonably available to them to deal with any professional misconduct or unsatisfactory professional conduct of a solicitor employed by the practice.<sup>24</sup>

The OLSC has, by agreement with the Law Society, assumed the role of auditing ILPs for compliance with the LPA 2004 and Regulations pursuant to sections 140(3) and 670 of the LPA 2004. The OLSC seeks to guide an audited legal practice towards the ultimate objective of better practice management and compliance with the LPA 2004.<sup>25</sup> The OLSC can audit a practice's management systems, files and behavior reflected in a returned self-assessment form. An ILP can be also subject to a compliance audit, which refers to compliance with the LPA 2004, the Regulations and the Professional Conduct and Practice Rules and is not limited to management systems. Should the results of an audit warrant disciplinary action it is the OLSC's role to so act.

Section 140(3) of the LPA 2004 sets out the test for compliance. This section provides that a legal practitioner director must ensure that "appropriate management systems" are implemented and maintained by the ILP. Failure to implement an appropriate management system may constitute professional misconduct.<sup>26</sup> Appropriate management systems are not defined in the LPA 2004. Accordingly, the OLSC has collaborated with the Law Society, the College of Law (the largest provider of practical legal training courses in Australia) and LawCover (the provider of legal insurance in NSW) to define the key criteria to 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 the OLSC considers to be the ten objectives of a sound legal practice, namely:<sup>27</sup>

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

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23. *Id.* §140(4).

24. LPA 2004 §141.

25. There are two types of audits that can occur under the LPA 2004. The first is a general power to audit any law practice regardless of entity status. *See id.* § 670(1) (providing for a compliance audit). The second is an audit of an ILP, which is broken into two components – compliance of the ILP with the requirements of Part 2.6 of the LPA 2004 and management of the provision of legal services. *See id.* § 670(2)(a)-(b) (ILP Audit).

26. *Id.* §140(5).

27. This approach was first discussed in Steve Mark & Georgina Cowdroy, *Incorporated Legal Practices—A New Era in the Provision of Legal Services in the State of New South Wales*, 22 PENN ST. LAW REV. 4, 671 (2004).

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, and 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 section 61 of the Act in relation to trust accounts.<sup>28</sup>

To enable legal practitioner directors to assess their management systems, a standard “self-assessment” document has been developed and is sent to all legal practitioner directors. The self-assessment document takes into account the varying size, work practices, and nature of operations of different ILPs, eschewing an inappropriate “one size fits all” approach requiring the fulfillment of uniform criteria. The self-assessment document instead suggests indicative criteria to assist legal practitioner directors in addressing each of the ten objectives along with examples of what an ILP *may* do that would provide evidence of compliance. For example, regarding “competent work practices to avoid negligence,” the self-assessment document suggests as a criterion that “fee earners practise only in areas where they have appropriate competence and expertise.” 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” would provide evidence that this criterion had been met. Legal practitioner directors then rate the ILP’s compliance with each of the ten objectives as either “Fully Compliant,” “Compliant,” “Non-Compliant,” or “Partially Compliant.”

The OLSC characterises this process as the systematisation of ethical conduct. If followed, these objectives will result in ethical outcomes. The management

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28. See Office of the Legal Services Commissioner, Ten areas to be addressed, [http://www.lawlink.nsw.gov.au/lawlink/olsc/ll\\_olsc.nsf/pages/OLSC\\_tenobjectives](http://www.lawlink.nsw.gov.au/lawlink/olsc/ll_olsc.nsf/pages/OLSC_tenobjectives) (last visited Feb. 6, 2009).

systems overseen and enforced by the OLSC are unapologetically value-based, and can be distinguished from those professional standards that seem to have existed in a vacuum in other industry regulating regimes. This approach sits well within the OLSC's general theory of regulation that a regulator should:

ensure compliance with the relevant laws, rules and regulations;  
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  
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 the OLSC. It has been a long standing stated aim of the OLSC to reduce the number of complaints about lawyers.

## B. THE ROLE OF THE OLSC

In order to manage the self-assessment process more effectively and efficiently, the OLSC is building an online Portal to automate the management and regulation of ILPs in NSW. The construct of the Portal is a browser-based system. Originally the Portal was specifically for ILPs in NSW to automate and replace much of the manual processing. The original system focused only on the regulation of ILPs through the self-assessment process. The parameters of the Portal have now however been extended to include all practices in NSW, not just ILPs. Accordingly, the OLSC is now building the Portal for all legal practices (including ILPs) and practitioners in NSW that comprises:

- a database of legal practices' and legal practitioners' data and functions to maintain that data;
- a facility to aid in information exchange between OLSC and external parties such as the legal practices and Law Society;
- a legal practices information and educational repository to aid legal practices improve their management systems;
- a facility to automate the review, assessment and management of the self-assessment process; and
- a comprehensive set of operational and management reporting.

The Portal will improve the process for regulating and improving ethical behavior by all legal practices and support the provision of high quality, ethical legal services. The OLSC believes that this will in turn reduce the number of consumer complaints about the legal profession. The Portal will also enhance the OLSC's technical capacity to provide timely and accurate information. The Portal will further provide an information and educational repository to aid legal practices in improving their management systems.

One of the most important functions of the Portal is its risk-profiling element. The use of risk profiling will assist the OLSC in focusing its resources on reducing complaints against practitioners by identifying those practitioners which are most at risk of non-compliance or unprofessional conduct. The key outputs of the risk-profiling framework will include priority audit recommendations as well as targeted education programs that will improve the performance of all firms, especially those not doing well.

The use of risk-profiling to better regulate the legal profession is an innovative move. The OLSC has engaged a specialist business strategy and management company to assist with the risk-profiling component of the project. That company has in conjunction with the OLSC developed a number of strategies based on risk profiling such as audits and will establish a risk-profiling framework. This framework will prioritise education programs and audits of legal practices based on their risk of non-compliance or unprofessional conduct. The methodology used will support the effective conduct of audits, maximise the opportunity to review operating practices and so minimise the opportunity for non-compliant practices to be missed. The Portal will draw upon both data from the Law Society database and the Complaints Tracking System currently used in the OLSC. Accordingly, the Portal will provide up-to-date information, which, *inter alia*, will enable risk-profiling to be conducted on all NSW legal practices and legal practitioners. The risk-profiling element of the Portal will allow the OLSC to rapidly acquire the data and the analytical capacity required to make evidence based risk assessments and review legal practices requiring regulation and attention. Risk profiling will also allow the OLSC to identify systemic risk factors for audit and further investigation and provide a framework to continue ongoing refinement and monitoring for non-compliant behaviors from legal practitioners.

This risk-profiling mechanism will be increasingly useful in monitoring an ever-more complex legal services market. The task of the OLSC in monitoring professional standards will become increasingly difficult, given the potentially serious outcomes flowing from a failure by an ILP to adequately meet the challenges posed by operating as a corporate entity, and the marked increase in the number of incorporated firms active in the market.

### III. THE ILP MARKETPLACE IN NEW SOUTH WALES

#### A. THE NUMBER OF ILPS

As of 6 March 2008 there are 800 ILP's in NSW. These firms are typically small in size. At present there are 311 sole practitioner ILPs. These practices are primarily located in the suburbs of Sydney and in the CBD. There are 193 ILPs

practising in rural NSW at present.<sup>29</sup>

Historically, large firms have, in the main, displayed little interest in incorporation. This is probably because until very recently few jurisdictions in Australia had enacted legislation permitting incorporation.<sup>30</sup> At present Victoria, Queensland, Western Australia, the Northern Territory and the Australian Capital Territory all have<sup>31</sup> identical legislation to that in NSW permitting incorporation and have adopted the same self-assessment program designed and introduced in NSW. South Australia, Tasmania and the Australian Capital Territory have not yet enacted legislation permitting the incorporation of law firms but have undertaken to do so by the end of this year.<sup>32</sup> Upon enacting such legislation these jurisdictions have also agreed to adopt the same self-assessment program.<sup>33</sup> The adoption by all jurisdictions of the NSW model will ensure harmonisation of practices and procedures and represents an important step towards the establishment of a national legal profession, which the OLSC as well as other regulators across Australia are working to achieve.

