The Law Society of British Columbia

# Alternative Business Structures in the Legal Profession: Preliminary Discussion and Recommendations

**For: The Benchers**
**Date: October 21, 2011**

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**Purpose of Report:** **Information, Discussion and Approval of Recommendations**

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# Alternative Business Structures in the Legal Profession: Preliminary Discussion and Recommendations

## I. Executive Summary

Alternative Business Structures or ABSs refer to any form of business model through which legal services are delivered that is different from the standard sole proprietorship or partnership model. They include models of outside ownership and delivery of legal services by third-party providers. Such models are already available to some extent in Australia. They have recently been permitted in England, subject to regulatory structures coming into place which are expected soon.

Proponents of ABSs argue that they will lay the foundation for the creation of business models that will increase access to legal services. They will be more consumer-oriented and market-driven to meet consumer needs. Opponents caution against the adverse effect they say ABSs will have on the core values of the legal profession, including lawyer independence, client confidentiality, and the duties owed by lawyers to a client – particularly the duty to avoid conflicts of interest.

The Independence and Self-Governance Committee, at the request of the Benchers, has examined the debate surrounding ABSs and in this Report outlines its views on

- the effect ABSs may have on the legal profession in British Columbia,
- whether ABSs will really benefit the delivery of and access to legal services, and
- whether ABSs will negatively affect self-regulation and the public right to independent lawyers.

The Committee concludes that, while it is skeptical that ABSs will improve access to and delivery of legal services, the possible benefits are valuable and that, in order to discharge its mandate, the Law Society would need to consider them. Ultimately, the *form* of the structure through which legal services are offered is less important than it is to ensure that the services that are offered are properly regulated. The Committee concludes that the alleged harm presented by ABSs could be addressed through appropriate regulations, and sets out what matters would need to be addressed through regulation should ABSs be permitted.

It is important, however, to be able to demonstrate that ABSs will improve access to and delivery of legal services in order that the users of such services will benefit. The Committee is concerned about the lack of empirical evidence given by proponents of ABSs, and believes that if the only demonstrable effect of ABSs was to enrich the legal profession or those who invested in it, the image of the profession and the Law Society would be tarnished. Consequently, some considerable caution needs to be exercised to

ensure that there is a public value in ABSs (such as improving access to legal services) and that valuable public protections that currently exist (such as client confidentiality, an absence of conflicts of interest, and the public right to an independent lawyer) are not lost.

With this in mind, the Committee has concluded that some outside ownership involvement in law firms could be considered, provided it is properly regulated and that lawyers remain in control of the provision of the legal services offered. On the other hand, the Committee is not convinced that the public sale, through securities markets for example, of shares in a law firm is warranted, as it is not convinced that there are benefits to users of legal services that outweigh identified risks.

Therefore, the Committee recommends that the Law Society give serious consideration to ABSs. However, before more work is done, the Committee recommends waiting to see if the case for improving access to legal services through ABSs can be more clearly demonstrated. The Law Society should await the outcome of the debate currently underway through the American Bar Association, should follow what happens in England and Wales once ABSs come into being, and should continue to monitor the situation in Australia. In many ways, England could provide some direct evidence about whether access to legal services can be improved through ABSs as well as giving an indication about whether they can be effectively regulated.

If there is an appetite to consider permitting properly regulated ABSs in British Columbia, the Committee recommends a wider consultation within the legal profession (including users of legal services) and the business community.

## II. Introduction and Purpose of Report

> *Business development strategies have to adapt to legal principles rather than the other way around.*
> *R v. Neil,* [2002] 2 S.C.R. 631 per Binnie J.

Through its history as a profession, law has been practised mostly by sole practitioners or through a partnership model. Indeed, even now, lawyers in private practice in British Columbia generally practise law this way. Statistics in British Columbia show 75% of all law firms in the Province are sole practitioners and another 19% of firms comprise two to five lawyers. It has only been relatively recently that large partnerships have become a more common model of business structure for lawyers, but even so, in British Columbia firms of more than 16 lawyers comprise just slightly over 1% of the total number of law firms, although 30% of the lawyers who provide legal services to the public practice in such firms. National firms are an even more recent model, but these are still based on the partnership model.

Lawyers in British Columbia are not, however, limited to providing legal services either by themselves or through the partnership model with other lawyers. Offering legal services through a "law corporation" has been available since the late 1980s, and recently

lawyers have been able to provide legal services through a "multi-disciplinary partnership" where other professionals can become partners with lawyers. In each instance, the Benchers engaged in a considerable amount of policy debate about the form of the business structure that would be allowed, and how it would be regulated to protect the public interest. In each case, decisions were made by which lawyers were required to remain in control of the entity, and the entity was either only able to provide legal services (law corporations) or provide services ancillary to the provision of legal services (multi-disciplinary partnerships).

"Alternative Business Structures" (commonly referred to as "ABS") is a term that has been used to denote the developments in other jurisdictions toward permitting the delivery of legal services through business entities that may quite starkly contrast with the current delivery model in British Columbia. ABSs contemplate the "outside ownership" (that is, ownership by people who are not lawyers) of businesses that offer legal services. Two of the most commonly discussed examples of ABSs are:

- Incorporated law practices in which shares are offered publicly and where the shares issued may trade on a public securities exchange;

- Third party providers of legal services, often dubbed "Tesco-law" after the name of a chain of supermarkets in England. Through this model, a non-lawyer business could hire lawyers to provide legal services to the public.

Proponents of ABSs argue that they will lay the foundation for the creation of business models that will increase access to legal services. They will be more consumer-oriented and market-driven to meet consumer needs. Opponents caution against the adverse effect they say ABSs will have on the core values of the legal profession, including lawyer independence, client confidentiality, and the duties owed by lawyers to a client – particularly the duty to avoid conflicts of interest. These issues will be dealt with more fully further on in this Report.

