Before and after

The introduction of alternative business structures and outcomes-focused regulation has actually all happened before – nearly a decade ago, in New South Wales. **Steve Mark**, Legal Services Commissioner, looks at the aftermath

In July 2001, New South Wales (NSW) became the first jurisdiction in Australia (and the rest of the common law world) to permit law firms to incorporate, share receipts and provide legal services alongside other legal service providers who may or may not be legal practitioners.

Not unexpectedly, there has been extensive debate as to the ethical and professional implications of allowing law firms to become alternative business structures (ABSs). One of the main concerns was whether and how the legal profession would be able to maintain its ethical responsibilities and professional duties in the face of commercial pressures. Incorporation, particularly public listing, raises a myriad ethical and professional challenges. These challenges include, for example, how to balance the competing professional obligations of a legal practitioner against the duties to a company's shareholders, and how to deal with the duty of confidentiality owed by a legal practitioner to his or her client, when compared with the continuous disclosure requirements established under a jurisdiction's corporations law.

The regime adopted in NSW addressed these concerns by ensuring that legal practices wishing to become ABSs preserve the ethics and the integrity of the legal profession.

THE LEGISLATIVE FRAMEWORK

The principal legislation governing the legal profession in NSW is in the Legal Profession Act 2004 (NSW) (LPA 2004 (NSW)) and the Legal Profession Regulations 2005. The legislation permits legal service providers to register as a company with the Australian Securities and Investments Commission, the agency responsible for ensuring compliance with corporations law.

The regime is overseen by the Office of the Legal Services Commission (OLSC), which receives complaints about solicitors and barristers in NSW, as part of a co-regulatory system with the Law Society of NSW (professional body for solicitors) and NSW Bar Association (professional body for barristers).

The LPA 2004 (NSW) imposes a number of requirements on legal service providers on incorporation.

First, an incorporated legal practice (ILP) must appoint a "legal practitioner director". He or she is generally responsible for the management of the legal services provided by the ILP and ensuring that the practice (and its legal practitioners) meet their ethical and practice requirements under the legislation and the rules. The institution of this role is historically significant. Since 1990, NSW required legal practices to retain at least 51% of the net income of a partnership. The concept of the 51% rule is carried into the LPA 2004 (NSW) by the requirement that a legal practitioner director must be appointed in every ILP, irrespective of its size.

Second, the legislation requires, *inter alia*, that a legal practitioner director of an ILP implements and maintains "appropriate management systems" to enable the provision of legal services in accordance with the professional obligations of legal practitioners. To fulfil this duty, an ILP must demonstrate that it has implemented a management system addressing 10 specific objectives. These objectives include competent work practices to avoid negligence and achieve effective communication; acceptable processes for liens; timely identificaticn and resolution of conflicts of interest; and effective staff supervision. The legal practitioner director is responsible and accountable for insuring the implementation of an appropriate management system.

In order to enable legal practitioner directors to assess the appropriateness of their management systems, the OLSC has developed a standard self-assessment document. This takes into account the varying size, work practices, and nature of operations of different ILPs. This means that, it is not a 'one size fits all' approach, unlike most compliance-based regimes. The legal practitioner director rates the ILP's compliance with each objective as either "fully compliant", "compliant", "partially compliant", or "non-compliant", and then sends the completed form to the OLSC for review.

Third, the legislation imposes a range of reporting responsibilities on legal practitioner directors. A legal practitioner director has a responsibility to report any conduct of another director of the practice (whether or not a legal practitioner) that has resulted in, or is likely to result in, a contravention of that person's professional obligations or other obligations imposed by or under the LPA 2004 (NSW). In addition, the legal practitioner director must report any professional misconduct of a solicitor employed by the practice. A legal practitioner director must also disclose both all the services to be provided by the ILP, whether or not they will be provided by a legal practitioner, and those legal services that will not be provided by a legal practitioner. This means that the OLSC will know which services each ILP will be providing and the status or qualifications of the person(s) providing them.

ALTERNATIVE BUSINESS STRUCTURES

Since the enactment of this legislation, ABSs have been increasingly embraced in NSW. There are now more than 1,000 ILPs in NSW, making up about 20% of the profession. The majority of these practices are either sole practitioners or firms with

three to 10 partners. Several large national firms have also incorporated.