Approximately one third of firms who incorporated in the first year later reverted to their prior structure or ceased to practice entirely. These failures were largely due to the volatility of the small firm market, lack of planning and an incomplete understanding of the requirements of incorporation. The numbers of ILPs ceasing to practice since 2001 has decreased quite dramatically over the years with only fifty-five ILPs ceasing to practice in 2007. ILPs have collapsed altogether as a result of significant financial issues, following ineffective or non-existent attempts at implementation of the 'appropriate management systems' required by the Act and Regulations. For example, an OLSC audit discovered that lawyers creating a new business with real estate and accountancy partners relied on the accounting firm for start-up funds. These funds proved insufficient to provide for necessary management and trust accounting systems. Unable to fulfil his statutory obligations, the solicitor-director had his practicing

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29. There are at present 344 ILPs practicing in suburban Sydney and 251 ILPs practicing in the CBD. Statistics from the Law Society of NSW, as of April 1, 2008.

30. Incorporation was permitted in the Australian Capital Territory in 2006, *Legal Profession Act*, 2006, pt. 2.6 (Austl. Cap. Terr.); in the Northern Territory in 2007, *Legal Practitioners Act 2006 (NT)* pt. 2.6 (NT); in Victoria in 2005, *Legal Profession Act 2004* pt. 2.7 (Vict.); in Western Australia in 2004, *Legal Practice Act, 2003 (W. Austl.)* §§ 45-74; and in Queensland in 2007, *Legal Profession Act 2007 (Queensl.)* pt. 2.7.

31. The establishment of a national legal profession is a major project of the Law Council of Australia. The aim of the project is to remove the existing barriers to the practice of law across borders and harmonise standards of regulation. See Law Council of Australia, National Practice, available at <http://www.lawcouncil.asn.au/initiatives/national-practice.html> (last visited Mar. 5, 2009).

32. Legislation is in progress in Tasmania but has not yet been proclaimed: *Legal Profession Act 2007 (Tas)* Part 2.5 (Not yet proclaimed, received assent 15/08/07); In South Australia the legislation is still being considered; *Legal Profession Bill 2007 (SA)* Part 5.

33. All of the States and Territories in Australia agreed to adopt the same self-assessment program at the 2006 Conference of Regulatory Officers which was held in Sydney on 9-10 November 2006. The Conference of Regulatory Officers is the pre-eminent conference of statutory regulators, Law Societies, Bar Associations and admitting authorities involved in the regulation of the legal profession in Australia. See <http://www.coro.com.au>

certificate cancelled and the ILP consequently failed.<sup>34</sup>

The OLSC has also encountered several examples of a phenomenon dubbed by them as “phoenix ILPs.”<sup>35</sup> The term refers to those ILPs who 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.

## B. COMPLIANCE WITH THE LEGISLATION

Despite these failures, anecdotal evidence suggests that the regulatory regime established for ILP’s is being overwhelmingly complied with. In 2004 the OLSC asked 300 ILPs to complete self-assessment packages (containing general information, the self-assessment document and the “ten commandments”).<sup>36</sup> To the OLSC’s astonishment, an impressive 294 were ultimately completed and returned.<sup>37</sup> Many solicitor directors commented that the process of self-assessment had been a valuable one. The self-assessment process is today a key feature of the regulation of ILP’s and a feature that they embrace without objection.

According to research the OLSC conducted in July 2006 in conjunction with the Centre for Applied Philosophy and Public Ethics (2006 Research Study) analysing our complaints data and returned self-assessment forms of 184 ILPs,<sup>38</sup> 63% of self-assessment forms were returned with substantial comment thereon and 56% of ILPs were prompted to make management system changes by the self-assessment process. The study concluded that the self-assessment process is being taken seriously and is having a significant impact. The OLSC has received numerous letters from practitioners thanking them for the opportunity to conduct the self-assessment and commenting on it being a worthwhile experience. As one respondent wrote:

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34. The practitioner failed to implement appropriate management systems as required by the legislation and failed to comply with the trust account provisions of the LPA 2004.

35. This concept was first discussed in Steve Mark & Molly Hutcherson, “New Structures for Legal Practices and the Challenges they Bring for Regulators,” Paper for the 14th Commonwealth Law Conference, London (Sept. 2005), available at [http://www.lawlink.nsw.gov.au/lawlink/olsc/ll\\_olsc.nsf/pages/OLSC\\_speeches](http://www.lawlink.nsw.gov.au/lawlink/olsc/ll_olsc.nsf/pages/OLSC_speeches)

36. *Id.*

37. Those ILPs, which did not return the self-assessment document, were audited by the OLSC. Four of the six firms audited achieved compliance; the remaining two ILPs did not and their solicitor directors had their practising certificates cancelled.

38. Note that there were actually 200 ILPs in the OLSC database. See S. Miller & M. Ward, OFFICE OF THE LEGAL SERVICES COMMISSIONER, Complaints and Self-Assessment Data Analysis in Relation to Incorporated Legal Practices (July 2006) (study available upon request from OLSC).

As a general comment, the process has been very useful for us and the main effect is I believe to highlight the need for consolidation of our various policies and procedures. In this respect the Quality Assurance C/Tee which comprises me and 3 principals will have further discussions as to how best to consolidate these. Included in this will be a more detailed examination of the QIL certification which we have had a preliminary look at and which we generally agree we should implement in due course.<sup>39</sup>

And from another:

I found your suggestions concerning the elements of a [sic] Appropriate Management Systems for ILPs in NSW document to be very useful and easy to understand. Thank you for the work in this area and the assistance your office has [sic] to not only me (as a sole solicitor director) but other ILPs who are required to comply with s 47E(3)(a) of the LPA. In addition to responding to your self-assessment, I have found the exercise itself very beneficial and have decided to take further steps in strengthening this area of my practice . . . I have studied business planning and marketing over a number of years and know that the “scalability” of a business is critical to its successful growth. It is clear that each of the systems that support the objectives assist greatly in building not only a practice that is “solid” in terms of quality of service provided to clients and the quality of risk management but also dramatically adds to the scalability of the business and its future prospects of success.<sup>40</sup>

On the rare occasion that a self-assessment package is not returned for assessment the reasons for the non-return relate more to time management than actual objection.<sup>41</sup>

Since 1 January 2008 the OLSC has conducted four formal audits on ILPs as well as a number of less formal audits. The audits were conducted on the ILPs for numerous reasons including a returned self assessment form with seven of the ten objectives rated as partially compliant,<sup>42</sup> a returned self-assessment form with all of the ten objectives rated as non-compliant, a trust account inspection report which raised major issues with respect to supervision of employees and the veracity of the legal practitioner director’s certification that appropriate management systems had been established and maintained,<sup>43</sup> and sixty-five complaints

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39. Letter to Practice Compliance Manager, OLSC from a solicitor (April 30, 2004) (on file with author).

40. Letter to Practice Compliance Manager, OLSC from a solicitor (Oct. 13, 2004) (on file with author).

41. Anecdotal statistics from the OLSC indicate that only a handful of self-assessment forms are not returned.

42. The ILP had previously completed a self-assessment form and was deemed compliant in around 2004. The OLSC asked the legal practitioner director to complete another form, as there had been a couple complaints about him that had given the OLSC cause for concern. As the ILP, which had been established for sometime, was only compliant with some of the objectives, an audit was appropriate.

43. Following the Trust Account inspection both the Law Society of NSW and the OLSC initiated complaints about the legal practitioner director (The OLSC subsequently took over the Law Society complaints and are awaiting further submissions from the legal practitioner director with respect to the complaint). Around

made against an ILP with forty-nine complaints being made since incorporation in 2003.<sup>44</sup> The OLSC is also in the process of auditing another ILP on the basis of a complaint, which raised issues concerning the appropriateness of the management systems at that ILP.

All of the ILPs have responded reasonably positively to the audits. Several were very nervous about the process but were still very accommodating. The OLSC decided that it would be beneficial for all concerned if we sent the ILPs a copy of the OLSC audit workbook which contains questions that the OLSC asks before the audit occurred. This gives the firm time to prepare, formulate the answers to the questions and also obtain copies of any documents that the OLSC might request. The OLSC has not had any refusals or come across anyone that has been particularly adverse as yet. This is largely because the OLSC takes a positive, non-adversarial approach to the audit and at all times emphasizes that we are assisting and working with the ILP's.