As part of its monitoring function, the Independence and Self-Governance Committee has been paying close attention to the development of and the debate surrounding ABSs, as it had identified concerns that ABSs could adversely affect lawyer independence or self-governance.

The Committee has noted:

- Australian jurisdictions permit "Incorporated Legal Practices" ("ILP") which may provide legal and other services and in which lawyers and other service providers may practice together. External investment in these ILPs is allowed, and the ILP may be listed on the Australian Stock Exchange;

- In England, ABSs are now permitted under the *Legal Services Act 2007* and it is expected such structures will begin to exist early in 2012 (after an initial start date of October 2011 was moved back);

- European Bars appear to have reservations about ABSs;

- In the United States, the American Bar Association's "Ethics 20/20" initiative has recently conducted a consultation on this subject, which was the subject of debate at the Association's 2011 meeting in Toronto, at which members gave some direction on the subject. A further proposal is being drafted.

Comments about ABSs in the legal media from major Commonwealth jurisdictions has varied. Some refer to the move to permit ABSs in Australia and England as the "de-regulation of the legal profession" and liken it to the "big bang" in the de-regulation of the financial services industry beginning in the mid-1980s. Proponents advocate that ABSs will mark a watershed event in the way legal services are delivered, allowing consumers to shop for legal services in a way they never have before. However, fears over the consequences of the financial services industry's big bang (on which many commentators blame much of the 2008 recession) give critics an opportunity to call for caution. Others call the move to permit ABSs a "big whimper" and expect it will not have much effect on the profession at all.

Whichever is true, the Committee recognizes that the legal profession in British Columbia and Canada, as well as other potentially interested parties (including, perhaps the Competition Bureau), are or will be following the debate concerning and development of ABSs. The Committee therefore recommended that, as part of the Law Society's Strategic Plan, it would be prudent for the Law Society to begin an examination of the benefits and detriments of ABSs in order to begin to develop a position concerning whether they should be permitted in British Columbia, and if so, how that might be accomplished. In this sense, the Committee recommends the start of a policy debate, much the same way as was the case when law corporations and MDPs were considered by the Benchers.

The Benchers adopted the Committee's recommendation as part of the Law Society's Strategic Plan, and this Report is prepared to begin the process.

## III. Alternative Business Structures

What are ABSs and why are they at issue?

ABS is a generic reference to any form of business model through which legal services are delivered that is different from the standard sole proprietorship or partnership model. Law corporations or MDPs in British Columbia are therefore really ABSs, although law corporations in this province are quite tightly regulated with the result that the model of delivery usually resembles either a sole proprietorship or partnership. It remains to be seen how "alternate" a business structure an MDP is, as to date there has been only one application made to the Law Society to form an MDP.

There are other ways to structure a business model through which legal services could be provided beyond the partnership and sole proprietorship model. Historically, however, such structures have generally not been possible due to prohibitions against fee-splitting with non-lawyers, which are meant to avoid the risk that a lawyer's independence might be compromised by a non-lawyer's interest in the fee.[1] Fee splitting prohibitions also ensure that third party non-lawyers do not have a financial interest in directing the lawyer's conduct of a file or retainer.

Over the past decade in particular, likely in part as a result of various factors such as globalization, the expansion of the size of some international firms, mergers within the legal profession, financial needs for law firm expansion, and investments in information systems and technology, some legal service providers have needed to access greater quantities of capital. For example, Clifford Chance raised $150 million (US) in 2002 through the private debt market in order to finance its move to new offices and related infrastructure needs.[2]

Australian states began reforms in the 1990s. New South Wales permitted a limited form of MDP in 1994 that permitted partners in a law firm who were not members of the legal profession, but required legal practitioners to retain at least 51% of the net partnership income in order to ensure that the MDP maintained proper ethical practices.[3] Later, competition authority pressure seeking to enhance consumer interests lead to the creation of MDPs and Incorporated Legal Practices ("ILPs"). MDPs permit Australian lawyers and non-lawyers to provide legal services and other services. ILPs also allow Australian lawyers to provide legal services with other service providers who may or may not be lawyers. Moreover, ILPs themselves are not required to have a legal practice certificate and may have external investors. They may also be listed on the Australian Stock Exchange.[4]

In April 2007, Slater & Gordon (a firm based in Melbourne) issued a Prospectus for the sale of 35 million shares at A$1 per share, becoming the first firm to do so. The offer was fully subscribed. The "Use of Funds" as stated in the Prospectus was:

- A$17.3 million represented by the sell down of shares by Vendor shareholders; to be paid to the Vendor shareholders and

- A$17.7 million represented by an issue of new shares to be applied in the short term to meet the costs of the offer (A$2.3 million) and to reduce the amount drawn down by the Company under its debt facilities, and thereafter to draw down debt to fund the Company's growth strategy, including the investigation of the

[1] Law Society of Upper Canada, Report to Convocation by the Professional Regulation Committee, January 27, 2005, para 74
[2] *Ibid*, para 57
[3] Issues Paper Concerning Alternate Business Structures, prepared by ABA Commission on Ethics 20/20 Working Group on Alternate Business Structure, April 5, 2011, page 8.
[4] For a general description of MDPs and ILPs in Australia, see pages 8-10 of the ABA Issues Paper Concerning Alternate Business Structures.

> potential acquisition of law firms, advertising, project litigation and additional working capital.

But moreover, developments in England have really brought a focus to the debate on ABSs. These arise from the focus on "consumer interests" in the legal market place, and the lack of alternatives that consumers have when "purchasing" legal services. The English government released a report in 2003 titled "Competition and regulation in the legal services market" that supported ABSs provided they were appropriately regulated to protect both public interests and the core values of the legal professions[5].

