

# Innovating Regulation

A Collaboration of the Prairie Law Societies



Discussion Paper | November 2015



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## I. INTRODUCTION

The way in which people access the services of lawyers in Canada is changing. Canadian law societies, however, have regulated those services in the same way for over 100 years.

Canadian legal regulators have largely held to a model that is prescriptive and based on members of the public complaining about lawyer conduct. Increasingly, law societies are coming to understand that to fulfill their mandate of protecting the public interest, simply being reactive to complaints is insufficient. Instead, law societies must find ways of ensuring that consumers of legal services can trust that they will receive ethical and competent service from those they rely on for legal advice.

Layered onto our outdated regulatory models are a variety of changing imperatives:

- Most people cannot afford to hire lawyers, resulting in an ever-increasing load of unmet legal needs in Canada.
- Technology is dramatically changing the way legal services are delivered.
- Clients, as consumers of legal services, expect more for their money.
- Competition cannot be impaired and any sense that lawyers are protecting a monopoly must be quashed.
- Law firms are profit-driven businesses with expanding global scope and high overhead.

This oversimplified list is but the tip of the iceberg. The onus is on us, as Canadian law societies, to decide how we will respond to these changing imperatives. If we fail to do so, we risk losing the confidence of the public and of our governments, thereby eroding the fundamental democratic value of independent regulation of the legal profession.

The pressure is on. 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 Canadian Bar Association (CBA) Futures Report bringing focus to these issues.

The question that arises, and that is being explored in this preliminary discussion paper, is what is the best way for law societies to respond to these pressures? We believe innovation is a central part of the answer. The term “innovation” connotes creativity and action. We must, as law societies, be innovative in how we regulate to protect the public interest but we must also understand that a key aspect of innovative regulation is getting out of the way and encouraging lawyers, and others, to innovate in how legal services are delivered.

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\*The impetus for developing this discussion paper came from a meeting of senior staff and Benchers of the three Prairie law societies, held in 2014. A joint-staff committee was formed, led by the CEOs of the three Prairie law societies and a detailed work plan was developed in 2015.

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It is intended to serve as both a resource and a springboard to encourage engagement in discussion around the evolving regulation of legal services in the Prairie provinces.

## a) Prairie Law Societies Collaboration

The Law Societies of Alberta, Saskatchewan and Manitoba decided that these complex issues are best tackled collaboratively.

National lawyer mobility, combined with the proliferation of national and global law firms, drives the need to ensure consistency in approach to legal regulation across Canada. It is impractical to have different regimes across provinces and remain effective.

We are a large geographic country with a small population and, compared to other jurisdictions where regulatory reform is occurring, we have relatively few lawyers. This reality means that our resources are limited and it is strategically wise to share them. It is also our view that a diversity of perspectives from different jurisdictions will achieve better, more effective outcomes.

For these reasons, the law societies of Alberta, Manitoba and Saskatchewan are doing this work together. We are also keeping a close eye on developments across the country, particularly in Nova Scotia, Ontario and British Columbia where work is ongoing.

The work of the Prairie provinces began with a focus on alternative business structures (ABS). Looking at what was happening around the world, and at the actual changes in the way legal services are delivered led to the conclusion that limitations we as regulators currently impose on lawyers are likely outdated. In particular, given the pressures lawyers face to run their practices as businesses, regulatory restrictions around fee sharing, referral fees, and other limitations may no longer be appropriate. Further, a move towards allowing ABS has the potential to open the door to innovations, which may assist in addressing unmet legal needs.

These factors, and others, led the Prairie law societies to an initial focus on ABS. However, as discussions evolved, it became clear that it was largely impractical to look at ABS alone. How would we regulate an ABS? What are the appropriate tools? In order to create opportunities for ABSs, we could regulate not only individual lawyers but also their organizations as a whole. In other words, we would have to regulate entities.

Further, as we began to investigate the possibility of entity regulation, it became clear that while paving the way for ABS was one motivation, even more important were the proactive regulatory possibilities that entity regulation presented. We know that most lawyers organize themselves into firms. In practice, it is the infrastructure of the firm that dictates how ethical issues such as conflicts are managed. The opportunity to influence everything from the way files are managed to the culture of the profession also resides at the firm level. If law societies were able to ensure that the appropriate infrastructures exist within a firm to avoid complaints, this would truly be a proactive and preventative approach to protecting the public. This took us back to the beginning and the recognition that three components – entity regulation, compliance-based regulation and ABS – are all intimately connected.

In brief, entity regulation would represent a move from largely regulating only individual lawyers to also regulating the organizations in which they work. A possible mechanism for entity regulation is compliance-based regulation, which would set out a series of objectives and require lawyers and their organizations to demonstrate how they are meeting those objectives within their organizations. Finally, ABSs would be a type of entity regulated through a compliance-based regime. There are many possible forms of ABS but they might include provisions for non-lawyer investment in law firms, multi-disciplinary practices or a variety of other arrangements.

In initiating this process of regulatory innovation, we are cognizant of the reality that one approach may not suit all practice structures or practice areas. As the work and ongoing discussion and dialogue develops, we will ensure that the impact (and regulatory burden) is considered for a variety of stakeholders.

This is not a revolution in regulation, but rather an evolution that will be guided by our duty to protect the public interest.

## b) The Discussion Paper

The purpose of this discussion paper is threefold:

1. Provide an update on the work of other jurisdictions, both inside and outside of Canada, on regulatory reform.
2. Explain and define entity regulation, compliance-based regulation and alternative business structures.
3. Develop the start of a regulatory framework, applicable across Alberta, Saskatchewan and Manitoba for consideration and discussion.

In doing this work, we are clear that this discussion paper is a first step. We have no illusions that simply opening the discussion to these issues will enable us to find all of the answers. This is a process and the intention of this paper is to set the groundwork and try to advance the discussion with a clear understanding that there will be more to come.

We also recognize that a tremendous amount of work has been done on these topics and we are not original in our approach. On the contrary, we are borrowing heavily from the work of others in developing this work and appreciate the thoughtful and rigorous study that many have contributed. Learning from other leaders, other jurisdictions' experiences will continue to be of ongoing benefit to the Prairie law societies as this process unfolds.

## II. ENVIRONMENTAL SCAN

A more detailed discussion of initiatives around the world and in Canada that are applicable to our work will follow later in the paper. At this stage, however, it is helpful to have a general overview of what is happening in Canada and internationally, in this arena.

Several Canadian jurisdictions are looking closely at proactive regulation. Some, including Nova Scotia, British Columbia, Saskatchewan and shortly Manitoba, have the formal legislative authority to regulate entities; neither Alberta nor Ontario currently have that authority.

Many of the initiatives that we are now grappling with have already been implemented and are evolving in other countries, particularly England and Wales and Australia. In fact, not surprisingly, many jurisdictions remain in flux. It is useful to have a general understanding of the direction these countries are taking in order to ground our discussion in the Prairie provinces.<sup>1</sup> We are in the fortunate position of being able to learn from the pathways many jurisdictions have taken and select the most effective forms of regulation for our environment.

For a complete review of the history of the development of ABS in Australia, the UK and Canada, as well as the debate over ABS in the United States, see "Access to Justice and The Ethics and Politics of Alternative Business Structures" by Richard Devlin and Ora Morison.<sup>2</sup>

### a) Nova Scotia

Of all the Canadian provinces, Nova Scotia is the most advanced in its consideration of entity and compliance-based regulation. Starting with the paper *Transforming Regulation and Governance in the Public Interest*, published in October 2013, the Nova Scotia Barristers Society (NSBS) began to explore changes to their regulatory model that would be "proactive, principle based and outcomes focused; able to encourage and accommodate new business models; able to enhance access to justice and affordable legal services and involve new ways of engaging law firms to achieve outcomes".<sup>3</sup> Nova Scotia is not currently looking at ABS regulation.

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<sup>1</sup> Note: Some U.S. states are engaging in discussion around proactive regulation as well. In Washington, the state has begun licensing Limited License Legal Technicians. The American Bar Association has established the Commission on the Future of Legal Services, whose mandate is to "propose new approaches that are not constrained by traditional models for delivering legal services and are rooted in the essential values of protecting the public, enhancing diversity and inclusion and pursuing justice for all".

<sup>2</sup> Richard Devlin and Ora Morison, "Access to Justice and The Ethics and Politics of Alternative Business Structures" (2014) 91 Canadian Bar Review: <[http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2437035](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2437035)>.

<sup>3</sup> Creative Consequences P/L, *Transforming Regulation and Governance Project, Phase 4* (September 23, 2014) at 16.

In order to create this model, the NSBS established six phases of their project:

1. Review of the present regulatory and ethical requirements for lawyers including an analysis of conduct complaint data and professional indemnity claims.
2. The design of a set of 'objectives' considered necessary to encompass the findings of Phase 1.
3. A consultation phase for stakeholders on the entire process but specifically on the 'objectives'.
4. The design of a 'self-assessment' process to enable entities to address the 'objectives'.
5. A further consultation phase.
6. The implementation phase including design of an 'audit' or 'review' function.

The first four phases of the project are complete and they have now established a series of working groups moving towards implementation. The process and approach continues to evolve in Nova Scotia and they are fine-tuning as they proceed.

#### **b) Ontario**

The Law Society of Upper Canada (LSUC) initiated action on ABS with a Discussion Paper issued in the fall of 2014 on ABS.<sup>4</sup> The Discussion Paper was designed to assist lawyers and the public in understanding ABSs as a means of delivering legal services in Ontario and sought input from that same constituency. The Discussion Paper sparked a heated debate among lawyers in Ontario, and generated more than 40 formal responses. LSUC is continuing to study the matter of ABSs along with the responses received and has made no decision on whether they will move forward with the initiative.<sup>5</sup>

More recently, LSUC has decided to take a closer look at compliance-based entity regulation and the Benchers have struck a task force to study the matter.

#### **c) British Columbia**

The Law Society of British Columbia has the legislative authority to regulate law firms of any size and organizational structure. "Law Firm" is defined as "a legal entity or combination of legal entities carrying on the practice of law". The Law Firm Regulation Task Force has been given the mandate to recommend a framework for the regulation of law firms.<sup>6</sup> It does not appear that ABS is part of the discussion in B.C. at this time.

#### **d) Québec**

The Barreau du Québec permits multidisciplinary practices as well as non-lawyer ownership of voting shares in professional corporations that practice law. Lawyers or other regulated professionals must own at least 50 per cent of the voting shares.<sup>7</sup>

#### **e) Australia**

Australia, New South Wales (NSW) in particular, has led the world in developing a proactive approach to regulation of lawyers. This model served as a starting place for regulatory changes in England and Wales and is now grounding the Canadian discussion of entity regulation, compliance-based regulation and ABS.

In 2001, legislation was passed in NSW allowing for the creation of Incorporated Legal Practices (ILPs), which could include Multi-Disciplinary Practices (MDPs).<sup>8</sup> Amendments in the 2004 legislation allowed for a legal service

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<sup>4</sup> The Law Society of Upper Canada, "Alternative Business Structures and the Legal Profession in Ontario: A Discussion Paper" (September 2014) [LSUC Discussion Paper]. Online at: <<https://www.lsuc.on.ca/uploadedFiles/abs-discussion-paper.pdf>>.

<sup>5</sup> <http://www.lsuc.on.ca/ABS/>

<sup>6</sup> <http://www.lawsociety.bc.ca/page.cfm?cid=3966&t=Law-Firm-Regulation-Task-Force>

<sup>7</sup> Regulation respecting the practice of the profession of advocate within a limited liability partnership or joint-stock company and in multidisciplinary, CQLR, c B-1, r 9 [Quebec Regulation]. Online at: <<https://www.canlii.org/en/qc/laws/regu/cqlr-c-b-1-r-9/latest/cqlr-c-b-1-r-9.html>>.

<sup>8</sup> *The Legal Profession (Incorporated Legal Practices) Act 2000* No 73 (NSW).

provider to incorporate either alone or along with other providers who may or may not be “legal practitioners”.<sup>9</sup> Other Australian jurisdictions subsequently amended their legislation to model the NSW legislation and currently, South Australia is the only Australian state or territory that does not regulate ABSs.<sup>10</sup> Today, there are over 1,200 approved ILPs in NSW, representing roughly 30 per cent of all legal practices in that jurisdiction.<sup>11</sup>

NSW’s new rules also required each ILP to appoint a Legal Practitioner Director accountable for the management of legal services of the practice.<sup>12</sup> In addition, all ILPs were required to create and maintain a management framework called an “appropriate management system” which was intended to ensure the professional and other obligations of lawyers were upheld. Failure to establish and maintain such a system could result in a finding of professional misconduct.<sup>13</sup>

On 1 July 2015, the Legal Profession Act 2004 was repealed and replaced by the *Legal Profession Uniform Law, Legal Profession Uniform Law Application Act 2014*. The Uniform Law and Uniform Rules will be implemented in NSW and Victoria. The OLSC website indicates that while some of the ways in which appropriate management systems are maintained will change, the concept still exists under the new regime.<sup>14</sup> It appears that these changes will represent a less proactive approach in NSW and Victoria, but how the changes will actually be implemented by the regulators remains to be seen.

## f) England and Wales

Changes in regulation in England and Wales over the last decade have been dramatic. The *Legal Services Act 2007*<sup>15</sup> established an entirely new regime for the regulation of lawyers. While the overall framework in England and Wales is complex<sup>16</sup>, they have, among other things, introduced entity and compliance-based regulation that also allows for the creation of ABSs. Most of this work has been done by the Solicitors Regulatory Authority (SRA), which is charged with setting standards for and regulating solicitors in England and Wales.<sup>17</sup> The Bar Standards Board (BSB) is responsible for regulating barristers and has recently begun regulating entities, but not yet ABSs.<sup>18</sup>

The SRA currently regulates approximately 10,500 entities, which include sole practitioners, law firms and ABSs.<sup>19</sup> The SRA approved its first ABS application in early 2012.<sup>20</sup> As of June 2014, of the 10,571 solicitor firms in England and Wales, approximately 330 of them are ABS firms.<sup>21</sup> The SRA’s approach to regulation is based on 10 mandatory principles, which support their Code of Conduct.

A recent report prepared for the Legal Services Board and the SRA has suggested that the adoption of an ABS has resulted in a positive impact on innovation.<sup>22</sup>

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<sup>9</sup> Steve Mark, Office of the Legal Services Commissioner, “The Future is Here: Globalization and the Regulation of the Legal Profession, Views From an Australian Regulator” (Chicago, May 2009) at 3 [Mark 1].

<sup>10</sup> Christine Parker, Tahlia Gordon and Steve Mark, “Regulating Law Firm Ethics Management: An Empirical Assessment of an Innovation in Regulation of the Legal Profession in New South Wales” (2010) 37:3 *Journal of Law and Society* 466 Parker, Gordon and Mark]. Available at SSRN: <<http://ssrn.com/abstract=1527315> or <http://dx.doi.org/10.2139/ssrn.1527315>>.

<sup>11</sup> Steve Mark, “Commercialisation of Legal Practice – Regulatory Reflections from NSW”, Commonwealth Law Conference, 21 April 2012 [Mark 2].

<sup>12</sup> Andrew Grech and Tahlia Gordon, “Should Non-Lawyer Ownership of Law Firms be Endorsed and Encouraged” (May 2015). <<http://www.law.georgetown.edu/academics/centers-institutes/legal-profession/upload/Grech-Gordon-Non-Lawyer-Ownership-Paper-Final.pdf>>.

<sup>13</sup> *Ibid.*

<sup>14</sup> *Legal Profession Uniform Law Application Act 2014 (NSW)* s. 257.

<sup>15</sup> *Legal Services Act, 2007*, c.29 pt. 5 (U.K).

<sup>16</sup> Victoria Rees provides an excellent summary of the England and Wales model in her paper *Transforming Regulation and Governance in the Public Interest*, Nova Scotia Barristers’ Society, October 2013, <<http://nsbs.org/sites/default/files/cms/news/2013-10-30transformingregulation.pdf>>.

<sup>17</sup> <http://www.sra.org.uk/sra/how-we-work/what-we-do.page>

<sup>18</sup> See: <<https://www.barstandardsboard.org.uk/regulatory-requirements/for-prospective-entities/>>.

<sup>19</sup> Presentation from Jonathan Smithers, President of the Law Society (England and Wales), (Law Society of Alberta, August 14, 2015).

<sup>20</sup> Dan Bindman, “ABSs top 300 mark with latest licensees demonstrating variety of new legal breed”, April 16, 2014, *Legal Futures*, online at <<http://www.legalfutures.co.uk/latest-news/abs-top-300-mark-latest-licencees-demonstrating-variety-new-legal-breed>>

<sup>21</sup> [www.sra.org.uk/sra/how-we-work/reports/data/population\\_solicitors.page](http://www.sra.org.uk/sra/how-we-work/reports/data/population_solicitors.page)

<sup>22</sup> Enterprise Research Centre, “Innovation in Legal Services, A Report for the Solicitors Regulatory Authority and the Legal Services Board”, July 2015.

## **g) United States**

In the United States, the District of Columbia permits some non-lawyer ownership and management of law firms. As part of the American Bar Association (ABA) Commission on Ethics 20/20, an ABA Working Group on ABS was established in 2009 to consider changes to its regulatory model to allow ABS. The ABA ultimately rejected all proposals to allow ABS in 2012.<sup>23</sup>

### **III. ENTITY REGULATION**

#### **a) What is entity regulation?**

The delivery of legal services has changed. On an increasing basis, services are being provided by entities, including law firms, in-house departments and other structures, rather than by lawyers offering services in sole practices.

“Entity Regulation” or “entity-based regulation” or “law firm regulation” simply means regulating law firms as well as lawyers and other individuals operating within the firm who are non-lawyers. Put another way, it amounts to the regulation of the business entity through which professional legal services are delivered.

Regulating entities that provide professional legal services would allow complaints to be made to the Law Society regarding a firm and firms could face sanctions for failing to comply with certain obligations. Standards of conduct could be set for firms to meet. Depending upon how an entity is regulated, we could be proactive in our regulation rather than simply reactive – that is, by becoming involved after receipt of a complaint.

#### **b) Don't we already regulate firms?**

Some aspects of what we do, as regulators, already involve 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, the rules are insufficient, as they have arisen piecemeal to deal with particular circumstances. The practice of law has changed and law societies must respond by developing and implementing the tools that are necessary to effectively govern the delivery of legal services. Is it fair to take one lawyer to task and impose discipline if that lawyer was simply following firm policies or directives? To govern more effectively, we must consider all aspects of entity regulation and the innovations that both drive and enable such regulation.

Currently, individual lawyers are held to account for conduct that is viewed as a breach of a Code of Professional Conduct provision or a specific rule. Lawyers are sanctioned for their conduct. However, there is no overall regulation of law firms even though the firm may bear some responsibility for improper conduct on the part of an individual lawyer. It may be that the lawyer's conduct was driven by firm expectations, norms or cultures. Typically, we focus our investigative resources on determining what took place, how the lawyer was involved, if any rules were breached and, if so, how the lawyer should be sanctioned. Arguably, when investigating what happened and why, we have not taken all potentially relevant factors into account.

#### **c) Why regulate entities?**

It is recognized that regulators of the profession must evolve in order to remain relevant and to fulfill the mandate of protecting the public interest. Increasingly, regulators are asking whether it is enough to react to complaints or initiate investigations following receipt of information that already raises a red flag.

To some extent, regulators who conduct practice audits or random trust account spot audits are already adopting a proactive regulatory vision and putting it into practice. But, we ought to consider whether we could and/or should do more.

Regulation of entities would close a gap in the current regulatory framework. Professor Adam Dodek is of the view that: “The absence of law firm regulation creates a problem of legitimacy for Law Societies mandated to regulate the practice of law in the public interest. This regulatory gap also raises Rule of Law concerns and may threaten public confidence if the public believes that the most powerful groups of lawyers escape regulation...

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<sup>23</sup> *Ibid* at 9-10.

Consequently, the failure to regulate law firms may threaten self-regulation of the legal profession in Canada.”<sup>24</sup>

It is recognized that firms play a considerable role when examining what drives the behaviour of its members. As Professor Adam Dodek has observed: “...the law firm is an independent actor exerting significant influence on the practice of law...”. He points out that, “Law firms are front and center in the lawyer-client relationship.”<sup>25</sup>

It has been suggested that the law firm is now the intermediary between client and lawyer.<sup>26</sup>

Professor Dodek notes that:

This is certainly true in terms of advertising, solicitation, client intake, conflicts of interest, retainer agreements, billings and many other interactions that clients and potential clients have with the delivery of legal services via ‘the firm’. With larger law firms, the influence of a collective culture may be even stronger.<sup>27</sup>

The American Bar Association’s Model Rules regarding law firms recognize that “*the ethical atmosphere of a firm can influence the conduct of all its members.*”<sup>28</sup>

This reality underscores the need to examine the regulation of firms.

### i) Advantages of Entity Regulation

There are several advantages that could be gained if entity regulation became a reality:

- the regulator could encourage those who control the entity to develop and monitor training, supervision, and quality control systems;
- there would likely be improved management and cultures of law firms, as a whole;
- overall, there would be greater accountability to the regulator;
- effective entity regulation may enhance individual accountability by creating an “ethical infrastructure”<sup>29</sup> for lawyers within a firm;
- the public would have increased confidence that regulators have the ability to self-regulate in the public interest;
- there would be increased protection of the public;
- since entity regulation may result in the regulation of lawyers and non-lawyers (who work within an entity), barriers could be removed which may increase:
  - access to justice; and
  - regulatory effectiveness.

### ii) Disadvantages of Entity Regulation

Possible disadvantages of entity regulation require consideration of the following:

- 1) An expanded regulatory regime will require firms to focus on ethical behavior and conduct at a firm level. While some firms may do this already, others don’t and smaller firms, in particular, may find this to be a difficult adjustment.

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<sup>24</sup> Adam Dodek, “Regulating Law Firms in Canada” (2011) 90 Canadian Bar Review 383 at 387.

<sup>25</sup> *Ibid* at 389.

<sup>26</sup> Lucie Lauziere, “Dependence and Interdependence in the Lawyer-Client Relationship” in Law Commission of Canada, ed., *Personal Relationships of Dependence and Interdependence in Law* (Vancouver: UBC Press, 2002) 40 at 41.

<sup>27</sup> Dodek, *supra* note 24 at 389.

<sup>28</sup> *ABA Model Rules of Professional Conduct, Rule 5.1, Commentary 2.*

<sup>29</sup> “Ethical infrastructure” describes a law firm’s organization, policies and operating procedures. The term was first used by Professor Ted Schneyer of the University of Arizona; see, for example, Ted Schneyer, “On Further Reflection: How “Professional Self-Regulation” Should Promote Compliance with Broad Ethical Duties of Law Firm Management” (2011) 53 Ariz. L. Rev. 577 at 585 [Schneyer 1].

- 2) Buy in from the profession will be needed as the concept represents a departure from the traditional approach to lawyer regulation.
- 3) Effective planning for entity regulation will require consultation with the profession which represents a time commitment and utilization of resources.
- 4) Creating compliance systems within firms will require time and money.
- 5) Some jurisdictions may require legislative amendments in order to bring about such changes but changes take time and require support of stakeholders.
- 6) There is a danger associated with creating another layer of regulation for what is an otherwise highly regulated profession.

#### d) Defining “legal entity”

How should we define a “legal entity?” It is helpful to compare relevant legislation currently in place in Nova Scotia, British Columbia and Saskatchewan, and pending Manitoba legislation relating to the ability to regulate entities. It is also useful to note some developments in Ontario.

##### i) Nova Scotia

Since 2005, the Nova Scotia Barristers’ Society has had express statutory authority to regulate law firms. In Nova Scotia, the governing act defines “law firm” as a “partnership, a law corporation, any other joint arrangement, or any legal entity carrying on the practice of law.”

Under their “authority to practice law” sections, it is set out in s. 16 that “only a lawyer, a law firm or a law corporation may advertise or hold out that the services of a lawyer are available to the public.

The act provides authority for their Council to make regulations:

- Requiring law firms to register with the Society.
- Requiring law firms to designate a member of the firm who is to receive official communication from the Society to the firm.
- Specifying what information law firms must provide and keep current with the Society.

Council may also make regulations permitting the practice of law in the Province by law firms having an office in the Province and an office in one or more foreign jurisdictions, and regulating the practice of law by a firm.

The Society’s authority to regulate law firms is found in Part III of their Act. Section 27 provides that unless otherwise indicated, in Part III and IV, “member of the Society” includes a law firm. Accordingly, in Nova Scotia, the Society may receive complaints against firms, investigate firms, commence a discipline hearing against a firm, and in the event of an adverse finding, discipline the firm by reprimand, fine or other order or condition as is appropriate.

“Legal entity” is not currently defined in Nova Scotia’s act or rules but they have developed a working definition as follows: “a lawyer or a group that carries out the work that is supervised by a lawyer, whether the work is done by a lawyer or a non-lawyer, including but not limited to law firms, in-house counsel and teams, government counsel and teams, and Legal Aid.”

##### ii) British Columbia

British Columbia’s governing statute was amended in 2012. At that time, the Law Society was given the authority to regulate “law firms” in addition to its authority to regulate individual lawyers. “Law firm” is defined as “a legal entity or combination of legal entities carrying on the practice of law.” (Emphasis added.)

The Society may:

- receive complaints against law firms;
- investigate law firms;

- commence a discipline hearing against a law firm; and,
- if a discipline panel makes an adverse finding against a law firm, discipline the firm by reprimand, fine, or other order or condition as is appropriate.

### iii) **Saskatchewan**

In Saskatchewan, the Society has the ability to regulate firms by virtue of the new definition of “member” in section 2(1)(h) which includes firms. “Firm” is then defined in s. 2(1)(f.1) as follows:

“firm” means any of the following that provides or provide legal services to the public:

- (i) a sole proprietorship;
- (ii) a partnership;
- (iii) a corporation;
- (iv) two or more members holding themselves out as practising in association;
- (v) any other business entity;

but does not include any entity that receives all or substantially all of its funding from the Government of Saskatchewan;

In addition, the “preamble” to all of section 10 (which sets out the Benchers’ rule-making authority) was amended to include firms as follows: “The benchers may make rules for the governing of the society, for the regulating of lawyers, firms, articled students-at-law and applicants, and for the carrying out of this Act, for the following purposes:”

The Society can also require firms to have permits pursuant to s. 10(1)(k) – although this provision has not yet been utilized. It may be something that they consider incorporating once a regulatory scheme is determined.

### iv) **Manitoba**

Manitoba’s pending legislation sets out that “law firm” means a sole proprietorship, a partnership, a law corporation or any other joint arrangement or legal entity that provides legal services. The legislation will give Benchers the authority to make rules respecting law firms that:

- permit and regulate different types of arrangements to provide legal services, including arrangements between lawyers and non-lawyers and that establish conditions and requirements for the arrangements;
- require law firms to “register” with the society;
- require law firms to designate a practicing lawyer of the firm who is to receive official communication from the society;
- specify what information the law firms must provide and keep current with the society;
- set fees to be paid by law firms.

These rules may also deal with the complaints and discipline process, the financial accountability rules and the use of a code of conduct.

The proposed legislation will also authorize panels of the discipline committee to:

- reprimand the firm;
- order the firm to pay a fine of not more than \$100,000.00;
- make any other order or take any other action the panel deems appropriate.

## v) Ontario

In considering ABSs, the Law Society of Upper Canada contemplated the merits of firm or entity-based regulation for Ontario. The responsible Working Group recommended that the Law Society develop a framework for the regulation of firms, including entities, providing legal services. Convocation approved this recommendation and work has begun on this initiative.

### e) Developing a working definition of “legal entity”

For the purposes of discussions amongst the Prairie provinces, it may be useful to put some parameters on our discussions such that we agree to consider a couple of options for a rough working definition.

#### i) Option A

We could consider a “legal entity” to be an organization **which includes lawyers** and provides legal services **to the public**.