The outcomes are proving to be, by and large, better, more ethically managed legal practices. Already, in New South Wales, we are seeing a fall in the number of complaints about legal practitioners. For the last three years, complaints in relation to all legal practices have fallen at the rate of approximately 5% per annum. Statistics regarding complaints in relation to ILPs are even better. According to the 2006 Research Study discussed above;

- Of the 184 ILPs who ranked themselves against the OLSC's ten objectives, the average number of complaints per solicitor per annum was 0.6;
- of the 21 ILPs who ranked themselves as being compliant (i.e. not being either non compliant or only partially compliant) in respect of all 10 objectives, the average number of complaints per solicitor per annum of the 21 ILPs was 0.47; and
- of the 46 ILPs who ranked themselves as being non-compliant or only partially compliant with 3 or more of the 10 commandments, the average number of complaints per solicitor per annum was 0.69.<sup>45</sup>

The study concluded that there was a positive correlation between very high levels of compliance and the 10 objectives and relatively low levels of complaints. The increased transparency demanded by compliance together with the requirements of professional responsibility, may have been enough to relieve

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9 complaints had been made about the legal practitioner director in the past and coupled with the findings of the inspection report an audit was conducted.

44. This does not reflect the OLSC's position that complaints about practitioners fall after a practice has incorporated. The OLSC asked the legal practitioner director to complete another self-assessment form. It was returned with all 10 objectives rated as compliant or fully compliant. Given the nature and number of complaints made, an audit was appropriate.

45. See S. Miller & M. Ward, OFFICE OF THE LEGAL SERVICES COMMISSIONER, *Complaints and Self-Assessment Data Analysis in Relation to Incorporated Legal Practices (July 2006)* (available on request from the OLSC).

the pressure to act unethically.

Ultimately, the regulatory regime and its compliance mechanisms were introduced because this pressure would increase, not diminish, as law firms themselves became corporate entities. The OLSC's experience with firms making the transition to one of the most challenging of the various structures afforded by incorporation—public listing—is that the legal practitioners involved are just as mindful of these potential pressures in the construction of the business as they are to their compliance with the law during its operation. The same is true of other firms, which have pursued alternative business structures, such as franchising and limited partnerships.

#### IV. THE EMERGENCE OF ALTERNATIVE STRUCTURES

Law firms have expressed considerable interest in the prospect of incorporation and beyond. Incorporation in New South Wales has taken a number of different forms. These forms have included MDPs, 'complete service' firms, which provide a 'one-stop shop' for clients of property and financial services and other smaller MDP firms.

In March 2004, Noyce Legal, a Sydney based law firm, listed the banking and finance division of its practice on the ASX.<sup>46</sup> Noyce Legal did not list the whole firm but incorporated the division which specialised in residential mortgage processing, into National Lending Services Ltd (NLS) and sold all of its shares to listed consumer finance website Infochoice. On so listing the managing partner of Noyce Legal, Michael Noyce became the executive director of Infochoice. In July 2007, NLS was acquired by Perpetual Limited (Perpetual).<sup>47</sup> Perpetual acquired the mortgage processing assets of NLS for \$3.5 million integrated NLS assets into the Perpetual Mortgage Services business.

Three years after Noyce's partial listing, on 21 May 2007, Slater & Gordon an ILP made legal and corporate history when it became the first law firm in the world to list its whole firm on the ASX<sup>48</sup>. Slater & Gordon is an Australian law firm specialising in personal injury, commercial, family, and asbestos-related law. Operating for over 70 years Slater & Gordon is one of Australia's most successful and well-known plaintiff law firms claiming to be synonymous with fair access to justice for thousands of Australians.<sup>49</sup> The firm had more than 95 million shares on offer and another 12 million non-voting shares.

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46. THE SYDNEY MORNING HERALD, Mar. 17, 2004 available at <http://www.smh.com.au/articles/2004/03/16/1079199222857.html?from=storyrhs>.

47. K. Kachor, *Perpetual acquires mortgage assets*, Investor Daily, July 24, 2007, available at <http://www.investordaily.com.au/cps/rde/xchg/id/style/2553.htm?rdeCOQ=SID-3F579BCE-0347ABCE>.

48. "World first as law firm lists on ASX," THE SYDNEY MORNING HERALD, May 21, 2007, available at <http://www.smh.com.au/news/Business/Slater-amp-Gordon-debut-at-premium-on-ASX/2007/05/21/1179601291947.html>.

49. See Slater & Gordon, [http://www.slatergordon.com.au/pages/the\\_firm.aspx](http://www.slatergordon.com.au/pages/the_firm.aspx) (last visited Mar. 5, 2008).

Following Slater & Gordon's listing, Integrated Legal Holdings (IHL), a Western Australian based law firm, listed on the ASX on 17 August 2008. IHL offered lawyers and non-lawyers an opportunity to invest in their firm via an Initial Public Offer (IPO) offering of 24 million shares at 50 cents each.<sup>50</sup> Unlike Slater & Gordon, IHL's initial listing was not spectacular. At the close of trade on the first day of listing, a day after the ASX suffered its biggest loss in seven years, IHL shares fell to just 38c, losing about a quarter of the value in one day.<sup>51</sup> Interestingly this has not prevented continuing interest in listing by other law firms, as IHL has appeared to recover some lost share price.<sup>52</sup>

IHL's model is considerably different from Slater & Gordon's. IHL was formed to own and operate a number of firms under one business structure, the Integrated Legal Group. IHL plans to either purchase a law firm and merge that law firm into an existing IHL firm or acquire a firm, which continues to operate under its own business name. IHL's involvement in the latter will extend to its CFO working with each practice acquired on budget and budget performance.<sup>53</sup> To this end IHL initially acquired the legal practices of two firms—Talbot Oliver and Brett Davies Lawyers. In addition to purchasing law firms, IHL is also acquiring shares in a legal information company, Law Central Co Pty Ltd. Of the opportunity to invest in IHL, Brett Davies, IHL's spokesperson, said:

We believe that there are better ways of operating a law firm than the old partnership model . . . Traditionally, the ultimate aim of joining a law firm was obtaining a partnership. This meant that you spent a long time in one firm to eventually build up to that position. But eventually you retire with little value for your partnership interest. However, this structure is beginning to break down due to the X and Y generation's perspective. Often they do not want that long term tenure or the joint financial liability with other partners. So, our business plan is transforming the structure of law firms to make them more appealing and therefore fast track growth.<sup>54</sup>

According to Davies there are five reasons why law firm equity partners would consider joining IHL:

1. making a partner's interest liquid and providing ongoing passive income through potential dividends;
2. allowing equity partners to continue managing their practices but with

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50. *IHL—Sharing lawyers' profits*, Cover Story, THE AUSTRALIAN INVESTOR, July 9, 2007 [hereinafter "*Sharing lawyers' profits*"].

51. Susannah Moran, *New listing rocked by turbulence*, THE AUSTRALIAN, August 24, 2007, available at <http://www.theaustralian.news.com.au/story/0,25197,22296937-17044,00.html>.

52. See Integrated Legal Holdings (IAW) Price History Chart, available at <http://www.asx.com.au/asx/research/CompanyInfoSearchResults.jsp?searchBy=asxCode&allinfo=on&asxCode=IAW#chart> (last visited Mar. 5, 2009).

53. *Sharing lawyers' profits*, *supra* note 50.

54. *Sharing lawyers' profits*, *supra* note 50.

employee share schemes to increase staff retention and hiring—rather than the traditional offer of partnerships which is less appealing to the X and Y generation;

3. facilitating growth of their practices through “tuck in” opportunities where the purchased law firms are merged into a willing existing IHL law firm;
4. enabling Integrated law firms to refer work to other Integrated practices; and
5. providing group economies of scale.<sup>55</sup>

Since publicly announcing a possible float, IHL has received over 89 requests from other law firms and associated businesses for information, and it is acting on these enquiries.<sup>56</sup> IHL’s latest acquisition occurred on 19 September last year when they acquired legal practice Peter Marks Succession Lawyers for \$125,000, to be incorporated into subsidiary Talbot Olivier. The move represents the company’s first acquisition since its initial listing on the ASX on 17 August 2007.<sup>57</sup>

Another variation of incorporation that has emerged in Australia is franchising. The OLSC is aware of one law firm in NSW that has already adopted this structure. This law firm operates through a group of independent branch offices throughout New South Wales, the ACT and Queensland. Each branch office is an ILP and is related to the law firm but not to each other, as is typically the nature of franchises. The law firm has to date entered into a franchise agreement with over 20 branch offices.<sup>58</sup> The OLSC is also aware of another firm with offices operating in three States in Australia that has changed its structure from the traditional partnership structure to a limited partnership.<sup>†</sup>

In an alternate model, PwC Legal, a major professional services firm has

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55. Integrated Legal Holdings Limited, Integrated Legal Holdings IPO Closes Early and Oversubscribed (July 20, 2007), available at <http://www.ilh.com.au/Documents/ClosedEarlyOverSubscribed.pdf>.