Interestingly, the report on the review of the Regulatory Framework for Legal Services in England and Wales (the "Clementi Report"), released in December 2004, discussed the benefits consumers might realize from ABSs, but it was focused on partnerships between legal professionals ("LDPs") and on MDPs. It made no recommendations, nor did it really address, ABSs beyond the LDP or MDP models. Despite this, the English government in its White Paper that preceded the *Legal Services Act 2007* (UK) indicated that it was prepared to move beyond the recommendations in the Clementi Report to provide for the creation of a much broader range of ABS. The *Legal Services Act* created a framework allowing for "full ABSs" – including models of outside ownership of the entity providing the legal services, subject to regulation.

In the Explanatory Notes to part 5 of the *Legal Services Act 2007* (the Part that deals with ABSs), the following background is noted:

> 180. Historically, there have been a number of statutory restrictions on the type of business structures through which legal services may be provided. Some existing regulators have also prohibited lawyers from entering into partnership with non-lawyers. Certain regulators have also placed restrictions on the ways in which non-lawyers can participate in the management of firms. In other cases, regulators do not have the powers they need to regulate a more diverse range of business structures.
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> 181.In March 2001, the [Office of Fair Trading (OFT)] identified a number of rules of the legal profession that were potentially unduly restrictive, and that might have negative implications for consumers. The OFT recommended that rules governing the legal professions should be fully subject to competition law and that unjustified restrictions on competition should be removed.
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> 182.Following the 2004 Clementi Review, in 2005 the Government published a White Paper, *The Future of Legal Services: Putting Consumers First*. It proposed ABS, which would allow different types of lawyers and non-lawyers to work together in an ABS firm

[5] "The Government supports in principle enabling legal services to be provided through alternative business structures. Such new structures would provide an opportunity for increased investment and therefore enhanced development and innovation, for improved efficiency and lower costs...." Competition and regulation in the legal services market, CP(R2) 07/02 DCA, July 2003

> or company, and/or the possibility of non-lawyer ownership and investment. It identified potential benefits for both consumers and legal services providers.[6] (footnotes omitted)

## III. The Benefits of and Concerns About ABSs

The Committee has reviewed a number of articles, reports, press releases of various organizations, "backgrounders" to legislation, and media commentary about ABSs in an effort to try to outline succinctly what benefits may be realized through ABSs as well as what legitimate concerns ABSs may create. Its considerations follow.

As a general comment, however, the Committee cautions that there is little, if any, empirical evidence that any of the stated benefits can actually be realized through ABS structures, or for that matter that ABSs would create undue harm to the provision of legal services or professionalism within the legal profession. When the *Legal Services Act 2007* was debated in the House of Lords, an amendment was passed to require the Lord Chancellor to commission an independent report on ABSs before they were allowed. The report was also to have analysed threats to the independence of lawyers. This recommendation was not, however, passed by the House of Commons when the Bill was eventually voted on and thus a useful opportunity for an independent discussion and analysis of ABSs was lost.

### (a) Benefits of ABSs

Proponents of ABSs say that they will benefit the interests of consumers of legal services by providing for increased competition between forms of legal service providers through the opening-up of business models that will permit non-lawyer participation. This, it has been argued, will permit innovations that will improve the efficient and cost-effective provision of legal services. Access to public capital will improve a law practice's ability to enhance its technological services to improve the delivery of legal services. A liberalized market will improve access to justice and protect and promote consumer interests while promoting competition. An independent, strong diverse and effective legal profession will be encouraged in the result.[7]

Further, proponents suggest that being able to offer legal services through third-party providers will benefit consumers by making legal services easier, and less intimidating, to access. For example in a 2010 Consultation Paper, the Legal Services Board (England and Wales) states[8]:

> ABSs…remove many of the barriers in relation to non-lawyers owning organisations providing legal services and provide new opportunities for

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[6] *Legal Services Act 2007* Explanatory Notes. http://www.legislation.gov.uk/ukpga/2007/29/notes/division/7/5/1

[7] See *Wider Access, Better Value, Strong Protection*: Discussion Paper on developing a Regulatory regime for Alternative Business Structures. Legal Services Board, 2009. Para 4.1

[8] *Alternative Business Structures: Approaches to Licensing*, Consultation Paper on Draft Guidance to Licensing Authorities on the Content of Licensing Rules, 2010 at para 3.

innovation, wider access to justice and the reshaping of legal services in the consumer interest.

The Ministry of Justice (England and Wales) created a "Legal Services Reform Fact Sheet". It describes the "main benefits of ABSs", which include:

- ABSs will increase access to finance: at present, providers can face constraints on the amount of equity they can raise;

- New providers in the marketplace should lead to innovation and price reductions, which should result in more people being able to access legal services.

The Explanatory Notes to the *Legal Profession Act 2007* stated potential benefits of ABSs as follows:

> Potential benefits for consumers:
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> - more choice: consumers will have greater flexibility in deciding from where to obtain legal and some non-legal services;
> - reduced prices: consumers should be able to purchase some legal services more cheaply. This should arise where ABS firms realise savings through economies of scale and reduce transaction costs where different types of legal professionals are part of the same firm;
> - better access to justice: ABS firms might find it easier to provide services in rural areas or to less mobile consumers;
> - improved consumer service: consumers may benefit from a better service where ABS firms are able to access external finance and specialist non-legal expertise;
> - greater convenience: ABS firms can provide one-stop-shopping for related services, for example car insurance and legal services for accident claims; and
> - increased consumer confidence: higher consumer protection levels and an increase in the quality of legal services could flow from ABS firms which have a good reputation in providing non-legal services. These firms will have a strong incentive to keep that reputation when providing legal services.
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> Potential benefits for legal service providers:
>
> - increased access to finance: at present, providers can face constraints on the amount of equity, mainly debt equity, they can raise. Allowing alternative business structures will facilitate

expansion by firms (including into international markets) and investment in large-scale capital projects that increase efficiency;

