Innovating Regulation

A Collaboration of the Prairie Law Societies

Abstract| November 2015

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For more than a century Canadian law societies have held to a regulatory model that is prescriptive and based largely on members of the public complaining about the conduct of lawyers. Increasingly, law societies are coming to understand that in order to properly fulfill their mandate of protecting the public interest, including improving access to justice, simply being reactive to complaints is insufficient. Instead, we must find ways of ensuring that consumers of legal services can trust they will receive ethical and competent service from those they turn to for legal advice.

Driven in part by changing imperatives in the legal profession including new technologies, new business models and access to justice concerns, regulation of legal services is evolving around the world. We have seen drastic regulatory changes in Australia, England and Wales. Further changes are being explored across Canada and in some U.S. states. We also have the recommendations of the CBA Futures Report bringing focus to these issues.

In response to this dynamic environment, the Law Societies of Alberta, Saskatchewan and Manitoba decided a number of years ago to tackle these complex issues collaboratively. In particular, we in the Prairies decided to take a close look at a spectrum of regulatory tools including entity regulation, compliance-based regulation and alternative business structures to determine which, if any, might be effective in our jurisdictions. This paper represents an early step in both understanding and assessing the regulatory options available.

ENTITY REGULATION

"Entity Regulation" simply means regulating law firms as well as lawyers and other individuals operating within the firm who are non-lawyers. It amounts to the regulation of the business entity through which professional legal services are delivered. This can mean regulating traditional law firms or, possibly, other organizations that provide legal services.

Some aspects of what we do, as regulators, already involves the regulation of law firms. For example, we have rules relating to firm names and trust accounting. We have rules that govern the ownership of firms.

However, there is no overall regulation of law firms even though the firm may bear some responsibility for the improper conduct of an individual lawyer. It may be that the lawyer's conduct was driven by firm expectations, norms or cultures. Regulation of entities would plug a hole in the regulatory framework.

Advantages to entity regulation might include:

- Improved management and cultures of law firms;
- Enhanced individual accountability;
- Removal of some barriers to non-lawyers providing legal services which may increase:
    - access to justice, and
    - regulatory effectiveness.

Disadvantages of entity regulation might include:

- Another layer of regulation;
- Challenges inherent in focusing on firm level conduct;

- Compliance systems within firms will require time and money.

For the purposes of discussion, the Prairie provinces are considering what should be included in a definition of "entity". One option may be to define entity as an organization that includes lawyers and provides legal services to the public. A broader definition might include in-house counsel and government lawyers.

At this point in the discussion, there is some early consensus amongst the Prairie law societies that we should treat legal services as those that are provided by lawyers, or by non-lawyers under the supervision of lawyers. At this stage, we are not considering whether the law societies should regulate the provision of legal services generally (i.e., those provided by non-lawyers such as paralegals, without the supervision of lawyers) as this is beyond the mandate of the joint working group.

Firm regulation may be direct or indirect. Indirect regulation attempts to regulate the conduct of firms by regulating the individuals in firms who are in positions of authority. Direct approaches range from the intricate regimes found in England and Wales, where firms must provide the regulatory authority with details of their governance structures before they are allowed to operate, to less complex models such as simple registration.

The Prairie provinces are in early agreement that entity regulation should be an enhancement to individual lawyer regulation, rather than a substitute for it.

COMPLIANCE-BASED REGULATION

Law societies generally regulate the individual lawyer, not a law firm or an entity itself. The possibility of entity regulation raises the question of how entities should be regulated.

Traditionally, law societies have regulated lawyers using a reactive, complaint-oriented, rules-based approach. Regulation of entities could be achieved by using similar prescriptive regulation – that is, telling entities what to do and how to do it. However, proactive approaches to entity regulation have been attracting considerable interest and attention, because they are focused on mitigating risk and preventing harm to the public.

One proactive approach is compliance-based regulation. Generally, compliance-based regulation is premised on the regulation of the entity using an outcomes-based, rather than a rules-based, approach. An outcomes-based approach articulates the expected objectives and outcomes with which an entity must comply but does not prescribe rules that tell the entity how it must achieve compliance. Instead, an entity has the flexibility and the autonomy to determine its own systems and processes that will allow it to achieve the outcomes.

In addition to setting out objectives and outcomes, compliance-based regulation may include some or all of the following components:

- Management systems for compliance with prescribed outcomes;
- Self-assessment of compliance with, or achievement of, prescribed outcomes;
- Ethical or compliance officers/directors;
- Reporting requirements;
- Review/auditing process for compliance.

Many of these components are not entirely new to the legal profession. For example, in some trust safety regimes lawyers are given a prescription about how to account, and then they have to report (annually or more frequently). If something goes wrong, such as a negative balance on a trust ledger card, they are further obliged to report.

Some concerns have been raised about compliance-based regulation, including:

- Ambiguity and less certainty for firms as to what they must actually do to achieve compliance;

• Lawyers' responsibilities to comply with their legal and ethical duties will be diluted by transferring obligations to entities rather than continuing to hold individuals responsible for their conduct.

These concerns are addressed and allayed by the numerous benefits that compliance-based regulation provides to the regulation of the legal profession. Compliance-based regulation:

• seeks to prevent problems from arising rather than reacting to complaints after the fact;

• can promote an ethical firm culture that improves the ethical best practices of both the firm and of the lawyers acting within it;

• recognizes that an entity has a role to play in ensuring lawyers' ethical behaviour;

• adapts to the size and needs of an entity rather than providing a "one size fits all" model of regulation;

• responds to a changing legal environment, which allows flexibility in regulation;

• enables regulators and entities to work cooperatively together; and

• may reduce complaints and enhance public confidence in the legal profession.