Under this definition, we would not seek to regulate as an entity a company such as IBM (that is a legal entity and which has in-house counsel), provided that the company does not provide legal services to the public. Nor would such a definition lead to regulation of groups of government lawyers, as services are not provided to the public.

As well, such a definition would not amount to the regulation of entities or organizations that provide legal services to the public in the form of representation for minor highway traffic act offences since there are no lawyers involved. In Manitoba (for example), those who provide such HTA services are authorized to do so under the provisions of our Act without offending the unauthorized practice of law sections.

Under this option, though, Legal Aid would be considered a governable entity – at least to some extent – since services are provided to the public, unless a decision is made to exempt such an entity.

Keep in mind that the wording of the pending legislation in Manitoba seems to open the door to the regulation of an entity such as POINTTS, because it does not stipulate that lawyers are the only ones who may provide “legal services.” And, surely a non-lawyer advocate for someone who is charged with a HTA offence is, of course, providing legal services. That will be a matter for Law Society of Manitoba’s Benchers to consider at some point.

As noted above, the British Columbia act defines a law firm as an entity or entities carrying on the practice of law (as opposed to entities that provide legal services).

#### ii) Option B

Nova Scotia’s working definition is: a lawyer or a group that carries out the work that is supervised by a lawyer, whether the work is done by a lawyer or a non-lawyer, including but not limited to law firms, in-house counsel and teams, government counsel and teams, and Legal Aid.” Nova Scotia has determined to include in its working definition, in-house counsel and teams, government counsel and teams as well as Legal Aid.

Should we give serious consideration to option B – especially since the practice of law has changed and many lawyers practice law as in-house counsel or in a government setting?

We must consider what we would hope to regulate when it comes to the types of services that are delivered by in-house counsel to their clients or government lawyers. Do we want to extend our regulatory reach such that we could fine, for example, Legal Aid Manitoba? We must also consider how we might reasonably hope to be able to regulate these kinds of entities – or parts of those entities (e.g., law departments)

In light of the above, it is clear that we must give careful consideration to our working definition of “legal entity” for our current purposes.

### f) Defining “legal services”

As noted above, Manitoba’s pending legislation and Saskatchewan’s legislation include reference to the provision of “legal services.” The Act in British Columbia references the practice of law.” We will need to consider what is meant by the provision of legal services or, indeed, whether we ought to be focusing upon this at all.

When Nova Scotia embarked on its plan to revise regulation, they struggled with how to define “legal services.”

We should keep in mind that many Law Societies already have statutory provisions that define the “practice of law,” typically in the context of outlining what constitutes unauthorized practice.

Non-lawyers, most of who are non-regulated, are already providing some legal services to the public. In some cases, the provision of such services does not amount to unauthorized practice because of statutory exemptions.

When considering a potential definition for legal services, it is important to bear in mind that there are those who believe that:

...it is important to avoid the Siren call of defining the “practice of law.” Such efforts typically result in a division of the world into two groups – those who “practice law” and those who do not. Those who practice law are required to be lawyers, and those who do not are largely free of any direct regulation or oversight.

There are at least two problems with this binary approach. First, we do not always need to choose between highly regulated lawyers and completely unregulated “others.” It is possible to have a third group who can deliver legal and law-related services and advice while being subject to appropriate training and licensing. These kinds of innovations are not possible, or at least made more difficult, if the definition of “law practice” is the sole focus of attention...

Rather than trying to define the practice of law, we should ask a fundamentally different question: should someone without a law degree be “authorized” to provide a particular service, even if it might be the “practice of law?” By focusing attention on whether the provider is competent to deliver a service, we can more effectively achieve what really matters: protecting the public.<sup>30</sup>

For our purposes, at this point in the discussion, there is some early consensus amongst the Prairie law societies that we wish to treat legal services as those that are provided by lawyers or by non-lawyers under the supervision of lawyers. In other words, **at this stage**, we are not considering whether the law societies should regulate the provision of legal services however they are provided (i.e., even if provided by non-lawyers without the supervision of lawyers). To consider whether the Prairie law societies want to regulate the provision of all legal services is beyond the mandate of the joint working group.

Of interest, very recently Nova Scotia determined that “legal services” cannot be effectively defined in any meaningful way. This decision was made following discussions with various jurisdictions around the world at the International Legal Regulators Conference. Accordingly, they will now focus on defining “legal entity” and work on defining their “scope of regulation.”

There is a consensus in Nova Scotia to increase the scope of what a non-lawyer can do as long as non-lawyers remain under a lawyer’s supervision. There is little support to expand the provision of non-supervised legal services by non-lawyers although they want to consider the advisability of allowing non-lawyers to engage in some form of legal services, which do not include providing legal advice in some specified areas (such as child welfare, real property, criminal matters where life and liberty are at stake) and which do not indicate demonstrable harm to the public.

### **g) Models of firm regulation**

The regulation of professionals can be classified in different ways. For example, we might distinguish between “input measures” and “output measures.”<sup>31</sup> Input measures are mechanisms that focus on entry into the profession (e.g., good character requirements, articling) while output measure focus on actions while in practice: complaints, discipline, insurance, continuing legal education.<sup>32</sup>

We could also consider the difference between a complaint-based system and a compliance-based system. Most law societies are complaint-based and a lawyer who is not the subject of a complaint will not typically attract the attention of the regulator. The fairly recent introduction of mandatory continuing legal education (CLE) or continuing professional development (CPD) is an example of a compliance-based regulatory initiative.

We could also contrast direct and indirect forms of regulation. An example of direct regulation relates to the

<sup>30</sup> Andrew M. Perlman, “Towards the Law of Legal Services” (February 1, 2015), Suffolk University Law School Research Paper No. 15-5 June 23, 2015. Available at SSRN: <<http://ssrn.com/abstract=2561014>>.

<sup>31</sup> Michael Trebilcock, “Regulating Legal Competence” (2001) 3 Can Bus LJ 444.

<sup>32</sup> *Ibid* at 444.

imposition of strict accounting rules and conflicts rules that apply when lawyers switch firms. Indirect regulation may consist of attempts to regulate the conduct of firms by regulating individuals who are in positions of authority.

When looking at direct regulation, as pointed out by Professor Dodek,<sup>33</sup> there are numerous ways to directly regulate the activities of a firm as follows:

- Registration - essentially, an information gathering exercise.
- Licensing - where there are some requirements and a vetting process and the requirements may be minimal or onerous. Typically, there is an ability to impose conditions or restrictions on a license and an ability to revoke it.
- Information, which means that firms must provide information to the regulator. The information may be used for compliance purposes (e.g., could trigger an audit) or it may lead a firm to make changes to its own policies (following a self-audit experience).
- Compliance - various tools could be used such as practice reviews or firm audits. Self-audits could be required or firms could be required to establish compliance systems.
- Discipline - imposition of sanctions against a firm (e.g., reprimands, fines, suspension of licenses, imposition of conditions, requiring a firm to establish certain systems).

#### **h) Current regulatory structure in Canada**

As summarized by Professor Dodek in his comprehensive article:<sup>34</sup>

- Canadian law societies regulate the legal profession primarily through two mechanisms: licensure and discipline.
- Currently, such regulation is primarily “complaints-based”, i.e., one that is reactive to complaints received about the conduct or competency of lawyers (although there have been some changes when you consider that mandatory CLE fits into a “compliance” model).
- Generally, law societies regulate individual lawyers such that regulatory obligations are imposed, complaints are investigated and lawyers are sanctioned.
- One exception relates to financial regulation. Consider the fact that law societies conduct spot audits of firms (not individual lawyers).
- Currently, there is a fair bit of regulation when it comes to law corporations but little regulation of limited liability partnerships.
- The Barreau du Québec regulates law firms through compliance measures but not discipline. Every firm must provide the Barreau with a detailed undertaking under which it promises to facilitate the ethical behaviour of the advocates working in the firm.
- Nova Scotia seems to have more regulatory powers than other law societies in relation to law firms (from licensing to discipline).

#### **i) Entity regulation in other jurisdictions (provision of legal services): Models to consider**

##### **i) England and Wales**

The most complex regime of entity regulation is found in England and Wales. The legal profession is divided (i.e., solicitors and barristers are regulated separately). The Solicitors Regulation Authority (SRA) is the independent regulatory body that governs solicitors. The SRA introduced “outcomes-focused regulation” (“OFR”) in the fall of 2011, which will be described in more detail later in the paper.

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<sup>33</sup> Dodek, *supra* note 24 at 405-409.

<sup>34</sup> *Ibid* at 409-414.

Using an “outcomes-focused regulation” model requires:

- all new law firms to go through an authorization process; and,
- that compliance officers be appointed for each firm.

The SRA also supervises firms and can take enforcement action against firms and/or individual lawyers. The Solicitors Disciplinary Tribunal and the Legal Ombudsman can also order sanctions/relief against firms.

Under the current regime, if a solicitor is not a sole practitioner or practicing in-house, he/she can practice as a manager, employee, member or interest holder of an “authorized body” which includes both traditional law firms and entities operating as alternative business structures.

#### **A. Authorization process**

As part of the “authorization process” firms are required to provide details of the firm’s governance structure, sources of funding, debt management plans, projected cash flow, service delivery channels (will services be delivered in person/on the phone/via internet), referral arrangements and how the firm will ensure that it will run the business and that individuals will carry out their roles in a way that encourages equality of opportunity and respect for diversity.<sup>35</sup>

The key outcomes that the SRA identifies as the basis for the authorization process include:

- Clients and the general public remain confident that legal services provided by those we regulate will be delivered to the required standard and in a principled manner.
- Firms that the SRA authorizes will be managed in such a way, and with appropriate systems and controls, so as to protect the public and safeguard the reputation of the legal profession.
- Only those individuals and firms who/that meet the SRA’s criteria for authorization or approval (including the requirements to be suitable and capable of providing legal services to the required standard) are authorized or approved.

All authorized bodies must appoint a Compliance Officer for Legal Practice (“COLP”) and a Compliance Officer for Finance and Administration (“COFA”). The SRA views these two roles as an integral part of its move to “outcomes-focused regulation.”

#### **B. Supervision and enforcement**

Once an authorized firm is running, the SRA stays involved in both supervision and enforcement.

Key features of the supervisory role include:

- engaging with firms in response to “events” (e.g., a report of misconduct) or as part of broader “thematic” work with a number of firms;
- using both “desk-based supervision” and “visit-based supervision (former involves telephone contact with firms while the latter involves visits by regulatory officials to firms);
- “constructive engagement” with the aim to assist firms in tackling their own risks and help them improve their standards; and,
- if there is serious non-compliance with the SRA principles or a risk to the public exists which cannot be mitigated, then enforcement action will be taken.

Enforcement action may be taken against a firm or an individual. If there is a failure to comply with the relevant obligations, the SRA may give a warning, impose a fine, revoke or suspend authorization of the firm, withdraw approval of a person being an owner of a licensed body or impose conditions on the holding of an interest. There may also be an “intervention” into a practice, which means the SRA will step in and take possession of the firm’s client documents and funds.

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<sup>35</sup> Solicitors Regulation Authority, “Firm-Based Authorization” (online: <<http://www.sra.org.uk/solicitors/firm-based-authorisation.page>>).

Sometimes, the SRA does not make a final decision and refers the matter instead to the Solicitors Disciplinary Tribunal, an independent body with the authority to make decisions relating to alleged misconduct of individual solicitors and firms.

### Barristers

There are significantly fewer barristers but the Bar Standards Board – the independent regulatory body for barristers – has initiated involvement with entity-regulation.

### Legal Ombudsman

The Ombudsman also has authority over firms as well as individual solicitors and barristers. It provides a more informal process for clients to pursue complaints about poor service. The Ombudsman may order relief against an individual lawyer or law firm.

## ii) **Australia**

In Australia, Alternative Business Structures have been allowed in several states and territories. For example, in New South Wales, the governing act allows for legal service providers to incorporate and provide services alongside non-lawyers. These entities are known as “incorporated legal practices” (ILPs) and they led to the introduction of regulatory controls.

Until the very recent implementation (July 2015) of the new act known as the *Legal Profession Uniform Law*, ILPs were required to have a “legal practitioner director” who had to implement and maintain “appropriate management systems.” Under the former governing statute, a self-assessment process was developed to assist ILPs to demonstrate that they had implemented appropriate management systems. Although it appears that self-assessments are no longer required, preliminary studies showed that the self-assessment process had been successful.

### Legal Profession Uniform Law

#### *Qualified Entities*

The Uniform Law prohibits an entity from engaging in legal practice in New South Wales unless it is a “qualified entity.”

A qualified entity includes sole practitioners and partnerships as well as incorporated legal practices and community legal services and introduces a new practice structure known as unincorporated legal practices.

#### *Incorporated Legal Practices and Unincorporated Legal Practices*

An Incorporated Legal Practice (ILP) is a corporation, which is a company within the meaning of the Corporations Act (or of a kind approved by the Council).

An Unincorporated Legal Practice (ULP) is an unincorporated body or group that is:

- a partnership or
- an unincorporated body or group or an unincorporated body or group as approved by Council.

The legal services that the ILP or the ULP provides cannot be limited to either or both of the following:

- in-house legal services for the corporation or related legal entity services that are not legally required to be provided by an Australian legal practitioner and that are provided by an officer or employee who is not an Australian legal practitioner.

An ILP and an ULP may provide both legal and non-legal services. Where the ILP or ULP provides both types of services, certain disclosure requirements apply. The law practice must disclose to the client which of the services are legal services and who will be providing them. Although the obligation to disclose resides with the law practice, if a law practice contravenes any provision of the Uniform Law imposing an obligation on the law practice, a principal of the law practice is taken to have contravened the same provision in certain circumstances.

An ILP or an ULP must provide 14 days' written notice of intention to engage in legal practice and must also provide written notice within 14 days after it ceases to engage in legal practice. The incorporated legal practice must also hold professional indemnity insurance.

The Law Society of NSW indicates that it “seeks to align the commercial imperatives that drive the business of legal practice with the regulatory framework largely contained in the Uniform Law. This approach encourages solicitors to view regulatory compliance not as an authoritative burden, but as a means to generate client satisfaction and drive profitability.”<sup>36</sup>

A Regulatory Compliance Support Unit offers confidential assistance to prevent compliance issues from escalating into complaints and disciplinary actions. For example, assistance may be provided with respect to practice management, business structures for practices, risk management, incorporated legal practices, multidisciplinary partnerships, transferring a law practice and management systems, including trust accounts, and avoiding a conflict of interest.

A compliance audit can only be conducted if there are reasonable grounds to do so based on conduct or complaint relating to either the law practice of one or more of its associates.

A law practice must have at least one “authorised principal.”

Management system directions may also be given to a law practice and entities may be disqualified from providing legal services under certain circumstances.

### iii) **United States**

Following some high profile scandals in the United States, there was much debate over the issue of disciplining law firms. Only New York and New Jersey have taken steps to directly regulate law firms and engage in law firm discipline. Such powers have been used sparingly. Interest in law firm discipline has waned although there is greater interest in adopting some of the compliance regulation that has been established in Australia and that has been enacted in England and Wales.

## j) **Entity regulation in other professions**

### i) **Accounting**

Across the country, Chartered Accountants, Certified Management Accountants, Certified General Accountants and Certified Public Accountants are moving towards (or have already obtained) the new designation of a Chartered Professional Accountant.<sup>37</sup>

Provincial and regional bodies represent the Canadian Chartered Professional Accountant membership. The accounting profession is provincially regulated and therefore, the timing for integration and use of the CPA designation is different across Canadian regions. Currently, some of the provinces and regions will be represented by a merged CPA body while others will be represented by “legacy bodies” until an integrated CPA organization is in place.

CPA Alberta is the professional accounting organization for that province, with the proclamation of the Chartered Professional Accountants Act on July 1, 2015. With the proclamation of *The Accounting Profession Act* on November 10, 2014, all of Saskatchewan’s accountants are now united under the single CPA designation. In Manitoba, CPA legislation received Royal Assent on June 30, 2015 and transitional provisions will allow members and firms to begin using the CPA designation following approval of the CPA Manitoba Bylaws by the Transitional Boards.

The CPA self-regulatory bodies regulate (or will soon regulate) both individuals and entities (such as firms or corporations). In Saskatchewan, CPAs, their professional corporations, firms and candidates who are training to attain the CPA designation are collectively referred to as “registrants.”<sup>38</sup>

<sup>36</sup> The Law Society of New South Wales – Regulatory compliance <http://www.lawsociety.com.au/ForSolicitors/professionalstandards/RegulatorySystems/index.htm>

<sup>37</sup> <https://cpacanada.ca/en/the-cpa-profession/about-cpa-canada>

<sup>38</sup> <https://cpask.ca/en/Protecting-the-Public/Discipline-Process>

The regulatory bodies are involved with registrants through:

- Registration and Licensing
- Supervision/Compliance (practice inspection of firms – typically, when a new entity enters practice and on regular intervals)<sup>39</sup>
- Professional Obligations or Discipline (complaints can be made against registrants – individuals and entities – and the discipline process may result in a variety of sanctions including issuance of fines or restrictions on the right to practice)

## ii) Securities Industry

Like the accounting profession, the securities industry is provincially regulated. Across the Prairies, the provincial securities commissions enforce compliance with provincial securities laws.

The individual securities commissions participate in the Canadian Securities Administrators (CSA), an umbrella organization of Canada's provincial and territorial securities regulators. Its objective is to improve, coordinate and harmonize regulation of the Canadian capital markets. It achieves this by issuing national instruments.<sup>40</sup>

The CSA aims to achieve consensus on the policy decisions, which affect our capital markets and its participants. It also aims to work collaboratively in the delivery of regulatory programs across Canada, such as the review of continuous disclosure and prospectus filings.

While the CSA co-ordinates initiatives on a Canada-wide basis, provincial or territorial regulators handle all complaints regarding securities violations in their respective jurisdictions. This provides a more direct and efficient service since each regulator is closer to its local investors and market participants. Enforcement of securities regulations is also done on an individual basis by each province or territory.

In Manitoba, for example, if you are in the business of trading or advising in securities or exchange contracts, you must be registered with a provincial securities commission. Applicants must meet certain educational standards and capital requirements, and follow detailed conduct, solvency and reporting duties. Securities commissions' staff review financial reports, conduct on-site examinations and, when necessary, launch investigations. The type of activities a firm or individual is permitted to carry out determines their registration categories.<sup>41</sup>

All mutual fund dealers and registered investment dealers must also hold membership with a self-regulatory organization, as set out below.

### Mutual Funds

Mutual funds are created by a company or a trust that is responsible for the mutual fund family it issues. These companies or trusts are the distributors and are commonly known as “dealers” and are responsible for the mutual fund families they issue. Securities commissions regulate dealers in each of the jurisdictions in which they operate. The individual securities commissions delegate authority to the Mutual Fund Dealers Association (MFDA) in various provinces.

The Mutual Fund Dealers Association of Canada (MFDA) is the national self-regulatory organization (SRO) for the distribution side of the Canadian mutual fund industry. The MFDA is structured as a not-for-profit corporation and its members are mutual fund dealers that are licensed with provincial securities commissions.<sup>42</sup>

The MFDA is formally recognized as a self-regulatory organization by the provincial securities commissions in Alberta, British Columbia, Manitoba, New Brunswick, Nova Scotia, Ontario, Prince Edward Island and Saskatchewan. An application for recognition is pending before the Superintendent of Securities of Newfoundland and Labrador. The MFDA has also entered into a Co-Operative Agreement with the Autorité des marchés

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<sup>39</sup> See, for example <<https://cpamb.ca/regulating-the-profession/practice-inspection>>.

<sup>40</sup> <http://www.securities-administrators.ca/>

<sup>41</sup> <http://www.mbsecurities.ca/registration/who-needs-to-register/index.html>

<sup>42</sup> <http://www.mfda.ca/>

financiers and actively participates in the regulation of mutual fund dealers in Quebec.<sup>43</sup>

As an SRO, the MFDA is responsible for regulating the operations, standards of practice and business conduct of its members and their representatives with a view to enhancing investor protection and strengthening public confidence in the Canadian mutual fund industry. The majority of the MFDA's staff are actively involved in compliance and enforcement activities.

### *Licensing/Registration*

The MFDA regulates the “dealer” companies (such as the entity through which a bank distributes mutual funds).

Membership in the MFDA means that mutual fund dealers are subject to active and effective regulation. Membership is granted through a formal application process in which applicants must demonstrate that they satisfy the requirements of the MFDA, as well as securities legislation.

Canada's securities regulatory authorities (outside the province of Quebec) require that all mutual fund dealers be members of an SRO. Accordingly, businesses seeking to operate as mutual fund dealers (whether corporations or partnerships) must apply for membership in the MFDA. Please note that businesses, not individuals, apply for MFDA membership. The MFDA regulates the conduct of its members. Individual mutual fund salespersons are regulated by the MFDA by virtue of their employment relationship with their sponsoring mutual fund dealer.<sup>44</sup>

In Canada, becoming registered as a mutual fund dealer is a two-step process. A business must apply to become a member of the MFDA and at the same time, it must apply to the securities regulatory authority in every jurisdiction in which it intends to operate to become registered as a mutual fund dealer.

### *Supervision/Compliance*

MFDA Rules set out detailed requirements for members, including particulars respecting:<sup>45</sup>

- business structures
- capital requirements
- insurance
- books and records
- client reporting, and
- business conduct

Each “member” must have an “ultimate designated person”<sup>46</sup> (e.g., the C.E.O./sole proprietor/officer in charge of a division) who is responsible for:

- supervising the activities of the member that are directed towards ensuring compliance with the by-laws, rules and policies and with applicable securities legislation by the member and its approved persons; and
- promoting compliance with the by-laws, rules and policies and with applicable securities legislation by the member and its approved persons.

Each “member” must also designate a chief compliance officer<sup>47</sup> (e.g. an officer/partner) who is responsible for:

- establishing and maintaining policies and procedures for assessing compliance by the member with by-laws, rules and policies and with applicable securities legislation;

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<sup>43</sup> <http://www.mfda.ca/about/aboutMFDA.html>

<sup>44</sup> <http://www.mfda.ca/members/becoming.html>

<sup>45</sup> <http://www.mfda.ca/regulation/rules.html>

<sup>46</sup> <http://www.mfda.ca/regulation/rules/RulesJun29-15.pdf>

<sup>47</sup> *Ibid.*

- monitoring and assessing compliance;
- reporting to the ultimate designated person as soon as possible if he/she becomes aware of any circumstances indicating that the member may be in non-compliance and the non-compliance:
  - reasonably creates a risk of harm to a client;
  - the non-compliance reasonably creates a risk of harm to the capital markets;
  - the non-compliance is part of a pattern of non-compliance; and
- submitting a report to the board of directors or partners not less than annually for the purpose of assessing compliance by the member.

### *Professional Obligation/Discipline*

A core mandate of the MFDA is to ensure a high level of conduct among its members with regard to mutual fund distribution in Canada.

The activities of the Enforcement Department support the MFDA's goal of developing and establishing firm, fair and transparent regulatory processes and its strategy to enforce MFDA requirements to enhance investor protection. The activities of the Enforcement Department also directly support the MFDA's goal of participating in the Canadian securities regulatory framework, by developing and maintaining collaborative working relationships with other securities regulatory authorities and law enforcement agencies.<sup>48</sup>

The Enforcement Department operates on several general principles:

- Its actions are firm, fair and transparent.
- Members and approved persons are provided opportunity for input before a decision is made on disciplinary action, except in urgent cases involving potential public harm.
- In all cases, the level of supervision by the member (and its approved persons) will be part of the review.
- Cases are reviewed proactively, with a view to identifying possible associated misconduct and assessing root causes.
- The Department works on a cooperative basis with the Compliance and Policy departments to refer cases and issues where appropriate.
- The Department works on a cooperative basis with Enforcement staff at securities commissions and self-regulatory organizations.

The MFDA's Enforcement Department investigates when MFDA member firms and their approved persons breach their rules.

Penalties at Enforcement Hearings may include a reprimand, a fine, a suspension or (at the severe end of the sanction range) prohibition or termination of a member's (or approved person's) authority to conduct securities related business.<sup>49</sup>

In its most recent annual report, the MFDA states:<sup>50</sup>

“We believe the current regulatory framework for MFDA Members is effective and robust considering the combination of our Rules, proactive compliance examinations, enforcement actions and educational efforts. The MFDA's core focus is investor protection and we believe there is still more we can do within the current regulatory framework to make the client/advisor relationship better. As we pursue this goal, we recognize that the solution does not always require rule development; rather, we believe improvements can be made through more effective and practical application of existing requirements. In this regard,

<sup>48</sup> <http://www.mfda.ca/enforcement/enforcement.html>

<sup>49</sup> <http://www.mfda.ca/enforcement/PenaltyGuidelines.html>

<sup>50</sup> <http://www.mfda.ca/about/AnnReports/AR2014.pdf>

we are continually looking for ways to improve the efficiency and effectiveness of our regulatory process through better education and engagement of investors and Members on all aspects of the client/advisor relationship.

## Securities

If an advisor is engaging in the sale of actual securities, rather than a mutual fund, a securities license is involved. The Investment Industry Regulatory Organization of Canada (IIROC) is the national self-regulatory organization that is empowered through securities regulation. It oversees all investment dealers and trading activity on debt and equity marketplaces in Canada. IIROC sets high quality regulatory and investment industry standards, protects investors and strengthens market integrity while maintaining efficient and competitive capital markets.<sup>51</sup>

### *Licensing/Registration*

The IIROC oversees the licensing process with respect to securities and is responsible for discipline.<sup>52</sup> IIROC staff oversees the application process for IIROC-regulated investment dealers and their registered/approved individual staff. They require that all partners, directors and officers of IIROC Dealer Members and all Dealer Member staff who conduct or supervise regulated activities meet regulatory requirements. These requirements pertain to proficiency, integrity, experience, conflicts of interest and client service as required under IIROC rules and applicable Securities Acts and regulations.

IIROC also oversees a membership process for Canadian marketplaces. Any marketplace that retains IIROC as its regulation services provider to regulate equity trading activity will become a Marketplace Member. All firms operating as Alternative Trading Systems must become Dealer Members, in addition to being Marketplace Members.

### *Supervision/Compliance*

IIROC is responsible for monitoring the compliance of its regulated dealer firms and their registered employees with rules related to business conduct, financial operations and trading practices. Effective compliance is viewed as being essential to effective securities regulation.<sup>53</sup>

With respect to financial operations, staff monitors investment dealer finances to ensure firms comply with capital requirements and more.<sup>54</sup> With respect to business conduct, staff monitors dealers' nonfinancial regulatory requirements, including compliance with supervision guidelines and ensuring transactions reflect client needs and instructions.<sup>55</sup> And, with respect to trading conduct, staff monitors dealer firms to ensure trading activity is in compliance with marketplace rules.<sup>56</sup>

IIROC staff also creates a Risk Trend Report (RTR) for every dealer member, reflecting both the financial condition, business conduct and trading conduct of that firm.<sup>57</sup> Circulation of the RTR is restricted and can only be accessed or used by the dealer member, the dealer member's panel auditor and regulators. The objective of the RTR is to encourage dealer members, particularly those with a high or deteriorating risk profile, to strengthen their governance and risk management practices.

The RTR identifies the key factors in the firm's risk assessment, makes specific recommendations, if any, for dealer member action and provides comparisons of both its peer group and the industry as a whole. Each dealer member has been categorized into one of nine peer groups, as presented in the List of IIROC Dealer Members by Peer Group. The assessment is based on information available to Financial & Operations Compliance (FinOps) and Business Conduct Compliance (BCC).

