CREATIVE CONSEQUENCES P/L

LAW, BUSINESS AND REGULATION ADVISORY

THE REGULATORY FRAMEWORK IN AUSTRALIA

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Introduction

Australia is a federation of eight States and Territories. While there has been a move in recent years towards national consistency in lawyer regulation, each State and Territory remains independently responsible for the lawyers in its jurisdiction, similar to the United States and Canada.[1]

In N.S.W. regulation of the legal profession is shared between the Office of the Legal Services Commissioner (OLSC)[2], the Law Society of New South Wales,[3] (the professional body for solicitors) and the New South Wales Bar Association[4] (the professional body for barristers). The OLSC receives all complaints about solicitors and barristers in NSW in the first instance. If a complaint raises a question of misconduct on the part of the practitioner, the complaint will be investigated. The OLSC may investigate the complaint or refer the complaint to the Law Society of NSW or the NSW Bar Association for investigation. The OLSC can review decisions by the Law Society or the Bar Association. In our co-regulatory structure, the OLSC acts as independent statutory body and its decisions can only be challenged through the normal process of administrative law. This co-regulatory system has been in place since 1994.[5]

The primary purpose of the OLSC as a co-regulator of the legal profession is to reduce complaints against lawyers within a context of client protection, increased professionalism of lawyers and support for the rule of law.[6] This has been the OLSC's stated purpose since it was first established in 1994. The way in which the OLSC has proceeded to achieve this purpose has been through the employment of an effective and proactive regulatory regime that seeks to encourage lawyers to adopt more ethical work practices. At the heart of this approach lies the notion of 'regulating for professionalism.'[7] So, when the OLSC receives a

[1] For a comprehensive discussion of lawyer regulation in Australia see Office of the Legal Services Commissioner, Regulation of the Legal Profession in Australia, http://www.olsc.nsw.gov.au/olsc/olsc_education/lsc_lawregulate.html?s=1001
[2] See Office of the Legal Services Commissioner, http://www.olsc.nsw.gov.au/olsc/lsc_index.html
[3] See the Law Society of New South Wales, http://www.lawsociety.com.au/
[4] See the New South Wales Bar Association, http://www.nswbar.asn.au/
[5] See Office of the Legal Services Commissioner, Complaint process, http://www.olsc.nsw.gov.au/olsc/lsc_complaint/lsc_complaintprocess.html
[6] Office of the Legal Services Commissioner, *About Us*, http://www.olsc.nsw.gov.au/olsc/lsc_aboutus.html
[7] Steve Mark, Tahlia Gordon, Marlene Le Brun, and Gary Tamsitt, Preserving the Ethics and Integrity of the Legal Profession in an Evolving Market: A Comparative Regulatory Response (2010).

complaint against a lawyer, the regulator's first response, where possible and appropriate, is not to prosecute the lawyer but to work with him/her in trying to determine the underlying basis of the complaint. The OLSC's role as a regulator, in addition to its disciplinary powers, is therefore to work with the profession rather than against them in entrenching an ethical culture and promoting professionalism, while reducing complaints.

Alternative Business Structures

Historically, legal practitioners in Australia, like in many other common law jurisdictions, could traditionally form partnerships with other legal practitioners, but they were not permitted to practise in any other kind of business arrangement.[8] Partnerships were regarded as the only appropriate business structure to preserve the independence of the legal profession. Partnerships were seen to provide optimal protection to clients: because a solicitor partnership has unlimited liability, unlike a company established under the *Corporations Act (2001) (Cth)* and because partners are jointly and severally liable for the actions of the partnership. The structural limitation was also justified because it was feared that if non-lawyers were entitled to fees from legal work, they could influence the way in which lawyers conducted their work. Barristers were similarly only permitted to practise as sole practitioners. The sole practice rule for barristers was justified on the basis that it ensured independence and, moreover, promoted the primary duty of a barrister to the court and, thereafter, the client. The structural limitations remained the dominant paradigm until the early 1970s when regulators were forced to re-evaluate the purpose and functions of the limitations against a sea of desire for change. Over the ensuing years amendments were made to the legislative framework tweaking the rules concerning law firm structures, but it was not until 2001 when that legislation fundamentally changed.