56. Moran, *supra* note 51.

57. Edited Announcement, *Integrated Legal acquires Peter Marks for \$125,000*, WA BUSINESS NEWS, Sep. 19, 2007 available at <http://www.wabusinessnews.com.au/en-story/1/56863/Integrated-Legal-acquires-Peter-Marks-for-125K>.

58. The OLSC understands that under the franchise agreement new partners may not be admitted to the branch office (though new directors can be, this appears simply to reflect the transition from partnership to ILP); and profit sharing in the branch office is determined by the issue of shares in the branch office. The OLSC also understands that the franchise agreement between the law firm and branch offices stipulates that initially, the new branch office will have two directors (presumably this element of the agreement can be adjusted to account for greater numbers) who are given equal voting shares on the board of the branch office as founding directors. Until the board of the branch office determines otherwise, the voting shareholders determine the appointment and removal of directors. The agreement further stipulates that shares in the new entity are divided equally between the founding directors. The board then determines the division of profits amounts, the different classes of shareholders and the issue of additional shares. A percentage of the branch office’s turnover is paid to the law firm monthly. The branch office is permitted to use the firm’s name, branding, signage etc and is subject to the law firms management systems and practices.

<sup>†</sup> Eds. Note: Due to confidentiality concerns, the authors cannot disclose the identity of the firm.

transformed their practice into the broader PwC partnership under an MDP.<sup>59</sup> The rationale for the transformation was to provide the professional services firm with an opportunity to further differentiate itself from its competitors and to provide the firm with an opportunity for certain Partners and staff within the existing practice to give advice that attracts legal professional privilege.<sup>60</sup> All legal partners and employees previously operating in PwC Legal will join PricewaterhouseCoopers Australia. According to PwC the move is “simply part of the natural evolution of the firm.”<sup>61</sup> As Leigh Minehan Deputy CEO, PricewaterhouseCoopers stated:

We have been working towards this for some time to bring more value to our clients. The newly formed MDP provides our clients with seamless access to specialist legal expertise in areas of Corporate and Commercial, Employment and Industrial Relations, Tax Controversy, Environment, Property and Litigation, as well as new areas of legal practice such as Corporate Tax consulting services<sup>62</sup>

The move has been welcomed in NSW with Hugh Macken, the President of the NSW Law Society commenting:

PwC’s move is unique in terms of the scale, depth and breadth of its legal service offerings in a multi-disciplinary environment. The market for legal services in Australia is sophisticated, and I am sure many organisations will appreciate the benefits of receiving both legal and non-legal services from the one provider.<sup>63</sup>

Depending on your viewpoint, the beauty or the tragedy of the global market so significantly liberalised by the General Agreement on the Trade of Services (GATS)<sup>64</sup> is that providers may not be prevented from trading in a domestic

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59. Press Release, PricewaterHouseCoopers Legal, PricewaterhouseCoopers becomes Australia’s Largest Multi-disciplinary Partnership, *available at* <http://www.pwclegal.com.au/legal/pwclegal.nsf/pages/530CA548F8DA8D87CA2573E1007D8391> (last visited Mar. 5, 2008).

60. Legal professional privilege is a fundamental rule central to the practise of law. In Australia, the rule exists for the benefit of the client and is the client’s privilege and not the lawyer’s privilege, which is intended to be protected. It is a privilege that protects confidentiality of certain communications made in connection with the giving or obtaining of legal advice or the provision of legal services.

61. *What is old is new: PwC opts for MDP*, LAW WEEKLY, Feb. 12, 2008, *available at* [http://www.lexisnexis.com/Community/lwau/blogs/top\\_stories/archive/2008/02/12/what-is-old-is-new-pwc-opts-for-mdp.aspx](http://www.lexisnexis.com/Community/lwau/blogs/top_stories/archive/2008/02/12/what-is-old-is-new-pwc-opts-for-mdp.aspx).

62. PricewaterhouseCoopers Press Release, *supra* note 59.

63. *Id.*

64. The General Agreement on Trade in Services (GATS) is one of the agreements that was signed in April 1994 when the Agreement Establishing the World Trade Organization was signed. The GATS applies to all trade in services, including legal services. GATS has encouraged trade in legal services to flourish, fuelling a transnational legal services market. *See* World Trade Organization, Services trade, *available at* [http://www.wto.org/english/tratop\\_e/serv\\_e/serv\\_e.htm](http://www.wto.org/english/tratop_e/serv_e/serv_e.htm) (last visited Mar. 5, 2009); *see also* International Bar Association, General Agreement on Trade in Services, A Handbook for International Bar Association Member Bars, *available at* [http://www.ibanet.org/barassociations/WTO\\_Working\\_Group.cfm](http://www.ibanet.org/barassociations/WTO_Working_Group.cfm) (last visited Mar. 5, 2009).

market purely on the basis of their business structure. All jurisdictions thus must now face the reality of the ILP as a very real participant in their domestic legal services market. This recognition has already been acted upon in other States and Territories in Australia and in other nations. The latest jurisdiction to enact comparable legislation is the United Kingdom.<sup>65</sup> Following the UK's legislative changes Scotland after much angst, expressed that they would be willing to implement a version of the reforms to remove the ownership restrictions. The Scottish Government has recently indicated that although it would not go as far as the "Tesco reforms,"<sup>66</sup> it would preserve the integrity of the profession and allow larger firms to raise outside capital.<sup>67</sup>

## V. RESISTING THE COMMODITIZATION OF LAW

Despite the legislative changes in Australia and the recent enactment of legislation in the United Kingdom, other jurisdictions are still hesitant about following suit. The United States, for example, has not yet embraced the concept of alternate business structures. This is probably due in part to legislative prohibitions<sup>68</sup> and in part to a failure to understand why a law firm could possibly need or want outside investment.<sup>69</sup> The listing of Slater & Gordon in Australia has, however, brought about renewed interest in the issue from ethical commen-

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65. The *Legal Services Act 2007 (UK)* came into effect on 30 October 2007. The Act permits alternative business structures (ABs), allowing lawyers to form partnerships with non-lawyers, and accept outside investment or operate under external ownership. The Act permits new kinds of legal practices in which lawyers are able to join with other kinds of lawyers and non-lawyers to form legal disciplinary practices (LDPs). In a LDP up to 25 percent of partners or equivalent managers are permitted to be non-lawyers, without any external ownership. In the longer term, the UK Act also allows lawyers to form multidisciplinary practices with other kinds of professionals, accountants, for example. The "Tesco Law" proposal as it has come to be colloquially known (because of the assumption that big retailers and supermarkets will want to buy law firms and offer their own legal services), also allows non-lawyers to own firms that provide legal services whether by flotation of law firms on the UK Stock Exchange or by the setting-up or acquisition of law firms by commercial companies.

66. The Tesco reforms refer to Tesco law, a phrase coined by Lord Falconer of Thoroton, the Constitutional Affairs Secretary and Lord Chancellor in the United Kingdom in July 2003 when announcing a regulatory review of legal services. One of the issues to be discussed in the review was whether supermarkets should be allowed to offer off-the-shelf legal services. Tesco is a chain of supermarkets in the United Kingdom. In June 2004, the UK Government announced that non-legal companies could sell legal services, and Tesco supermarkets responded by offering shoppers the chance to purchase documents such as do-it-yourself wills, rental agreements and a number of legal advice handbooks online. See Damian Reece, 'Tesco Law' imminent as supermarket launches legal service, 22 June 2004, THE INDEPENDENT, available at <http://www.independent.co.uk/news/uk/crime/tesco-law-imminent-as-supermarket-launches-legal-service-733053.html>.

67. See Ian Fraser, *SNP Victory Ushers in New Look at Legal Services Market Reform*, THE HERALD, June 28, 2007 available at <http://www.scottishlegaljobs.com/news/2007-05-28-1.shtml> (last visited Apr. 15, 2009).

68. ABA Model Rule 5.4 prohibits firms from selling equity shares in firms to non-lawyers. The Rule states that a lawyer shall not share legal fees with a non-lawyer. The purpose of the Rule is to ensure that non-lawyer factors or interests do not compromise lawyers. See MODEL RULES OF PROF'L CONDUCT R. 5.4 (2008).