- better spread of risk: a firm could spread its risk more effectively among shareholders. This will lower the required rate of return on any investment, facilitate investment and could deliver lower prices;
- increased flexibility: non-legal firms such as insurance companies, banks and estate agents will have the freedom to realise synergies with legal firms by forming ABS firms and offering integrated legal and associated services;
- easier to hire and retain high-quality non-legal staff: ABS firms will be able to reward non-legal staff in the same way as lawyers; and
- more choice for new legal professionals: ABS firms could contribute to greater diversity by offering those who are currently under-represented more opportunities to enter and remain within the profession.[9] (footnotes omitted)

Others have suggested that incorporation and listing of law firms present an opportunity to *improve* ethical practices in law firms by allowing for the development of new models for ethical practice in the business of law, and to develop better models for regulating law firms' practice. This would include ensuring that incorporated firms put in place management systems that are appropriate and ensure that professional obligations are met.[10] [11]

**(b) Concerns about ABSs**

Concerns about ABSs generally focus on three issues:

- Core values of the legal profession
- Conflicts of Duty
- Quality of Service

[9] http://www.legislation.gov.uk/ukpga/2007/29/notes/division/7/5/1

[10] Parker, Christine: *Peering Over the Ethical Precipice: Incorporation, Listing and the Ethical Responsibilities of Law Firms* Melbourne Law School Legal Studies Research Paper no. 339, University of Melbourne April, 2008;

[11] Parker, Christine: *Law Firms Incorporated: How Incorporation Could and Should Make Firms More Ethically Responsible* University of Queensland Law Journal, Vol. 23, No. 2, pp. 347-380, 2004

1. Effects on Core Values of the Legal Profession

Opponents of ABSs have raised a number of concerns about the effect of new business structures. These are based primarily on the effect that ABSs may have on the core values of the legal profession. It was these concerns that brought the issue to the attention of the Committee in the first place, which prompted the Committee to recommend that an early consideration be given to the issue, rather than an after-the-event-occurs "catching up."

The Council of the Bars and Law Societies of Europe ("CCBE") has expressed concern about ABSs. It has questioned whether any safeguards other than an outright ban are enough.[12] It has also been quite outspoken on the dangers that ABSs pose to the core values of the legal profession. In fact, in its response to the Legal Services Board's 2009 consultation paper on ABSs, the CCBE said that it would advise, if the question were asked, "not to go ahead with the ABS project."[13]

The CCBE notes that common "core values" of the legal profession protect the client's interests while at the same time guarantee the proper administration of justice. These core values include lawyer independence, client confidentiality, and the avoidance of any conflict of interest. The CCBE states that while lawyers have a need to make a profit on the provision of their services, lawyers (like other professionals) are presumed to operate their law firm

> not with a purely economic objective, but also from a professional perspective. Their private interest concerned with making a profit is thus tempered by their training, by their professional experience, and by the responsibility which they owe, given the fact that any breach of the legal rules of professional conduct undermines not only the value of their investment but also their own professional existence.
>
> It seems to us evident that non-lawyers who invest their money in ABSs [presumably as investors or as non-lawyer owners] can neither be expected to be in that situation, nor can they be expected to refrain from the legitimate demand to influence the firm's policies and to seek the economically appropriate return on investment.[14]

In its conclusion, the CCBE said:

> We see the lawyer's duties to maintain independence, avoid conflicts of interest, and to respect client confidentiality endangered if non-lawyers are allowed a significant degree of control over the affairs of the firm. …
>
> Non-lawyers, who do not practice as regulated professionals themselves, constitute risks to clients and to the due administration of justice. The public's perception of their participation as investors... could compromise the integrity of the business structure as a whole…

[12] Council of Bars and Law Societies of Europe: CCBE Position on Non-Lawyer Owned Firms, June 2005

[13] Council of Bars and Law Societies of Europe: CCBE Response to the Solicitors Regulation Authority's Consultation on New Forms of Practice and Regulation for Alternative Business Structures, September 4, 2009

[14] ibid

> Lawyers in most jurisdictions are obliged to accept instructions that, from a purely economic point of view, are not profitable e.g. legal aid. The client needs to be confident that its case, even under these circumstances, is given the necessary attention. Where mere economic aspects seem to prevail, doubts will arise whether the defence of the client's rights is taken more seriously that other interests, even where the regulation stipulates that the company's duty to the court will prevail over all other duties, and the duties to its clients will prevail over the duty to shareholders.[15]

When examining issues concerning publicly-traded law firms in 2004, the Law Society of Upper Canada quoted from the Final Report of the Working Group on Multi-Discipline Partnerships, September 25, 1998 concerning the need for lawyer's independence:

> Independence requires for its efficacy untrammeled freedom on the part of the lawyer to interact with, for and on behalf of the client. Questions necessarily arise as to whether any such environment could be maintained where the lawyer is but a small part of a larger commercial enterprise, full service in nature, in which inter-professional dependencies are vital to its well-being. Is the lawyer's practical freedom to react in the best interests of the client not likely to be compromised in these circumstances, more so where the enterprise is controlled by non-lawyers?[16]

Some concern has also been raised about the potential for dual or even conflicting regulation in the case of publicly listed firms. While law societies would be expected to administer and enforce professional duties (including financial accounting) and ensure competence in connection with the provision of legal services, securities commissions have strict regulatory and enforcement regimes over public companies. For example, would securities commissions need to access confidential client information to enforce their regulatory and public interest protection requirements?