Incorporation in NSW has taken a number of different forms. These have included multi-disciplinary practices (MDPs), which provide a 'one-stop shop' for clients of property and financial services, as well as at least one firm that has franchised its practice. These MDPs include, for example, law firms providing legal services together with real estate agents, financial advisors or mediators. Although the MDP structure offers a potential increase in the range of choices available to consumers by combining existing professional services and by effectively creating new ones, client demand for MDPs in NSW remains relatively low; there are only about 30 MDPs in NSW.

In addition to allowing law firms to become an ILP or MDP, the legislation also provides an opportunity for firms to list on the stock market. In May 2007, Slater & Gordon made legal and corporate history when it became the first law firm in the world to list its entire firm on the Australian Securities Exchange (ASX). One other law firm in NSW, Integrated Legal Holdings, has since listed on the ASX, and a number of other firms have expressed an interest in doing so.

The public listing of law firms has not been without controversy, and has raised a number of challenges for their regulation in NSW, which the OLSC was keen to address. For example, public ownership in a law firm could cause tension between a solicitor-director's professional obligations and his or her duties to a company's shareholders. Public listing could also result in a conflict in legal profession regulation and corporations law. These concerns were, however, addressed by the legislation and the OLSC's approach in regulating firms which publicly list.

The OLSC has encouraged law firms which want to list on the ASX to preserve the ethics of legal practice by explicitly stating in their prospectuses, constituent documents and shareholder agreements that the primary duty of the legal practice is to the court, the secondary duty to the client and the tertiary duty to the shareholder. Both Slater & Gordon and Integrated Legal Holdings have stated so in their documentation. This articulated hierarchy of duties ensures that the listed legal practice – as well as the client and shareholders – clearly understand where the legal practices ethical and professional obligations lie.

A POSITIVE EXPERIENCE

Far from being the means by which legal practitioners subvert the ethics of the profession, as was commonly thought, ABSs in NSW have provided lawyers with a viable option for restructure. There are a number of reasons as to why incorporation has become so popular. Firstly, ILPs offer limited liability for their partners, as those partners become shareholders, whose liability is limited to that of their investment in the practice. Secondly, there are a number of financial benefits in a corporate structure, including tax advantages, and favourable superannuation and redundancy arrangements. Thirdly, the ILP structure provides better management options for firms.

The OLSC has found that, by and large, new ABSs have embraced the systemisation of compliance, and as a result, have reaped the rewards in terms of effective and efficient management. We know this because the OLSC has seen a fall in the number of complaints against these firms; an empirical study of ILPs in NSW in 2008 showed their complaint rates had dropped by two-thirds after having gone through the self-assessment process.

We also know that the system is a success because the OLSC and its representatives regularly hear that it is from the profession itself, including during self-assessment and practice reviews. Practitioners have told us that, through the self-assessment process, their practices are now better managed and less stressful to run, and generate more profit.

The OLSC has found that, whilst practices may initially have been nervous about the self-assessment or practice review process, they understood its function and purpose and were ultimately very accommodating. This is largely because the OLSC takes a positive, non-adversarial approach to the practice review and, at all times, emphasises that it is assisting and working with ILPs (notwithstanding the understanding that a review can lead to disciplinary consequences). The OLSC approach is centered on transparency. This means that, before a review takes place, we will send an ILP a copy of the OLSC practice review workbook, which contains the questions that they will be asked during the review. This gives the firm time to prepare answers and obtain copies of any documents that might be requested during the course of the review. We have not come across any firm that has been particularly averse to this approach as yet.

We believe that the success of our model is also due to the change from a traditional regulatory framework of prescriptive regulation to an outcomes-based model for ILPs. One of the greatest advantages of outcomes-based regulation is that it can provide a basis for open dialogue between the regulator and regulated, facilitating a cooperative and educative approach to supervision. Enhanced cooperation is particularly important for those practitioners and firms who are well intentioned, but either ill informed or simply confused as to what the regulatory provisions require. Similarly, outcomes-based regulation also allows the consumer to have a voice through the regulator. This is a particularly important benefit, because of the OLSC's stated function – to reduce complaints against lawyers within a context of consumer protection.

If there is one lesson to be learnt from the NSW experience, it is that the challenges of ABSs are indeed manageable, as long as appropriate standards to preserve the integrity of the legal profession and professionalism within the context of client protection and support for the rule of law are devised and applied in conjunction with the profession. ■

New ABSs have embraced the systemisation of compliance, and as a result, have reaped the rewards in terms of effective and efficient management

Steve Mark is Legal Services Commissioner for New South Wales.