69. The idea has however featured on the American Bar Association's (ABA) agenda for discussion. In 2000 the ABA specifically voted down, by a wide margin recommendations by one of its commissions to amend the ABA's mode rules to allow for multidisciplinary partnerships.

tators and bloggers alike. The OLSC has read with interest the many blogs that have covered the idea of listing in the United States.<sup>70</sup> Whilst there have been some blogs supporting the idea, the majority appear to view the proposal as preposterous. Many see outside investment as a threat to a law firm's independence and professionalism. For example, as one blogger wrote:

I don't know why a client would choose a publicly traded law firm. The incentives are at odds with his/her/its personal interests. The objective is to make as much money (translation, bill the client as highly) as possible. Furthermore, the reporting requirements would undermine attorney-client confidentiality. Fee splitting between lawyers and non-lawyers is prohibited under most states canons' of legal ethics precisely because, especially in the context of legal representation for real live people (as opposed to the more sophisticated user) there is more of a potential for abuse of client trust where one of the end recipients of the fee is someone not bound by the canons of ethics.<sup>71</sup>

And from 'Nate' in Milwaukee who wrote on 30 March 2007;

Aren't lawyers 'officers of the court'? Hey, why don't we do IPOs of courts too, huh?

The greed has no end in the profession, and clearly American lawyers don't know when to stop pushing for more, more, more. But at least with IPOs, the public gets to express their view on 'valuation.'

In that vein, I would expect no more success for law firm IPOs than I would for those other 'legal warehouses' in Nevada, you know, the Chicken Ranch et al.<sup>72</sup>

Lastly, from "Fight The Corrupt":

Hey, how about letting organized crime syndicates go public? Isn't that the same as letting law firms go public? So which American Mafia will IPO first? The lawyers or the Sicilians?<sup>73</sup>

However it was the comments about Australians and Australian law firms that were most amusing.<sup>74</sup>

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70. See, e.g., The Legal Soapbox, *Listing a Law Firm on the Stock Exchange*, available at <http://legalsoapbox.wordpress.com/2007/05/21/listing-a-law-firm-on-the-stock-exchange/> (last visited Mar. 5, 2009); see also Peter Lattman, *The Publicly Traded Law Firm*, THE WALL STREET JOURNAL, March 30, 2007 available at <http://blogs.wsj.com/law/2007/03/30/the-publicly-traded-law-firm-z/> (last visited Mar. 5, 2008).

71. See Peter Lattman, *Slater & Gordon: The World's First Publicly Traded Law Firm*, THE WALL STREET JOURNAL, May 22, 2007 available at <http://blogs.wsj.com/law/2007/05/22/slater-gordon-the-worlds-first-publicly-traded-law-firm/>.

72. See Lattman, *supra* note 70.

73. *Id.*

74. A blogger Hank wrote on 6 June 2007 as follows: "Australia seems famous for new ideas that have already been done by others such as Crocodile Dundee's knife, which was a knock-off of Jim Bowie's (of Alamo

One of the many reasons cited for not embracing a rule change to allow publicly listed law firms are the ethical problems listing raises.<sup>75</sup> Critics have argued that outside ownership would permit non-lawyers to interfere with a law firm's exercise of professional judgment. Professionalism speaks of ethically minded conduct and duties to the court all of which may be antithetical to business objectives. Critics have also argued that the firm's duty to its shareholders would lead it to focusing more on profits than the client's case.<sup>76</sup> Another reason cited for not permitting public listing is the fact that regulation of the legal market in the United States is undertaken by each of the 50 States independently and the professional rules across the 50 States are not harmonious as is the case in Australia.

These criticisms can be overcome. As Professor Milton C. Regan, Co-Director of the Center for the Study of the Legal Profession at Georgetown University, Washington explains, law firms can take a number of steps to prevent interference with professional judgment. Such steps could include for example, offering a minority of shares to outside investors or ensuring the law firms have an ethical infrastructure such as appropriate management systems to prevent unethical behavior. Not all commentators consider this a significant threat. According to Paul Grout, a professor of political economy at Bristol University, law firms owned by non-lawyers may be at less risk of undue influence than lawyer-run practices.<sup>77</sup> Where the lawyer has a larger ownership of the business there would be far more incentive to take the risk.<sup>78</sup> Secondly, Regan suggests that firms could precisely specify the duty it owes to shareholders or indicate that it is committed to providing a certain amount of pro bono representation each year.<sup>79</sup>

Rationalising the risk however is rather trite. Firstly, by and large law firms already operate like businesses. In moves that replicate the corporate world law firms are for example already appointing non-lawyers to top management positions. The analogy of the law firm as a business is thus credible.<sup>80</sup> As Larry

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and other fame) large blade (forged by James Black of Arkansas), Foster's Larger, second-rate beer in large cans which had already been offered years ago in Japan and Germany among several, and publicly-traded law firms which have been done in at least three other countries in the past 20 years. And it hasn't worked well yet. Maybe the Aussies should stick with kangaroos, reef fishing and scantily-clad lady lifeguards." See *An Idea from Down Under: Law Firm's I.P.O's*, N.Y. TIMES, June 6, 2007, available at <http://dealbook.blogs.nytimes.com/2007/06/06/an-idea-from-down-under-law-firm-ipo/>.

75. Bruce MacEwen et al., *Law Firms, Ethics and Equity Capital*, 21 GEO. J. LEGAL ETHICS 61 (2008).

76. Milton Regan, *Commentary: Nonlawyer Ownership of Law Firms Might Not Cause the Sky to Fall*, THE AMERICAN LAWYER, August 14, 2007 available at <http://www.law.com/jsp/llf/PubArticleLLF.jsp?id=1186996017686> (last visited on Jan. 29, 2008).

77. See Paul A. Grout, *The Clementi Report: Potential Risks if External Ownership and Regulatory Responses A Report to the Department of Constitutional Affairs*, July 2005 at 3, available at <http://www.bristol.ac.uk/cmpo/publications/papers/2005/wp135.pdf>.

78. See *id.*

79. *Id.*

80. See Bill Myers, *Firms Gravitating to Corporate Model: Study*, THE CHICAGO DAILY LAW BULLETIN, Sept. 15, 2003 available at [http://www.kellogg.northwestern.edu/faculty/uzzi/ftp/media%20hits/Kellogg%](http://www.kellogg.northwestern.edu/faculty/uzzi/ftp/media%20hits/Kellogg%20030915%20Firms%20Gravitating%20to%20Corporate%20Model.pdf)

Ribstein has commented:

It's pretty clear right now that law-firms are for profit businesses . . . And the only difference really between a law firm and any other business is that law firms don't have the same flexibility to choose a financial structure that is more conducive to its long-term interests.<sup>81</sup>

Secondly, it appears that the practice of non-law firm ownership has already started to emerge in the United States with insurance companies in at least one jurisdiction, Ohio, being permitted to own law firms that represent third parties. If it is permissible for insurance companies to own a law firm then it should be equally permissible for other types of non-lawyers such as doctors or bankers for example, to own a law firm. Although the lawyers are actually employees of the insurance company but if it's okay for insurance companies why should it not be okay for other types of non-lawyers?

As we have seen from the responses above to many lawyers and ethicists it is almost instinctive with this subject matter to first turn our attention to the significant concerns associated with it. The debate currently running in the US replicates the arguments that have been raised in both Australia and the UK prior to the reforms introduced in those countries.<sup>82</sup> This is an instinct that is difficult to fight. But, from the experience in NSW the tensions associated with incorporation are surmountable and the prospective benefits for both practitioners and consumers considerable.

## VI. THE CONSEQUENCES OF COMMODITISING A LEGAL PRACTICE

### A. THE CHALLENGES

#### 1. INTERPLAY BETWEEN LPA 2004 AND THE CORPORATIONS LAW

Australia is a Federation of seven jurisdictions with a centralised Federal Government and State and territory governments. It is a Parliamentary democracy. In the sphere of corporate law in Australia, the Federal Corporations Act establishes the pre-eminence of the rights of and protection for shareholders. Accordingly, there is a latent tension between a solicitor-director's professional obligations and a solicitor-director's duties to a company's shareholders. Historically, corporations law was a power largely held by the States. In 2001 after a major controversy and debate which ran for decades, the States ceded their Corporations power to the Commonwealth so that uniformity throughout

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20in%20the%20Media,%20Chicago%20Daily%20Law%20Bulletin,%20September%2015,%202003,%20Kellogg%20School%20of%20Management.htm (last visited Mar. 5, 2009).