On 1 July 2001 legislation was enacted in NSW, Australia permitting legal practices, including multidisciplinary practices (MDPs) to incorporate, share receipts and provide legal services either alone or alongside other legal service providers who may, or may not be legal

[8] For a good overview of the traditional structure of the legal profession in Australia, see J .Disney, P. Redmond, J. Basten & S. Ross, LAWYERS 27 (1986). See also New South Wales Law Reform Commission, The Structure of the Legal Profession, THE LEGAL PROFESSION BACKGROUND PAPER IV 19 (1981); Attorney General"s Department, The Structure and Regulation of the Legal Profession, Issues Paper, Nov. 1992, at 10.

practitioners.[9] Since the enactment of such legislation more than 3,000 law firms in Australia have altered their practice structures through incorporation (representing 30% of the law firms). The majority of these law firms, known as "incorporated legal practices" (ILPs), are based in New South Wales.

The rationale for introducing new forms of legal structures in 2001 was multi-fold. Reasons included removing the regulatory barriers between states and territories to facilitate a seamless, truly national legal services market and regulatory framework; providing greater flexibility in choice of business structures for law practices; enhancing choice and protection for consumers of legal services; and enabling greater participation in the international legal services market.[10] There was also a growing perception in Australia that the traditional structure of law firms no longer met the needs of many practitioners and clients.[11]

As a result of the legislation, numerous law firms have incorporated to gain access to external investment and several law firms in Australia have listed on the Australian Securities Exchange (ASX). The first law firm to seek public listing was Slater & Gordon.[12] Slater & Gordon's decision to publicly list in 2007 saw them move from being a traditional partnership to becoming a publicly listed law firm. Following Slater & Gordon's listing, Integrated Legal Holdings (IHL), a Western Australian based law firm, listed on the ASX on 17 August 2008[13] and in May 2013, Shine Lawyers, a law firm originally based in Queensland, became the third law firm to publicly list in Australia[14].

Slater & Gordon's listing created, to put it mildly, a whirlwind of interest and concern. Questions were raised about the ability of an externally owned law firm to maintain its

[9] 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).

[10] S, Mark and T. Gordon, Innovations in Regulation - Responding to a Changing Legal Services, 22 Geo. J. Legal Ethics 501 (2009)

[11] Law Council of Australia, (2001) '2010: A Discussion Paper: Challenges for the Legal Profession', available at http://www.lawcouncil.asn.au/shadomx/apps/fms/fmsdownload.cfm?file_uuid=0BE36A97-1C23-CACD-2225-CBD6713A3E09&siteName=lca

[12] Australian Stock Exchange, Slater & Gordon Limited (SGH), http://www.asx.com.au/asx/research/companyInfo.do?by=asxCode&asxCode=SGH#headlines

[13] Australian Stock Exchange, ILH Group Limited (IAW), http://www.asx.com.au/asx/research/companyInfo.do?by=asxCode&asxCode=IAW

[14] Australian Stock Exchange, Shine Corporated Ltd (SHJ), http://www.asx.com.au/asx/research/companyInfo.do?by=asxCode&asxCode=SHJ

independence and its primary duty to the Court and many alleged that external ownership would lead to a lowering of professional standards; and diminish the ethical standing of all legal practitioners as members of an honourable profession.[15] In addition to the above concerns, many asked why a law firm would want to publicly list. It seemed inconceivable at the time that a law firm might want to acquire this form of external capital to assist in growing their business. Many refused to acknowledge that a law firm, like a corporation, may wish to expand their business by using external investment, rather than using the bank.

The Introduction of Entity-Based Regulation as Part of the Regulatory Framework for ABSs

The 2001 legislation in NSW introduced a number of unique regulatory features for the legal profession.