Compliance-based regulation represents a fundamental shift from the existing rules-based, one-size fits all model of regulation focused on complaints and discipline of the individual lawyer to a proactive, proportionate, outcomes-based model that focuses on the ethical culture and behaviour of a firm. The end result could be better ethical practices, which ideally result in improved delivery of legal services to the clients, ultimately benefitting and protecting clients.

REGULATION OF ALTERNATIVE BUSINESS STRUCTURES

The term "alternative business structure" (ABS) may have many meanings. For the purpose of this discussion paper, ABS refers to who may own, fund, earn revenue from and provide services in a legal practice, as well as the services that can be provided by a legal practice. These options can best be monitored if the law societies have the authority to regulate the entire entity.

The following are some features that could be combined to form an ABS, or that could be applied to an existing legal practice structure to change the way legal services are managed and delivered:

• *Non-lawyer ownership*: Currently, lawyers with novel ideas for the delivery of legal services have very few options to finance new ventures, and thus innovation is often hampered. This keeps the cost of delivering and accessing legal services high. Permitting non-lawyer ownership has the potential to foster innovation including allowing non-profit corporations to deliver legal services.

• *Fee-splitting and referral fees*: An ABS model that includes Multi-Disciplinary Partnerships (MDPs) or other non-lawyer ownership will also require that lawyers be permitted to share fees or revenue with non-lawyers. Similarly, more flexibility may be created by removing the limitations on referral fees. The Model Code of Professional Conduct currently prohibits both fee splitting and referral fees.

• *Provision of non-legal services*: Some of the work performed by lawyers is not strictly legal work and could be performed effectively by others. There are also many services that complement legal services and these could be provided in one package for greater efficiency and convenience to the client.

• *Provision of legal services by non-lawyers*: Currently the "practice of law" is exclusive to lawyers, and while lawyers are able to offer clients more protections in certain contexts, clients would benefit from having more choice as to who can assist them with law-related issues, especially if they cannot afford to hire a lawyer.

• *Third party litigation funding (TPLF)*: In some circumstances litigants struggle to fund their own legal disputes. An ABS may include the commercial financing of an individual or portfolio of lawsuits by a person or entity that is not a party to the litigation itself, but does not include contingency fees, insurance or public funding entities.

There are many ways that the delivery of legal services could be structured using the features above. However, many of these are not currently permitted in the Prairie provinces. For example, these might include multi-disciplinary partnerships, publically traded corporations, franchises or not-for-profit organizations.

Critics of ABS regulation tend to focus on concerns relating to rules of professional conduct that apply to lawyers, whether through Codes of Conduct or the common law. Key amongst these concerns are:

- *Preservation of professionalism*: Protection of the altruistic reputation of the profession. There are concerns that non-lawyers will be more likely to eschew professionalism and prioritize profit over client interests and the rule of law and that the motives of the lawyer and non-lawyer partners will be at odds because ethical decisions are not always the most profitable.

- *Preservation of independence of the bar*: Lawyer independence from the state, from non-lawyers and from their firms or business entities. Lawyers have a duty to place client interests above all else through freedom from outside influence such as commercialism. Critics argue that non-lawyer shareholders or partners might undermine independence by demanding that lawyers disclose confidential client information, encourage lawyers to cut corners and focus on the most profitable clients and drop the others, among other things.

- *Preservation of solicitor-client privilege and confidentiality*: The common law principle of privilege protects communications between lawyer and client from disclosure. As privilege applies to communications that seek and give legal advice, but not to business advice, it will be necessary to contemplate how privilege will be protected when legal advice is given by an ABS that provides legal services in conjunction with other types of services.

- *Conflicts:* There are concerns that a lawyer's loyalty to, or representation of, a client would be materially and adversely affected by the lawyer's own interest or the interest of the owners of the ABS. Lawyers are prohibited from acting in the event of a conflict by the Code of Conduct but in the case of an ABS, the concern is that the interests of a non-lawyer partner or owner may conflict with those of the lawyer's client.

While these are valid concerns, none are insurmountable if properly regulated and monitored. There are, however, many ways in which allowing lawyers to deliver legal services through ABSs may allow for greater flexibility in the ways that legal service can be delivered. For example, the current restrictions increase the price of capital by limiting the ways in which firms can raise money, impede the emergence of large consumer-focused law firms and preclude inter-professional collaborations that could have the potential to enhance access. Larger, multi-disciplinary firms might be able to offer more accessible legal services through risk-spreading and economies of scale.

Further, if lawyers are permitted to partner and share fees with non-lawyers, law firms could provide more convenient and accessible delivery of services in a one-stop shopping environment. Allowing non-lawyers to become involved in ownership, funding and provision of services alongside lawyers can also provide easily accessible expertise to lawyers themselves on a myriad of issues. Other benefits to ABSs may include increased competition, economic efficiency and enhanced use of technology and innovation.

Based on developments in other jurisdictions, the risk of significant harm as a result of ABS is remote and capable of mitigation. Many of the arguments against ABS are based on theoretical risks to lawyer independence rather than concrete evidence that significant harm will result from the risk of liberalizing ABS. Liberalizing rules respecting business structures does not mean that traditional firm structure will be abandoned; it simply means that it will no longer be the only choice available to lawyers.

While non-lawyer ownership of law firms tends to be the most controversial aspect of ABS regulation, ABS addresses more than the ownership of entities. Liberalizing the constraints on permissible business structures can take many forms. As with any tradition, it may be that it will take time for lawyers to adjust to the change and to develop those new ideas. Regulation can be changed or relaxed incrementally.