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<sup>51</sup> <http://www.iiroc.ca/about/Pages/default.aspx>

<sup>52</sup> <http://www.iiroc.ca/industry/registrationmembership/Pages/default.aspx>

<sup>53</sup> <http://www.iiroc.ca/industry/industrycompliance/Pages/default.aspx>

<sup>54</sup> <http://www.iiroc.ca/industry/industrycompliance/Pages/Financial-Operations.aspx>

<sup>55</sup> <http://www.iiroc.ca/industry/industrycompliance/Pages/Business-Conduct.aspx>

<sup>56</sup> <http://www.iiroc.ca/industry/industrycompliance/Pages/Trading-Conduct.aspx>

<sup>57</sup> <http://www.iiroc.ca/industry/industrycompliance/Pages/Risk-Trend-Report.aspx>

IIROC typically assigns each firm a Risk Trend Report – once every three years. Firms considered “high risk” receive an annual Risk Trend report.

The Risk Trend Report gives each IIROC-regulated firm a risk score in each of three categories based on its financial condition, business conduct compliance track record, and trading conduct. The RTR benchmarks each firm’s individual risk score in each category against that of comparable firms so they can gauge their performance against competitors.

### *Professional Obligation/Discipline*

IIROC enforces rules on the proficiency, sales, business and financial conduct of all Canadian dealer firms and their registered employees. It also enforces market integrity rules regarding trading activity on all Canadian equity marketplaces. Effective enforcement helps to enhance investor confidence in the financial services industry.<sup>58</sup>

Enforcement personnel have the authority to investigate possible misconduct by firms or their registered individual staff and to conduct disciplinary proceedings. Enforcement personnel work in four different areas: Case Assessment, Investigations, Prosecution and Intelligence & Analysis.

The IIROC Enforcement process has three stages: Assessment, Investigation, and Prosecution. Not all concerns proceed to an investigation. For example, Enforcement personnel may provide warning letters to firms or individuals.

IIROC investigates possible dealer or marketplace misconduct by its dealer firms, approved persons and other market participants and can bring disciplinary proceedings which may result in penalties including fines, suspensions and permanent bans or terminations for individuals and firms.<sup>59</sup>

### *Regulatory Philosophy*

IIROC has set out its position that its rules should not reflect a “one-size-fits-all” approach. They believe that the move towards a more principles-based approach to regulation is desirable and that the balance between principles and prescriptive requirements in any particular policy formulation will inevitably depend upon the problem sought to be addressed. IIROC has stated that Rules should clearly state principles or desired outcomes so that regulatory expectations are clear to market participants. In order to achieve certain outcomes or regulatory objectives, IIROC is of the view mandatory or minimum requirements may need to be established. To the extent possible, regulation should allow sufficient flexibility for market participants to assume responsibility for determining how best to comply with clearly stated expectations to achieve the desired outcome in their particular circumstances. Rules should be supported by regulatory guidance notices and education sessions to promote compliance, to communicate and share best practices and to monitor the impact of regulatory initiatives in actual practice.<sup>60</sup>

### **iii) Real Estate**

In Manitoba, for example, the provincial Securities Commission administers *The Real Estate Brokers Act*, which seeks to protect homebuyers and sellers by regulating brokers and salespersons. There are specific registration requirements.<sup>61</sup>

The Securities Commission also administers *The Mortgage Brokers Act*, which seeks to protect mortgage investors and borrowers by regulating mortgage brokers and mortgage salespersons. In order to be a mortgage broker, the business or individual arranging a mortgage must be registered with the Securities Commission. Registration ensures that a business or individual arranging a mortgage has the proper training and resources necessary to conduct business in a way that protects the consumer.<sup>62</sup>

In addition to administering the above-referenced acts, the real estate division of the Securities Commission

<sup>58</sup> <http://www.iiroc.ca/industry/enforcement/Pages/Enforcement.aspx>

<sup>59</sup> <http://www.iiroc.ca/industry/enforcement/Pages/Penalties-What-the-Panels-Can-Impose.aspx>

<sup>60</sup> [http://www.iiroc.ca/documents/2010/2A515782-A230-4987-B3FD-6E558EF135F8\\_en.pdf](http://www.iiroc.ca/documents/2010/2A515782-A230-4987-B3FD-6E558EF135F8_en.pdf)

<sup>61</sup> <http://www.mbrealestate.ca/registration/how-to-register/real-estate.html>

<sup>62</sup> <http://www.mbrealestate.ca/registration/how-to-register/mortgage-broker.html>

also monitors brokers' trust accounts and investigates complaints against real estate brokers, salespersons and mortgage brokers.

Securities Commission staff may review complaints regarding a real estate transaction and complaints involving mortgage brokers. When reviewing a complaint, Commission staff may determine that the complaint could be more efficiently handled by another organization or that the complaint will be closed without further review.<sup>63</sup> The Commission may hold hearings and issue orders in order to protect the public.

In some cases, a complaint is filed with a local Real Estate Board or the Manitoba Real Estate Association as well as with the Securities Commission. This can lead to two investigations that have different purposes. The Board or Association is concerned with members' conduct under the Code of Ethics and the right to membership in the Board or Association. The Commission considers registrants' fitness for registration. The Commission may by order suspend a registration for a stated term or until a condition has been met, and after notice and hearing, cancel a registration if it is in the public interest to do so.<sup>64</sup>

#### iv) Doctors

Doctors are licensed by provincial Colleges of Physicians and Surgeons, which are self-regulatory organizations, similar to the Law Societies. Individual Colleges act as front-line regulators. With respect to doctors and medical corporations, the Medical Act (in Manitoba) is the relevant profession-specific Act and the College is the primary regulator. The Registrar looks after the registration and licensing of individual doctors as well as the registration and licensing of medical corporations.<sup>65</sup>

Pursuant to the legislation, a medical corporation may carry on the practice of medicine through one or more licensed members under its own name or as a member of a general partnership of medical corporations or of medical corporations and licensed members under a name approved by the Registrar. Corporate licenses may be issued subject to various conditions. For example, each voting share of the corporation must be legally and beneficially owned by a licensed member or a medical corporation.<sup>66</sup>

Licenses may be issued or renewed subject to conditions. Registrations may also be cancelled.

The College is responsible for setting standards for doctors and for investigating concerns relating to competence or misconduct. The College has a Standards Committee that is responsible for the supervision of the practice of medicine by members of the College, and the Committee or its designate may inspect books, records, or other documents of any member or medical corporation that relate to the member's or corporation's practice of medicine and review the professional competence of any member either on direction from its council or on its own initiative.<sup>67</sup>

The College may also appoint a Program Review Committee, which may investigate and inspect on behalf of the council all diagnostic and treatments facilities in which services are performed by members (other than those which are under the jurisdiction of provincial or municipal governments that are approved as "hospitals" under *The Hospitals Act*).<sup>68</sup>

The College may also make by-laws relating to the establishment and operation of such diagnostic and treatment facilities to ensure that the procedures and standards of care set by the council for the protection of the public are carried out. The council may even order the closure of a facility if it does not meet the required standards.<sup>69</sup>

As is the case with lawyers, doctors and medical corporations may become subject to charges that result in a discipline hearing where various sanctions can be meted out, including the suspension or revocation of a license to practice medicine. As well, instead of suspending or cancelling the licence of a medical corporation, a decision may be made to reprimand the corporation, impose a restriction on the corporations' licence or to impose a fine,

<sup>63</sup> <http://www.mbrealestate.ca/complaints-guidance/how-to-file-a-complaint.html>

<sup>64</sup> <http://www.mbrealestate.ca/complaints-guidance/the-investigation-process.html>

<sup>65</sup> <http://cpsm.mb.ca/registration>

<sup>66</sup> *Medical Act*, CCSM c M90, s 21.

<sup>67</sup> *Ibid* at s 38.

<sup>68</sup> <http://cpsm.mb.ca/about-the-college/committees-and-governance/committees-of-council/program-review>

<sup>69</sup> *Medical Act*, *supra* note 66, at s 40.

payable to the College.<sup>70</sup>

Doctors may choose to provide their services individually or through a corporation or they may provide services in a hospital setting. But in Manitoba, (as is the case in other provinces), hospitals are regulated by the government pursuant to *The Hospitals Act*. In Manitoba, where a hospital is contained within a health region, it must operate pursuant to the provisions of *The Regional Health Authorities Act*.<sup>71</sup>

## k) Establishing a regulatory framework

### i) Decisions to Make

In order to establish a framework for entity regulation, certain decisions would need to be made.

With respect to this initiative of the Prairie provinces, we are in early agreement that entity regulation should be a supplement to and not be a substitute for individual lawyer regulation.

But, there are many other considerations such as the following:

- Should entities be regulated indirectly or directly? (e.g., should a “designated solicitor” be regulated as opposed to the entity?)
- How much scrutiny should there be related to the fitness of the entity to be regulated? (e.g., should an entity simply register and therefore accept regulatory scrutiny or should regulators scrutinize the fitness of the entity to be regulated such as through an authorization process?)
- Should entities be required to provide certain information to the regulator, if so, what type of information and how often? (e.g., Nova Scotia requires LLPs to file an annual report.) Should that information be available to the public who may be seeking information about an entity?
- Should a person have compliance responsibility – whether or not the entity is regulated? (e.g., In England, the SRA requires a compliance officer for legal practice. New South Wales requires an authorized principal. If so, what should be the nature of that person’s duties?)
- What should be the nature of the regulatory scheme?
  - light vs. heavy (as in England);
  - rules-based regulation or outcomes focused or compliance based management (complaint driven vs. prospective better practices)
  - what, if any compliance tools should be used to regulate entities? (e.g., practice reviews, firm audits, self-audits, obligation to establish particular compliance systems)
  - risk-based or random/universal (relates to proportionality)?
  - should regulation include discipline, i.e., the ability to sanction an entity?

### ii) Preliminary discussion

It may be appropriate to consider whether firms should have “ethics counsel” (as recommended by Professor Dodek).<sup>72</sup> This lawyer would serve as a sort of compliance officer. Some firms already have such counsel in place. Dodek suggests such a person would be responsible for ensuring, maintaining, supervising and applying the firm’s policies and procedures to ensure compliance with regulatory and ethical responsibilities. Such a person would become an ethics counsellor to other members of the firm.

Whether the Societies go down this road, an early decision would have to be made about whether the individual “ethics counsel” would be regulated as opposed to the entity. Some would argue that it would be unfair to place the regulatory burden of collective activity upon any individual lawyer and that there should be collective responsibility for collective obligations. Those in favour of this approach are in favour of direct entity regulation.

<sup>70</sup> *Medical Act*, *supra* note 66 at s 26.

<sup>71</sup> *The Hospitals Act*, CCSM c H120.

<sup>72</sup> Dodek, *supra* note 24 at 437.

However, it may still be appropriate to take the position that an individual lawyer, designated by the entity, should still be the person who is primarily responsible for regulatory compliance by the firm. It is often the case that if someone is not appointed to ensure that something gets done, it simply does not get done.

A registration process (which is an information gathering exercise) can be minimal or more extensive. For example, in Ontario, all professional corporations must be registered with the regulator and the required information is fairly minimal. But, it would be up to the Law Societies to determine the extent of the information that should be gathered and determine for what purpose such information would be used. (e.g., to trigger an audit)

In contrast, the SRA in England and Wales looks carefully at the proposed entity and its proposed activities (in order to address “fitness”) before determining whether the entity will be recognized and thereby be in a position to provide legal services. It does not seem to be necessary (in order to protect the public interest) for Law Societies to engage in the level of scrutiny that is undertaken in England before an entity is authorized. The approach in England (in terms of the SRA being involved in ongoing supervision) involves more engagement with the regulator and, again, is not necessarily warranted having regard to our public interest mandates. Rather, it would seem that a lighter approach could represent a balance between the need to fill a regulatory gap and the concern that we not engage in over-regulation, having regard to the desire to be fair, efficient and effective.

Early reports from jurisdictions that have adopted compliance-based regulation are positive. For example, in New South Wales, they reported a significant reduction in the number of complaints that were received. Therefore, this approach to regulation merits a detailed examination and this occurs in the next segment of this report.

Arguably, entity regulation should include both compliance and discipline measures. Compliance emphasizes prevention over punishment but without the ability to sanction an entity, there is no “stick” for the purpose of ensuring cooperation with any compliance obligations. Professor Dodek is of the opinion that firm discipline is not something that is likely to be used frequently by regulators. But, he notes that discipline of a firm may be appropriate where lawyer misfeasance may be attributable to lack of firm policies or flawed policies or procedures. It would not be fair to attribute a lawyer’s breach of, for example, conflicts rules if the lawyer was following firm procedures. The individual lawyer should be held accountable but so should the firm, as an entity. He also notes that firm discipline may be appropriate where malfeasance is so widespread that it may be attributed to the organizational culture of a firm. In such a case, collective sanction would be appropriate.<sup>73</sup>

## IV. COMPLIANCE-BASED REGULATION

### a) Introduction

As we consider transforming the regulation of the legal profession to include the regulation of entities, a related issue to be examined is how those entities should be regulated. Currently, the regulatory frameworks of a number of law societies across Canada have several rules that regulate law firms with respect to specific issues, such as trust accounts or client identification. However, the traditional regulatory regimes that are in place are designed to regulate the individual lawyer. They are not designed to regulate the law firm itself. Therefore, in the current regulatory approach taken by law societies, if entities are to be regulated, then a gap exists with respect to how those entities should be regulated.

This paper discusses a compliance-based approach to the regulation of entities that is proactive, principled and proportionate. Compliance-based regulation is an outcomes-based approach that articulates expected objectives and outcomes with which a firm must comply and, rather than prescribing how a firm must achieve compliance with those objectives and goals, provides the firm with the flexibility and autonomy to determine how it will do so. By passing responsibility to the firm, the firm engages in an educative process to arrive at the policies, procedures and systems – an ethical infrastructure – that will enable it to achieve compliance with the stated objectives and outcomes of the regulatory model. Compliance-based regulation is a shift from the traditional, reactive, prescriptive rules and complaints-based regulation toward a proactive, flexible and outcomes-based regulation.<sup>74</sup>

<sup>73</sup> *Ibid* at 438.

<sup>74</sup> Julia Black, Martyn Hopper and Christa Band, “Making a success of Principles-based regulation” (2007) *Law and Financial Markets Review* 191.

Compliance-based regulation is generally discussed in the context of law firm regulation, reviewed above. In discussing proactive regulation of entities, various authors use various terms including compliance-based regulation, outcomes-based regulation, principles-based regulation, management-based regulation and proactive management-based regulation. There are subtle differences with respect to each term. **For our purposes “compliance-based regulation” will be used in this paper.**

### b) Current regulatory framework

In order to protect the public interest, which is the mandate of law societies, law societies regulate individual lawyers by prescribing and enforcing set rules with which lawyers are obligated to comply, thereby ensuring their “conduct meets the professional standards that legal regulators promise to the public.”<sup>75</sup> If a complaint is received about a lawyer’s conduct, the law society’s complaints process responds to the complaint.

There are two significant criticisms of the traditional, rules-based, complaints-driven model of regulation. One criticism is that it is a reactive system.<sup>76</sup> That is, the law society only reacts when a complaint is received that a lawyer’s conduct failed to meet the professional standards as prescribed by set rules. The law society implements the complaints process, investigates the complaint and, where appropriate, enforces the standards by disciplining the lawyer. Therefore, the criticism is that rather than taking steps to prevent the conduct from occurring in the first place, the law society intervenes after the fact and then only to sanction the lawyer for the conduct that occurred:

Finally, complaints-driven regimes confine our gaze to the past - they are inherently reactive. Again as regulators we can exhort as much as we like but our powers in relation to complaints are confined to dealing with things only after the horse has bolted – only after some conduct has occurred and given rise to complaint or, in the case of ‘own motion’ investigations, which give us at least a measure of pro-active capacity, still only after some conduct has occurred that causes us to have reasonable suspicions.<sup>77</sup>

Another significant criticism of complaints-driven, rules-based regulation is that it focuses exclusively on the conduct of individual lawyers while failing to recognize that many lawyers work in law firms. As discussed previously in the context of entity regulation, the firm sets the standards for the lawyers acting within the firm and those lawyers tend to make decisions that comply with the firm’s systems and processes. Despite the law firm being responsible for setting the environment in which the individual lawyer makes such decisions, the individual lawyer, rather than the firm, is regulated by the law society.

Law societies can no longer afford to continue to ignore law firms in the regulation of the legal profession, hence the previous discussion on entity regulation. The issue then is how to regulate the legal entity.

### c) Ethical infrastructure

The traditional regulatory approach focuses on the individual lawyer and deals with complaints regarding conduct after the fact. As many lawyers practice in law firms, the ethical behaviour of lawyers is influenced by a number of factors, including the ethical culture and environment of the law firm in which lawyers practice, as well as personal values, professional identity and client and workplace demands.<sup>78</sup> This means that ethical behaviour is not just an individual matter; it is also a firm matter. However, traditional regulation of the lawyer exposes an inherent shortcoming – it ignores the responsibility that a law firm has for the standards and culture that develop in a firm, which influence the behaviour of lawyers in the firm.

The recognition that law firms have a significant influence on the ethical behaviour of lawyers has resulted in a shift towards examining the ethical behaviour of law firms. It has been proposed that law firms should have responsibilities as firms to implement an “ethical infrastructure” to encourage best practices and to ensure their lawyers are providing legal services to their clients in an ethical way.<sup>79</sup>

<sup>75</sup> Canadian Bar Association, CBA Legal Futures Initiative, “Futures: Transforming the Delivery of Legal Services in Canada” (2014) at 46 [CBA Futures Initiative]. Available at <<http://www.cbafutures.org/CBA/media/mediafiles/PDF/Reports/Futures-Final-eng.pdf?ext=.pdf>>.

<sup>76</sup> John Britton and Scott McLean, “Incorporated Legal Practices: Dragging the Regulation of the Legal Profession into the Modern Era” (2008) 11 Legal Ethics 242.

<sup>77</sup> *Ibid.*

<sup>78</sup> Christine Parker, Adrian Evans, Linda Haller, Suzanne Le Mire and Reid Mortensen, “The Ethical Infrastructure of Legal Practice in Larger Law Firms: Values, Policy and Behaviour” (2008) 31:1 UNSW Law Journal 158 at 159 [Parker et al].

<sup>79</sup> Parker, Gordon and Mark, *supra* note 10.

The term “ethical infrastructure” was first developed by Professor Ted Schneyer in 1991 to refer to a law firm’s “organization, policies, and operating procedures that cuts across particular lawyers and tasks.”<sup>80</sup> He expanded the definition in 2011 as follows: “Ethical infrastructures consist of the policies, procedures, systems, and structures—in short, the ‘measures’ that ensure lawyers in their firm comply with their ethical duties and that non-lawyers associated with the firm behave in a manner consistent with the lawyers’ duties.”<sup>81</sup> The term can also include other measures:

[Ethical infrastructure] might include the appointment of an ethics partner and/or ethics committee; written policies on ethical conduct in general, and in specific areas such as conflicts of interest, billing, trust accounting, opinion letters, litigation tactics and so on; specified procedures for ensuring ethical policies are not breached and to encourage the raising of ethical problems with colleagues and management; the monitoring of lawyer compliance with systems and processes; and, ethics education, training and discussion within the firm.<sup>82</sup>

#### d) **Compliance-based regulation**

Requiring a law firm to implement an ethical infrastructure could be achieved by prescriptive regulation of firms – that is, telling a firm what and how to do it. However, proactive approaches to regulation have been attracting considerable interest and attention. Proactive models of regulation comprise an educative component whereby the firm develops an ethical infrastructure – the systems and processes – to ensure lawyers comply with their ethical duties.

Compliance-based regulation is such a model and is premised on the regulation of the entity using an outcomes-based approach. In this model, the expected objectives and outcomes with which a firm must comply are articulated. That is, a firm is told what it must do. However, it is not given prescriptive rules that tell the firm how it must achieve compliance. Rather, the firm is given the flexibility and autonomy to take into account its size, practice areas and client base in order to determine the systems and processes that will be appropriate for it to achieve regulatory compliance with the outcomes.<sup>83</sup>

For example, a law society may set as an expected outcome or objective for firms that they develop competent practices but without telling them how to do that. Therefore, to achieve the outcome of developing competent practices, the firm could institute a continuing education program.

The key tenet is that the firm has the responsibility to determine how to achieve compliance with that outcome. By giving an entity the autonomy to determine and implement the systems and processes in order to achieve compliance with the regulatory goals or objectives, compliance-based regulation enables a firm to develop its own unique ethical infrastructure in order to promote ethical behaviour.

Compliance-based regulation is a regulatory approach that represents a fundamental shift from the existing rules-based, one-size fits all model of regulation that focuses on the individual lawyer to an outcomes-based, proportionate model that focuses on the culture and behaviour of a firm. It is described as a shift in “regulatory emphasis from responding to complaints and enforcement through discipline to a proactive approach in which goals, expectations and tools for licensees are established.”<sup>84</sup>

#### e) **Developments in compliance-based regulation**

Compliance-based regulation or outcomes-based regulation is in the process of being implemented in Nova Scotia (where it is called proactive management-based regulation or PMBR) and is being considered in Ontario. The Canadian Bar Association also supports compliance-based regulation and ethical infrastructures in firms. Compliance-based regulation was first implemented in Australia (New South Wales) and subsequently in England and Wales. These developments are discussed below.

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<sup>80</sup> Ted Schneyer, “Professional Discipline for Law Firms?” (1991) 77 Cornell L. Rev. 1 [Schneyer 2].

<sup>81</sup> Schneyer 1, *supra* note 29 at 585.

<sup>82</sup> Parker et al, *supra* note 78 at 172.

<sup>83</sup> Law Society of Upper Canada, *Treasurer’s Report*, Tab 5, Report to Convocation June 25, 2015.

<sup>84</sup> *Ibid.*

## i) Canada

### A. Nova Scotia

Nova Scotia has an existing authority to regulate law firms in Part III of the *Legal Profession Act 2004* (“the Act”). Section 27 of the Act provides that in Part III and Part IV, unless otherwise indicated, “member of the Society” includes a law firm.

The Nova Scotia Barristers’ Society has been the most progressive law society in Canada regarding entity and compliance-based regulation. The Society’s governing body, the Council, established a Strategic Framework for 2013-2016, which had two specific priorities:<sup>85</sup>

- Transforming regulation and governance in the public interest, and
- Enhancing access to legal services and the justice system for all Nova Scotians.

In support of its Strategic Plan, the Society conducted extensive research, which culminated in a comprehensive research paper in October 2013, “Transforming Regulation and Governance in the Public Interest”, prepared by Victoria Rees, Director of Professional Responsibility.<sup>86</sup> In November 2013, Council agreed that the Society would strive to develop a “proactive, risk-focused and principles-based regulatory regime”.<sup>87</sup>

The Society proceeded to consider a model regulatory regime comprised of a framework that is “proactive; is principle-based and outcomes-focused; is risk-based; is able to encourage and accommodate new business models; is able to enhance access to justice and affordable legal services and involves new ways of engaging law firms to achieve outcomes.”<sup>88</sup>

In order to create this model, the Society developed six phases:

1. Review of the present regulatory and ethical requirements for lawyers, including an analysis of conduct complaint data and professional indemnity claims;
2. The design of a set of ‘objectives’ considered necessary to encompass the findings of Phase 1;
3. A consultation phase for stakeholders on the entire process but specifically on the ‘objectives’;
4. The design of a ‘self-assessment’ process to enable entities to address the ‘objectives’;
5. A further consultation phase; and
6. The implementation phase, including design of an ‘audit’ or ‘review’ function.

Phase 1 determined Nova Scotia was structurally and culturally ready for entity regulation and proactive management-based regulation (“PMBR”). This term was first developed by Professor Ted Schneyer, and involves a framework to embed competent practice and ethical behaviour, where one or more lawyers are appointed to be responsible for the ethical infrastructure of the firm.<sup>89</sup> The conclusion that Nova Scotia was ready for entity regulation and PMBR was based on the following reasons:

- Nova Scotia has a strong relationship with the profession and is well accepted as the regulator.
- The profession appears to accept the regulatory framework currently in place in Nova Scotia.
- Nova Scotia already has a framework for entity regulation.
- Nova Scotia has been engaging in discussions with the profession about its plans and is continuing to engage.

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<sup>85</sup> Nova Scotia Barristers’ Society, *The Society’s Strategic Framework for 2013-2016*, <<http://nsbs.org/societys-strategic-framework-2013-2016>>.

<sup>86</sup> Rees, *supra* note 16.

<sup>87</sup> Nova Scotia Barrister’s Society, NSBS Seeks Your Assistance, Transforming regulation – Consultation Document.

<sup>88</sup> Creative Consequences P/L, *Transforming Regulation and Governance Project, Phase 2* (May 18, 2014) at 2.

<sup>89</sup> Schneyer 2, *supra* note 80.

- The Society is prepared to assist and support the profession through the transformation.<sup>90</sup>

The second phase looked at designing a model of PMBR by first examining the regulatory landscape and culture in Nova Scotia. The process then considered the regulatory instruments that form the basis for Nova Scotia's regulatory framework, such as the *Code of Professional Conduct* and the Standards; the models that already exist for entity regulation; the demographics of the Nova Scotia Bar; and the type of complaints against Nova Scotia lawyers. The process determined that any model that would be designed would need to be suitable for Nova Scotia – that is, “cutting and pasting” from other models would not deliver the desired outcomes and likely would not receive the necessary support from those on whom it would be imposed.<sup>91</sup>

After taking all of this into consideration, ten elements, which reflect the content and theme of Nova Scotia's regulatory instruments, in particular the *Code of Professional Conduct*, were identified as the elements that should comprise Nova Scotia's ethical infrastructure:<sup>92</sup>

1. Developing competent practices to avoid negligence;
2. Achieving effective, timely and courteous/civil communication;
3. Ensuring confidentiality requirements;
4. Avoiding conflicts of interest;
5. Maintaining appropriate records/file management;
6. Ensuring effective firm/staff management;
7. Charging of appropriate fees and disbursements;
8. Ensuring reliable trust accounts practices;
9. Sustaining effective relationships with clients, colleagues, courts, regulators and the community; and
10. Achieving access to justice.

The model for the Nova Scotia Barristers' Society is called “A Management System for Ethical Legal Practice”.

Phase 3 of the project was the consultation phase with relevant stakeholders about entity regulation and the proposed model for Nova Scotia.<sup>93</sup> The consultation phase resulted in productive discussions with very little concern expressed about the proposed regulatory model for entity regulation.

Phase 4 examined the type of self-assessment that would be best for the proposed regulatory regime and determined that a hybrid self-assessment model that incorporated statements and a matrix would be most appropriate.<sup>94</sup> This model presents respondents with a document that sets out the ten elements, as well as a series of statements that describe management systems and approaches in relation to each element. At the end of each of the ten elements, respondents are asked to assess themselves as either one of the following:<sup>95</sup>

- “not applicable”
- “non-compliant”
- “partially compliant” or,
- “fully compliant.”

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<sup>90</sup> Creative Consequences P/L, *Transforming Regulation and Governance Project, Phase 1* (March 26, 2014).

<sup>91</sup> Creative Consequences P/L, Phase 2, *supra* note 88.

<sup>92</sup> *Ibid* at 19.

<sup>93</sup> Creative Consequences P/L, *Transforming Regulation and Governance Project, Phase 3* (June 2014).

<sup>94</sup> Creative Consequences P/L, Phase 4, *supra* note 3 at 24.

<sup>95</sup> *Ibid* at 24.

In November 2014, Council approved the following Regulatory Objectives as the first step towards building a new regulatory model:

1. Protect those who use legal services.
2. Promote the rule of law and the public interest in the justice system.
3. Promote access to legal services and the justice system.
4. Establish required standards for professional responsibility and competence in the delivery of legal services.
5. Promote diversity, inclusion, substantive equality and freedom from discrimination in the delivery of legal services and the justice system.
6. Regulate in a manner that is proactive, principled and proportionate.