Firstly, the legislation required that on incorporation a legal practice must appoint at least one "legal practitioner director".[16] The legislation required that a legal practitioner director must be an Australian legal practitioner who holds and unrestricted practising certificate. This was the first time law firms in NSW were required to appoint such a person. The rationale for this requirement is to ensure that a legal practitioner maintains a direct interest and accountability in the management of legal services of the practice.[17] The requirement that the legal practitioner director must be an Australian legal practitioner is by and large grounded on the same premise as the 51% rule. That is that the overall management and control of a law firm should be based on maintaining the high ethical standards of the legal profession. This means that the practice is able to retain their professional structure as a law firm.

Secondly, the legislation mandated that all law firms who incorporate must establish and maintain a management framework, legislatively coined "appropriate management systems", to enable the provision of legal services in accordance with the professional and other

[15] The topic has been so hotly debated that a Google search of "non-lawyer ownership law firms" comes thousands of results. See for example, Bruce MacEwen, Milton Regan, Larry Ribstein, 'Law Firms, Ethics and Equity Capital: A Conversation (2007) 21 Georgetown Journal of Legal Ethics 61; Milton Regan Jr, 'Commentary: Nonlawyer Ownership of Law Firms Might Not Cause the Sky to Fall' (2007) The American Lawyer; Paul Grout, 'The Clementi Report: Potential Risks of External Ownership and Regulatory Responses (July 2005) available at http://www.dca.gov.uk/legalsys/grout.pdf ; S.Mark & T.Gordon, "Innovations in Regulation Responding to a Changing Legal Services Market" 22 Geo. J. Legal Ethics 501 (2009).
[16] Section 140(1) Legal Profession Act 2004 (NSW).
[17] S, Mark and T. Gordon, Innovations in Regulation - Responding to a Changing Legal Services, 22 Geo. J. Legal Ethics 501 (2009), 506.

obligations of lawyers.[18] The responsibility for establishing and implementing "appropriate management systems" rests with the legal-practitioner director. The legislation provided that failure to establish and maintain "appropriate management systems" is capable of being professional misconduct.[19]

The introduction of legislation requiring "appropriate management systems" was unique not only to legal profession regulation but to regulation generally. It was not based on any pre-existing model and the regulators were not given any guidance from the legislators as to what "appropriate management systems" or a management based system for law firm should comprise.

Consequently the regulator in NSW was forced to think about the concept of "appropriate management systems" and what an appropriate management system for a law firm should comprise. After an extensive period of consultation with the profession and key stakeholders the regulators created the content for "appropriate management systems" for law firms. They did so by considering the types of complaints that were made against lawyers and what elements would comprise of sound legal practice. The regulator came up with ten such elements:

1. **Negligence** (providing for competent work practices).
2. **Communication** (providing for effective, timely and courteous communication).
3. **Delay** (providing for timely review, delivery and follow up of legal services).
4. **Liens/file transfers** (providing for timely resolution of document/file transfers).
5. **Cost disclosure/billing practices/termination of retainer** (providing for shared understanding and appropriate documentation on commencement and termination of retainer along with appropriate billing practices during the retainer).
6. **Conflict of interests** (providing for timely identification and resolution of "conflict of interests", including when acting for both parties 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** (minimising the likelihood of loss or destruction of correspondence and documents through appropriate document retention, filing, archiving etc and providing for compliance with requirements regarding registers of files, safe custody, financial interests).
8. **Undertakings** (providing for undertakings to be given, monitoring of compliance and timely compliance with notices, orders, rulings, directions or other requirements of regulatory authorities such as the OLSC, courts, costs assessors).
9. **Supervision of practice and staff** (providing for compliance with statutory obligations covering licence and practising certificate conditions, employment of persons and providing

[18] Section 140(3) of the Legal Profession Act 2004 (NSW).
[19] Section 140(5) of the Legal Profession Act 2004 (NSW).

for proper quality assurance of work outputs and performance of legal, paralegal and non-legal staff involved in the delivery of legal services).