2. Conflicts of Duties

"Conflicts of Duties" has been raised frequently as a concern with ABSs, particularly in the publicly-traded-shares model of ABS. A lawyer's primary duty is to the court, with a very close secondary duty to the client. The duty of a director of a company, however, is to act "honestly in good faith in the best interest of the company." Shareholders of the company are entitled to rely on the directors to do so, and have rights of action where they do not. It is not difficult to envisage circumstances where lawyers of a publicly-listed company could find their obligations to the court or their client to conflict with corporate obligations and shareholder interests. The Committee notes that this conflict may already exist with in-house counsel who are also directors, but that conflict may still be capable of resolution in extreme circumstances through the resignation of counsel. Could that be done in a publicly-traded firm in the same way?

Slater & Gordon's Prospectus notes that lawyers have a primary duty to the courts and a secondary duty to their clients, which duties are paramount given the nature of the business of the Company. It continues: "[t]here could be circumstances in which the

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[15] *Ibid*
[16] See footnote 1. Quote appears in para 77.

lawyers of Slater & Gordon are required to act in accordance with these duties and against the interests of shareholders or the short-term profitability of the company."[17]

The conflict of duties is therefore a concern of enough severity to warrant specific disclosure as a "risk" to investment under a prospectus. The Slater & Gordon Prospectus deals with the issue by advising of the risk to alert investors. The Committee has wondered, however, (without seeking to legally determine) whether a company can purport to disengage a statutory and common law duty owed by directors to the company, under which all directors must act, by giving primacy to a professional ethical obligation arising out of the nature of business conducted by the company.

3. Quality of Service

The debate about ABSs has also raised concerns about the quality of service and advice that may be offered through them.[18] How the law applies to the particular needs of a client can vary considerably depending on the circumstances presented by the client. A move toward commoditization, which has been suggested as likely on some models of ABSs – particularly the "Tesco-law" model - would apply a more basic "one-size-fits-all approach" that may not in fact meet the need of the consumer. While the cost to obtain the advice may well be cheaper, the actual advice received may not meet the client's needs. Moreover, the business imperative to address the cost of delivery could, some have suggested, reduce the time the lawyer is prepared or able to give to the client to explain the advice offered.

## IV. Discussion

1. What is the effect of ABSs on the legal profession

There are clearly a number of possible benefits that could be realized through the adoption of ABS structures. Any innovations that improve access to legal services or present opportunities to increase the ethical or professional responsibilities of the deliverers of legal services cannot be ignored and need to be considered seriously.

However, there are also a number of concerns that need to be taken into account when determining whether ABSs should be permitted. Concerns about quality of services and effects on the core values of and protections offered by the legal profession are not to be lightly dismissed.

The Committee has had an opportunity to discuss and consider the benefits and concerns that ABSs raise. As with any "new direction," understanding the ramifications of such models is fraught with difficulties. Moreover, while the legal profession is generally quite conservative and may be less inclined to jump into a new venture, the business community is a much different beast, more inclined to accept risk if a reasonable business model and plan can be devised. Consequently, if ABSs are permitted in Canada at some

[17] Slater & Gordon Limited, Prospectus, April 13, 2007 at page 84.
[18] ABS drive is "threat" to quality of advice. *Gazette* [2007] 5 July

future date, the Committee is convinced that some business entity (including, possibly, law firms) will create a model that would utilize some form of ABS. Ensuring that the Law Society knew where it stood with respect to such models, together with having a clearer understanding of the effects they may have, would therefore be highly advisable in order, with confidence, to ensure that it is able to protect the public interest in the administration of justice properly with regard to regulations addressing the issue.

No independent analysis of the public interest risks and benefits appears to have taken place in England. The English government seems to have been prepared to take a leap of faith into ABSs and to bring the profession along with it. Consumer groups in the United Kingdom advocated for the creation of ABSs, and the Law Society of England and Wales has supported the introduction of ABSs for almost a decade.

The Law Society of Scotland, on the other hand, engaged in a consultation from which it made a recommendation endorsing ABSs in principle. Ultimately, however, a very acrimonious debate grew within the profession about ABSs and the Law Society's role. The debate was ultimately resolved – at least for present purposes – when a compromise was reached requiring majority ownership of an ABS to be retained by legal professionals. However, the Scottish example shows the dangers of the regulator being, perhaps, somewhat underprepared on the issue and not understanding the perspectives of all interested parties.

As noted by the Legal Services Board in England[19] the safeguards that the LSB considers are "inherent in ABS are viewed skeptically by several other national bars in Europe who may choose to prohibit ABS in some respects because of the perceived loss of independence of lawyers who work within such ABS." Germany and Austria have expressed concerns that the opening up of law firms to capital would be contrary to basic principles of the profession in other European member states,[20] and as stated above, the CCBE has expressed concerns. Questions were raised as to whether firms that accepted external capital would be allowed to trade in European countries. The Committee understands that the ABS approach in England continues to be viewed with caution in Europe on the belief that core values of the profession may be compromised to an unacceptable degree.

2. Will ABSs really be a benefit to the delivery of and access to legal services?

The Committee considered a number of points in the discussion of benefits and concerns about ABSs. It has noted that advocates for ABSs claim that an improvement to the access to legal services will be realised through ABSs, but believes that the claims that are made are largely, if not completely, untested, such as the presumption that ABSs will improve consumer confidence in the delivery of legal services by having well-known non-legal brands entering the legal market and having a strong incentive to maintain their reputation when providing legal services.[21] It notes that the potential benefits of ABSs

[19] Footnote 8 at para. 329
[20] "City firms face global Clementi Backlash" *Gazette* [2005] 26 May.
[21] See for example, "New Bedfellows," *Gazette* [2005] 24 November

listed by the Explanatory Notes to the *Legal Services Act 2007* are stated in conditional language, with many "coulds," "mays" and "mights."