Two phases remain in the process to develop a new regulatory approach in Nova Scotia: a further consultation phase, and the implementation phase, including design of an 'audit' or 'review' function.<sup>96</sup> It is expected that final approval will be June 2016 with implementation phased in commencing in 2016.<sup>97</sup>

## B. Ontario

In Ontario, the Law Society of Upper Canada has commenced the process of examining compliance-based regulation. In the February 27, 2014 Report to Convocation, the Working Group acknowledged that the current regulatory approach in Ontario is "predominantly reactive rather than proactive", which contrasted with other regulators adopting a compliance-based approach in conjunction with implementing alternative business structures ("ABSs").<sup>98</sup>

The Working Group recommended the Law Society "give further consideration to the implementation of compliance-oriented regulation for existing and alternative business structures...".<sup>99</sup> The Working Group further recommended that Convocation consider compliance-based regulation to supplement the current rule-based regulation.

On February 27, 2014, Convocation approved further consideration of the regulation of firms and referred the proposal that firm regulation can be used to support a more proactive, compliance-based regulatory approach to the Professional Regulation Committee for consideration.<sup>100</sup> The Professional Regulation Committee of the Law Society of Upper Canada continued to update Convocation on the issue of compliance-based regulation, issuing Reports on September 24, 2014, January 29, 2015 and April 23, 2015.

On June 25, 2015, the Treasurer issued a Report to Convocation, which proposed that a task force be established to continue working on a compliance-based regulatory approach.<sup>101</sup> The Report stated:

Compliance based regulation (also referred to outcomes based regulation or proactive regulation) is an approach to professional regulation that is based on the encouragement and support of improved practices by the regulator, primarily by setting goals and expectations, and providing supports and information as needed to law firms and legal practices.

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<sup>96</sup> Steve Mark and Tahlia Gordon, "Entity regulation 101: Transforming regulation and governance in the public interest" (Fall 2014) 32:2 *The Society Record* 31 at 33.

<sup>97</sup> Tilly Pillay QC, President Nova Scotia Barristers' Society, Presentation to LSA Benchers' Retreat June 2015.

<sup>98</sup> Law Society of Upper Canada, Professional Regulation Committee, *Report to Convocation* February 27, 2014 [LSUC Working Group Report].

<sup>99</sup> *Ibid.*

<sup>100</sup> Law Society of Upper Canada, Professional Regulation Committee, *Report to Convocation* January 29, 2015.

<sup>101</sup> LSUC Treasurer's Report, *supra* note 83.

Compliance based regulation shifts regulatory emphasis from responding to complaints and enforcement through discipline to a proactive approach in which goals, expectations and tools for licensees are established. This means that licensees can themselves ensure that they have appropriate systems and processes in place to achieve regulatory compliance.<sup>102</sup>

On June 25, 2015, Convocation agreed to establish a task force to study and make recommendations on a process for compliance-based regulation of entities through which lawyers and paralegals provide legal services defining such regulation as:

... a proactive approach where the regulator identifies matters to be proactively addressed in practice and provides flexibility as to the approach to be taken, primarily through the setting of goals and the provision of supports to achieve those goals.<sup>103</sup>

The Treasurer's Report set out the scope of the Compliance-Based Entity Regulation Task Force's study:<sup>104</sup>

- Determining the value and merits of a compliance-based entity regulatory scheme for the Law Society in terms of advancing regulation in the public interest;
- How information on Ontario licensee and firm demographics can be used to assist the review;
- Exploring the proportionality of this approach to regulation against the goals to be achieved, including enforcement and accountability issues;
- Determining how information about other regulators' best practices and outcomes in this approach to regulation might be used to advance the study;
- Determining the range of possible ways that regulatory authority can most effectively be applied to firms;
- Deciding how the costs of this approach to regulation should be assessed against its merits.

The task force has the mandate to:<sup>105</sup>

- review research and information, and gather further information;
- consider current models of the compliance-based approach to regulation, determine the merits of similar approaches for regulating lawyers and paralegals, and assess such an approach against specific criteria;
- prepare a proposal explaining the elements and structure of compliance-based entity regulation and its applicability to entities;
- consult with Law Society licensees and other stakeholders for input;
- following consultation and assessment of the results
  - prepare a report for Convocation specifying the task force's conclusions,
  - include discussion of appropriate implementation issues, costs and resource implications,
  - report to Convocation with proposals to consider;
- determine and request approval for a budget;
- periodically provide interim information reports to Convocation on the status of its work.

The Compliance-Based Entity Regulation Task Force is to report to Convocation by June 2016.

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<sup>102</sup> *Ibid.*

<sup>103</sup> *Ibid.*

<sup>104</sup> *Ibid.*

<sup>105</sup> *Ibid.*

## C. Canadian Bar Association

### Ethical Practices Self-Evaluation Tool

In 2013 the CBA Ethics and Professionalism Responsibility Committee developed a voluntary “Ethical Practices Self-Evaluation Tool” (“Tool”) to encourage law firms to develop an ethical infrastructure to promote ethical best practices within their firms.<sup>106</sup> The CBA states that the Tool is not intended to be prescriptive but instead is intended to encourage firms to explore and discuss firm practices.<sup>107</sup>

The Tool identifies ten potential components of a law firm’s ethical infrastructure, and categorizes them under three relationship categories:<sup>108</sup>

#### I. Relationship to Clients

1. *Competence*
2. *Client Communication*
3. *Confidentiality*
4. *Conflicts*
5. *Preservation of Clients’ Property/Trust Accounting/File Transfers*
6. *Fees and disbursements*

#### II. Relationship to Firm Members

7. *Hiring*
8. *Supervision/Retention/Lawyer and Staff Wellbeing*

#### III. Relationship to Regulator, Third Parties, and the Public Generally

9. *Rule of Law and the Administration of Justice*
10. *Access to Justice*

In order to assist law firms with using the Tool, each of the ten components has a stated objective, as well as questions that can be asked to assess compliance with each objective. It also provides firms with suggested systems and practices to ensure the firm achieves compliance with the objective.

### Futures: Transforming the Delivery of Legal Services in Canada

The CBA’s Legal Futures Initiative published its report, *Futures: Transforming the Delivery of Legal Services in Canada* in 2014, which looked at the various changes that are facing the legal profession in Canada. The Futures Report recommended that regulatory bodies should adopt compliance-based regulation to promote ethical best practices as a supplement to, rather than as a substitute for, the current rule-based regulation of individual lawyers.<sup>109</sup>

The Futures Report proposed that the principles identified in the *CBA Ethical Practices Self-Evaluation Tool* could act as an effective framework for compliance-based regulation. In accordance with a regulatory framework of compliance-based regulation:<sup>110</sup>

- law firms would be required to register with the law societies;
- law firms become regulated entities upon registration;

<sup>106</sup> Canadian Bar Association, “Assessing Ethical Infrastructure in Your Law Firm: A Practical Guide” (2013). Available at <<http://www.cba.org/CBA/activities/pdf/ethicalinfrastructureguide-e.pdf>>.

<sup>107</sup> CBA Ethical Practices Self-Evaluation Tool, <<http://www.cba.org/CBA/activities/pdf/ethicalselfevaluation-e.pdf>>.

<sup>108</sup> Canadian Bar Association, *supra* note 106.

<sup>109</sup> CBA Futures Initiative, *supra* note 75 at 47.

<sup>110</sup> *Ibid.*

- law firms would be required to designate a lawyer with whom the law society may deal on behalf of the law; firm and who is responsible for overseeing law firm regulatory compliance; and
- regulation of law firms would include the requirement of supplementary compliance-based regulation to promote ethical best practices.

## ii) Developments internationally

### A. Australia

Australia was at the forefront of developing a transformative regulatory approach for the regulation of the legal profession that shifts regulation from a reactive, individual, rules-based approach to a proactive, firm-based, outcomes-based approach. These developments in New South Wales in Australia led to similar developments in England and Wales, and were the starting point for discussions focusing on entity regulation and compliance-based regulation.

In 2001, legislation in New South Wales came into force permitting providers of legal services to incorporate by registering a company with the Australian Securities and Investment Commission. The legislation that superseded this legislation, the *Legal Profession Act 2004* (the “LPA 2004”) also contained similar provisions and imposed a number of requirements.

The legislation had a number of safeguards in place. First, an incorporated legal practice (“ILP”) had to appoint at least one legal practitioner director (“LPD”), who is a director of the incorporated legal practice.<sup>111</sup> The LPD is generally responsible for the management of legal services provided by the ILP.<sup>112</sup>

Secondly, section 140(3) of the LPA 2004 required the LPD to implement and maintain “appropriate management systems” (“AMS”) to enable the provision of legal services in accordance with the professional obligations of solicitors and the other obligations imposed by the statute.<sup>113</sup> This was the test for compliance and failure to establish and maintain this system could result in a finding of professional misconduct.<sup>114</sup>

#### Objectives of a Sound Legal Practice

The legislation did not define “appropriate management systems”. The Office of the Legal Services Commissioner for New South Wales collaborated with stakeholders to develop the 10 key objectives of a sound legal practice with which ILPs must comply in order to determine whether an IPL has “appropriate management systems” in place.<sup>115</sup> The 10 objectives of appropriate management systems for ILPs were:<sup>116</sup>

1. Negligence	Competent work practices to avoid negligence.
2. Communication	Effective, timely and courteous communication.
3. Delay	Timely delivery, review and follow up of legal services to avoid instances of delay.
4. Liens/File Transfers	Acceptable processes for liens and file transfers.
5. Cost Disclosure/ Billing Practices/ Termination of Retainer	Shared understanding and appropriate documentation from commencement through to termination of retainer covering costs disclosure, billing practices and termination of retainer.

<sup>111</sup> *Legal Profession Act*, No. 112 (2004) NSW Stat, s. 140(1).

<sup>112</sup> *Ibid* at s. 140(2); Steve Mark and Tahlia Gordon, “Innovations in Regulation – Responding to a Changing Legal Services Market” (2009) 22 *The Georgetown Journal of Legal Ethics* 501 [Mark and Gordon]. Available at <[http://www.olsc.nsw.gov.au/Documents/innovations\\_regulation\\_geo\\_journal.pdf](http://www.olsc.nsw.gov.au/Documents/innovations_regulation_geo_journal.pdf)>.

<sup>113</sup> *Ibid.* *Legal Profession Act*, s. 140(3).

<sup>114</sup> Mark 1, *supra* note 9 at 3.

<sup>115</sup> Susan Saab Fortney, “Promoting Public Protection through an ‘Attorney Integrity’ System: Lessons from the Australian Experience with Proactive Regulation of Lawyers” (2015) 23:1 *The Professional Lawyer* [Fortney 1].

<sup>116</sup> Parker, Gordon and Mark, *supra* note 10.

6. Conflict of Interests	Timely identification and resolution of the many different incarnations of conflicts of interest including when acting for both parties to a transaction or acting against previous clients as well as potential conflicts which may arise in relationships with debt collectors and mercantile agencies or conducting another business, referral fees and commissions etc.
7. Records Management	Records management which includes minimizing the likelihood of loss or destruction of correspondence and documents through appropriate document retention, filing, archiving etc. and providing for compliance with requirements as regards registers of files, safe custody, financial interests.
8. Undertakings	Undertakings to be given with authority, monitoring of compliance and timely compliance with notices, orders, rulings, directions or other requirements of regulatory authorities such as the OLSC, Law Society, courts or costs assessors.
9. Supervision of Practice and Staff	Supervision of the practice and staff.
10. Trust Account Regulations	Avoiding failure to account and breaches of s61 of the Act in relation to trust accounts.

### Self-Assessment Process

The OLSC also devised an “education toward compliance” strategy whereby the LPD engaged in a self-assessment process (“SAP”) by completing a self-assessment form (“SAF”) reporting on compliance with each of the 10 objectives to demonstrate that the firm had implemented appropriate management systems.<sup>117</sup> The SAF required the firm’s LPD to evaluate the firm’s policies, practices and management systems.<sup>118</sup>

Rather than requiring all ILPs to have the same management systems to achieve compliance with the objectives, the self-assessment process enabled the ILPs to develop and implement management systems that were appropriate for their size, work practices and nature of operations.<sup>119</sup> Therefore, the outcomes-based regulatory approach in NSW eschewed a “one size fits all” approach to requiring uniform management systems to achieve compliance with the objectives.

The LPD rated the firm’s compliance with each of the 10 objectives, using a scale ranging from “non-compliant” to “fully complaint plus”.<sup>120</sup> The OLSC characterized this process as the “systematization of ethical conduct”, which, “[i]f followed, these objectives will result in ethical outcomes.”<sup>121</sup> When the self-assessment indicated a firm was non-compliant or partially complaint, the OLSC worked with the firm to determine the management systems that were appropriate for the firm.<sup>122</sup>

### Impact of Appropriate Management Systems and Self-Assessment

An empirical study in 2008 by Christine Parker, Tahlia Gordon and Steve Mark assessed the impact of the regulatory regime for ILPS with respect to the number of complaints registered. The study found that on average, the complaints rate for self-assessed ILPs dropped by two-thirds after they completed their initial self-assessment.<sup>123</sup> The study also found that before self-assessment, ILPs had a slightly lower rate of complaints than non-incorporated legal practices. However, after self-assessment, the study concluded that the complaint rate

<sup>117</sup> Susan Saab Fortney, “Proactive Regulation of Law Firms: Proof and Possibilities” (2014) 23<sup>rd</sup> F.B. Wickwire Lecture in Professional Responsibility and Legal Ethics, Nova Scotia Barristers Society and Schulich School of Law, Dalhousie University [Fortney 2].

<sup>118</sup> Susan S. Fortney and Tahlia Gordon, “Adopting Law Firm Management Systems to Survive and Thrive: A Study of the Australian Approach to Management-Based Regulation” (2012) 10 U. St. Thomas L.J. 152 at 163 [Fortney and Gordon 1].

<sup>119</sup> *Ibid* at 161; Mark and Gordon, *supra* note 112 at 508.

<sup>120</sup> *Ibid*.

<sup>121</sup> Mark and Gordon, *supra* note 112 at 508.

<sup>122</sup> Parker, Gordon and Mark, *supra* note 79 at 473.

<sup>123</sup> *Ibid* at 485.

for ILPs was one-third that of non-incorporated legal practices that had never completed the self-assessment.<sup>124</sup>

The authors concluded there was empirical evidence that the requirement that ILPs implement appropriate management systems and conduct a self-assessment process may have contributed to ethics management in firms, as indicated by the lower complaints rates after self-assessment. The authors attributed this to the learning and changes prompted by the self-assessment process rather than to the actual (self-assessed) level of implementation of management systems.<sup>125</sup>

In 2012, Susan Saab Fortney conducted a mixed media (survey and interviews) study on the impact of appropriate management systems and self-assessment.<sup>126</sup> The study found that a vast majority (84%) reviewed firm policies or procedures, while 71% indicated their firms revised firm systems, policies or procedures. In addition, 47% reported their ILPs actually adopted new systems, policies or procedures. Fortney concluded that these results indicated that the self-assessment process had a positive impact in encouraging firms to examine and improve the firms' management systems, training and ethical infrastructure.<sup>127</sup>

The study also found that 62 per cent of respondents agreed that the self-assessment process was a learning exercise that enabled firms to improve client services. Almost half of the respondents indicated that using the self-assessment process promoted them to consider ethical concerns. With respect to the question as to the impact of the self-assessment process, the largest number of respondents reported the greatest impact was on matters relating to firm management, risk management and supervision, while the second greatest impact was on client relations and professionalism.<sup>128</sup> Fortney concluded that the NSW "education toward compliance" approach effectively provided guidance to lawyers.<sup>129</sup>

### Summary

The focus of the new regulatory approach in NSW was to promote ethical behaviour and to require ILPs to implement an ethical infrastructure that supported and encouraged ethical behaviour.<sup>130</sup> The concept of an "ethical infrastructure" was first conceived by Professor Ted Schneyer in 1991, who expanded the definition in 2011. Schneyer credited the NSW regulatory approach with giving the term "ethical infrastructure" content by "identifying ten types of recurring problems that infrastructure should be designed to prevent or at least mitigate."<sup>131</sup>

Steve Mark discussed the new regulatory structure in NSW as a shift from sole reliance on complaint-based regulation to compliance-based regulation in order to protect consumers by ensuring that legal practitioners were conducting themselves ethically and professionally:

The requirement to implement an ethical infrastructure provides better protection for consumers of legal services. That is because the management systems we require ILPs to maintain act as a quasi-educative mechanism teaching practitioners best practice to achieve compliance with the requirements of the legislation and promote cultural change.<sup>132</sup>

### Legal Profession Uniform Law

On July 1, 2015, the *Legal Profession Act 2004* was repealed and was replaced by the *Legal Profession Uniform Law Application Act 2014*, *Legal Profession Uniform Law* ("Uniform Law") in New South Wales and Victoria. The Uniform Law will create a common legal services market in these two states and the aim is to harmonise regulation of the legal profession while retaining local performance of regulatory functions.<sup>133</sup> The Uniform Law

<sup>124</sup> *Ibid* at 488.

<sup>125</sup> *Ibid* at 493.

<sup>126</sup> Susan Saab Fortney, "The Role of Ethics Audits in Improving Management Systems and Practices: An Empirical Examination of Management-Based Regulation of Law Firms" (2014) 4 St. Mary's J. Legal Mal. & Ethics 112 [Fortney 3].

<sup>127</sup> Fortney 1, *supra* note 115.

<sup>128</sup> Fortney 3, *supra* note 126 at 123.

<sup>129</sup> Fortney 1, *supra* note 115.

<sup>130</sup> Mark 1, *supra* note 9 at 3.

<sup>131</sup> *Ibid*.

<sup>132</sup> *Ibid*.

<sup>133</sup> Law Council of Australia, <<http://www.lawcouncil.asn.au/lawcouncil/index.php/current-issues/legal-uniform-professional-law-consultation>>.

establishes an interjurisdictional Legal Services Council to oversee the uniform regulation of the legal profession and delivery of legal services, as well as a Commissioner for Uniform Legal Services Regulation.<sup>134</sup>

Under the new law, rather than having a legal practitioner director, all law firms (an ILP or an unincorporated legal practice (UPL)) must have at least one authorized principal who ensures all legal practitioners of the law practice comply with the Uniform Law and Rules.<sup>135</sup>

The Uniform Law, which applies to all law firms, including ILPs, does not require appropriate management systems to be implemented, although the concept still exists under the new law. If a law practice is given a management systems direction after an audit, examination or investigation, then it must comply by implementing and maintaining an appropriate management system and providing periodic reports to the Legal Services Board.<sup>136</sup> It consists of a direction “to ensure that appropriate management systems are implemented and maintained to enable the provision of legal services by the law practice...”. Entities may be disqualified from providing legal services on certain grounds including if the law practice has failed to comply with a management system direction.<sup>137</sup> In addition, authorized principals do not have to complete a self-assessment process.

The governing statute also contains provisions that allow for “external intervention” which involves the appointment of a Supervisor, Manager or Receiver to a law practice. An example of when this might occur would be where a sole principal of a practice has died or is in prison, where a corporation is being wound up, or where there is a belief that proper procedures regarding trust money are not being followed.<sup>138</sup>

## B. England and Wales

England and Wales has undergone a remarkable shift in the regulation of the legal profession from a focus on the individual lawyer to a focus on the firm.

In July 2003, Sir David Clementi was appointed to conduct a review of the regulatory framework for legal services in England and Wales. In response to Clementi’s report, Review of the Regulatory Framework for Legal Services in England and Wales (the “Clementi Report”),<sup>139</sup> which recommended wide-sweeping reforms to how legal services were being regulated in England and Wales, the *Legal Services Act 2007* (the “LSA 2007”) was enacted.

The LSA 2007 established the Legal Services Board (“LSB”), which is the independent body that oversees the eight separate approved regulators of the legal profession in England and Wales. In addition, the LSA 2007 permitted the creation of alternative business structures, requiring all ABSs to be regulated as entities. In 2009, Lord Hunt of Wirral conducted a review of the regulation of legal services in the United Kingdom and concluded that principles (outcomes)-based regulation was the preferred approach for the regulation of the legal profession.<sup>140</sup>

In 2011, the Solicitors Regulatory Authority (“SRA”), which is charged with setting standards for and regulating lawyers in England and Wales, extended entity regulation to encompass traditional law firms as well.<sup>141</sup> The SRA began accepting applications from prospective ABSs in January 2012 and the first ABSs were licensed in March 2012.<sup>142</sup> The SRA shifted to outcomes-focused regulation that focuses on the “high-level principles and outcomes that should drive the provision of services for clients.”<sup>143</sup> In October 2011, The SRA Handbook, which applies to all firms regulated by the SRA, came into effect. The Handbook sets out the key regulatory elements,

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<sup>134</sup> *Ibid.*

<sup>135</sup> *Legal Profession Uniform Law Application Act 2014*, No. 17 of 2014 Schedules, Schedule 1, *Legal Profession Uniform Law*, s. 105.

<sup>136</sup> *Ibid* at s. 257.

<sup>137</sup> *Ibid* at s. 120.

<sup>138</sup> *Ibid* at s. 326.

<sup>139</sup> Sir David Clementi, Review of the Regulatory Framework for Legal Services in England and Wales, Final Report, December 2004.

<sup>140</sup> Lord Hunt of Wirral, The Hunt Review of the Regulation of Legal Services (October 2009), <[https://www.lsc.qld.gov.au/data/assets/pdf\\_file/0016/260035/The-Hunt-Review-of-the-Regulation-of-Legal-Services-NZ-Dec-2009.pdf](https://www.lsc.qld.gov.au/data/assets/pdf_file/0016/260035/The-Hunt-Review-of-the-Regulation-of-Legal-Services-NZ-Dec-2009.pdf)>.

<sup>141</sup> Entity Regulation, Frequently Asked Questions – paper presented at the International Conference of Legal Regulators, Toronto, Ontario, July 27-28, 2015.

<sup>142</sup> Grech and Gordon, *supra* note 12.

<sup>143</sup> Solicitors Regulatory Authority, “Outcomes-focused regulation at a glance,” <<http://www.sra.org.uk/solicitors/freedom-in-practice/OFR/ofr-quick-guide.page>>.

which include SRA Principles and the SRA Code of Conduct.

The SRA Principles, of which there are 10 and are mandatory, define the fundamental ethical and professional standards that are expected of all firms and individuals in the provision of legal services. The Principles are all pervasive and solicitors must:<sup>144</sup>

1. Uphold the rule of law and the proper administration of justice;
2. Act with integrity;
3. Not allow your independence to be compromised;
4. Act in the best interests of each client;
5. Provide a proper standard of service to your clients;
6. Behave in a way that maintains the trust the public places in you and in the provision of legal services;
7. Comply with your legal and regulatory obligations and deal with your regulators and ombudsmen in an open, timely and co-operative manner;
8. Run your business or carry out your role in the business effectively and in accordance with proper governance and sound financial and risk management principles;
9. Run your business or carry out your role in the business in a way that encourages equality of opportunity and respect for diversity; and
10. Protect client money and assets.

The SRA Code of Conduct is divided into 5 sections, and each section sets out the Outcomes that are required and mandatory. The Outcomes describe what firms and individuals are required to achieve so that they can comply with the relevant Principles. Achieving these Outcomes will aid in ensuring compliance with the Principles. The Outcomes are supplemented by “indicative behaviours”, which are not mandatory but which may determine whether an Outcome has been achieved in order to comply with the Principles.<sup>145</sup>

In order to ensure compliance, the SRA Authorisation Rules require all firms that the SRA authorizes to appoint compliance officers for legal practice (COLPs) and compliance officers for finance and administration (COFAs). The SRA takes the view that these two roles are an integral part of its move to outcome-focused regulation.

The COLP supports risk management and compliance within a firm, and is required to take all reasonable steps to:<sup>146</sup>

- ensure the authorised body, its managers and employees comply with all terms and conditions of its authorisation (except any obligations imposed under the SRA Accounts Rules);
- ensure the authorised body complies with relevant statutory obligations;
- record any failure to comply with authorisation or statutory obligations and make such records available to the SRA;
- report any material failure (either taken on its own or as part of a pattern of failures) to the SRA as soon as reasonably practical. Licensed bodies (ABS firms) must, in accordance with the Legal Services Act 2007, also report non-material breaches.

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<sup>144</sup> SRA Handbook, SRA Principles 2011, <<http://www.sra.org.uk/solicitors/handbook/handbookprinciples/content.page>>.

<sup>145</sup> SRA Handbook, SRA Code of Conduct 2011, <<http://www.sra.org.uk/solicitors/handbook/code/content.page>>.

<sup>146</sup> SRA, Responsibilities of COLPs and COFAs, <<http://www.sra.org.uk/solicitors/colp-cofa/responsibilities-record-report.page>>.

The COFA is responsible for the overall financial management of the firm, and is required to take all reasonable steps to:<sup>147</sup>

- ensure that the authorised body, its employees and managers, comply with any obligations imposed under the SRA Accounts Rules;
- keep a record of any failure to comply and make this record available to the SRA;
- report any material failure (either taken on its own or as part of a pattern of failures) to the SRA as soon as reasonably practical. Licensed bodies (ABS firms) must, in accordance with the Legal Services Act 2007, also report non-material breaches.

The COLP, who must be a lawyer, and the COFA must be fit and proper and of sufficient authority and responsibility to assume the role and this is assessed upon initial approval by taking into account the criteria in the SRA Suitability Test 2011.<sup>148</sup> Approval of the role may be withdrawn if the COLP or COFA is assessed to be unfit.

The Bar Standards Board, which is responsible for regulating individual barristers, recently began regulating entities owned and managed by barristers and other professionals; it does not yet authorize ABSs. The regime for entity regulation of barristers is similar to that of solicitors in that each entity is required to have a Head of Legal Practice (HOLP) and a Head of Finance and Administration (HOFA).<sup>149</sup>

#### f) **Benefits of compliance-based regulation**

There are a number of advantages to implementing a compliance-based approach to entity regulation.

First, the compliance-based approach to regulation is proactive and preventative rather than reactive as it focuses on results rather than rules. That is, instead of focusing on prescriptive rules and reacting to a complaint when a rule is breached, in a compliance-based regulatory model, the regulator sets out the expected outcomes that the regulator expects firms to achieve by adopting systems and processes. The result is that rather than complying with prescriptive and rigid rules, this model of regulation seeks to prevent problems from arising in the first place.

Second, with compliance-based regulation, firms are provided the “incentive, tools and authority to take steps to improve the delivery of legal services.”<sup>150</sup> The management and culture of the firm as a whole is improved by implementing an ethical infrastructure that will allow the firm to comply with the regulatory objectives. The implementation of an ethical infrastructure creates an ethical firm culture that promotes and improves the ethical best practices of both the firm and of the lawyers acting within it.

Third, in a compliance-based approach, the individual lawyer is not singled out. Instead, as discussed previously, the firm organization and culture often sets the tone and environment in which lawyers practice. Compliance-based regulation recognizes that the firm has a role to play in ensuring that the ethical behaviour of lawyers is promoted and that a firm may be accountable for system failures that resulted in the lawyer’s conduct.<sup>151</sup>

Fourth, although firms are required to comply with the set objectives and outcomes, not all firms will face the same risks. Therefore, firms are not required to implement the same systems and processes in order to achieve compliance regardless of their size. Instead, compliance-based regulation provides firms the flexibility and autonomy to develop the internal systems and processes that are appropriate to their own practices in order to achieve compliance with the regulatory objectives. Rather than implementing a “one-size fits all” approach, which may not necessarily be appropriate for all entities, firms can tailor their systems and processes by taking their own specific circumstances, such as size, practice type and client base, into account. A potential advantage of doing so is that “if you allow entities to develop their own rules, they are more likely to regard those rules as reasonable and, as a result, compliance may be improved.”<sup>152</sup>

Fifth, compliance-based regulation is flexible and responsive by utilizing general principles that can adapt to a

<sup>147</sup> *Ibid.*

<sup>148</sup> Solicitors Regulation Authority, What is a COLP and COFA? <<http://www.sra.org.uk/solicitors/colp-cofa/ethos-roles.page>>.

<sup>149</sup> The Bar Standards Board for Prospective Entities, <<https://www.barstandardsboard.org.uk/regulatory-requirements/for-prospective-entities/>>.

<sup>150</sup> Fortney 1, *supra* note 115.