10. **Trust account requirements** (providing for compliance with Part 3.1 Division 2 of the *Legal Profession Act 2004 (NSW)* and proper accounting procedures).[20]

The regulator then developed a process by which law firms could assess themselves against the ten objectives. The process was based on a self-assessment. That is, the legal practitioner director of the law firm assesses the appropriateness of their management systems using a self-assessment document (developed by the regulator) that is forwarded after completion by the legal practitioner director to the regulator for review.[21] The self-assessment document takes into account the varying size, work practices, and nature of operations of different firms. Legal practitioner directors rate firm compliance with each of the ten objectives as either 'Fully Compliant,' 'Compliant,'' 'Partially Compliant,' or 'Non-Compliant.'[22] In addition to developing the framework for appropriate management systems, the regulator in NSW also developed processes and procedures to assist incorporated legal practices through the self-assessment process, and to improve their management systems. This is discussed in greater detail in the next section.

Proactive Management-based Regulation (PMBR)

The purpose of the appropriate management systems framework is to ensure that the legal practice considers and implements measures that support and encourage ethical and client-focused behaviour. One of the most important features of this framework, aside from the fact that it promotes ethics and professionalism is that the framework applies to not just lawyers (directly) within an incorporated legal practice but to all staff, including non–lawyers (indirectly). The management systems incorporated legal practices are required to maintain act, in effect, as a quasi-educative mechanism teaching practitioners best practice to achieve compliance with the requirements of the legislation and promote cultural change.

[20] Office of the Legal Services Commissioner, *Appropriate Management Systems to Achieve Compliance*, http://www.olsc.nsw.gov.au/olsc/lsc_incorp/olsc_appropriate_management_systems.html
[21] Office of the Legal Services Commissioner, Self-Assessment Process, http://www.olsc.nsw.gov.au/olsc/lsc_incorp/olsc_self_assessment_process.html
[22] Ibid.

According to Professor Ted Schneyer, is the Milton O. Riepe Professor of Law Emeritus at the University of Arizona's James E. Rogers College of Law, the framework implemented in NSW is a prototype for "proactive, management based regulation"[23]. That is because the framework in NSW has given content to the term "ethical infrastructure" by "identifying ten types of recurring problems that infrastructure should be designed to prevent and mitigate." The term "proactive based management regulation" (PMBR), coined by Ted Schneyer, is characterised by the appointment of one or more lawyer–managers by the firm to take enhanced responsibility for their firm's "ethical infrastructure". The term "ethical infrastructure", again coined by Ted Schneyer refers to formal and informal management policies, procedures and controls, work team cultures, and habits of interaction and practice that support and encourage ethical behaviour.[24] PMBR is also characterised by collaboration between firms and regulators. As implemented in New South Wales, PMBR allows regulators to work proactively with firms in order to reduce the chance of future violations.
PMBR is a radical departure from the traditional regulatory approach in which certain behaviours or conduct standards are defined and lawyers are disciplined if the behaviours and standards are not met. Rather than the regulator reacting ***after*** a complaint against a lawyer, the PMBR is designed to help firm leaders detect and avoid problems by focusing on management systems and processes designed to entrench ethical behaviours. This can occur because PMBR allows firms to develop their own process and management system standards and develop internal planning and management practices designed to achieve regulatory goals. In New South Wales, the regulator provided resources to firms to assist them in their efforts to develop the internal planning and management practices referred to above. Thus, the "appropriate management systems" requirement, as implemented in New South Wales, means that *both* the firm *and* the regulator take steps proactively to reduce future problems.

Principle-Based Regulation

The regulatory goals in PMBR set by the regulator are based on principles. The goals are typically drafted at a broad level of generality, with the intention that there should be

[23] T. Schneyer, On Further Reflection: How "Professional Self-Regulation" Should Promote Compliance with Broad Ethical Duties of Law Firm Management, 53 ARIZONA L. REV. 576; T.Schneyer, Proactive Management based-regulation and the case for fresh thinking about how to improve "professional Self-Regulation" for American Lawyers, 2013 Conference on Legal Ethics, Hofstra Law School, April 5, 2013. .
[24] On Further Reflection: How "Professional Self-Regulation" Should Promote Compliance with Broad Ethical Duties of Law Firm Management, 53 ARIZONA L. REV. 576, 585 (2011)

overarching requirements that can be applied flexibly. The goals as principles contain terms that are qualitative and not quantitative and are purposive, expressing the reason behind the rules. The goals represent in effect behavioural standards.