Some empirical evidence that ABSs would improve the delivery of and access to legal services would have been much appreciated. On the basis of what it has reviewed, the Committee is somewhat skeptical that the introduction of ABSs will lead to a marked improvement in the delivery of or access to legal services.

a. Access to Capital Markets

Firstly, concerning access to finance and the capital markets through the sale of shares to the public and the listing of shares on securities exchanges, the Committee notes that the most likely candidates to utilize this model would be large firms. They would be perceived to have the most value, and it would be expected that they would generate the most interest by investors. However, access to capital is not currently a difficult problem for large firms. It is true that such access is generally reliant on debt equity or partnership contributions or both, but the Committee does not understand that large firms, at least in Canada, have suffered by not being able to access capital when needed. The Committee notes that similar comments are noted in a recent Report prepared for the Legal Services Board in England and Wales, which states:

> …large firms believed that they could easily fund their business plans through retained profits or through borrowing directly from banks if they had a particular need. There was considerable reluctance among firms to seek external funding that would involve partners ceding control of the firm to external investors. Furthermore, interviewees generally saw little advantage of seeking external investment for which a proportion of the future profit stream would have to be paid, preferring instead to maintain full ownership of that profit stream.[22]

The ability to finance through a public equity offering would simply be to create a new method of accessing capital. The Committee is not entirely convinced that the ability to access capital in this manner would improve access to or the delivery of legal services any more than current avenues available to access capital. It is worth noting that a one-half of the proceeds raised by Slater & Gordon represented the sell down of shares by Vendor shareholders to be paid to the Vendor shareholders.

The Committee does recognize that access to capital through the markets might allow partners to convert debt into capital equity. It is unclear to the Committee, however, how this would benefit consumers, unless it could be established that there was a more direct link between investment of capital into a law firm and delivery of legal services. If that could be established, and if it was more likely that law firms would access capital through the markets than through debt financing, the Committee would be less skeptical. The fact that so few firms have accessed the capital markets in Australia suggests otherwise. The Committee believes it is equally likely that partners would not be interested in sharing profits with outside investors unless it was not possible to raise capital in any other way,

[22] *Benchmarking the Supply of Legal Services by City Law Firms* A Report prepared by Charles River Associates for the Legal Services Board, August 2011, page 24.

and to date this has not appeared to be the case. This model might be of interest to partners nearing retirement, as there is a possibility that publicly traded shares in a law firm would be worth more than the value of a privately held partnership interest[23], but the Committee does not believe that increasing the value of a lawyer's retirement fund is proof of an ability to improve the access to legal services.

On the other hand, the Committee recognizes that some commentators and proponents of ABSs adamantly assert that access to capital, particularly if invested in firm infrastructure, allows for the development of innovative ways to improve a business's delivery of its services. A New York lawyer, quoted in an article in the Canadian Bar Association's *National* Magazine, noted that "all ways of growing law firms are increasingly capital-intensive. I think it's a failure of imagination that law firms couldn't do more if they had real access to capital."[24] The Committee does not want to discount the ability of creative minds to develop innovative ways to improve the delivery of legal services in an effort to reduce their costs. However, as stated above, there are already ways to access capital, so these innovations may not necessarily be dependent upon access to the capital markets.

b. Third Party Delivery of Legal Services

The Committee gave a good deal of thought to the ABS model by which legal services might be provided through non-lawyer businesses hiring lawyers to provide legal services to customers.

The Committee is less skeptical that this model might improve access to legal services, although again, it would be more comforted if there was some empirical evidence to support any assertions to this end. However, the Committee recognizes that attendance at a law firm – whatever its size – can be a daunting prospect for many people. If the ability to approach lawyers through a business with which a consumer was more familiar would lead individuals in need of legal advice to seek it more frequently and in a more timely manner, the Committee could see that there would be a benefit to the overall access to legal services. Advertising and "brand recognition" might assist consumers/clients to compare prices and understand how to shop around to obtain the services they seek. It will be interesting to see whether access to legal services improves though the recent agreement in England between the "Quality Solicitors" group and WHSmith Books, as it may be a precursor to the development of a true ABS model. However, the Committee wondered if the better use of the advertising rules in British Columbia, which now allow comparative advertising by lawyers, would also improve the client's interests and access to services. In other words, perhaps the solution lies in a better use of the tools that already exist rather than the development of a new model.

While recognizing this model might generate some benefits, the Committee is still cautious. The corporate structure of the business through which the legal services are offered may limit the types of services or clients that the lawyer is allowed to offer or

[23] See *Who owns the firm?* CBA National Magazine, Sept, 2008, page 19
[24] *Ibid,* pg 21

represent. The prospects for the offering of *pro bono* legal services might be remote, for example, unless such services were mandated by the Law Society. However, these sorts of concerns also exist in some law firms, so it is possible that an ABS model to this end would be no worse.

From its review of the literature on this subject, the Committee is also concerned that this model might be more likely to deliver legal services capable of being commoditized, such as real estate transactions, wills, and incorporations, as they might be viewed as being the most cost-effective services to offer. However, there is currently less of a general problem in the delivery of or access to these sorts of legal services. The Committee is much less confident that businesses with a market-wide reputation to maintain would be interested in providing legal services in areas where access is perceived to be more difficult (such as family law, for example), because the opposing party may also be a customer of the business. Acting against an individual in an acrimonious legal matter would not be expected to be a good business model to retain the continued business of that party.