<sup>151</sup> Entity Regulation, *supra* note 141 at 12.

<sup>152</sup> The Law Society of Scotland, “Regulation in the 21<sup>st</sup> Century: Entity Regulation – Second Consultation Paper” (July 2015) at 13.

changing legal environment. Unlike rules that are rigid and prescriptive, a compliance-based approach allows for “future-proofing”, which enables the regulator to respond to new issues as they arise without the necessity of having to create new rules.<sup>153</sup>

Sixth, a compliance-based regime enables the regulator to proactively partner with law firms by working with – not against – them.<sup>154</sup> In moving away from prescriptive regulatory requirements and setting expected outcomes and objectives, the regulator focuses on helping law firms improve their ethical practices by assisting them in developing the systems and processes to achieve compliance with regulatory objectives, resulting in ethical outcomes and the delivery of quality legal services.<sup>155</sup>

Finally, compliance-based regulation will serve to enhance public confidence in the legal profession and protect the public interest. The jurisdictions that have implemented this model of regulation, specifically NSW, have shown a significant reduction in the number of complaints made against regulated entities likely due to more ethically managed legal practices arising as a result of the self-assessment regime.<sup>156</sup> Therefore, a compliance-based model of proactive regulation, where the regulated entity must determine the ethical infrastructure that will enable it to comply with the stated objectives and outcomes, will certainly raise consciousness about professional ethical obligations.<sup>157</sup> This should translate into more ethical legal practices of the firm and highly ethical behaviours of the lawyers, which will only benefit the public.

### g) Concerns with compliance-based regulation

Although the benefits of compliance-based regulation are numerous, concerns have been raised about implementing this regulatory model for the regulation of the legal profession.

The principal concern is that as compliance-based regulation is focused on outcomes rather than rules, there is more ambiguity and less certainty for firms as to what they must actually do to achieve compliance. Generally, lawyers prefer to know exactly what they are required to do rather than figuring it out by themselves.<sup>158</sup> Professor Black states: “Detailed rules, it is often claimed, provide certainty, a clear standard of behaviour and are easier to apply consistently and without retrospectivity.”<sup>159</sup> However, she explains that rules can “lead to gaps, inconsistencies, rigidity and are prone to “creative compliance”, to the need for constant adjustment to new situations and to the ratchet syndrome, as more rules are created to address new problems or close new gaps, creating more gaps and so on.”<sup>160</sup>

Although the outcomes-focused approach of compliance-based regulation does not tell firms how to achieve compliance, there are opportunities for law societies to work with and provide educational and assessment opportunities for firms so that they can develop systems and processes to achieve compliance with the stated outcomes and objectives of the law society. By using these resources, firms should have greater clarity as to what is expected of them.

Another challenge is the concern that compliance-based regulation would “dilute” individual lawyers’ perceptions of their obligations to abide by professional rules and ethics, or their duties to the court, with lawyers blaming the firm for their conduct.<sup>161</sup> Regulation of the ILPs in Australia, at the time, and outcomes-based regulation of the firms in England and Wales, did not replace the traditional model of regulating individual lawyers. At this time, the prairie law societies have not considered replacing the current, traditional model of individual lawyer regulation. Rather, compliance-based regulation is currently being reviewed as a means of regulating the entity, in addition

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<sup>153</sup> Julia Black, “Principles based regulation: risks, challenges and opportunities” (2007) in *Principles Based Regulation*, 28 March 2007, Sydney, Australia at 7.

<sup>154</sup> Fortney 3, *supra* note 126.

<sup>155</sup> *Ibid.* Entity Regulation, *supra* note 141; Fortney 2, *supra* note 117.

<sup>156</sup> Mark and Gordon, *supra* note 112 at 514.

<sup>157</sup> Parker, Gordon and Mark, *supra* note 10 at 494.

<sup>158</sup> Victoria Rees, Director of Professional Responsibility, NSBS: “Lawyers are often more comfortable with strict rules than a broader space for their professional judgment...”, in Donalee Moulton, “N.S. Moves Forward on ‘Entity Regulation’” (2015) *Lawyers Weekly*, <<http://www.lawyersweekly.ca/articles/2427>>.

<sup>159</sup> Black, *supra* note 153 at 7.

<sup>160</sup> *Ibid.*

<sup>161</sup> The Law Society of Scotland, *supra* note 152 at 14.

to the current model of regulating the lawyer.

A concern has also been expressed about compliance-based regulation accompanied by self-assessment of the firm's ethical infrastructure – the systems and processes it has in place. The concern is that the self-assessment process will act as a checklist whereby the criteria for the outcomes are simply implemented or, worse, it will result in “ritualistic and ineffective ‘box-ticking’”, replacing professional values and ethical judgment.<sup>162</sup>

The study conducted in Australia indicates that while a small percentage agreed that the self-assessment amounted to meaningless “box-ticking”, which may imply they reported compliance without actually reviewing their systems and processes, a large number reported the self-assessment was a learning process they used to review and revise existing policies and to adopt new ones.<sup>163</sup> The study concluded that the self-assessment process acted as an educational exercise towards compliance for directors in developing their ethical infrastructure.

Although the concerns with implementing compliance-based regulation are understandable, given that it is an approach that is on the other end of the regulation spectrum, these concerns are allayed by the numerous benefits that compliance-based regulation provides to the regulation of the legal profession.

#### **h) Establishing a regulatory framework**

As discussed in the previous section concerning entity regulation, the applicable governing legislation for each law society must allow the law society to regulate law firms. This is required before a model of compliance-based regulation of entities can be implemented. Currently, the law societies of Nova Scotia, Saskatchewan and British Columbia have legislation that provides for the regulation of law firms. In Manitoba, the Benchers of The Law Society of Manitoba agree that the Society ought to be able to regulate firms and not simply individual lawyers. Recently, legislation permitting the Society to regulate firms was introduced and is in second reading. The *Legal Profession Act* in Alberta currently does not authorize the law society to regulate law firms.

This discussion focuses on examining what an appropriate compliance-based regulatory framework for entity regulation might look like if the necessary legislative provisions for the regulation of law firms are in place.

#### Regulatory Framework - Example

##### **I. Regulatory Objectives for the Law Society**

In developing a regulatory framework, it is necessary for a law society to establish its regulatory objectives. There are numerous benefits in doing so:

The adoption of regulatory objectives has multifaceted benefits. First, the inclusion of regulatory objectives definitively sets out the purpose of lawyer regulation and its parameters. ...Regulatory objectives thus serve as a guide to assist those regulating the legal profession and those being regulated. Second, regulatory objectives identify, for those affected by the particular regulation, the purpose of that regulation and why it is enforced. Third, regulatory objectives assist in ensuring that the function and purpose of the particular legislation is transparent. Thus, when the regulatory body administering the legislation is questioned—for example, about its interpretation of the legislation—the regulatory body can point to the regulatory objectives to demonstrate compliance with function and purpose. Fourth, regulatory objectives can help define the parameters of the legislation and of public debate about proposed legislation. Finally, regulatory objectives may help the legal profession when it is called upon to negotiate with governmental and nongovernmental entities about regulations affecting legal practice.<sup>164</sup>

Regulatory objectives of a law society relate to the role and purpose that a law society plays in the regulation of the legal profession. They also identify the purpose of the regulation and why it is enforced.

In order to develop a framework for compliance-based regulation, it is necessary to first develop the regulatory objectives of the law society in pursuing this model of regulation. In order to do so, a review of the enabling legislation and the mission and vision statements of the three law societies provide assistance.

Based on the review, the regulatory objectives for a law society could be as follows:

##### a) Uphold and protect the public interest;

<sup>162</sup> Parker, Gordon and Mark 1, *supra* note 10 at 475.

<sup>163</sup> Fortney 3, *supra* note 126 at 124.

<sup>164</sup> Laurel S. Terry, Steve Mark, and Tahlia Gordon, “Adopting Regulatory Objectives for the Legal Profession” (2012) 80 *Fordham L. Rev.* 2685 at 2686.

- b) Promote the fundamental principles of justice and the rule of law;
- c) Promote access to legal services;
- d) Establish requisite standards for professional responsibility, competency and integrity in the delivery of legal services;
- e) Promote inclusion, diversity, equity and freedom from discrimination in the delivery of legal services; and
- f) Regulate in a manner that is proactive, principled and proportionate.

## II. Regulatory Outcomes for Legal Entities

The regulatory outcomes are the objectives that a legal entity is required to comply with that apply to the entity in order to establish and maintain an ethical infrastructure that accommodates the nature and size of the entity's practice. Although the outcomes state what the entity is expected to achieve, they do not tell the entity how to achieve compliance with the outcomes.

Identification of the regulatory outcomes is critical to the development of an ethical infrastructure in a compliance-based model of regulation. The outcomes cannot simply be "pulled out of a hat". Indeed, they should be tied to the regulatory landscape and legal culture that exists within the applicable province. While the regulatory landscape can be determined by examining the regulatory instruments that are in place, an understanding of the legal culture that is in place in Alberta, Saskatchewan and Manitoba, that is, the demographics and the nature and type of complaints against lawyers, would require research, consultation and analysis.

With respect to the regulatory landscape, the law societies of Alberta, Saskatchewan and Manitoba have similar, if not almost identical Codes of Conduct. As in Nova Scotia, the Codes of Conduct establish the standards of behaviour that lawyers are expected to meet, and directly relate to service and management issues that can be incorporated into an ethical infrastructure.<sup>165</sup>

Therefore, based on a review of the Codes of Conduct in the three Prairie provinces, the proposed regulatory framework in Nova Scotia, and the regulatory approach in Australia (at the time) and England and Wales, an ethical infrastructure could comprise the following outcomes:

- a) Develop competent practices;
- b) Communicate in a manner that is timely, conscientious, efficient and civil;
- c) Ensure confidentiality obligations are fulfilled;
- d) Avoid conflicts of interest;
- e) Implement and maintain appropriate systems to protect client trust money and property;
- f) Charge and accept reasonable fees and disbursements;
- g) Maintain appropriate file and records management systems;
- h) Ensure effective management of staff and legal entities;
- i) Maintain effective and respectful relationships with clients, colleagues, courts, the community and the Society;
- j) Work to improve the administration of justice and access to legal services.

## III. Self-Assessment Process

Since compliance-based regulation gives firms the flexibility and autonomy to review and develop their own systems and processes in order to achieve compliance with the outcomes that are set by the regulator, the firms must conduct a self-assessment of their ethical infrastructures. A self-assessment process acts as an educational management strategy for the entity, enabling it to evaluate the strength and weaknesses of its ethical

<sup>165</sup> Creative Consequences, Phase 2, *supra* note 88

infrastructure and to determine where improvement is required.

#### a) Indicative Criteria

Although the outcomes above appear to be self-explanatory, it may not always be the case. This is particularly so if the entity is smaller in scale and has not previously had to consider these issues in detail and therefore does not yet have processes or procedures in place to deal with these ethical considerations. Therefore, providing indicative criteria that are relevant and applicable to each outcome may assist an entity to think about whether or not it has achieved compliance with the regulatory outcomes and, if it has not, what it might do to comply with the outcomes. However, the criteria would be suggestive rather than mandatory.

#### b) Self-Assessment of Compliance

The self-assessment form could set out the 10 outcomes as well as the indicative criteria for each element. After reviewing the indicative criteria in relation to each outcome, the entities could assess whether:

- i) The outcome is not applicable to the entity, or
- ii) If the outcome is applicable, whether they are:
  - A. Not compliant
  - B. Partially compliant
  - C. Fully compliant

If the entity indicates that the outcome is not applicable, then it must explain why this is so in the self-assessment form.

If the entity indicates that it is partially compliant or not compliant with an outcome, then it must explain why this is the case in the self-assessment form.

#### IV. Designated Compliance/Ethics Director

The regulatory framework could require an entity to appoint one or more senior or managing lawyers as a compliance or ethics director. The director's responsibilities could include, but may not be limited to, the following:

- a) management of legal services provided by the entity
- b) the implementation and maintenance of the entity's management systems to ensure compliance with the outcomes
- c) the duty to
  - i) conduct the self-assessment for the entity
  - ii) record and report the self-assessment to the law society
  - iii) report any professional misconduct of a lawyer in the entity to the law society
- d) acting as the main contact for the regulator

#### V. Reporting

The regulatory framework should set out the reporting requirements that entities must comply with. At the outset, all regulated entities would complete an annual self-assessment form and return it to the law society.

The issue is whether or not a self-assessment report must be filed annually. It could be. Or, reporting could be structured so that those firms that indicate compliance with all of the outcomes that are applicable to them in two (or more) consecutive annual self-assessment reports would be exempt from filing an annual self-assessment report thereafter. Instead, for these firms, self-assessment reports could be filed every second year. Regardless, the frequency of reporting could be less for those firms that demonstrate consistency in compliance. However, if these firms subsequently demonstrate less than full compliance, they would revert to filing an annual self-

assessment.

Self-assessment forms could be filed on paper or through an on-line portal system. An on-line portal system would enable the law society to readily track the assessments in order to determine which entities have implemented an ethical infrastructure to achieve compliance with the regulatory outcomes and which have not.

Reporting frequency could be as follows:

- Annual (filing of self-assessment form)
- Every two years if two consecutive years of filing fully complaint self-assessment forms
  - Reverts to annual filing if subsequent self-assessment reports indicate less than full compliance

## VI. Compliance

The purpose of a compliance-based regulatory approach is to ensure that firms implement appropriate systems and processes, an ethical infrastructure, to ensure that the regulatory outcomes set by the regulator are complied with. The aim is to promote ethical behaviour of the lawyers in the firm, thereby improving practice, improving client satisfaction and reducing complaints.

Therefore, an evaluation and review process is required to ensure that compliance is being achieved. The framework for this component could be as follows:

### a) Evaluation

The law society will evaluate the self-assessment forms to determine which firms are at risk of non-compliance and possible unethical or unprofessional conduct.

### b) Communication

If a firm self-reports as partially compliant or not compliant, an open dialogue between the law society and the firm takes place to discuss systems and processes that may be appropriate for the firm to implement.

### c) Compliance Review

A Compliance Review could be triggered where:

- The firm fails to file the self-assessment form;
- The firm fails to implement systems and processes after the Communication stage;
- The law society's evaluation of the self-assessment form indicates that the firm has self-reported as partially compliant or not compliant;
- A complaint has been made against the firm – the frequency of the complaints that would trigger a Compliance Review would need to be determined (for example, one in 12 months, more than one in 12 months?);
- The law society has concerns that appropriate systems and processes are not being implemented or maintained;
- The law society has concerns that the law firm has not provided accurate information on the appropriate systems and processes;
- There is a referral from a department within the law society, e.g., trust safety.

### d) Components of a Compliance Review

If a Compliance Review is triggered, the law society would work with the Compliance or Ethics Director. The components of a compliance review could include, but are not limited to, the following:

- Confirmation that appropriate systems and processes are implemented and maintained;

- Identify the systems and processes relating to the applicable outcomes where the firm is deficient;
- Provide guidance and information as to how deficiencies may be addressed and improvements made;
- Determine the necessity for a follow-up Compliance Review

## VII. Remediation

The objective of a Compliance Review is to ensure that a firm has implemented appropriate systems and processes to ensure compliance with the regulatory outcomes and, consequently, better practice management.

If the firm fails to:

- take steps to implement appropriate systems and processes;
- take measures to improve the existing but deficient systems and processes;
- continue to file a self-assessment report;

then the law society must determine the measures it will implement to remedy the situation.

Possible remedies could be, but are not limited to:

- Mandatory training/continuing education;
- A conduct complaint against the firm or the Director, resulting in
  - reprimand
  - fine
  - conditions imposed on certificate
  - suspension of certificate

Some models suggest that the director, such as the legal practitioner director in Australia, be disciplined for the actions of the firm. However, as Dodek states,

This approach is problematic because it imposes individual responsibility for collective malfeasance. The preferred approach is to maintain a system of predominantly individual responsibility but impose collective responsibility where warranted.<sup>166</sup>

## V. REGULATION OF ALTERNATIVE BUSINESS STRUCTURES

### a) What is an alternative business structure?

The traditional paradigm for the delivery of legal services has the following characteristics:

- Delivery of legal services is restricted to lawyers to the exclusion of all others, which is justified by the need to protect the public from unqualified, unregulated legal advice.
- Regulation is aimed at the qualifications and conduct of individual lawyers rather than legal services or legal practice entities.
- Regulation of legal services is controlled by lawyers (or former lawyers) through law societies and the courts with minimal public representation.
- Delivery of legal services is regarded as a profession rather than a business.
- The concept of privilege distinguishes the legal profession from all others and is central to lawyer-centric business associations.<sup>167</sup>

<sup>166</sup> Dodek, *supra* note 24 at 439.

<sup>167</sup> Noel Semple, *Legal Services Regulation at the Crossroads* (Cheltenham: Edward Elgar, 2015) [Semple 1].

Due to these restrictions, the only viable business association is often thought to be a partnership of individual lawyers. This business association excludes non-lawyers from participating in all aspects of the business including ownership, fee-sharing and provision of legal services. Currently, the following business structures are permitted for the delivery of legal services in Canada: 1) sole practitioner; 2) partnership, including limited liability partnership and, in Ontario, multi-disciplinary partnership; 3) professional corporation and 4) associations. In the Prairie provinces, only lawyers may own shares in legal practices and deliver legal services. Lawyers are not permitted to enter into partnerships with non-lawyers.

The meaning of the term “alternative business structures” (ABS) may differ from jurisdiction to jurisdiction. While the *Legal Services Act 2007* of England & Wales defines a “licensable body” as “any law firm in which non-lawyers are owners or managers”<sup>168</sup>, the term holds a wider meaning elsewhere. Although it has not yet taken steps to regulate ABS, the Law Society of Upper Canada (LSUC) defines such an entity as “an alternative to currently permitted law and paralegal firm structures” which “can refer to both ownership and the services to be provided.”<sup>169</sup>

**For the purpose of this discussion paper, ABS refers to considerations respecting 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.**

## **b) Aspects of ABS**

### **i) Entity Regulation**

Entity regulation has been covered in detail in section III of this paper. It is worth restating, however, that the prevailing paradigm regulates the conduct of individual lawyers and entity regulation is a necessary precursor to allowing ABS to operate. In order to allow the development of business models involving non-lawyer involvement, the Prairie provinces would require the ability to regulate all business entities that deliver legal services. Non-lawyers involved in ownership, fee-sharing and provision of legal services can only be monitored if the law societies have the authority to regulate the entire entity.

### **ii) Non-lawyer involvement and ownership**

#### **A. Overview**

With the exception of Québec, Canada and the United States<sup>170</sup> require professional legal services to be delivered by firms owned and controlled solely by regulated lawyers. While, multidisciplinary practices (MDPs) are permitted in Ontario and British Columbia, lawyers must maintain control of the practice. Ownership of voting shares in professional corporations that deliver legal services is restricted to practising lawyers. Currently, family members of practising lawyers who hold voting shares in the professional corporation are the only non-lawyers who are permitted to own shares, and even then they are restricted to non-voting shares. See section (c)(v) below for further discussion on this topic.

While most business have a variety of options to raise the capital needed to operate, lawyers and law firms are not permitted to raise capital outside of seeking bank loans and partnership buy-ins. Entrepreneurial lawyers with novel ideas for the delivery of legal services have very few options to finance new ventures, and thus innovation is often hampered. Without the ability to innovate, the cost of delivering legal services and, in turn, the cost of accessing legal services, remains high.<sup>171</sup>

The traditional prohibition against non-lawyer ownership of law firms is entrenched in statute and is rooted

<sup>168</sup> *Legal Services Act 2007*, c. 29 (England and Wales), s. 72. [England and Wales LSA]. Available at: <<http://www.legislation.gov.uk/ukpga/2007/29/part/5>>.

<sup>169</sup> Law Society of Upper Canada, “Frequently Asked Questions regarding Alternative Business Structures and the Future of Legal Services,” online at: <<https://www.lsuc.on.ca/with.aspx?id=2147499627>>.

<sup>170</sup> American Bar Association, “Model Rules of Professional Conduct” (2010), online at: <[http://www.americanbar.org/groups/professional\\_responsibility/publications/model\\_rules\\_of\\_professional\\_conduct/rule\\_5\\_4\\_professional\\_independence\\_of\\_a\\_lawyer.html](http://www.americanbar.org/groups/professional_responsibility/publications/model_rules_of_professional_conduct/rule_5_4_professional_independence_of_a_lawyer.html)>, R. 5.4(d)(1); In the United States, only the District of Columbia permits limited non-lawyer ownership or management of law firms, similar to the Law Society’s multi-disciplinary partnership model. The ABA Commission on Ethics 20/20 established a Working Group on Alternative Business Structures to study this issue but as of April 2012, the ABA has no plans to propose changes to its policy prohibiting non-lawyer ownership of law firms. See ABA Commission on Ethics 20/20, Issues Paper Concerning Alternative Business Structures (April 5, 2011).

<sup>171</sup> Semple 1, *supra* note 167 at 158-161.

in the ideology that lawyers must be isolated from non-lawyers in order to maintain their professionalism and independence and remain free from outside influence.<sup>172</sup> This ideology was developed in the late 19<sup>th</sup> century in response to concerns that entrepreneurial aspects of law were undermining the profession's reputation. As lawyers were seen as more altruistic than businesspersons, by placing the good of their clients and society above financial self-interest, it was thought that lawyers should be isolated from businesspersons and exempted from the regulation that businesspersons were subject to.<sup>173</sup>

Whether this description of the legal profession remains true in the 21<sup>st</sup> century is somewhat dubious. In the 19<sup>th</sup> century, most lawyers practiced as sole practitioners or in small partnerships. Today, law has become big business, with mega-firms establishing offices all over the world and servicing multi-billion dollar transactions. Firms have arguably become less and less altruistic in order to achieve this scale of growth. As firms have grown, they have also benefited from implementing business infrastructure, such as accounting, human resource managers, technology, and marketing. It follows that the delivery of legal services could be enhanced by adding further business infrastructure such as management skills, as well as access to capital.

A full discussion of the potential impact of non-lawyer involvement on professionalism and independence of the legal profession is provided in section (d) below.

## B. Examples in other jurisdictions

Ownership of incorporated legal practices has been open to non-lawyers in parts of Australia for over a decade.<sup>174</sup> Three Australian ABSs have now been listed on the Australian stock exchange, starting with Slater & Gordon, which was the first law firm in the world to be publicly listed on May 21, 2007. Prior to its listing, Slater & Gordon worked closely with the Office of the Legal Services Commissioner (OLSC) in New South Wales to ensure that its prospectus, constitution, and shareholder agreements specified that the firms' primary obligation is to the courts and clients. Further, Slater & Gordon has adopted corporate governance policies to reinforce the primacy of professional and ethical obligations of legal practitioners in the company.<sup>175</sup> There are no restrictions on the percentage of shares that can be owned by non-lawyers and the OLSC does not evaluate the suitability of shareholders but the principals (meaning partners or directors) of the firm are responsible for ensuring that the legal practice, and the lawyers within it, complies with all professional obligations.<sup>176</sup>

The *Legal Services Act* of 2007 in England and Wales was amended to permit ownership of legal businesses by non-lawyers and by investors outside of the firm in 2012.<sup>177</sup> In this case, the ABS must receive approval from the Law Society based on the suitability of the proposed shareholders and proposed activities of the ABS. The ABS is regulated by the Law Society as an entity that has ethical obligations, rather than as a lawyer-director being subject to regulation. However, the ABS is required to appoint a compliance officer who acts as the primary contact for the Law Society and is responsible for creating a culture of compliance with regulatory obligations within the ABS.<sup>178</sup> As of April, 2014, there were 308 ABSs licensed in England and Wales.<sup>179</sup>

Some jurisdictions permit non-lawyer ownership with more stringent restrictions. Recently, legislation was introduced in Singapore to permit non-lawyer ownership capped at 25%.<sup>180</sup> The Barreau du Québec (the "Barreau") permits certain non-lawyers to own voting shares as long as at least 50% of voting shares are owned

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<sup>172</sup> *Ibid.*

<sup>173</sup> Russell Pearce, "Professionalism Paradigm Shift: Why Discarding Professional Ideology Will Improve the Conduct and Reputation of the Bar" (1995) Fordham University School of Law Archive of Scholarship and History. [Pearce] Available at: <[http://ir.lawnet.fordham.edu/cgi/viewcontent.cgi?article=1466&context=faculty\\_scholarship](http://ir.lawnet.fordham.edu/cgi/viewcontent.cgi?article=1466&context=faculty_scholarship)>.

<sup>174</sup> *Legal Profession Act, 2004*, No 112, [NSW 2004 LPA] s. 136. Available at: <<http://www.legislation.nsw.gov.au/maintop/view/inforce/act+112+2004+cd+0+N>>; *Legal Profession Uniform Law (NSW) No 16a, 2015*, [NSW 2015 LPA] s. 32. Available at <<http://www.legislation.nsw.gov.au/maintop/view/inforce/act+16a+2014+cd+0+N>>.

<sup>175</sup> Andrew Grech & Kirsten Morrison, "Slater & Gordon: The Listing Experience" (2009) 22 *Georgetown Journal of Legal Ethics* 535.

<sup>176</sup> NSW 2015 LPA, *supra* note 174, ss. 32-35.

<sup>177</sup> England and Wales LSA, *supra* note 168, s. 89 & Schedule 13, available at: <<http://www.legislation.gov.uk/ukpga/2007/29/schedule/13>>; The Law Society, "Setting up an ABS," October 21, 2012. Available at: <<http://www.lawsociety.org.uk/support-services/advice/articles/setting-up-an-abs/>>.

<sup>178</sup> England and Wales LSA, *supra* note 168, ss. 85 & 91.

<sup>179</sup> Bindman, *supra* note 20.

<sup>180</sup> Julius Melnitzer, "Alternative Business Structures Spread to Singapore", *The Financial Post* (January 31, 2014) online at <<http://business.financialpost.com/2014/01/30/alternative-business-structures-spread-to-singapore>>.

by lawyers or other regulated professionals.<sup>181</sup>

### iii) Fee-splitting and referral fees

Rule 3.67 in the Federation of Law Societies of Canada's Model Code of Professional Conduct (the "Model Code"), which has been adopted by all three Prairie provinces, is as follows:

**3.6-7** A lawyer must not:

- (a) directly or indirectly share, split, or divide his or her fees with any person who is not a lawyer;  
or
- (b) give any financial or other reward for the referral of clients or client matters to any person who is not a lawyer.

The commentary following this Rule clarifies that the prohibition is really against compensation or reward paid to non-lawyers for the referral of clients. The commentary lists a few exceptions to this general prohibition (including paying employees for services), and Rule 3.6-8 goes on to exempt MDPs, so long as the partnership agreement provides for the "sharing of fees, cash flows or profits among the members of the firm."<sup>182</sup>

#### A. Fee-splitting with non-lawyers

An ABS model that includes MDPs or non-lawyer ownership will also require lawyers to be permitted to share fees or revenue with non-lawyers, which has also been referred to as "fee-splitting." Historically, the Code of Professional Conduct used by Canadian law societies has prohibited the payment of referral fees between lawyers and non-lawyers, but fee-splitting is a recent, and possibly an inadvertent addition.<sup>183</sup> The LSUC Code of Professional Conduct was used as a model for the Model Code. In turn, LSUC's Code was based on the Canadian Bar Association's (CBA) Code of Professional Conduct, which was adopted in 1974 as an expansion of the "Canons of Legal Ethics" adopted by the CBA in 1920.<sup>184</sup> The CBA Canons were short and made broad statements of principle, with no reference to fee sharing at all.

The first reference to fee-splitting appeared in the 1974 Code in Chapter X, commentary 6 and applied to fee-splitting between lawyers, as follows:

A fee will not be a fair one within the meaning of the Rule if it is divided with another lawyer who is not a partner or associate unless (a) the client, having been informed that a division of fees is proposed, has consented to the employment of the other lawyer, and (b) the fees are divided in proportion to the work done and responsibilities assumed.