The benefits of PMBR are many. According to theorists like Cary Coglianese and David Lazer, management-based regulation is far more effective than traditional regulatory approaches.[25] This is because in a management-based regulatory framework, the role of regulation ceases to be primarily about inspectors or auditors checking compliance with rules, and becomes more about encouraging entities to put in place processes and management systems which promote ethical behaviour and are then scrutinized by regulators or corporate auditors to determine the results. In a management-based regulatory framework the responsibility of establishing and implementing systems rests with the entity. Cogilanese and Lazar argue when entities have the power to make their own decisions "managers and employers are more likely to view their own organization's rules as reasonable and as a result there may be greater compliance than with government [externally] imposed Rules in achieving regulatory objectives." [26]

Furthermore, the use of principles in defining regulatory objectives or goals offers flexibility for both the regulated and the regulator in determining how to interpret and comply with the principles. The use of principles to articulate regulatory goals can also result in the minimisation of regulatory burden by removing "red tape", i.e., unnecessary and administratively burdensome proscriptive requirements which have little ultimate utility in defining the standards of services delivered to clients.[27] Principles can also influence both the culture within the regulator and within firms, by defining how each should behave (e.g., with integrity, with due skill and care, proportionately, in the best interests of clients) and the expected outcomes of such behaviour.

Empirical Research Confirmed the Positive Impact of these Changes – NSW Had a 2/3 Reduction in Client Complaints

[25] C. Coglianese and D. Lazer, 'Management Based Regulation: Prescribing Private Management to Achieve Public Goals' (2003) 37(4) Law and Society Review 69.
[26] Ibid.
[27] See J. Black, Forms and Paradoxes of Principles Based Regulation (September 23, 2008). LSE Legal Studies Working Paper No. 13/2008. Available at SSRN: http://ssrn.com/abstract=1267722

The benefits outlined above have had a dramatic effect in New South Wales. In 2008, a research study by Dr. Christine Parker of the University of Melbourne Law School in conjunction with the NSW regulator assessed the impact of ethical infrastructure and the self-assessment process in NSW to assess whether the process is effective and whether the process is leading to "better conduct" by firms required to self-assess.[28] The research focused on the number of complaints relating to incorporated legal practices after incorporation and comparing this with prior to incorporation. The research found that complaints rates for incorporated legal practices were two-thirds lower than non-incorporated legal practices after the incorporated legal practice completed their initial self-assessment. The research also revealed that the complaints rate for incorporated legal practices that self-assessed was one-third of the number of complaints registered against similar non-incorporated legal practices.

Moreover, in another recent research study conducted on incorporated legal practices in NSW, by Professor Susan Saab Fortney of Hofstra University, New York, in conjunction with the NSW regulator, revealed that a majority of law firms (71%) who completed the self-assessment process had revised their firm systems, policies, and procedures and 47% had actually adopted new systems, policies, and procedures.[29] Forty-two percent (42%) of firms indicated that they "strengthened firm management" following the completion of the first self-assessment.

Going Forward: The New Regulatory Framework for NSW

On 27 March 2014 legislation was introduced in the NSW Parliament setting out a new regulatory framework for NSW. The *Uniform Legal Profession Application Bill 2014* (NSW), as it is formerly known will repeal the *Legal Profession Act 2004* (NSW) and replace it with a new "template legislation", to be known as the Legal Profession Uniform Law (the Uniform Law)[30]. The Uniform Law is intended to apply in the two largest States in Australia, NSW and Victoria at this stage and eventually have application in the remainder of the States

[28] C.E. Parker, T. Gordon, S. Mark, 2010, Regulating law firms ethics management: an empirical assessment of an innovation in regulation of the legal profession in New South Wales, Journal of Law and Society [P], vol 37, issue 3, Blackwell Publishing, UK, pp. 466-500.
[29] Susan Fortney & Tahlia Gordon, Adopting Law Firm Management Systems to Survive and Thrive: A Study of the Australian Approach to Management-Based Regulation, 10 ST. THOMAS L. J. 152 (2012).
[30] *Uniform Legal Profession Application Bill 2014* (NSW), Legal Profession Uniform Law, http://www.parliament.nsw.gov.au/prod/parlment/NSWBills.nsf/1d436d3c74a9e047ca256e690001d75b/07eb41c6b04dca11ca257ca600183bba?OpenDocument

and Territories of the Commonwealth. These two states represent approximately 80% of Australia's practicing lawyers.