81. Chris Mondics, *Buy Stock in a Law Firm? There's Talk Again*, PHILA. INQUIRER, available at [http://findarticles.com/p/articles/mi\\_kmtpi/is\\_200708/ai\\_n19455976](http://findarticles.com/p/articles/mi_kmtpi/is_200708/ai_n19455976), (last visited Mar. 5, 2008).

82. See, e.g., MacEwen et al., *supra* note 75.

Australia could be achieved.<sup>83</sup> Prior to this, the *Legal Profession Act 1987 (NSW)* (LPA 1987) explicitly stated that where an inconsistency existed in the Corporations Act and the LPA 1987, then the LPA 1987 would prevail to the extent of that inconsistency.<sup>84</sup>

The LPA 2004 attempts to incorporate the same concept by providing that Corporations Act displacement provisions are to be established by the *Legal Profession Regulation 2005 (NSW)* (the Regulation).<sup>85</sup> The Corporations Act displacement provisions provide that if a State law declares a provision of a State law to be a Corporations legislation displacement provision, any provision of the Corporations legislation with which the State provision would otherwise be inconsistent does not apply to the extent necessary to avoid the inconsistency.<sup>86</sup> The Regulation has not however established any displacement provisions to date.

The OLSC has become aware that tension may arise between a practitioner's duties owed under the LPA 2004 and the requirements of a director, officer or employee under sections 181-184 of the Federal Corporations Act. Section 181 of the Corporations Act provides for example that a director or an officer must exercise his or her powers and discharge their duties "in good faith in the best interests of the corporation" and "for a proper purpose." Section 182 provides that a director, officer or employee must not improperly use their position to "gain an advantage for themselves or someone else" or "cause detriment to the corporation." Without any displacement provisions, a practitioner's duty to the court, which must be paramount, may cause a detriment to the corporation which will breach section 182 of the Corporations Act. An example of this inconsistency could be as basic as settling major litigation in accordance with the lawyer's duty to the court and the client but thereby causing a detriment to the corporation because of the diminution in fees earned.

We are firmly of the view that it is essential that the provisions of the LPA 2004 prevail over provisions of the Corporations Act where they are incompatible. The OLSC is presently holding discussions with the NSW State Government with a view to displacing the Corporations Act to the extent of any inconsistency with the LPA 2004 to ensure that the hierarchy of a lawyers duties; court, client then shareholder, will receive clearer legislative backing.

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83. George Williams, *Cooperative Federalism and the Revival of the Corporations Law*, 20 COMPANIES AND SECURITIES L. J. 160 (May 2002).

84. See Legal Profession Act 1987 § 47S(1) (this legislation has been repealed).

85. See LPA 2004 § 163.

86. See Corporations Act 2001 § 5G, available at [http://www.austlii.edu.au/au/legis/cth/consol\\_act/ca2001172/](http://www.austlii.edu.au/au/legis/cth/consol_act/ca2001172/) (Austl.).

## 2. THE DUTY TO THE COURT

In Australia a legal practitioner's primary duty is owed to the court.<sup>87</sup> No other profession shares this duty. This poses a problem for a listed corporation whose primary duty is to its shareholders.

Realising the possibility of this conflict between the duties owed to the company and shareholders and the duties owed to the court and to clients the OLSC worked together with Slater & Gordon prior to listing to ensure that its prospectus, constituent documents and shareholder agreements dealt with the issue. As a result, the Slater and Gordon prospectus states:

The constitution states that where an inconsistency or conflict arises between the duties of the company (and the duties of the lawyers employed by the company), the company's duty to the court will prevail over all the duties and the company's duty to its clients will prevail over the duty to shareholders.<sup>88</sup>

The primacy of a lawyer's duties to the court, as stated above is reflected throughout the prospectus. For example, in the investment overview section of the prospectus, Slater & Gordon acknowledge that the conflict of duties is a key risk and may therefore impact on the performance and financial position of the firm.<sup>89</sup> The conflict is also mentioned again in risk section of the prospectus.<sup>90</sup> In addition to the prospectus the conflict is also reflected in Slater & Gordon's constituent documents and shareholder agreements. These references act as an educative tool, illuminating the statutory regime they iterate.

## 3. THE DUTY OF CONFIDENTIALITY

The duty of confidentiality owed by a legal practitioner to his or her client is fundamental and applies to all information provided by the client. By comparison, confidentiality only really attaches to a business relationship through explicit agreement between the parties. Issues thus arise regarding access to the confidential information of clients by shareholders who are not bound by the same ethical obligations as legal professional employees, owners and managers of a listed firm.

So if Slater & Gordon is running an action against a particular individual who is very well-resourced, and that individual buys a substantial number of shares in Slater & Gordon and then demands that the action against him cease, the dilemma ceases to arise because Slater & Gordon's prospectus explicitly states that legal

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87. See THE LAW SOCIETY OF NEW SOUTH WALES PROF'L CONDUCT AND PRACTICE RULES R. 17-24, Statement of Principles (1995).

88. Slater & Gordon Lawyers, Prospectus, April 13, 2007, available at <http://www.slatergordon.com.au/docs/prospectus/Prospectus.pdf>, [hereinafter "Slater & Gordon Prospectus"].

89. *Id.* at 15.

90. See section 7, "Risk Factors", *id.* at p. 83.

professionals have a primary duty to their client in the event of such a conflict. The prospectus also makes it explicitly clear that the interests of shareholders are second to the firm's duty to the court. This ameliorates the risk that a well-resourced person against whom the firm is conducting proceedings could purchase a significant stake in the firm with a view to demanding the cessation of the action.

But what happens if Slater & Gordon is, for example, obliged to disclose that they are appearing for a client pursuant to the continuous disclosure rules of the ASX,<sup>91</sup> but the client does not want Slater & Gordon to disclose such representation? Depending on the circumstances of the client, this may well be information that could have a material effect on the value of securities in the firm.

The disclosure rules of the ASX obviously have significant implications for confidentiality. Section 674 of the *Corporations Act 2001* makes it a legal requirement for listed disclosing entities to abide by the ASX Listing Rule 3.1 on continuous disclosure.<sup>92</sup> The continuous disclosure requirement is based on the following principle: "Timely disclosure must be made of information which may affect security values or influence investment decisions, and information in which security holders, investors and ASX have a legitimate interest."<sup>93</sup> The obligation of continuous disclosure is further reinforced in Principle 5 from the ASX Corporate Governance Council *Principles of Good Corporate Governance and Best Practice Recommendations* which supports timely and balanced disclosure.<sup>94</sup> A failure to comply with the continuous disclosure requirements is an offence under Section 674 of the *Corporations Act*<sup>95</sup> and can lead to civil or criminal liability.

The underlying principle is that all investors should have equal and timely access to information about a company that a reasonable person would expect, were it generally known, would have a material affect on the price or value of enhanced disclosure (ED) securities of the entity.<sup>96</sup> Specifically, the ASX requires disclosure of:

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91. *Guidance Note 8, Continuous Disclosure: Listing Rule 3.1*, AUSTRALIAN STOCK EXCH., June 2005, available at <http://www.asx.com.au/ListingRules/chapters/Chapter03.pdf>; ASX Guidance Note 8: Listing Rule 3.1, <http://www.asx.com.au/ListingRules/guidance/GuidanceNote8.pdf> (last visited Jan. 28, 2008) [hereinafter *Guidance*]; see also *Continuous Disclosure Requirements*, AUSTRALIAN INSTITUTE OF COMPANY DIRECTORS, Feb. 2, 2006, available at <http://www.companydirectors.com.au/Policy/FAQs/Reporting+Requirements/Continuous+disclosure+requirements.htm> [hereinafter *Requirements*].

92. *Continuous Disclosure*, AUSTRALIAN STOCK EXCH., available at <http://www.asx.com.au/ListingRules/chapters/Chapter03.pdf>; ASX Guidance Note 8: Listing Rule 3.1, <http://www.asx.com.au/ListingRules/guidance/GuidanceNote8.pdf>, (last visited Jan. 29, 2008).

93. *Id.*

94. See *Requirements*.

95. See *Corporations Act 2001* § 674, available at [http://www.austlii.edu.au/au/legis/cth/consol\\_act/ca2001172/s674.html](http://www.austlii.edu.au/au/legis/cth/consol_act/ca2001172/s674.html) (Austl.).

96. See ASX, Listing Rules, R. 3.1 Continuous Disclosure, available at <http://www.asx.com.au/ListingRules/chapters/Chapter03.pdf>.