However, the 1974 CBA Code did not provide a prohibition against fee-splitting with non-lawyers. The first such prohibition appeared in LSUC's Code in 2000, but was adopted as a rule that specifically prohibited referral fees, not fee-splitting generally.<sup>185</sup> The Final Report of the Ethics and Regulatory Issues Team for the CBA Futures Inquiry states that the Rule that was subsequently published in the LSUC Code was not the Rule adopted by Convocation. The Report goes on to state that:

it does not appear that there has ever been any substantial policy-based decision to ban fee-sharing with non-lawyers in Canada. There is a history with respect to payment for referrals. It is indeed surprising that the source of the broad fee-sharing prohibition now adopted across most of Canada is the adoption, for harmonization, of a rule that was never actually adopted.<sup>186</sup>

The CBA Report suggests that the prohibition against fee-splitting with non-lawyers may have been an unintended effect of a 1966 Ontario ruling regarding "kickbacks" demanded by solicitors for referrals for counsel work. The CBA Report suggests that the real concern has always been about referral fees rather than fee-splitting as a

<sup>181</sup> Quebec Regulation, *supra* note 7.

<sup>182</sup> Federation of Law Societies of Canada, "Model Code of Professional Conduct," as amended October 10, 2014. Online at <<http://flsc.ca/wp-content/uploads/2014/10/ModelCodeENG2014.pdf>> [Model Code].

<sup>183</sup> CBA Futures Inquiry: Ethics and Regulatory Issues Team, "Final Report," April 1, 2014 [CBA Regulatory Issues] at 26.

<sup>184</sup> *Ibid* at 26; See also Canadian Bar Association, Ethics and Professional Responsibility Committee, online at: <<http://www.cba.org/CBA/activities/code/>>.

<sup>185</sup> Transcript of LSUC Convocation, May 5, 2000 at 126-127.

<sup>186</sup> CBA Regulatory Issues, *supra* note 183 at 27.

blanket concept.

In a 2005 report to Convocation, LSUC's Professional Regulation Committee stated that the prohibition against fee-splitting with non-lawyers was intended "to avoid the risk that the lawyer's independence could be compromised by a third party's interest in the fee." The report suggested that, if unrestricted, non-lawyer investment in law firms would pose a risk of creating instability in the firm and its management which could filter down to effect client interests. However, LSUC has since approved the creation of a working group to examine how to structure a regulatory scheme that could facilitate ABS and their financing (whether by lawyers or non-lawyers) which is one of LSUC's strategic priorities for the years 2013-2017.<sup>187</sup>

The American Bar Association (ABA) has had a prohibition against fee-splitting since 1928, which can be further traced back to 1910, when corporations were first prohibited from practicing law in the United States. The rationale behind that prohibition was that lawyers working for a corporation would be beholden to the corporation rather than the client. In 1925, the case that prohibited corporations from practising law was applied to the sharing of fees with non-profit organisations. Then, in 1928 the prohibition was extended to all non-lawyers as a way to stop large banks and ambulance chasers from practising law, both of which were major issues of the day.<sup>188</sup>

Professor Roy Simon suggests that, while part of the motivation behind the prohibition was likely to protect the lawyer's duty of loyalty, it may have been just as much about a desire to protect lawyers from competition. Simon suggests that all of the concerns about loyalty are already protected under other American rules and statutes. He asserts that the only real concern related to fee-splitting of any consequence is the protection of the attorney-client relationship against interference by non-lawyers.<sup>189</sup> The CBA Report also suggests that the debates surrounding MDPs in the 1990s might inform the policy justifications for prohibiting fee-splitting, the most prominent being the protection of independence of judgment.<sup>190</sup> Conceivably, rules could be created to guard against such interference, and such possibilities will be explored below.

## **B. Paying referral fees to non-lawyers**

Originally, the CBA Code of Conduct prohibited payment of any referral fees, including those between lawyers in different firms. When LSUC revised their Code of Conduct in 2000, they removed that prohibition and also considered a suggestion to remove the prohibition against the payment of referral fees between lawyers and non-lawyers. That suggestion was rejected, with no explanation except for the implicit observation that all other Canadian jurisdictions had maintained the prohibition. However, the commentary to that section of the Code was changed so that it no longer stated that payment of referral fees to anyone is an "unprofessional competitive practice".<sup>191</sup>

The ABA maintains a complete prohibition against referral fees, other than the payment to a general lawyer referral service that has been approved by the regulatory authority. On the other hand, England has no general ban on referral fees, but has recently introduced a prohibition against payment or receipt of referral fees in claims for damages related to personal injury or death. In all other circumstances, England uses an outcomes-based criterion which focuses on ensuring that: a) clients are not inappropriately referred, whether by misinformation or pressure; b) professional judgment or independence is not influenced by the referrer; and c) the referral is transparent so that clients are able to make informed choices.<sup>192</sup>

Concerns about maintaining lawyers' independence have more application to referral fees than to fee-splitting. Further, referral fees are not as crucial to facilitating ABS as fee-splitting. However, the CBA has recently recommended that the Model Code be changed to permit referral fees between lawyers and non-lawyers, subject to a list of fairly stringent conditions. Those conditions include the application of ethical rules such as those respecting conflicts and confidentiality, as well as requirements that the fee be reasonable, fully disclosed

<sup>187</sup> "Alternative business structures explored," Law Society of Upper Canada Gazette, December 27, 2012 [LSUC Article]. Online at: <<http://www.lawso-cietygazette.ca/news/alternative-business-structures-explored/>>.

<sup>188</sup> Roy D. Simon, Jr., "Fee Sharing Between Lawyers and Public Interest Groups" (1989) 98 Yale Law Journal 1069 as cited in CBA Regulatory Issues, *supra* note 183 at 27-28.

<sup>189</sup> *Ibid.*

<sup>190</sup> *Ibid* at 29.

<sup>191</sup> *Ibid* at 32.

<sup>192</sup> CBA Regulatory Issues, *supra* note 183 at 33-34.

and consented to by the client, among others.<sup>193</sup> This approach would be more in line with that of England, and appears to maintain sufficient safeguards.

#### iv) Provision of non-legal services

Provision of non-legal services by a law firm is the key characteristic of an MDP, which will be discussed in section (c)(i). There are many tasks that fall within provision of legal services, and are currently required to be performed by lawyers, that are not strictly legal work and could be performed more effectively by others.

Additionally, there are many services that complement legal services and could be provided in one package for greater efficiency and convenience to the client. For example, an accountant could partner with a lawyer to provide either corporate and business planning advice or estate and tax planning advice; a mortgage broker, real estate agent, insurance broker and lawyer might partner to provide one-stop shopping for purchasing, financing, insuring and selling real estate; an engineer, architect and lawyer combine to provide real estate development services; or a family counsellor and lawyer might partner to provide family law counselling and divorce services.<sup>194</sup>

One example from the UK, which has one of the most established MDP regulatory regimes, is Lyons Davidson, a solicitor firm with offices throughout the UK that provides case management services to its insurance clients, and owns its own case management system. The firm also offers the services of a variety of health professionals including physiotherapists and nurses.<sup>195</sup>

#### v) Provision of legal services by non-lawyers

While the provision of legal services by non-lawyers is beyond the scope of this project, it is important to note that this concept is related to ABS and some jurisdictions may be interested in pursuing legislative amendments to permit non-lawyers to provide legal services within an ABS, or possibly even independently. Andrew Perlman suggests that, even though lawyers are able to offer clients more protections in certain contexts, clients should not be forced to hire lawyers to solve legal and law-related problems. He argues that, if someone who is not a lawyer is competent and conflict-free and if clients are made reasonably aware of the risks of selecting that person, the public should be given a choice of providers.<sup>196</sup>

Currently, most Canadian jurisdictions prohibit non-lawyers from delivering legal services. The only exception is Ontario, where paralegals can be licensed to provide certain services.<sup>197</sup> British Columbia has also been exploring the idea of permitting independent paralegals to provide some legal services.<sup>198</sup> The legislation in each jurisdiction contains either a definition of the “practice of law” and provides for the exclusive ability of lawyers to practice law, or contains provisions setting out what constitutes unauthorized practice and the penalties for doing so. Some legislation contains both of these provisions. Each piece of legislation also contains some exemptions for various categories of non-lawyers to provide legal services in limited circumstances.<sup>199</sup> There are also some federal statutes, such as the Criminal Code, which allow for some provision of legal services by non-lawyers.<sup>200</sup>

Chapter 5 of the Model Code also contains an extensive section on the restrictions placed upon services that can be carried out by non-lawyer staff and the requirements for lawyer supervision over non-lawyer staff. Further, Rule 6.06 imposes an ethical obligation on lawyers to guard against unauthorized practice.<sup>201</sup>

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<sup>193</sup> CBA Futures Initiative, *supra* note 75.

<sup>194</sup> Law Society of B.C., “Multi-disciplinary Practice,” online at: <<https://www.lawsociety.bc.ca/page.cfm?cid=2111>>.

<sup>195</sup> Neil Rose, “Exclusive: top consumer law firm targets tie-up with big brands after receiving ABS licence”, Legal Futures, November 1, 2012, online at <<http://www.legalfutures.co.uk/latest-news/exclusive-top-consumer-law-firm-targets-tie-up-big-brands-receiving-abs-licence/print/>>.

<sup>196</sup> Perlman, *supra* note 30 at 46.

<sup>197</sup> Law Society of Upper Canada By-Law 4, “Licensing,” online at <<https://www.lsuc.on.ca/WorkArea/DownloadAsset.aspx?id=2147485805>>.

<sup>198</sup> Law Society of British Columbia, “Report of the Legal Services Regulatory Framework Task Force,” December 5, 2014, at <<http://www.lawsociety.bc.ca/docs/publications/reports/LegalServicesRegulatoryFrameworkTF.pdf>>.

<sup>199</sup> *Legal Profession Act* [Alberta], RSA 2000, c L-8, s 106 [AB LPA]. Available at: <<http://www.qp.alberta.ca/documents/Acts/l08.pdf>>; *The Legal Profession Act, 1990* [Saskatchewan], SS 1990-91, c L-10.1 [LSS LPA], ss 31-32. Available at: <<http://www.qp.gov.sk.ca/documents/English/Statutes/Statutes/L10-1.pdf>>; *Legal Profession Act* [Manitoba], CCSM c L107 [MB LPA], ss 20 & 40. Available at: <<https://web2.gov.mb.ca/laws/statutes/ccsm/l107e.php>>.

<sup>200</sup> Criminal Code, RSC 1985, c C-46, ss 800-803. Available at: <<http://www.canlii.org/en/ca/laws/stat/rsc-1985-c-c-46/latest/rsc-1985-c-c-46.html?autocompleteStr=criminal%20code&autocompletePos=1>>.

<sup>201</sup> Model Code, *supra* note 182 at R. 6.06.

## vi) Third party litigation funding

Third party litigation funding (TPLF) refers to 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 insurance or public funding entities or contingency fees. TPLF has existed in Australia for approximately two decades, but within Canada it is currently concentrated primarily in Ontario, where it has grown increasingly prevalent over the last ten years. TPLF has been used in other jurisdictions and is most commonly used for personal injury suits, commercial arbitrations and class actions, where the risk of adverse costs can be a major impediment to pursuing litigation. It is unregulated by law societies, but is subject to supervision by the courts to some degree, most notably with respect to class actions.<sup>202</sup>

While there is no publicly available data about the value of TPLF in Canada, the total investments in lawsuits at any given time in the U.S. is believed to exceed \$1 billion.<sup>203</sup> In Australia, there are an estimated five major funders, two being publicly listed, with IMF Ltd. alone having earned \$1 billion in fees in the last decade.<sup>204</sup> The rate of return in the event of success required by funders ranges from 5-55 per cent, with individual litigation being on the low end and class actions on the high end.<sup>205</sup> TPLF is structured as a loan in some cases, usually for individual litigation, while the funding of class actions is structured as an investment with a return calculated as a percentage of the settlement or judgment if one is obtained.<sup>206</sup>

Professor Jasminka Kalajdzic has written about the advantages and disadvantages of TPLF. On one hand, it allows more plaintiffs to access legal services without having to worry about running out of money partway through, as long as they are willing to take out a loan to pay for those services. On the other hand, TPLF could encourage unnecessary litigation and frivolous claims. There are also worries that funders could inappropriately influence the handling of the file, although Canadian funders do not appear to have strategic control as they do in Australia.<sup>207</sup> Kalajdzic observes that even Canadian courts are split on the virtues of TPLF,<sup>208</sup> but that a recent decision held that maintenance and champerty laws, which remain in force in all of Canada, will not automatically bar commercial litigation funding of class actions.<sup>209</sup>

Whether or not the Prairie provinces find the possibilities of TPLF attractive, it may be worth considering whether any new rules are necessary to address this growing trend.

## c) Types of ABS

There are many ways that legal practices could be structured using the characteristics described in the previous section. Some structures combine two or more of the following types. The structures included in this section represent some of the most common types of ABS that have developed in Australia and the UK since business structure rules were liberalized, but also include some business structures that are being used in parts of Canada and the U.S.

While some of the following examples, such as professional legal corporations and limited liability partnerships, have become fairly ubiquitous in Canada, they have been included to demonstrate that an evolution in the type of business structures that are permitted has already been taking place. It was not so long ago that those business structures would have been considered “alternative.” However, they also serve to demonstrate that further changes must be made to the authorizing legislation in order to facilitate ABS.

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<sup>202</sup> Jasminka Kalajdzic, Peter Cashman and Alana Longmoore, “Justice for Profit: A Comparative Analysis of Australian, Canadian and U.S. Third Party Litigation Funding” (2012) 61:2 American Journal of Comparative Law 93 [Kalajdzic et al] at 113-118.

<sup>203</sup> Binyamin Appelbaum, “Investors Put Money on Lawsuits to Get Payouts”, NY Times, Nov. 14, (2010) online at: <[http://www.nytimes.com/2010/11/15/business/15lawsuit.html?pagewanted=all&\\_r=0](http://www.nytimes.com/2010/11/15/business/15lawsuit.html?pagewanted=all&_r=0)>.

<sup>204</sup> Kalajdzic et al, *supra* note 202 at 96.

<sup>205</sup> *Ibid* at 100; 113; 116; 130.

<sup>206</sup> *Ibid* at 118.

<sup>207</sup> *Ibid* at 119.

<sup>208</sup> See for example *Giuliani v. Region of Halton*, 2011 ONSC 5119 at para 56 and *Klychak v. Samchuk*, 2012 ABQB 85 at para 55.

<sup>209</sup> Kalajdzic et al, *supra* note 202 at 119. See also *Dugal v. Manulife Financial Corporation*, 2011 ONSC 1785 and *Bayens v. Kinross Gold Corporation*, 2013 ONSC 4974 (CanLII).

## i) Multi-disciplinary partnerships

MDPs are one of the most commonly discussed, distinct types of ABS. Generally speaking, MDPs refer to partnerships between lawyers and non-lawyers to form a practice that provides both legal and other services to its clients. MDPs of all kinds are currently prohibited in the Prairie provinces. In Saskatchewan, while lawyers may be permitted to share office space with a non-member, the businesses must be kept entirely separate.<sup>210</sup>

Australia first allowed MDPs in 1990 when New South Wales (NSW) allowed law firms to form such partnerships as long as lawyers retained at least 51 per cent of the net income. In 1998, the Australian government reviewed the legislation regarding competition in every jurisdiction and determined that the 51 per cent rule in NSW was found to be anti-competitive. As a result, law firms were permitted to incorporate, share receipts and provide legal services either alone or with other legal service providers who may or may not be lawyers for the first time in 2001.<sup>211</sup>

In Canada, MDPs are permitted in Ontario and British Columbia, as long as lawyers maintain control of the practice. In Ontario, lawyers and licensed paralegals are permitted to enter into a formal multidisciplinary partnership agreement with professionals who practice a profession, trade or occupation that supports or supplements their practice of law or provision of legal service (e.g., accountants, tax consultants, trademark and patent agents, etc.), subject to approval by the applicable law society.<sup>212</sup>

In 2010, the Law Society of British Columbia (LSBC) began allowing non-lawyers to become partners in law firms. The LSBC defines an MDP as “a partnership, including a limited liability partnership or a partnership of law corporations, that is owned by at least one lawyer or law corporation and at least one individual non-lawyer or professional corporation that is not a law corporation, and that provides to the public legal services supported or supplemented by the services of another profession, trade or occupation.”<sup>213</sup> The LSBC also allows paralegals to provide some legal services under the supervision of a lawyer.<sup>214</sup>

The Barreau permits advocates to practice law in an MDP, provided that such practices provide a detailed undertaking to ensure that members who engage in professional activities within the firm have a working environment that permits compliance with any law applicable to the carrying out of professional activities. They must also undertake to ensure that the partnership, corporation and all persons who comprise the partnership or corporation, or are employed there, are in compliance with legislation and regulations. The Barreau also allows members of other regulated professions to own shares in corporations practicing law so long as at least 50% of the voting shares of the professional corporation are owned by lawyers or other regulated professionals.<sup>215</sup>

In 2009, the ABA Commission on Ethics 20/20 established a Working Group to study the issue of ABS. In June 2011, the ABA decided against certain forms of ABS, including MDPs, publicly traded law firms, and passive non-lawyer investment or ownership of law firms. Although the Working Group did consider a proposal to permit non-lawyer employees of a firm to have a minority financial interest in the firm, the Commission announced that it would not propose changes to ABA policy prohibiting non-lawyer ownership of law firms in April 2012.<sup>216</sup>

## ii) Publicly traded corporations

One of the possibilities for ABS on the extreme end of the spectrum is for a legal practice to become a publicly traded corporation. There are only a handful of publicly owned legal practices in Australia and the UK. Slater &

<sup>210</sup> Law Society of Saskatchewan Rules [LSS Rules], R. 1458, online at: <<http://lawsociety.sk.ca/media/116588/lrulesconsolidateJul2015.pdf>>.

<sup>211</sup> “Alternative business structures: Australia,” Law Society of Upper Canada Gazette, December 27, 2012 [LSUC Australia Article]. Online at: <<http://www.lawsocietygazette.ca/news/alternative-business-structures-australia/>>.

<sup>212</sup> Law Society of Upper Canada, Bylaw 7 [LSUC Bylaw 7], s. 18, online at: <<http://www.lsuc.on.ca/WorkArea/DownloadAsset.aspx?id=2147485808>>; Law Society of Upper Canada, “Multi-Discipline Practice and Multi-Discipline Partnership,” online at: <<http://www.lsuc.on.ca/For-Paralegals/Manage-Your-Practice/Practice-Arrangements/Multi-Discipline-Practice-and-Multi-Discipline-Partnership/>>.

<sup>213</sup> Law Society of British Columbia Rules, R. 1, online at: <<https://www.lawsociety.bc.ca/page.cfm?cid=4090&t=Law-Society-Rules-2015-Definitions>>.

<sup>214</sup> Law Society of British Columbia, “Code of Professional Conduct,” R. 6.1-3.3, online at: <<http://www.lawsociety.bc.ca/page.cfm?cid=2644&t=Chapter-6-Relationship-to-Students,-Employees,-and-Others>>.

<sup>215</sup> Quebec Regulation, *supra* note 7; LSUC Working Group Report, *supra* note 98.

<sup>216</sup> American Bar Association Commission on Ethics 20/20 Working Group on Alternative Business Structures, “Issues Paper Concerning Alternative Business Structures” (April 5, 2011) online at: <[http://www.americanbar.org/content/dam/aba/administrative/ethics\\_2020/abs\\_issues\\_paper.authcheckdam.pdf](http://www.americanbar.org/content/dam/aba/administrative/ethics_2020/abs_issues_paper.authcheckdam.pdf)>.

Gordon was the first publicly traded law firm in the world and was first listed in 2007. The other two firms listed on the Australian stock exchange are Shine Lawyers and Integrated Legal Holdings. In October 2011, private equity firm Palamon Capital Partners secured a majority stake in QualitySolicitors (QS), a network of independent law firms in the UK (the equity firm did not acquire a stake in the law firms that are franchise members of QS).<sup>217</sup>

Publicly traded firms in Australia offer the ability to have non-lawyer management teams, including Chief Executive Officers, which can lead to more efficient, focused management. They also offer the incentive for employees to own a stake in the firm, both during and after the term of their employment, and provide alternatives to relying on bank loans and investment from partners.<sup>218</sup> These benefits will be examined further below.

Reporting for the CBA National Magazine, Mitch Kowalski visited Slater & Gordon in 2014 and observed that firms interested in attracting outside investment would likely need to focus more on processes and invest in IT that supports those processes. He also recommends removing key client and key lawyer risk by creating a more equally distributed reliance on both individual lawyers and clients which involved improving both the employee and client experience. Finally he recommends adopting an overall culture of continuous improvement, which he believes most Canadian lawyers will find counterintuitive as they tend to believe that a successful legal practice can rely solely upon providing quality legal services.<sup>219</sup>

Legal practices are not capital-intensive; their value lies primarily in human capital that is largely transient in nature. In recognition of this, Slater & Gordon targeted its initial public offering at institutional investors and staff. Success in this approach is largely dependent on name recognition, but a wide range of factors have also been identified to value a law firm, including the quality of the management team, the scale of the business, the quality of operational systems and work in progress, among others.<sup>220</sup>

Commentators have raised concerns about the potential conflict between ethical duties and duties to shareholders when legal practices are publicly owned. These concerns will be examined in detail below.

### iii) Franchises

Franchises are another new business structure for legal practices that has developed in Australia and England since the advent of ABS. Non-lawyer franchisors might grant franchises to owners and operators of local legal practices and provide headquarter support in terms of things like marketing, administration, business development, ethical infrastructure, technology platform, and general advisory services. While the head office might employ lawyers, it can also rely heavily on other service providers with relevant expertise. By allowing a centralized head office to handle all of the non-legal aspects of running a legal practice, the lawyers who own and work at the franchise can concentrate on delivering legal services. Franchises might be particularly attractive for sole proprietors, especially in rural settings where it can be difficult to find staff.

The franchisee benefits from the brand created by the franchisor, which could be made up of business, marketing, IT and other experts, while the franchisor works to maintain the brand's reputation by monitoring franchises to ensure that they meet the franchise standards.<sup>221</sup> Lawyers employed by both the franchisor and the franchisee would remain individually responsible for compliance with professional obligations, as well as being subject to civil liability for their own errors and omissions. The franchisor and franchisees would also presumably be vicariously liable for errors and omissions of legal and other personnel employed by them.<sup>222</sup>

An example of independently owned and operated firms working within a branded network is found in the UK with QS. The QS network promises its over 200 member firms access to national branding strategies, as well

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<sup>217</sup> The Law Society Gazette, "Private equity buys into QualitySolicitors", October 21, 2011 [LSUC QS Article]. Online at: <<http://www.lawgazette.co.uk/news/private-equity-buys-into-qualitysolicitors/62702.fullarticle>>.

<sup>218</sup> Mark and Gordon, *supra* note 112 at 530-531.

<sup>219</sup> Mitch Kowalski, "How to make a law firm float," CBA National Magazine, January/February 2014 Issue. Online at: <<http://www.nationalmagazine.ca/Articles/January-February-2014-Issue/How-to-make-a-law-firm-float.aspx>>.

<sup>220</sup> Mark & Gordon 1, *supra* note 112 at 528-529; See also M. Byrne, "Firm Offers" *thelawyer.com*, May 16, 2005, online at: <<http://www.thelawyer.com/firm-offers/115510.article>>.

<sup>221</sup> Edward M. Iacobucci and Michael J. Trebilcock, "An Economic Analysis of Alternative Business Structures for the Practice of Law" September 20, 2013 [Iacobucci & Trebilcock] at 56-57. Available at: <<http://www.lsuc.on.ca/uploadedFiles/ABS-report-iacobucci-Trebilcock-september-2014.pdf>>.

<sup>222</sup> *Ibid* at 20.

as other benefits of membership, including website support and buying power, but firms remain independent.<sup>223</sup>

#### iv) Professional legal corporations

From 1999-2001, most of the provincial governments of Canada changed their incorporation laws to include professionals. In turn, most law societies began allowing lawyers to incorporate their legal practices. Professional legal corporations (PLC) are corporate entities licensed to deliver legal services under a set of licensing requirements that are unique to the legal profession. A professional corporation may engage in the practice of a profession when it has obtained a permit from its professional association. With regard to the legal profession in Canada, law societies must approve a PLC and issue a permit before it can deliver legal services. They may have one or more directors and shareholders and may make up a larger partnership.

Common requirements of PLCs across Canada are that all directors and voting shareholders must be practising lawyers entitled to practice in the jurisdiction where the corporation is incorporated. Only lawyers (and in the case of Ontario, licensed paralegals) are permitted to provide legal services on behalf of the corporation and liability for professional negligence is not limited to the corporation; it is borne by the lawyer directors and shareholders. This structure improves the lawyer's tax and estate planning ability while maintaining the lawyer's accountability for the legal services delivered by the PLC.

Most of the Canadian provinces have allowed non-lawyers to own non-voting shares in PLCs since they have been permitted structures. Most often ownership is limited to the lawyer's spouse.<sup>224</sup> However, Newfoundland allows immediate relatives to own non-voting shares<sup>225</sup> and PEI allows relatives or those who reside with voting shareholders to own non-voting shares.<sup>226</sup> In New Brunswick, there is a slightly less onerous requirement that only a majority of the issued voting shares be owned by members of the law society, meaning that some voting shares can be owned by non-members.<sup>227</sup> Further, Nova Scotia allows any person to own non-voting shares, regardless of their relationship to the lawyer-shareholder.<sup>228</sup> The Law Society of Alberta began allowing non-lawyer family members (usually a spouse, common-law partner or children) of lawyers to own non-voting shares in PLCs in 2010. Non-voting shares can also be held in trust for minor children of the lawyer.<sup>229</sup>

The exception is Ontario, where only persons who are licensed to practise law or provide legal services subject to the by-laws, may own shares of a PLC.<sup>230</sup> Family members and other non-licensees are not permitted to hold shares in a PLC either directly or indirectly. While holding companies may own shares in a PLC, the ownership of shares in the holding company is restricted to licensees.<sup>231</sup>

While PLCs are now commonplace, it was not that long ago that they would have been considered alternatives to the norm in Canada. In some common law jurisdictions beyond our borders, they are still considered ABSs. In the United States, some states forbid the incorporation of law firms and only permit members to practice as either sole proprietorships or in partnerships comprised of individual lawyers.<sup>232</sup> While most states allow lawyers

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<sup>223</sup> *Ibid* at 23.

<sup>224</sup> *Legal Profession Act* [British Columbia], SBC 1998, c 9, s 82. Available at: <<https://www.lawsociety.bc.ca/page.cfm?cid=688&t=Legal-Profession-Act-Part-9-Incorporation-and-Limited-Liability-Partnerships>>; AB LPA, *supra* note 199, s 131; MB LPA, *supra* note 199, s 32; *The Professional Corporations Act* [Saskatchewan], SS 2001, c P-27.1, s 6. Available at: <<http://www.qp.gov.sk.ca/documents/English/Statutes/Statutes/P27-1.pdf>>; LSS Rules, *supra* note 210, R. 1401.

<sup>225</sup> *Law Society Act, 1999* [Newfoundland], SNL 1999, c L-9.1, s 63.4. Available at: <<http://assembly.nl.ca/Legislation/sr/statutes/109-1.htm>>.

<sup>226</sup> *Legal Profession Act* [PEI], RSPEI 1988, c L-6.1, s 36.2. Available at: <[http://www.gov.pe.ca/law/statutes/pdf/l-06\\_1.pdf](http://www.gov.pe.ca/law/statutes/pdf/l-06_1.pdf)>.

<sup>227</sup> *Law Society Act, 1996*, SNB 1996, c 89, s 37(4)(b). Available at: <[http://lawsociety-barreau.nb.ca/uploads/forms/Law\\_Society\\_Act%2C\\_1996\\_-\\_Loi\\_de\\_1996\\_sur\\_le\\_Barreau.pdf](http://lawsociety-barreau.nb.ca/uploads/forms/Law_Society_Act%2C_1996_-_Loi_de_1996_sur_le_Barreau.pdf)>.