The Uniform Law takes a refreshingly new different approach to regulation. Firstly, the Uniform Law is, by and large, principles-based. The Bill is about 300 pages smaller than the existing legislation and most of the provisions are stated as principles rather than prescriptive rules. Secondly, the Uniform Law includes many regulatory objectives.[31] The regulatory objectives are not only found at the commencement of the Bill but are also included throughout. This is the first time legislation has been enacted in Australia that uses principles and includes regulatory objectives. Thirdly, the framework for regulating incorporated legal practices has now been extended to all law firms in NSW, irrespective of their practice type.

Under the Uniform Law, all legal practices are now required to appoint an authorised "principal". A principal of a law practice is an Australian legal practitioner who:

> "(a) in the case of a sole practitioner—is the sole practitioner; or
> (b) in the case of a law firm—is a partner in the firm; or
> (c) in the case of a community legal service—is a supervising legal practitioner of the service; or
> (d) in the case of an incorporated legal practice or an unincorporated legal practice—
>
> (i) holds an Australian practising certificate authorising the holder to engage in legal practice as a principal of a law practice; and
> (ii) is—
>
> (A) if the law practice is a company within the meaning of the Corporations Act—a validly appointed director of the company;
> or
> (B) if the law practice is a partnership—a partner in the partnership;
> or
> (C) if the law practice is neither—in a relationship with the law practice that is of a kind approved by the Council under section 40 or specified in the Uniform Rules for the purposes of this definition."[32]

The responsibilities of principals are not dissimilar to the existing responsibilities of legal practitioner directors. Under the Uniform Law each principal of a law practice is responsible for ensuring that reasonable steps are taken to ensure that all of the lawyers in the law firm comply with their obligations under the Uniform Law and the Uniform

[31] On the impact of the use of regulatory objectives in legal profession regulation see Laurel S Terry, Steve Mark & Tahlia Gordon, Adopting Regulatory Objectives for the Legal Profession May 2012, Fordham Law Review, Fordham University School of Law, Vol 80, No 6, p.2685-2760.
[32] Section 6, *Legal Profession Uniform Law*.

Rules and their other professional obligations; and that the legal services provided by the law practice are provided in accordance with the Uniform Law, the Uniform Rules and other professional obligations.[33] The Uniform Law provides that a failure to uphold that responsibility is capable of constituting unsatisfactory professional conduct or professional misconduct.[34]

The Uniform Law has adopted a slightly different approach to appropriate management systems. The legislation does not require law firms to implement and maintain appropriate management systems, rather appropriate management systems are only required if a law firm receives a "management systems direction" to implement appropriate directions. A Management System Direction is defined in section 257(2) as a "direction to a law practice or class of law practices—

(a) to ensure that appropriate management systems are implemented and maintained to enable the provision of legal services by the law practice, or by a law practice of that class, in accordance with this Law, the Uniform Rules and other professional obligations; and
(b) to provide periodic reports to the designated local regulatory authority on the systems and on compliance with the systems."

Section 257(3) of the Uniform Law provides that a law practice must comply with a management system direction given to it.

Under the new regime, a "management systems direction" can be given to a law firm or a class of law firms if the regulator considers it reasonable to do so after the conduct of any examination, investigation or audit.[35]

The regulator has the option of establishing the ten objectives of appropriate management systems as being the standards that should be addressed when making a management systems direction with the result that the new regime continue to be proactive but with more "bite" in directing firms where necessary to adopt a particular management system.

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[33] Section 34(1), *Legal Profession Uniform Law.*
[34] Section 34(2), *Legal Profession Uniform Law.*
[35] Section 257(1), *Legal Profession Uniform Law*.