- Information relating to the making of a takeover bid;
- Certain information relating to share buyback offers;
- Changes to the company's capital structure;
- Information relating to options;
- Certain information when shares in a no liability company are forfeited;
- Information relating to meetings—dates, resolutions and outcomes announcements given to investors;
- Change of contact details of the principal office or share registry;
- Other changes of substantial shareholders to the share register;
- Changes to the chair, directors, responsible, entity, management company or auditors;
- Documents sent to security holders;
- Notice of directors' interests;
- Information memoranda, product disclosure statements;
- If the entity's securities are subject to ownership limits, then certain information relevant to the ownership limit must be disclosed; and,
- Financial information and yearly and half yearly accounts.<sup>97</sup>

This obligation can extend to the requirement to clarify the company's position where media speculation leads to changes in security value. This scheme lifts the veil that had previously protected partnerships from a transparent, public accounting of their affairs. While some partnerships see this as a significant disincentive to incorporating, consumers and regulators see great potential in improving services. The problem is that lifting the veil may unacceptably expose clients. Juxtaposed to this obligation is a lawyers duty to maintain confidentiality. Some law firms, for example, are uncomfortable about the level of transparency required for listed companies in terms of directors (partners) shareholding, salaries or take home pay.

The same problem exists in relation to reporting requirement obligations under the Corporations Law. An ILP must comply with the financial reporting requirements set out in the Corporation Act. Such requirements usually entail regularly submitting information regarding the company's financial position and the remuneration of solicitor-directors to ASIC.<sup>98</sup>

In a similar way, if an ILP is floated on the ASX it must also comply with the ASX's rules with respect to financial reporting both to shareholders and the ASX.

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97. *Id.*

98. There are a number of reporting requirement provisions in the Corporations law. Section 292 requires the preparation of an annual financial report and a director's report. *See* Corporations Act 2001 § 292, available at [http://www.austlii.edu/au/legis/cth/consol\\_act/ca2001172/](http://www.austlii.edu/au/legis/cth/consol_act/ca2001172/) (Austl.). Section 301 requires that the annual financial report be audited. *See id.* § 301. Section 315 requires that the annual financial report, directors' report and auditor's report be sent to members. *See id.* § 315.

Could a shareholder or the ASX for example, demand to know the “holdings” of the law firm such as the identity of its clients and how much money was due to the firm? A partnership or sole practitioner, in contrast, is not required to disclose any financial information to the ASIC and ASX, thereby ensuring that a veil is effectively placed around the affairs of such legal practices.

The evident tension in duties may be resolved through careful drafting of the corporation’s prospectus, constituent documents and shareholder agreements consistent with the principles outlined earlier. Yet constitutional issues remain: will the primacy of the Federal Corporations Act over inconsistent State law require a Court to strictly enforce duties under corporations law to override legal professional duties derived from the LPA 2004?

#### 4. PAYROLL TAX AND STAMP DUTY ISSUES<sup>99</sup>

Payroll tax issues represent another challenge for a legal practice that decides to publicly list. When a legal practice incorporates, partner drawings and profit shares will be replaced by salaries and dividend distributions. To the extent they are replaced by salaries and total annual salaries and wages are more than \$600,000 per annum, payroll tax will be increased by those additional salaries to partners. Dividend distributions are not subject to payroll tax. Furthermore, stamp duty is not specifically exempted under the LPA 2004, however it may be by other state legislation.

#### 5. INCOME SPLITTING—SHARING OF FEES WITH NON-LAWYERS

Perhaps the biggest issue for U.S. regulators is the concern created by the income splitting provisions or the sharing of fees between lawyers and non-lawyers in incorporated practices in Australia and the UK<sup>100</sup>. As discussed earlier, the legislative history, which has allowed the creation of multi-disciplinary practices in New South Wales, has been in place for almost 10 years<sup>101</sup>, with the ability for such practices to incorporate now in place for six

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99. Employers whose total Australian wages exceed the current NSW monthly threshold, are required to pay NSW payroll tax. The monthly threshold is 28 days—\$47,792, 30 days—\$51,205, 31 days—\$52,912. The tax is self-assessed in that the employer calculates the liability and then pays the appropriate amount to the Office of State Revenue, by way of a monthly, quarterly or annual return. See Payroll Tax Act, 2007 available at <http://www.legislation.nsw.gov.au/viewtop/inforce/act+21+2007+FIRST+0+n> (last visited Jan. 30, 2009). For more information about payroll tax see NSW Office of State Revenue, Payroll Tax, available at <http://www.osr.nsw.gov.au/taxes/payroll> (last visited Mar. 5, 2009). Stamp duty are taxes imposed on a range of paper and electronic transactions such as motor vehicle registration and transfer, insurance policies, leases and mortgages, hire purchase agreements and transfer of property such as businesses, real estate or shares. See Duties Act, 1997 (Austl.), available at <http://www.legislation.nsw.gov.au/viewtop/inforce/act+123+1997+FIRST+0+N/>.

100. See MacEwan et al., *supra* note 75.

101. Legal Profession Act 1987 § 58 (this legislation has been repealed).

years<sup>102</sup>. With the move to a national legal services market in Australia the ability for firms to list including multi-disciplinary practices will be available in all states and jurisdictions by the end of 2008.

Income splitting, as it is known in the U.S., will now be available for incorporated law firms not just where those firms are multi-disciplinary but where administrative and other non-legal staff are able to purchase shares in an incorporated legal practice, which is purely a legal practice. This will produce difficulties in the US in how they characterise Australian (and soon UK) lawyers who wish to practice in America, even *pro hac vice*.

#### 6. INCORPORATION AS AN EXIT STRATEGY

There is a concern that partners or legal practitioner directors may possibly use listing as an exit strategy. Listing on the stock market is a great way for partners and legal practitioner directors of an incorporated legal practice to make money if they decide to leave the practice. Once all the money has been made in listing and the directors have left it is doubtful that there would be any value left for subsequent directors/shareholders. The Slater & Gordon Prospectus attempts to placate some of these concerns by having staged processes by which the founding directors are required to stay for between three to six years to get the full economic value of their shareholding.

Interestingly listing as an exit strategy has also been seen as an advantage to listing. One commentator has referred to listing being a benefit as an exit strategy stating of partners—“[t]hey get to own any part of the firm going forward in perpetuity, which normally they wouldn't.”<sup>103</sup>

#### 7. VALUE OF INVESTING IN A FIRM AND GOODWILL

Perhaps the greatest threshold questions for a firm considering public listing are ‘who will invest in it?’ and ‘how is the value of the firm ascertained?’ With high levels of volatility in both stock markets generally and the legal services market particularly, it is difficult to pinpoint the potential ‘public’ that would be interested in investing in a sector which displays a higher than normal staff attrition rate. It is also difficult to see why potential investors would be interested in investing in a business that has no real capital other than its staff and clients, which are largely transient in nature. Unlike many other corporations, law firms are not particularly capital-intensive businesses, they don't have machinery or other property. Slater & Gordon specifically identified this issue, as well as the

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102. See Legal Profession Amendment (Incorporated Legal Practices) Act, 2000 (Austl.), available at <http://portsea.austlii.edu.au/cgi-pit/amendment.py?frag=/home/www/pit/xml/nsw/act/438eab19b793a194.xml&date=20021113> (last visited Mar. 5, 2009).

103. Jon Robins, *Listing the Pros*, THE LAW GAZETTE, Sept. 7, 2006 available at <http://www.lawgazette.co.uk/features/lbtglisting-prostlbot> (last visited Jan. 28, 2009) (internal quote omitted).

potential attrition of clients, in their prospectus. Rather than seeking to raise their capital directly from the market, they targeted their IPO at institutional investors and staff.

In doing so, the firm had to consider the value that was attached to goodwill. Rather than considering the question as a ‘favorable recognition’ test, the firm recast it as a simple ‘recognition’ test. Predominantly a personal injuries and class action litigation firm, Slater & Gordon has built a strong profile reflected in a study conducted by the firm in 2004: 60% of the public nationally, and 83% in Melbourne, recognised their brand.<sup>104</sup> The issue will be more complex for most other firms, which do not enjoy the same level of awareness in the broader community, however not insurmountable. As Steven Tudge, managing director of a private equity house in London has observed, there are a wide range of factors that could be considered in valuing a law firm such as:

The scale of the business, the quality of the management team, the current gross and net margins, the extent of contractual underpinnings to revenues, the spread of contracts, the visibility of the earnings growth from the existing income sources and the pipeline of new opportunities, the quality of operational systems and the asset base—fixed assets, WIP and so on.<sup>105</sup>

## B. THE BENEFITS

### 1. LIMITED LIABILITY

Once a company is registered with ASIC, one or more shares constitute the capital in the company and each shareholder’s liability is limited to the shareholder’s investment. This is of considerable benefit to partners whose previous liability was personal and unlimited.