3. Will ABSs negatively affect lawyer independence or self-regulation?

There is a danger that lawyer independence and self-regulation could be affected by ABSs, because the more that lawyers engage in business activities with other professionals or with non-lawyer investors, the more that the line between business and the practice of law will blur. If core values of the legal profession are not addressed or adhered to through regulations governing ABSs (should ABSs be permitted), the Committee believes that independence and self-regulation will be affected. A deterioration of lawyer independence, in particular, could have serious consequences on an important public right and safeguard of the rule of law.

The danger of this line blurring exists, however, even without the development of ABSs, and must be addressed by the profession. As has been pointed out by one commentator on this subject:

> [t]he incorporation and listing of law firms accentuate and bring into focus certain ethical issues, but it is not incorporation and listing as such that are the main thing we should worry about. Law is already a business as well as a profession and has been so for a very long time. The ethical issues that come with incorporation and listing are already with us at least among the largest firms and those that aspire to them.[25]

This danger is recognized by the Supreme Court of Canada in the quote from *R. v. Neil* in the introduction to this paper. In Canada, legal principles must taking precedence over business development strategies.

That being said however, the Committee is not convinced that the form through which legal services are provided would necessarily affect the ability of lawyers to act independently or to regulate themselves, provided that core values of the legal profession

[25] See Parker, footnote 11 above at page 29.

are protected and regulated appropriately and that the public interest is always given primacy in regulation or the development of business models. Proper education about the role of a lawyer in society, combined with the effective regulation of legal services, is necessary to ensure that the line between professionalism and business does not get obliterated. The Committee notes with interest that a similar caution was given and a similar conclusion was reached in 1990 by the Planning Committee's Multi-Disciplinary Practice Subcommittee.[26]

## V. Current Considerations by the American Bar Association Concerning ABSs

As mentioned above, the American Bar Association distributed in April, 2011 an "Issues Paper Concerning Alternative Business Structures."[27] The paper examines ABSs, outlines the history of the consideration of ABSs by the American Bar Association, explains developments in other jurisdictions, and sets out some possible approaches for consideration. ABSs have not been permitted by ABA rules and, more importantly, are not permitted in any U.S. jurisdiction except the District of Columbia (which allows some non-lawyer ownership in law firms).

The topic was debated by the ABA's Commission on Legal Ethics 20/20 in August 2011 at the American Bar Association Conference in Toronto. There was, by all reports, a lively debate on the topic. Ultimately, the Commission voted to circulate a proposed rule change that would allow law firms to include non-lawyers in *minority* ownership roles. In addition, the proposal includes a recommendation that any non-lawyer owner must demonstrate good character and be otherwise fit to hold a stake in an entity that provides legal services.[28]

A draft revised proposal to amend Model Rule of Professional Conduct 5.4 (the Model Rule that governs lawyers' professional independence) is to be prepared and circulated in September 2011 for comment, and the final proposal is to be submitted for consideration by the House of Delegates at the ABA Annual Meeting in August 2012.

On the basis of this outcome, the development of ABSs in the United States may well be destined for a markedly different outcome than has been the case in England and Wales and Australia. How the ultimate decision by the ABA may affect the development of ABSs in other jurisdictions, or how the tension between directions might resolve itself internationally, is an open question, but one that may have a considerable effect on whether ABSs have much relevance in Canada. The debate by the ABA is therefore very much worth following, and making a final decision on ABSs should perhaps await a final resolution of that debate.

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[26] *Multi-Disciplinary Practice* A Report prepared for the Planning Committee of the Law Society of British Columbia by the Multi-Disciplinary Practice Subcommittee, October 4, 1990.

[27] See footnote 3, above.

[28] For a report on the meeting, see http://www.bna.com/ethics-2020-commission-n12884903114/

## VI. Balancing the Perceived Benefits Against the Alleged Harm

As explained in this Report, the perceived benefits of ABSs are in improvements to the access to and delivery of legal services. While untested, these benefits, if capable of being realized, are valuable. They are benefits that, in order to discharge its public interest mandate, the Law Society would need to consider. The alleged harm that ABSs may cause is their perceived effects on the core values of the legal profession and on the quality of advice that consumers may receive.

The Committee believes that it would be possible to address the alleged harm through appropriate regulations, if the perceived benefits are considered worthwhile. The English model contemplates – indeed, requires – regulation, and the delay to date in the implementation of ABSs in England has been in order to get a regulatory model in place. Certainly, the Committee considers that the unregulated provision of ABSs would likely be disastrous. The unregulated – or too lightly regulated - expansion of the financial services industry is widely blamed for the 2008 recession. If ABSs are permitted, even jurisdictions that seem destined to embrace them have concluded that some form of regulation would be necessary. The delay beyond the initially announced date for full implementation of ABSs in England and Wales suggests that identifying all the regulatory parametres and requirements is not simple.

One issue concerning regulation that would need to be addressed at the outset is who would regulate the ABS? In England, with many different regulators of the legal profession, there has been a degree of jockeying between regulators in deciding whether to seek approval from the Legal Services Board to regulate ABSs. The Committee wonders if competition between regulatory bodies in this regard might at some point lead to differing regulatory mechanisms – some seeking perhaps to be more "light touch" than others in order to entice ABSs to seek regulation through a particular regulator – which may affect regulatory standards. Given the structure of the legal profession in Canada, this may be less of an issue, but if ownership of a law firm is opened to individuals other than lawyers, would other regulators (perhaps the Society of Notaries Public, for example), seek to regulate the entity?