<sup>228</sup> *Legal Profession Act* [Nova Scotia], SNS 2004, c 28, s 21. Available at: <<http://nsbs.org/sites/default/files/cms/menu-pdf/legalprofessionact.pdf>>; Nova Scotia Barristers' Society, Regulations made pursuant to the *Legal Profession Act*, SNS 2004, c 28, s 7.1.2. Available at: <<http://nsbs.org/sites/default/files/cms/menu-pdf/currentregs.pdf>>.

<sup>229</sup> Law Society of Alberta, "Family Members Can Now Own Shares in Professional Corporations" (April 2010) 8:2 The Advisory online at: <[http://www.lawsociety.ab.ca/advisory\\_2010/advisory\\_volume\\_8\\_issue\\_2\\_Apr2010/news/shares.aspx](http://www.lawsociety.ab.ca/advisory_2010/advisory_volume_8_issue_2_Apr2010/news/shares.aspx)>.

<sup>230</sup> *Law Society Act*, RSO 1990, c L.8, s 61.0.1(4). Available at: <<http://www.ontario.ca/laws/statute/90l08#BK165>>; *Business Corporations Act*, RSO 1990, c B.16, s 3.1(2). Available at: <<http://www.ontario.ca/laws/statute/90b16#BK6>>; See also Iacobucci & Trebilcock, *supra* note 221 at 19.

<sup>231</sup> Law Society of Upper Canada, "Information Sheet for Lawyers Forming a Professional Corporation" online at: <<http://www.lsuc.on.ca/WorkArea/DownloadAsset.aspx?id=2147499633>>.

<sup>232</sup> Gillian K. Hadfield, "The Cost of Law: Promoting Access to Justice through the (Un)Corporate Practice of Law" (2014) 38 *International Review of Law and Economics* 43. Available at: <<http://works.bepress.com/ghadfield/49>> [Hadfield 1].

to incorporate, they require all shareholders and directors to be licensed lawyers; however, in Washington D.C., non-lawyers may hold shares in law firms if they are employees of the firm and the firm provides only legal services.<sup>233</sup>

Like limited liability partnerships (LLPs) in the following subsection, PLCs could be used as a model for expanding the types of business structures permitted to practice law in the Prairie provinces as they have expanded ownership of law firms to non-lawyers to a certain degree. If the Prairie provinces wish to expand non-lawyer ownership of PLCs even further, amendments will be required to the applicable legislation in each jurisdiction.

#### v) Limited liability partnerships

Unlike general partnerships, where the liability is unlimited and shared jointly by all partners (even for one partner's professional negligence), LLPs limit each partner's liability in correspondence with the partner's personal assets. The property of the partnership is available to satisfy the partnership's debts generally and there are mandatory insurance requirements to provide sufficient coverage for negligence. A partner can still be held liable for his or her own negligent or wrongful act or omission or the negligent or wrongful act or omission of a person under the partner's direct supervision. A partner could even be held liable for the negligent or wrongful act or omission of another partner or an employee of the partnership who is not under the partner's direct supervision if: a) the act or omission was criminal or constituted fraud; or b) the partner knew or ought to have known of the act or omission and did not take the actions that a reasonable person would have taken to prevent it. Otherwise, a partner is not liable for the debts, liabilities or obligations of the partnership or any partner.<sup>234</sup>

Although LLPs are a common type of business structure used by law firms in Canada today, they were also first permitted in the Prairie provinces in the early 2000s. The transition to permit LLPs and create new requirements for lawyers operating in such a business structure could be used as a model for expanding the rules respecting business structures.

#### d) Common Concerns

Critics of ABS regulation tend to focus on the four following concerns, which relate to the specific rules of professional conduct that apply to lawyers, whether through Codes of Conduct or the common law. The ideals of solicitor-client privilege and confidentiality, professionalism, independence, and protection from conflicts of interest are touchstones of traditional lawyer regulation and critics argue that, because non-lawyers have not traditionally been subject to the same rules that protect those ideals, involving them in the practice of law in any way could jeopardize the protection of those ideals.<sup>235</sup>

There is also an over-arching concern that regulators will lose the ability to effectively regulate legal services provided by entities that are partly owned or managed by non-lawyers. The CBA Legal Futures Initiative encourages a thoughtful assessment of the impact of non-lawyer ownership on competence, conflicts of interest, confidentiality, independence and fidelity to law among other issues.<sup>236</sup>

However, as the practice of law has evolved over time, it might be argued that these concerns could apply equally to lawyers in the absence of non-lawyer influence. Andrew Perlman argues that lawyers already have incentives to put profit above the best interest of their clients, due to such modern trends as the prevalence of settlements and hourly billing. Perlman also asserts that regulators are capable of addressing the disparities between lawyers and non-lawyers with regard to client protection ideals. Confidentiality requirements and solicitor-client privilege can and have been extended to non-lawyers in other jurisdictions and regulators can establish rules to preserve professional independence by requiring that the client and the lawyers still exert a minimum level of control over the services being provided.<sup>237</sup>

<sup>233</sup> D.C. Bar, "D.C. Rules of Professional Conduct, Effective 2/1/07," R. 5.4: <<http://www.dcbbar.org/bar-resources/legal-ethics/amended-rules/rule5-04.cfm>>.

<sup>234</sup> Iacobucci and Trebilcock, *supra* note 221 at 45-46.

<sup>235</sup> Nick Robinson, "When Lawyers Don't Get All the Profits: Non-Lawyer Ownership of Legal Services, Access, and Professionalism" (2014), [Robinson], online at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2487878&download=yes](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2487878&download=yes); Ontario Trial Lawyers Association, "Response to the Law Society of Upper Canada Discussion Paper, Alternative Business Structures and the Legal Profession in Ontario," (December 15, 2014) [OTLA]. Available at: <<http://www.lsuc.on.ca/uploadedFiles/Ontario%20Trial%20Lawyers%20Association.pdf>>.

<sup>236</sup> CBA Futures Initiative, *supra* note 75 at 36.

<sup>237</sup> Perlman, *supra* note 30 at 46. See also Ted Schneyer, "Thoughts on the Compatibility of Recent U.K. and Australian Reforms with U.S. Traditions in

The Prairie provinces have the benefit of learning from the approaches taken by other jurisdictions to address each of these concerns. Where gaps have been identified by those other jurisdictions, the Prairie provinces can strive to improve on existing approaches.

## i) Preservation of professionalism and independence of the bar

### A. Professionalism

The concern that non-lawyers will be more likely to eschew professionalism and prioritize profit over client interests and the rule of law is tied to the protection of the reputation of the profession, which is traditionally conceived as altruistic. True professionalism is not averse to prosperity, but that prosperity must be incidental to putting the public interest first and rejecting commercial activity.<sup>238</sup> Critics of ABS argue that allowing non-lawyers to profit from the provision of legal services will erode professionalism by encouraging the partners to focus on profit and wealth and putting the motives of the lawyer and non-lawyer partners at odds. They argue that ethical decisions are not always the most profitable, and that non-lawyer partners will not accept putting ethics first.<sup>239</sup>

While there have been a number of organizations and individuals who have raised concerns about non-lawyer ownership of law firms, the Ontario Trial Lawyers Association (OTLA) has voiced the strongest Canadian opposition to this concept. It argues that cases that have high financial risk, such as test cases involving important legal issues, are likely to be rejected by investors. In addition, it argues that ABS firms that have established regional or national name recognition will be less willing to provide legal services in claims involving unpopular clients or causes for fear of brand denigration.<sup>240</sup> The OTLA also puts forth concerns that firms will undercut each other in a race to the bottom to offer the cheapest fixed fee services at the cost of quality service. They argue that fixed fees are dangerous because shareholders may not allow a lawyer to continue working on a file once the time equivalent has been reached.<sup>241</sup>

The OTLA's argument against ABS is primarily based on its assertion that there is an inadequacy of empirical evidence that: 1) ABS will improve access to justice; and 2) that the core values of the legal profession can be protected.<sup>242</sup> However, the OTLA itself does not rely on empirical evidence to make its arguments. Instead, it primarily relies on hypotheticals and anecdotal evidence.<sup>243</sup> The OTLA's argument also appears to be making an assumption that ABSs will adopt flat fee structures and abuse them, but ignores the fact that many lawyers are already using flat fees. Further, the OTLA has not acknowledged the reality that some partners in large firms exert the same pressure on associates that it fears will be exerted by non-lawyer shareholders.

Many of the OTLA's arguments might also be interpreted as being motivated by self-interest. The OTLA argues that conventional firms with traditional values and longstanding expertise could lose core business to aggressive and less-experienced new providers. It also asserts that associations such as the OTLA will lose business for providing continuing professional development (CPD) courses, as they assume that ABSs are likely to be large firms, and that large firms are more likely to provide their own CPD courses. While the OTLA argues that associations of its kind are an important resource for lawyers in sole and small practices, it also acknowledges that they depend on CPD revenue to exist.<sup>244</sup> In the absence of strong evidence to support its arguments that ABS will erode professionalism, many of these arguments can be interpreted as being protectionist and should not amount to a stand-alone reason to prevent consideration of these possibilities.

Although businesspeople and professionals are oft contrasted, Noel Semple points out that there is no evidence that money motivates professionals any less than their counterparts. Human beings in general have an innate capacity for altruism to some extent, and it should not be assumed that non-lawyer businesspeople will always act selfishly. While lawyers take pride in *pro bono* service, equivalent charitable activities exist in most other

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Regulating Law Practice" (2009) J. Prof. Law. 13 online at: <[http://www.americanbar.org/content/dam/aba/administrative/professional\\_responsibility/38th\\_conf\\_session14\\_schneyer\\_thoughts\\_on\\_the\\_compatibility\\_authcheckdam.pdf](http://www.americanbar.org/content/dam/aba/administrative/professional_responsibility/38th_conf_session14_schneyer_thoughts_on_the_compatibility_authcheckdam.pdf)>.

<sup>238</sup> Semple 1, *supra* note 167 at 189.

<sup>239</sup> OTLA, *supra* note 235 at 26.

<sup>240</sup> *Ibid* at 24; Robinson, *supra* note 235 at 14.

<sup>241</sup> OTLA, *supra* note 235 at 25.

<sup>242</sup> *Ibid* at 24.

<sup>243</sup> *Ibid* at 9.

<sup>244</sup> *Ibid* at 22.

occupations.<sup>245</sup>

Further, there are countless cases of lawyer misconduct, much of it profit-seeking and self-serving, that bring the profession into disrepute. There are studies that demonstrate that lawyers' work performance responds to changes in their compensation structure. There have even been some studies that indicate that lawyers may be more prone to ethical lapses than the general public. At the very least, these studies show that the superior professionalism of lawyers is very difficult to prove and has likely been overstated.<sup>246</sup> Professor Russell Pearce goes so far as to suggest that "professionalism" for the legal profession is socially constructed, with its authority resting not on its truth in any abstract sense, but in its acceptance by the profession."<sup>247</sup>

While it can be argued that the disparities between business and profession have narrowed over time, there are also a couple of safeguards inherent to a self-regulated profession that will continue to uphold the ideals of professionalism. First, the mandate of regulators to place the public interest above the interests of the bar creates a safeguard against the erosion of professionalism. Regulators in self-regulated professions themselves are required to be altruistic and this mandate will not change due to the inclusion of non-lawyers in practices that deliver legal services.<sup>248</sup>

The second safeguard is the desire of the individual members of the profession to preserve both their individual reputations and that of the profession at large. As an exclusive group of people trained in specialized knowledge and skill, lawyers recognize each other as an elite group of peers by virtue of their common ethical obligations, among other common experiences. Russell Pearce writes that it has been the "invisible hand" of reputation, rather than economic efficiency that has traditionally driven the legal services market. For the most part, the lawyers that will be the most successful, both with respect to wealth and respect, are those who live up to their professional obligations. Because lawyers have an interest in maintaining a good reputation, there is no reason to doubt that they will continue to strive to ensure that lawyers live up to the requirements of the Code of Conduct and will likely place importance on ensuring non-lawyer partners do the same, so as not to jeopardize their own reputations by association.<sup>249</sup>

## B. Independence

Another major tenet of the legal profession is independence of lawyers: from the state; from non-lawyers; and from their firms or business entities.<sup>250</sup> It is the latter two that warrant consideration when it comes to ABS regulation. Independence from non-lawyers is closely tied to professionalism and an emphasis on the client as the lawyer's master. Independence promotes the lawyer's duty to place client interests above all else through freedom from outside influence and 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.<sup>251</sup>

However, as is the case with professionalism, the reality is that lawyer independence has already been eroded. Lawyers and firms are not required to operate in a way that maximizes the principles of independence and client interest as there are already many conflicting interests that lawyers are subject to, such as partners who employ associates and executives of corporate clients. As employees, associate lawyers are beholden to not only the client but the firm as well. While critics warn that non-lawyers will demand profitability, firms already require associates to meet billable hour targets that emphasize maximizing profits, and to drop clients who cannot afford to pay. This does not constitute putting the clients' interests above all. Further, lawyers can be beholden to third parties who pay clients' fees, such as insurance companies, and usually have economic interests that differ from those of the client.<sup>252</sup>

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<sup>245</sup> Semple 1, *supra* note 167 at 201-202. See also: Pearce, *supra* note 173.

<sup>246</sup> Leslie Levin, "The Monopoly Myth and Other Tales about the Superiority of Lawyers" (2014) 82:6 Fordham L. Rev. 2611 at 2621-2622. Available at: <<http://ir.lawnet.fordham.edu/cgi/viewcontent.cgi?article=4994&context=flr>>.

<sup>247</sup> Pearce, *supra* note 173 at 1229.

<sup>248</sup> Semple 1, *supra* note 167 at 197.

<sup>249</sup> *Ibid* at 191. See also: Pearce, *supra* note 173 at 1245.

<sup>250</sup> Semple 1, *supra* note 167 at 219.

<sup>251</sup> *Ibid* at 230.

<sup>252</sup> *Ibid* at 235.

In the current climate, true independence from non-lawyers and firms is not possible, as it would mean that the current business model of most firms would be largely prohibited. This is not to suggest that independence of the profession is not important, but in the face of these realities, arguments against allowing ABS in favour of protecting independence ring somewhat insincere and may be interpreted by the public as being protectionist.<sup>253</sup> Nevertheless, the jurisdictions that have allowed ABS to operate have found ways to protect these ideals.

### C. Examples of safeguards in other jurisdictions

Until recently, in Australia an incorporated law firm had to appoint at least one lawyer as Director to be responsible for both managing legal services and ensuring those services complied with the professional obligations of lawyers under the *Legal Profession Act, 2004* (NSW 2004 LPA), regulated by the Office of the Legal Services Commissioner (OLSC).<sup>254</sup> This requirement assuaged fears that MDPs that were primarily non-legal would dominate the legal profession and ensured that the legal profession did not lose control of the provision of legal services in NSW. The Director had all the duties a lawyer has to the court and the client, as well as to the corporate regulator that any director would have, but they also had several additional duties.

The Director was also responsible for ensuring that all employees, whether they're licensed legal practitioners or not, act as if they have the ethical duties of a lawyer, and that the firm as a whole has an ethical profile, in the form of appropriate management systems, to comply with the legal ethics required of all lawyers. Failure to comply could amount to a finding of professional misconduct for the Director, resulting in the removal of that person's practicing certificate. When that happened, the firm had seven days to replace the Director to avoid going into involuntary liquidation.<sup>255</sup>

The *Legal Profession Uniform Law (NSW)* (NSW 2015 LPA), adopted on July 1, 2015, has eliminated the requirement for a Director and changed some of the above-mentioned requirements for ILPs. The new Act requires that all principals (which generally means all partners of the firm or directors of the corporation) are responsible for ensuring that all legal practitioners in the law practice comply with all professional obligations and that the legal services provided by the law practice are provided in accordance with the law and with professional obligations. A failure to do so is grounds for professional misconduct.<sup>256</sup>

The NSW 2004 LPA also included a provision that made it very clear that, where there was a conflict between that Act and the *Corporations Act, 2001*, under which ABSs are incorporated, the NSW 2004 LPA would prevail.<sup>257</sup> This ensured a lawyer's duties to the client, the court and duties to conduct themselves in a manner that upholds the rule of law and administration of justice under the NSW 2004 LPA superseded the ABS' duties to shareholders. Australia's publicly listed legal practices have stated in their prospectuses, constituent documents and shareholder agreements that their primary duty is to the court; their secondary duty is to the client; their tertiary duty is to the shareholder; and that where there is a clash between legal profession regulation and the *Corporations Act, 2001*, the former will prevail.

In both B.C. and Ontario, lawyer and paralegal partners in an MDP are responsible for the actions of non-lawyer partners and must ensure that those partners comply with various conditions, including protecting privileged and confidential information, preventing conflicts of interest, maintaining trust records and purchasing liability insurance from the Law Society, among others. The licensee/member is also required to submit an annual report to the Law Society, including any changes in participants or agreements, and failure to do so could result in administrative suspension.<sup>258</sup>

In both jurisdictions, the lawyers involved in the partnership must demonstrate that they have effective control over the legal services the partnership provides. Part of this requirement is that lawyers must ensure that non-lawyers provide only services that support or supplement the practice of law under the supervision of a lawyer

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<sup>253</sup> *Ibid* at 236.

<sup>254</sup> NSW 2004 LPA, *supra* note 174, s. 140.

<sup>255</sup> LSUC Australia Article, *supra* note 211.

<sup>256</sup> NSW 2015 LPA, *supra* note 174, s. 34.

<sup>257</sup> NSW 2004 LPA, *supra* note 174, s. 162(2)

<sup>258</sup> LSUC Bylaw 7, *supra* note 212, s. 18 & 19.

and that they have the appropriate skill, judgment and competence to provide those services.<sup>259</sup> In addition, non-licensees must be of good character.<sup>260</sup>

As is the case with PLCs that currently deliver legal services in Canada, the requirements to operate as an ABS could be established in a manner that ensures liability for professional negligence would continue to be borne by the lawyers in the partnership, as a way of creating personal incentives for the lawyer to comply with ethical obligations.<sup>261</sup>

## ii) Preservation of Solicitor-Client Privilege and Confidentiality Principles

### A. Overview of the issue

Solicitor-client privilege is arguably the most important hallmark of the legal profession. Communications between lawyer and client that are covered by the deeply enshrined common law principle of privilege are protected from disclosure and inadmissible in court. The principle, which is now protected under the *Canadian Charter of Rights and Freedoms*,<sup>262</sup> is therefore critical to the delivery of legal services and must be protected within the context of ABS. 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.<sup>263</sup>

In the 1990s, the CBA's MDP Working Group identified a risk that in a fully integrated MDP made up of lawyers and other professionals, privileged legal advice would be undermined by routinely being communicated to non-lawyers.<sup>264</sup> Those concerns were addressed by LSUC's By-Law 7, which requires lawyer control and the limitation of non-legal services to those that support or supplement legal services.<sup>265</sup> The Final Report of the CBA Futures Inquiry's Ethics and Regulatory Issues Team acknowledges that, over the past two decades that MDPs have existed in the common law world, the risk to solicitor-client privilege has been mitigated by measures taken by regulators. Further, as technology has evolved, it has become increasingly easier to maintain control and privacy of documents within an ABS.<sup>266</sup>

The Model Code acknowledges that non-lawyer staff in a law firm will routinely have access to and work on client files and will therefore possess confidential client information. Rule 3.4-23(b) places a responsibility on the lawyer and the firm to prevent further disclosure, as follows:

#### Lawyer Due-diligence for non-lawyer staff

**3.4-23** A lawyer or a law firm must exercise due diligence in ensuring that each member and employee of the law firm, and each other person whose services the lawyer or the law firm has retained:

(b) does not disclose confidential information:

- i. of clients of the firm; or
- ii. any other law firm in which the person has worked.<sup>267</sup>

Canadian courts have also extended the protection of solicitor-client privilege to other situations. For example, privilege will not be waived in situations where clients share the legal advice they have received with an expert in order to obtain an assessment of the legal advice they have received.<sup>268</sup> The courts have also held that the law

<sup>259</sup> Law Society of British Columbia Rules [LSBC Rules], R. 2-23.1 - 2.23.12. Online at: <<http://www.lawsociety.bc.ca/page.cfm?cid=979&t=Law-Society-Rules-Part-2-Membership-and-Authority-to-Practise-Law>>; LSUC Bylaw 7, *supra* note 212.

<sup>260</sup> LSBC Rules, *supra* note 259, R. 2-23.2; LSUC, Bylaw 7, *supra* note 212.

<sup>261</sup> Iacobucci & Trebilcock, *supra* note 221 at 28-29.

<sup>262</sup> *Lavallee, Rackel & Heintz v. Canada (Attorney General)*; *White, Ottenheimer & Baker v. Canada (Attorney General)*; *R. v. Fink* [2002] 3 SCR 209, 2002 SCC 61 (CanLII).

<sup>263</sup> LSUC Discussion Paper, *supra* note 4, at 18.

<sup>264</sup> The Law Society of Upper Canada "Futures" Task Force, "Final Report of the Working Group on Multi-Discipline Partnerships: Report to Convocation," September 25, 1998. Toronto, Ont: Law Society of Upper Canada, 1998.

<sup>265</sup> LSUC By-Law 7, *supra* note 212, ss. 17, 18(2) and (3). See also CBA Regulatory Issues, *supra* note 183 at 29.

<sup>266</sup> CBA Regulatory Issues, *supra* note 183 at 41.

<sup>267</sup> Model Code, *supra* note 182 at R. 3.4-23(b) and Commentary (2).

<sup>268</sup> *Barrick Gold Corporation v. Goldcorp Inc.*, 2011 ONSC 1325 at para 19, online at:

of privilege applies to in-house counsel.<sup>269</sup>

The CBA concluded that the current rules in LSUC's By-Law 7 and the Model Code are effective at protecting privileged communications and that those measures would be just as effective in an ABS context. However, they asserted that LSUC's limitation that MDPs only be permitted to provide non-legal services that are supportive or supplementary to legal services is unduly limiting. Instead, they recommended that, where there are non-legal services that would result in major regulatory difficulties or conflicts if supplied together with legal services in an ABS, exclusions for those services be provided in the Rules of the regulator.<sup>270</sup>

## B. Examples of provisions that protect solicitor-client privilege

Rules requiring: a) the entity to comply with the ethical obligations of lawyers; and b) a lawyer-director to assume responsibility for that compliance will also help to protect privilege. The CBA recommends that ABSs be required to be structured so that privileged information is not accessible for purposes of the ABS beyond the lawyer working on the file, including by the management and directors of the ABS, without informed express client consent and then only for the benefit of the client.<sup>271</sup>

Additionally, Rules and legislative provisions can be established by regulators to ensure that the obligations related to privilege supersede duties to shareholders. The NSW 2004 LPA provided that the law relating to privilege is not affected because a legal practitioner is acting in the capacity of a partner of an employee of an incorporated legal practice or an MDP.<sup>272</sup> Section 33 of the NSW 2015 LPA states that an Australian legal practitioners professional obligations are not affected by the type of business structure in which the practitioner provides legal services and that all law practices must comply with the professional obligations set out in that Act and elsewhere.<sup>273</sup> In England and Wales, under section 190 of the *Legal Services Act 2007*, privilege applies to communications made by an ABS, provided that the communications are made through, or under the supervision of, a relevant lawyer.<sup>274</sup>

In Washington State, attorney-client privilege has been extended to apply to Limited License Legal Technicians (LLLTs). The Supreme Court of Washington, which regulates the delivery of legal services in that state, authorizes LLLTs to render limited legal assistance or advice in approved areas of law. Admission to Practice Rule 28 prescribes the limitations on the provision of services by LLLTs and includes sub rule (k)(3) as follows:

The Washington law of attorney-client privilege and law of a lawyer's fiduciary responsibility to the client shall apply to the Limited License Legal Technician-client relationship to the same extent as it would apply to an attorney-client relationship.<sup>275</sup>

### iii) Conflicts issues

#### A. Overview

The Model Code provides that lawyers must not act where there is a conflict of interest, which is defined as "the existence of a substantial risk 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 lawyer's duties to another client, a former client, or a third person."<sup>276</sup> Model Code Rule 3.4-2 permits lawyers to act where there is a conflict of interest with consent, which must be fully informed and voluntary. Even with consent, lawyers may not act unless the lawyer reasonably believes that he or she is able to represent the client without the conflict of interest actually creating a material

<http://www.canlii.org/en/on/onsc/doc/2011/2011onsc1325/2011onsc1325.html>; *Camp Development Corporation v. South Coast Greater Vancouver Transportation Authority*, 2011 BCSC 88, at para 64, online at: <http://www.canlii.org/en/bc/bcsc/doc/2011/2011bcsc88/2011bcsc88.html?searchUrl-Hash=AAAAAQALU291dGggQ29hc3QAAAAAAQ>.

<sup>269</sup> *Pritchard v. Ontario (Human Rights Commission)*, [2004] 1 SCR 809, at paras 19-21, online at: <http://scc-csc.lexum.com/decisia-scc-csc/scc-csc/scc-csc/en/item/2144/index.do>.

<sup>270</sup> CBA Regulatory Issues, *supra* note 183 at 41.

<sup>271</sup> CBA Regulatory Issues, *supra* note 183 at 41.

<sup>272</sup> NSW 2004 LPA, *supra* note 174, ss. 143(1) and (3); 171(2).

<sup>273</sup> NSW 2015 LPA, *supra* note 174, s. 33.

<sup>274</sup> England and Wales LSA, *supra* note 168, s. 190.

<sup>275</sup> WASH. SUP. CT. R.: R. GEN. APPLICATION: ADMISSION TO PRACTICE RULE 28 (2013) at R. 28(k)(3), online at: [http://www.courts.wa.gov/court\\_rules/?fa=court\\_rules.list&group=ga&set=apr](http://www.courts.wa.gov/court_rules/?fa=court_rules.list&group=ga&set=apr).

<sup>276</sup> Model Code, *supra* note 182 at R. 1.1-1 and 3.4-1.

adverse effect on the duties owed to the client.<sup>277</sup>

In the case of an ABS, the concern is that the interests of a third person, namely, a non-lawyer partner or owner, may conflict with those of the lawyer's client. This concern would be increased where lawyers are in a minority position and not in control of the ABS. Concerns about protecting client representation against conflicting interests are the basis of the prohibition against lawyers splitting fees with non-lawyers as well as non-lawyer ownership and management.<sup>278</sup> In examining these concerns, the CBA's Ethics and Regulatory Issues team found that, while fee-splitting could create substantial risk of material impairment of representation in some circumstances, there has been no analysis suggesting that it always creates this risk or that actual material impairment of representation results from fee-splitting. Therefore, the CBA team concluded that, applying the standards for conflicts of interest, an absolute ban on fee-splitting is not justifiable even if it should sometimes be prohibited.<sup>279</sup>

Further, the CBA team concluded that non-lawyer ownership of legal practices should not be outright prohibited on the basis of the risk of conflicting interests. The team was satisfied by the evidence from Australia and England that non-lawyer ownership does not necessarily cause harm to client representation or the public interest, as regulatory structures and results of those jurisdictions have been well examined. The team did note that the positive experience in Australia and England is due to requirements that the ABS be effectively regulated by requiring lawyers to be responsible for regulatory compliance and that similar requirements should be adopted in Canada.<sup>280</sup>

The CBA team concluded that any rules allowing non-lawyer ownership of a legal practice should provide that the confidentiality, conflicts and candour rules of the Code apply to an ABS just as they would to any lawyer, including where other services are offered by the ABS to clients receiving legal services. They also recommend that the direct and material indirect owners of ABS shares should be deemed to be ABS clients, thereby sharing the same interests of the ABS for conflicts purposes.<sup>281</sup> LSUC's ABS Working Group also considered whether focused conflicts rules and fiduciary law can effectively address concerns that professional independence would be at risk in an ABS and came to the same conclusion as the CBA team.<sup>282</sup>

The LSUC ABS Working Group felt it was worth examining whether some types of business structures raise risks to the public that cannot be adequately addressed through regulation and should not be permitted by the Law Society.<sup>283</sup> The Working Group held consultations with members of the Ontario bar following the release of its September 2014 Discussion Paper. Several members, including those favourable to ABS, opined that not all types of ABS should necessarily be permitted in Ontario. One member suggested that non-lawyer ownership should be banned or strictly regulated in practice areas where the risks of conflict are high, such as personal injury, title insurance and real estate law. Examples of conflicts that could develop in this areas were a title insurer owning a real estate law firm or an insurer, which has an interest in keeping settlement values low, acquiring a plaintiff side personal injury firm. However, other responses acknowledged that restrictions as to who can provide legal services must be proportionate to the regulatory objective to be achieved.<sup>284</sup>

## B. Examples of safeguards in other jurisdictions

The examples regarding safeguards for professionalism, independence and privilege set out above also apply to conflicts of interest, which is a central tenet of those concepts. Conflicts rules will continue to apply to individual lawyers as they currently do, and regulators can ensure that the duty of a lawyer to avoid conflicts will prevail

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<sup>277</sup> *Ibid* at R. 3.4-2.