### 2. ASSET PROTECTION

Prior to registration with ASIC, a company constitution must be drafted. Dependent on the types of shares that constitute the company, as well as the combination of rights of ownership, control and distribution of profits, the constitution can ensure that the personal assets of investors are protected; creditors may only access the business assets of the firm rather than the personal assets of shareholders.

Conversely, in a traditional partnership structure a creditor that obtains judgment against the partnership can enforce the judgment against the partners personally.

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104. Slater & Gordon Prospectus, *supra* note 88, at 10.

105. M. Byrne, *The Clementi Review has Opened the Way for Law Firms to Float, but What are the Dangers?*, THE LAWYER.COM, May 16, 2005 available at <http://www.thelawyer.com/cgi-bin/item.cgi?id=115510&d=122&h=24&f=46>.

### 3. SHARE OWNERSHIP

The flexibility associated with share ownership is a powerful incentive for firms to incorporate. As noted earlier it opens up ownership—and consequently income distribution (income splitting)—to non-legal professionals, including other employees, family members, other companies or trusts, and can allow them to sit on the board of directors, broadening the talent pool that a company can draw to inform its corporate governance. Staff ownership of shares has a direct effect in terms of productivity and morale.

The transferability of shares is an important aspect of their attraction to traditional partnerships. The prospect of trading shares, of enlarging a holding over time, the potential to maintain a holding in retirement and to transfer by bequest are all considerations given favourable reflection by firms considering listing. A structure of share ownership affords the ILP the potential to undertake either an ‘off market’ or ‘on market’ buyback, depending on the nature of the company, reducing capital in the company and gaining greater control as a result. ‘Rainmakers’ or others who bring work or add value to the firm can be accommodated through an ILP even though they may not be able to show specific amounts created by their activities.

### 4. CAPITAL-RAISING

Partnerships simply do not have the same capacity for capital raising as an incorporated firm: tapping into the personal resources of partners soon loses what appeal it may ever have had. ILPs may grant security over its assets or issue unsecured debentures, bills of exchange and other debt securities. They may undertake a float to raise equity capital, or retain profits rather than distributing dividends to shareholders.

### 5. TAXATION

Depending on the jurisdiction’s taxation regime, it is possible that an incorporated firm will benefit from a transition from a personal taxation scheme attendant to partnership to a company tax scheme. Certainly in Australia, where the respective rates are 47% (at the upper bracket and applicable to most partners) and 30% respectively, ILPs have seen the benefits of such a move. In addition, should the company then distribute profits as after-tax or ‘franked’ dividends, the shareholder is entitled to an imputation credit for the tax paid when calculating their taxable income in their personal tax return.

### 6. RECRUITMENT AND RETENTION

A publicly listed firm can use its stock and stock options as a recruitment tool—an incentive to recruit young lawyers who would be able to share in the

equity without having to take the long road to partnership.

#### 7. BETTER MANAGEMENT

A publicly listed firm offers more efficient, flexible management structures that can be tailored to the needs of the firm and define roles with greater clarity. Practice areas can be organised vertically, improving accountability and control and affording solicitor directors, managing directors, and employees recognition and remuneration commensurate with their contribution to the success of the firm. The position of Chief Executive Officer in an ILP, by comparison to that in a partnership, enjoys a higher level of autonomy, answerable only to the board and not the individual legal practitioners who may be shareholders. An ILP also enjoys greater flexibility in the appointment and removal of legal practitioner directors. Finally, evidence suggests that the motivation and loyalty of staff in companies is more profound where incentive schemes are offered.

### VII. ETHICAL BEHAVIOR VS. PROFIT

The challenges set out above effectively fold into a broad issue—a false dichotomy between ethical behavior and profit. They are concerns that the OLSC has shared, but concerns which empirical analysis has largely assuaged. The OLSC’s regulatory oversight imposes a management methodology that encourages efficient and effective, high quality services delivered consistent with the professional responsibilities adhering to legal practice. Granted, such regulation is more complex than a simple prohibition. But the question of a blanket ban on these business structures is yesterday’s argument: the world has moved on, the business environment is more complex and requires complex responses from regulators.<sup>106</sup> The OLSC believes that the New South Wales experience shows that regulators can step up to the plate.

The OLSC has found that the oft-made distinction between ethics and profit is an illusory one. Many lawyers feel that 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 the OLSC provides in the form of “appropriate management systems” as based on the “ten

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106. Elizabeth Chambliss, *The Nirvana Fallacy in Law Firm Regulation Debates*, *FORDHAM URB. L. J.* 119 (2005); Christine Parker, *Law Firms Incorporated: How Incorporation Could and Should Make Firms More Ethically Responsible*, *U. QUEENSLAND L. J.* 347 (2004); Christine Parker, *Peering Over the Ethical Precipice: Incorporation, Listing and the Ethical Responsibilities of Law Firms*, Paper presented at Georgetown Law Center Symposium on the Future of the Global Law Firm, April 17-18, 2008, available at <http://www.law.georgetown.edu/LegalProfession/Papers.html> (last visited Mar. 5, 2009).

objectives”, 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.

### VIII. CONCLUSION

Far from being the means by which legal practitioners subvert the ethics of the profession, incorporation has provided lawyers with the incentive to more stringently formalise ethical behavior. ILPs have embraced the systemisation of compliance with practice standards introduced by the OLSC, and have reaped the rewards in terms of effective, efficient management that reduces the likelihood of client dissatisfaction. This is particularly so for the smaller law firms, rather than the larger firms who have effectively built up the necessary ethical structures to deal with the illusive profit versus ethics conundrum.

The OLSC’s scepticism about how the incorporation of legal practices would play out in New South Wales has been to date overborne by the benefits, which sound management principles can bring to legal practice. The OLSC always advises firms expressing an interest to either incorporate or publicly list to think about the consequences of changing their business structure and get sound accounting advice before doing so. Law can, and should, be regarded as both a profession and a business and in ILP’s 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. It does however raise a multitude of questions, such as, whether a director has a primary duty to the shareholders or the community. In fact, it seems 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.

We 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 behavior, 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.

The profit versus ethics conundrum may have been proved a myth but we must remain vigilant. The capacity to declare a firm compliant with OLSC standards can assist in quality assurance to clients, increasing the firm’s marketability.

Firms, shareholders and consumers, have complementary measures of a firm's success: revenue and the ethical standards that are implicit in the 'appropriate management systems' test. The result is a more ethical business environment in the legal services market, which may, if we behave wisely, permeate more widely through the web of business relationships with law firms and others in the corporate world. We hope that the stated primary ethical commitment to the client and the court, enshrined in Slater & Gordon's prospectus will have a positive effect on the practices of corporations and prompt ethical change

So far as national firms are concerned, the transition to an ILP structure has demanded harmonization of the legislation and regulations governing the activities of practices across the States. This issue of harmonization is one that now confronts regulators and professional standards associations internationally. Certainly, it affects domestic firms in jurisdictions that have not embraced these reforms in so far as they may be forbidden from competing with ILPs on comparable terms on their own turf. But if we can agree that the GATS has rendered absolute prohibitions on income-splitting virtually meaningless for transnational firms based in either Australia or the United Kingdom, jurisdictions which do not stipulate ethical standards accepting this new reality have an effective ethical vacuum. As with the move to harmonize laws within Australia, the greater the level of harmonization between national jurisdictions on these issues the more rigorous the monitoring of compliance can be.

The legal profession has always aspired to maintain the highest of ethical standards as a testament to the great privilege that attaches to a position as an Officer of the Court. With incorporation and public listing, the concomitant financial privilege of that position may be even further enhanced. Our experience in NSW has shown that the benefits of such a reform can outstrip the challenges. The challenges are manageable so long as appropriate standards are systematically applied and monitored. To date the system devised in New South Wales has proved adequate to the task.

In a collegiate profession such as ours, it is vital that we recognise the shifting pressures and opportunities that our colleagues are subject to. We can, supportively, assist legal practitioners to understand and confront the challenges inherent to incorporation and public listing, to expect and attain even higher ethical standards than currently prevail, and to comprehend those standards as measurable indicia of our commitment to our clients and the Court.