This Report does not intend to draft a regulatory regime for ABSs. However, the following matters appear to factor in places where regulation is being considered (such as England), and merit being noted:

1. <u>General requirements</u>[29]

- Regulations that would require the protection of the core values of the legal profession and the quality of service expected of competent legal professionals;

- "Fitness to own" requirements, akin to those required of non-lawyer partners in a MDP;

[29] The requirements listed draw on suggestions from the 2004 Clementi Report and the Report of the Law Society of Scotland *Delivering Legal Services: Policy Paper on Alternative Business Structures*

- Indemnification by outside owners in respect of loss of clients' money caused by an ABS;

- Requirements for a designated lawyer to be Head of Legal Practice within an ABS;

- Clear regulations concerning conflicts of interest, such as rules prohibiting an ABS representing a client were an outside owner has an adverse interest in the legal outcome;

- A prohibition on outside owners being able to interfere in individual client cases or have access to client files or other information about individual cases;

- A consideration whether regulatory requirements should be imposed against the *lawyers* providing legal services, or against the ABS itself. In other words, should the regulation be of the ABS directly, or indirectly through the lawyers practising in them?

2. Level of Outside Ownership

How much outside ownership should be permitted? The English model seems to contemplate unlimited ownership of an ABS by non-lawyers. On the other hand, the model that seems to have been approved in Scotland (after a very acrimonious debate) would require the majority of the ownership of the ABS to be held by legal professionals. It seems the direction currently considered by the American Bar Association is similar to that in Scotland.

The *form* of participation of outside ownership could be considered, as well. For example the *Legal Profession Act* permits only lawyers to own voting shares in a law corporation. Non-lawyer members of the law corporation (limited by statute to a limited group of related persons) may only own non-voting shares. Consideration could be given to whether "outside" investors in an ABS should be limited to non-voting membership. Such a limitation would, of course, be expected to reduce the potential value of the shares.

3. Disclosure Requirements

If a public offering of shares in a ABS is permitted, some consideration should be given to what sort of disclosure requirements might be required in the Prospectus. The Slater & Gordon prospectus does address risk and specifically identifies the duty to the court and clients as superseding a duty to shareholders.

## VII. Recommendations

After a considerable amount of discussion, the Committee has concluded that the *form* of structure through which legal services are offered is less important than it is to ensure that the services that are offered can be properly regulated. Consequently, the Committee believes that the Law Society should not take a position against ABSs solely on the basis that they may involve outside interests of ownership of business entities that deliver legal services.

Rather, the Law Society should consider ways to encourage innovations in providing legal services, provided that:

1. core values of the legal profession are protected, and

2. access to legal services can be improved through the new forms created.

If ABSs were permitted, and their only demonstrable effect was to enrich the legal profession or those who invested in it, the image of the profession and the Law Society would be tarnished. Consequently, some considerable caution needs to be exercised to ensure that there is a public value in ABSs (such as improving access to legal services) and that valuable public protections (such as client confidentiality, an absence of conflicts of interest, and the public right to an independent lawyer) that currently exist are not lost.

The Committee believes that some outside ownership involvement in law firms, provided it is properly regulated and lawyers remain in control of the provision of legal services offered by the ABS (subject to reasonable limits placed on the outside ownership, provided these are not contrary to core values of the profession), could conceivably benefit the consumers of legal services and still protect the public interest. It is possible, although speculative, that access to such services would be easier and less "intimidating" for the client, and that the services may be able to be offered at a lower price. The Committee is not fully convinced that the types of legal services that such an ABS would want to offer, however, would necessarily be services that the public is currently having difficulty accessing, but that remains to be seen.

On the other hand, the Committee is not convinced that the public sale, through securities markets, of shares in a law firm is warranted, as it is not convinced that the benefits to users of legal services outweigh the risks identified above.

However, even though it expresses cautious support for ABSs, the Committee believes that the benefits that have been stated by ABS proponents (including the English government) are at best very speculative and are based more on surmise than actual evidence.

Therefore, the Committee recommends that the Law Society give serious consideration to ABSs. However, before more work is done, the Committee recommends waiting to see if the case for improving access to legal services through ABSs can be more clearly

demonstrated. The Law Society should await the outcome of the debate currently underway through the American Bar Association, should follow what happens in England and Wales once ABSs come into being, and should continue to monitor the situation in Australia. In many ways, England could provide some direct evidence about whether access to legal services can be improved through ABSs as well as giving an indication about whether they can be effectively regulated.

The Committee therefore recommends against developing *specific* proposals for ABSs at this time.

If there is an appetite in the future to consider permitting properly regulated ABSs in British Columbia, the Committee believes that such regulatory models must:

- protect and promote the public interest above the interest of lawyers
- support the rule of law and independence of the legal profession
- ensure protection of the core values of the legal profession.

Should the issue be considered in the future, the Committee recommends a wider consultation within the legal profession (including users of legal services) and business community in British Columbia. A series of options could be developed at that time for the purposes of such a consultation, including:

- No ABSs beyond law corporations and MDPs
- Limited forms of ABSs, such as non-lawyer owned corporations providing legal services to third parties
    - Unlimited outside ownership models
    - Outside ownership limited to 49%
- Unlimited forms of ABSs.

## VIII. Conclusion

There are many calls for significant changes in the way that legal services are offered. The current model does not seem to be working in a way that allows people who need to access legal advice to obtain it in an affordable way. There will be considerable pressure to adopt new models for the delivery of legal services, and the Law Society as the regulator of lawyers and the body charged with the responsibility of protecting the public interest in the administration of justice in British Columbia must be prepared to give them serious consideration. However, core values of the legal profession and important rights that clients who need legal advice are entitled to expect must not be lost in a rush to adopt new ideas simply because business and competition models argue in their favour. Many

of the protections that the legal profession offers clients have been obtained at significant cost over the centuries and to abandon them lightly would be undesirable for all concerned. However, where benefits to the consumer can be attained with proper regulation to ensure that professional values are not lost, the Law Society must develop proper regulation to allow for changes to the profession through which improved access to legal services can be attained.

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