<sup>278</sup> CBA Regulatory Issues, *supra* note 183 at 35; See also Robinson, *supra* note 235.

<sup>279</sup> *Ibid* at 38. See also the discussion of non-lawyer involvement and fee-sharing *infra*, sections V(d)(ii) and (iii).

<sup>280</sup> *Ibid* at 39. See also: Parker, Gordon and Mark, *supra* note 10.

<sup>281</sup> CBA Regulatory Issues, *supra* note 183 at 39-40. For example, an ABS in which a real estate broker had a material interest could not act on the purchase of property whereby that real estate broker was paid a commission on closing.

<sup>282</sup> LSUC Discussion Paper, *supra* note 4 at 20.

<sup>283</sup> *Ibid* at 20.

<sup>284</sup> Law Society of Upper Canada Alternative Business Structures Working Group, "Report to Convocation," February 2015 [LSUC Working Group Report 2015] at 12. Online at: <<http://www.lsuc.on.ca/uploadedFiles/ABS-full-report.pdf>>. See also pages 14-16 for further discussion of how ABS might impact various practice areas.

over any duties to the ABS, as Australia and England have done.<sup>285</sup>

Further, if regulators have the ability to regulate entities, rather than individual lawyers alone, as is discussed in section III of this paper, regulators will be able to require that the entire entity comply with the conflicts Rules. As outlined in section III of this paper, one of NSW's 10 appropriate management systems objectives addressed conflict of interests. Firms must be able to demonstrate timely identification and resolution of all types of conflicts.<sup>286</sup> As with solicitor-client privilege, the CBA Ethics and Regulatory Issues team concluded that concerns about conflicts of interest with regard to MDPs in Ontario have been satisfactorily addressed by the requirement of lawyer control and the limitation of non-legal services to those supportive or supplementary to legal services.<sup>287</sup>

The Prairie provinces could also consider various ways to limit non-lawyer ownership if they conclude that the risk is too great in certain areas of practice.

#### **e) Benefits to allowing ABS**

Allowing lawyers to deliver legal services through ABS will allow for greater flexibility in the ways that legal service can be delivered. The possibilities are immeasurable, as lawyers and their partners would be able to develop innovative ways to deliver both legal and related services. For example, members would be better able improve their practices by using technology in new ways, and partnering with non-lawyers to structure their practices in ways that will be more effective for their clients.

Based on a review of developments in Australia and the UK, it is hard to predict whether lawyers in the Prairie provinces will seize these opportunities right away, or whether it will take some time to develop, as lawyers and the public alike adjust to the new landscape. The legal profession has not seen a lot of innovation over the past century and change may be slow to take hold. Whether there will be immediate uptake should not be the focus of the regulator; instead, law societies must consider whether they are unduly hindering innovation by maintaining prohibitions that: a) no longer have application or justification; b) have been addressed by modern developments; or c) were rooted in flawed logic in the first place.

#### **i) Increased access to legal services and related services**

It has been well established that there is an access to justice problem in Canada.<sup>288</sup> Recent studies indicate that as much as 70 per cent of family law litigants in Canada are unrepresented<sup>289</sup> and between 33 per cent and 42 per cent of people with legal problems either seek assistance from non-lawyers, or do not seek assistance at all, because they cannot afford the services of a lawyer.<sup>290</sup> Many people are turning to the internet as a source of legal information. In addition to the high costs of legal services, the legal profession in Canada is highly exclusive, with very little room for non-lawyers to provide any level of legal services. Even allowing non-lawyers to practice in partnership with lawyers may help to provide greater access.

#### **A. Removing regulatory barriers to access**

Noel Semple outlines the ways that rules prohibiting non-lawyer ownership, management or fee-sharing in a law firm impedes the accessibility of justice. He writes that these rules increase the price of capital by limiting the ways in which firms can raise capital, impede the emergence of large consumer-focused law firms and preclude inter-professional collaborations, which could have the potential to enhance access. Semple explains how larger, multi-disciplinary firms might be able to offer more accessible legal services through economies of scope, risk-

<sup>285</sup> NSW 2004 LPA, *supra* note 174, ss. 143(1) and (3), and 171(2); England and Wales LSA, *supra* note 168, s.190.

<sup>286</sup> Office of the Legal Services Commissioner, "Appropriate Management Systems to Achieve Compliance," online at: <[http://www.olsc.nsw.gov.au/Pages/lsc\\_incorp/olsc\\_appropriate\\_management\\_systems.aspx](http://www.olsc.nsw.gov.au/Pages/lsc_incorp/olsc_appropriate_management_systems.aspx)>; See also Parker, Gordon and Mark, *supra* note 10.

<sup>287</sup> LSUC Bylaw 7, *supra* note, 212 s. 17, s. 18(2) and (3); CBA Regulatory Issues, *supra* note 183 at 30.

<sup>288</sup> Action Committee on Access to Justice in Civil and Family Matters, "Access to Civil & Family Justice: A Roadmap for Change" (the "Cromwell Report"), October 2013, online at: <[http://www.cfcj-fcjc.org/sites/default/files/docs/2013/AC\\_Report\\_English\\_Final.pdf](http://www.cfcj-fcjc.org/sites/default/files/docs/2013/AC_Report_English_Final.pdf)>; Canadian Bar Association Access to Justice Committee, "Reaching Equal Justice: An Invitation to Envision and Act," November 2013 [CBA Access to Justice], online at: <[http://www.cba.org/CBA/equaljustice/secure\\_pdf/EqualJusticeFinalReport-eng.pdf](http://www.cba.org/CBA/equaljustice/secure_pdf/EqualJusticeFinalReport-eng.pdf)>.

<sup>289</sup> Dr. Julie Macfarlane, "The National Self-Represented Litigants Project: Identifying and Meeting the Needs of Self-Represented Litigants, Final Report," May 2013, online at: <<https://representingyourselfcanada.files.wordpress.com/2014/05/nsrlp-srl-research-study-final-report.pdf>>.

<sup>290</sup> Ab Currie, "The Legal Problems of Everyday Life: The Nature, Extent and Consequences of Justiciable Problems Experienced by Canadians" (Ottawa: Department of Justice, 2009) at 56. Available at <[http://www.justice.gc.ca/eng/rp-pr/csj-sjc/jsp-sjp/rr07\\_la1-rr07\\_a1/rr07\\_la1.pdf](http://www.justice.gc.ca/eng/rp-pr/csj-sjc/jsp-sjp/rr07_la1-rr07_a1/rr07_la1.pdf)>; Ontario Civil Needs Project, "Listening to Ontarians," May 2010, online at: <[http://www.lsuc.on.ca/media/may3110\\_oclnreport\\_final.pdf](http://www.lsuc.on.ca/media/may3110_oclnreport_final.pdf)> at 23.

spreading, and economies of scale.<sup>291</sup>

Gillian Hadfield believes that it is essential that the legal profession abandon the prohibition on the corporate practice of law in order to address the access problem. She sees ABS as good economic policy, as the prohibitions on the corporate practice of law rule out the use of essential tools widely used in most industries to control costs, improve quality and reduce errors. She predicts that allowing law firms to benefit from economies of scale, data analysis, product and process engineering and diversified sources of capital and innovation will bring the price of legal assistance down.<sup>292</sup>

QS is one example of a large consumer-focused firm that has developed as a result of ABS regulation in the UK. QS is a network of independent law firms in the UK with access to national branding strategies, website support, and buying power which has taken advantage of private investment opportunities.<sup>293</sup> In April 2014, QS launched a new service that allows clients with Small Claims to obtain low-cost initial advice from QS after which they are referred to Small Claims Mediation Ltd, described as a specialist service.<sup>294</sup>

Tesco, one of the largest supermarket chains in the UK, offers legal services through their stores such as will writing, do-it-yourself divorce kits, rental agreements, and forms for setting up a small company. Professor John Flood, an expert on regulation of the legal profession in the UK, notes that some people may actually be less skeptical of receiving legal services at a Tesco or a Wal-Mart, as they are familiar with the company and know that they will get a low price that is clearly stated up front.<sup>295</sup>

There has been some criticism of ABS on the basis that, so far, there has been little evidence that it has improved access to justice.<sup>296</sup> The OTLA argues that, while ABS may help to decrease the cost of certain types of legal services, not all services - such as complex and lengthy litigation matters - will lend themselves to this benefit. They further argue that Noel Semple's predictions that the savings inherent in economies of scale will be substantial enough to be passed on to the consumer in a meaningful way are unsupported. They argue that, even if there is a reduction in cost, it will be a small reduction.<sup>297</sup> However, it could be argued that any reduction in cost is meaningful and significant to a large percentage of the population that currently is not accessing legal services at all.

Regulators should consider whether their existing rules unnecessarily restrict lawyers to a degree that legal services cannot be delivered on an affordable basis. If legal services can be delivered on a more effective and economical scale through innovation and structures that are currently prohibited while remaining ethical and of high quality, then those restrictions should be considered barriers to access.<sup>298</sup> ABS will never be a complete answer to the access problem, which is made up of a myriad of issues, and it should not be ruled out simply because it has not proved to be the solution to all access problems.<sup>299</sup> Further, there are many other reasons that the Prairie provinces should consider exploring ABS, as discussed below.

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<sup>291</sup> Noel Semple, "Access to justice: is legal services regulation blocking the path?" (2014) International Journal of the Legal Profession, DOI: 10.1080/09695958.2014.896803 at 4-11 [Semple 2]. Available at: <<http://www.noelsemple.ca/wp-content/uploads/2013/07/Semple-2014-A2J-Is-Legal-Services-Regulation-Blocking-the-Path-PUBLISHED.pdf>>.

<sup>292</sup> Hadfield 1, *supra* note 232 at 43-63.

<sup>293</sup> LSUC QS Article, *supra* note 217.

<sup>294</sup> <http://www.qualitysolicitors.com/>.

<sup>295</sup> Renee Newman Knake, "Democratizing the Delivery of Legal Services" (2012) 73:1 Ohio State Law Journal at 41 [Knake]. Available at <[http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1800258](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1800258)>.

<sup>296</sup> Robinson, *supra* note 235.

<sup>297</sup> OTLA, *supra* note 235 at 3-8.

<sup>298</sup> Semple 2, *supra* note 291.

<sup>299</sup> Malcolm Mercer, "A Different Take on ABS – Proponents and Opponents Both Miss the Point," October 31, 2014. Available at: <<http://www.slw.ca/2014/10/31/a-different-take-on-abs-proponents-and-opponents-both-miss-the-point/>>.

## B. Increased competition

Commentators have also criticized the prohibition against ABS for unduly restricting competition. According to Richard Devlin and Ora Morison,

in a liberal democratic society committed to the public interest, competition is presumptively good, while monopoly is presumptively bad. The burden of proof should be on those who favour a monopoly in the provision of legal services to justify why it is defensible in the public interest, rather than lawyers' interests.<sup>300</sup>

In both Australia and England and Wales, the liberalization of the regulatory regime was driven by free-market ideology and a loss of self-regulation, which signals a major shift in the ideology surrounding the isolation of lawyers from entrepreneurial ideals.<sup>301</sup> In 1998, the National Competition Policy Review of Australia found the partnership model, which was the most common form of business structure for law firms in NSW, to be anti-competitive.<sup>302</sup>

Although there has not been the same pressure in Canada to liberalize the legal market, it hasn't been completely absent either. In 2007, the Competition Bureau of Canada released a report on the self-regulated professions in Canada, entitled, "Self-Regulated Professions: Balancing Competition and Regulation."<sup>303</sup> Among other things, the Competition Bureau recommended that, "law societies should consider less intrusive mechanisms than prohibiting multidisciplinary practices to circumvent possible conflicts of interests." The Competition Bureau recommended that all law societies in Canada allow MDPs, with appropriate regulation, to allow lawyers to share fees and revenues with non-lawyers and carry on activities other than legal services and services directly associated with providing legal services.<sup>304</sup>

The OTLA predicts that non-lawyer ownership will be targeted at firms that practice in areas that do not have access problems, such as high-profit personal injury firms or firms that provide commoditized legal services. Further, the OTLA asserts that permitting ABS may actually cause less access and less competition in some areas, such as personal injury law, because non-lawyers will invest heavily in those areas and will monopolize those markets, pushing out those providing legal services at a lower cost.<sup>305</sup> It should be noted that the OTLA did not offer any evidence to demonstrate that this has resulted in jurisdictions where ABS has been introduced.

In response to such predictions, Noel Semple argues that allowing firms to be traded publicly could encourage non-lawyers to invest in all types of law firms, since the risk of investment is low and the potential for reward is high.<sup>306</sup> He further predicts that, if big firms are opened to outside ownership, they could become more consumer-focused as they will be in a better position to add more flexibility, through things like fixed fees, more services, and ability to bear a greater degree of risk, due to their resources for marketing and research and development.<sup>307</sup>

Devlin and Morison suggest that ABSs are likely to have better access to capital, allowing them to take on riskier cases. This could enhance access to justice for those involved in cases that would have previously been unattractive for lawyers to take on. Further, they argue that concerns about excessively large legal services providers becoming dominant in the marketplace are unlikely to materialize because conflicts of interest rules will provide an effective restraint on excessive growth.<sup>308</sup>

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<sup>300</sup> Devlin & Morison, *supra* note 2 at 494.

<sup>301</sup> Office of Fair Trading, "Competition in Professions – A report by the Director General of Fair Trading", 2001, OFT 328, online at: <[http://webarchive.nationalarchives.gov.uk/20140402142426/http://www.offt.gov.uk/shared\\_offt/reports/professional\\_bodies/oft328.pdf](http://webarchive.nationalarchives.gov.uk/20140402142426/http://www.offt.gov.uk/shared_offt/reports/professional_bodies/oft328.pdf)>. Legal Services Board, "The Regulatory Objectives: Legal Services Act 2007," July 15, 2010, online at: <[http://www.legalservicesboard.org.uk/news\\_publications/publications/pdf/regulatory\\_objectives.pdf](http://www.legalservicesboard.org.uk/news_publications/publications/pdf/regulatory_objectives.pdf)>.

<sup>302</sup> Mark and Gordon, *supra* note 112 at 503.

<sup>303</sup> Competition Bureau of Canada, "Self-Regulated Professions: Balancing Competition and Regulation, December 1, 2007 [Competition Bureau]. Available at: <[http://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/vwapj/Professions-study-final-E.pdf/\\$FILE/Professions-study-final-E.pdf](http://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/vwapj/Professions-study-final-E.pdf/$FILE/Professions-study-final-E.pdf)>.

<sup>304</sup> *Ibid* at 77-78.

<sup>305</sup> OTLA, *supra* note 235 at 3-8.

<sup>306</sup> Semple 2, *supra* note 291 at 5.

<sup>307</sup> Semple 1, *supra* note 167 at 163-173.

<sup>308</sup> Devlin & Morison, *supra* note 2 at 496.

### C. Adding more services and expertise

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. There are many non-legal matters that are intrinsically connected to legal ones, such as financial and health services. Clients who seek out the associated non-legal service first may also decide to access legal services if they are conveniently located in the same place.

Devlin and Morison suggest that many people are intimidated by and sometimes even hostile toward lawyers and are reluctant to seek legal assistance except as a last resort. If, however, lawyers were part of an ABS that included other professionals, those clients might be more willing to approach the ABS and therefore access the services of a lawyer sooner. This might enable clients to avoid some of their legal problems, or resolve them sooner (and potentially less expensively).<sup>309</sup>

There are many examples in Australia and the UK of the partnerships that could be formed to create both broad and highly specialized practices that use combined services. Natalie Gamble and Associates is a firm with expertise in fertility law and offers related services such as donor conception and adoption.<sup>310</sup> Winn Solicitors is an accident management firm whose services include compensation, repairs, replacement vehicles, and rehabilitation.<sup>311</sup> Some jurisdictions, like Ontario and B.C., require non-lawyer partners to provide services that supplement legal services. If lawyers were permitted to combine their services with any other service providers, the possibilities could be endless.

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, such as human resource management, financial planning, and many others. There are many aspects to managing a law practice, and many lawyers who do not have either the skill or interest in some of those areas to maximize the potential of their practice would benefit from having a partner who specializes in those areas to assume some of those responsibilities.<sup>312</sup>

#### ii) Economic efficiency

There are many reasons law firms could benefit from increased flexibility in the way they structure both the human and financial capital of their legal practices. As the size and reach of law firms increase, client expectations become more demanding and require innovation. Permitting ABS would allow legal services providers to experiment with the best model for delivery in a complex and rapidly changing market for law. Options might include mergers of law firms, franchising options, co-operatives, and partnerships with other professions, as well as offering employee incentives.<sup>313</sup>

In their paper, entitled “Access to Justice and The Ethics and Politics of Alternative Business Structures”, Devlin and Morison describe the evolution of the business of law firms as follows:

Over the course of the last two centuries there have been a series of transitions in the delivery of legal services in the common law world. Initially lawyers were lone rangers, individual agents who provided their services to fee-paying clients. Over time there emerged the small partnership model in which two or three lawyers would come together to pool their talents. As legal systems became more complicated and with the exponential rise in the number of lawyers, firms became increasingly larger, morphing into boutique firms, then national firms, and then (with increasing globalization) multi-national law firms. Despite the changing scale of law firms, however, the basic economic model of the practice of a law firm remained the same as it was when the profession first emerged in thirteenth-century England – only lawyers could own and control legal practices.<sup>314</sup>

This passage demonstrates both the progress, and the lack of change permitted in law firm structure. As Steven Mark and Tahlia Gordon point out, large law firms already operate like businesses, including appointing non-

<sup>309</sup> *Ibid* at 495.

<sup>310</sup> [www.nataliegambleassociates.co.uk](http://www.nataliegambleassociates.co.uk).

<sup>311</sup> <http://www.winnsolicitors.com>.

<sup>312</sup> Devlin & Morison, *supra* note 2 at 494.

<sup>313</sup> *Ibid* at 494.

<sup>314</sup> *Ibid* at 484.

lawyers to top management positions. They quote Larry Ribstein's observation that law firms are for-profit businesses, the only difference being that "law firms don't have the same flexibility to choose a financial structure that is more conducive to its long-term interests."<sup>315</sup>

In 2013, LSUC commissioned a study by Professors Edward M. Iacobucci and Michael J. Trebilcock for the Law Society's ABS Symposium, held in October 2013. In a paper entitled, "An Economic Analysis of Alternative Business Structures for the Practice of Law," the authors explained that, due to the many factors that affect the economic optimality of each individual business, economic theory tends to recommend that the principals of the business be given wide latitude to choose the model that works best in their circumstances. Therefore, from a purely economic perspective, there should be no restrictions on the business structures of legal practices. Iacobucci and Trebilcock's study concludes that, not only is there no economic argument opposed to liberalization, but that there are reasons to expect economic gains from liberalization.<sup>316</sup>

### A. Cost of providing and consuming legal services

Iacobucci and Trebilcock suggest that there could be significant savings in transaction costs if lawyers were allowed to partner with non-lawyers, especially where a client requires more than one kind of service provided by the firm. The owner service providers will all receive an economic benefit through the incentivized internal referral network, and will be better able to coordinate their services for the same client than if they practiced independently. This would create productivity gains for the firm, and should lower the transaction costs of the client, who is able to engage in one-stop shopping.<sup>317</sup>

Firms could also benefit from passive investors who could provide capital to the firm that would be very difficult to raise from capital-constrained professionals within the firm or from banks, because passive investors may be willing to take more risks. This would be particularly true where there are many equity-owners, as they would be better able to spread the risk amongst them. Some examples where outside investors could be beneficial are investments in new technology and funding litigation taken on a contingency fee basis.<sup>318</sup>

Iacobucci and Trebilcock recommend that lawyers and other professionals in the firm should continue to have an equity stake in the firm, rather than allow for complete outside ownership, as that will provide incentives for those professionals to invest in the future of the firm.<sup>319</sup> Ownership also encourages personal investments in general assets of the firm, including its reputation, whether through referrals or otherwise. When there are more reputations at stake, there will also be more incentive for everyone to perform quality work. Allowing non-lawyers to assume management roles at a multi-disciplinary firm, while also owning equity stakes in the firm, will also incentivize them to perform well.<sup>320</sup>

While Iacobucci and Trebilcock acknowledge that there are also potential costs associated with non-lawyer ownership, such as increased costs of coordinating services and addressing cultural differences within the firm, they ultimately concluded that there could be significant gains that would offset these problems.<sup>321</sup> Further, they concluded that liberalized ownership rules create the potential for the most gains from ABS by creating a potential separation between the financiers of a legal business and the providers of legal advice within that business, and that those gains are most likely to materialize where a large capital investment is necessary.<sup>322</sup>

Franchises are another model of ABS that could have economic benefits, particularly for small firms. Traditional solo and small practice models often have limitations on their practice volume, capital and business and technological expertise. LSUC's informal member consultations revealed that many practitioners consider the business and marketing aspects of their practice to be a burden and found the idea of having access to business

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<sup>315</sup> Mark and Gordon, *supra* note 112 at 515-519.

<sup>316</sup> Iacobucci & Trebilcock, *supra* note 221 at 26-27.

<sup>317</sup> *Ibid* at 51.

<sup>318</sup> *Ibid* at 54-55.

<sup>319</sup> *Ibid* at 56.

<sup>320</sup> *Ibid* at 52.

<sup>321</sup> *Ibid* at 52.

<sup>322</sup> *Ibid* at 59.

expertise and infrastructure attractive.<sup>323</sup> Allowing lawyers to focus their energy and expertise on providing legal services and to rely on a head office to handle the non-legal aspects of running a law practice may both enhance the quality of the legal services and enable a firm to scale operations away from the billable hour to try alternative fee arrangements which could be more affordable for the firm's clients.<sup>324</sup>

The OTLA suggest that any significant cost savings resulting from ABS would be limited to practice areas that can be commoditized and are conducive to flat fee structures, such as simple real estate transactions, wills and divorces. It suggests that the areas where there is the greatest need for a reduction in costs, such as criminal law, family law and other civil litigation will not benefit from ABS without a compromise in the quality of the legal services. The OTLA explains this position by stating that there has been no concrete evidence of savings being passed along to consumers, and that any savings that are passed on will be minimal. Further, it states that the contingency fee system sufficiently manages the cost to consumers associated with contentious legal proceedings.<sup>325</sup> The OTLA's position seems to be that, even if there are reductions in costs, those reductions are insignificant, and aren't worth pursuing.

## B. Innovation and technology

While competition may develop from new types of business structures, Iacobucci and Trebilcock suggest that, because competition already exists among law firms, liberalizing the rules regarding business structures will benefit legal service providers and consumers alike. They believe that, if one firm innovates, there will be pressure for others to follow that lead, and presumably the fruits of that competition will be passed along to the clients.<sup>326</sup>

Iacobucci and Trebilcock explain that placing limits on the nature of services and expertise available within the firm and limiting equity investment can constrain firm development and innovation. As previously mentioned, when firm owners are restricted to debt financing as their only option, the personal risk they will be prepared to assume will be limited. Equity financing allows those lawyer-owners to share some of the risk, making them more likely to invest in new technology or try new methods of service delivery generally.<sup>327</sup>

Technology has already changed the way legal services are provided, whether through the first point of contact, ongoing communication, facilitating meetings, filing and billing, appearing in court, or any number of other things. Being able to take advantage of advances in technology could allow lawyers to innovate in immeasurable ways, including: developing the ability to work remotely; organizing administrative systems; predicting the cost of legal services in order to introduce fixed-fee arrangements; and developing online client intake.<sup>328</sup> While large Canadian firms have adopted many of these technological tools for some time now, liberalizing business structure rules could also allow small and sole practices to take advantage of technology.

Some legal services are already being provided entirely through technology and regulators have not kept up with these developments. Legal service providers such as Rocket Lawyer and LegalZoom in the United States deliver legal services through a combination of do-it-yourself, online legal document assembly, online legal information and the ability to speak to a lawyer for additional cost through websites using automatic fillable forms.<sup>329</sup> Both companies focus on providing assistance on common legal matters to individuals and small businesses, such as incorporating a business or making a will, for low, flat-fee prices.<sup>330</sup> These largely un-regulated service providers are able to access sources of capital and expertise that are currently not available to lawyers,<sup>331</sup> yet the South Carolina Supreme Court has ruled that the services provided by LegalZoom do not constitute unauthorized

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<sup>323</sup> LSUC Discussion Paper, *supra* note 4 at 16.

<sup>324</sup> *Ibid* at 16.

<sup>325</sup> OTLA, *supra* note 235 at 7.

<sup>326</sup> Iacobucci & Trebilcock, *supra* note 221 at 33.

<sup>327</sup> LSUC Discussion Paper, *supra* note 4. See also Gillian K. Hadfield, "Legal Barriers to Innovation: The Growing Economic Cost of Professional Control over Corporate Legal Markets" (2008) 60 Stan. L. Rev. 101 at 1727 [Hadfield 2].

<sup>328</sup> LSUC Discussion Paper, *supra* note 4 at 13.

<sup>329</sup> <https://www.rocketlawyer.co.uk/>.

<sup>330</sup> <http://www.legalzoom.com/>; <https://www.rocketlawyer.com/>; See also John O. McGinnis and Russell G. Pearce, "The Great Disruption: How Machine Intelligence Will Transform the Role of Lawyers in the Delivery of Legal Services" (2014) 82 Fordham L. Rev. 3041 at 3058 [McGinnis & Pearce]. Available at: <<http://ir.lawnet.fordham.edu/cgi/viewcontent.cgi?article=5007&context=fllr>>.

<sup>331</sup> LSUC Working Group Report, *supra* note 98 at 33.

practice of law.<sup>332</sup>

Some authors believe that technology will continue to advance and create greater competition to traditional legal practice, despite efforts of regulators to protect against such encroachment. The same authors argue that regulators should not try to stand in the way of such advancements, since they will result in better quality legal services at a lower cost.<sup>333</sup> Legal services can be provided online from anywhere in the world, which also makes them more difficult to regulate. Given these realities with respect to new competition in the market, lawyers will be at an even greater disadvantage if they are limited in the ways they are permitted to structure their firms.

In its Legal Futures Initiative paper, entitled “Innovations in Legal Services: 14 Eye-Opening Case Studies,” the CBA suggests the following benefits to allowing non-lawyer ownership:

Taking management out of the hands of a collection of partners may make it easier for the firm to achieve growth. There is no need for consensus building when making decisions as there is in a partnership. Furthermore, as profits are not split in the same manner, the executive has more leeway to pursue corporate objectives, including investments in technology that may be a key to higher profits and lower costs.<sup>334</sup>

The OTLA argues that allowing ABS is not necessary for lawyers to take advantage of technology. They point to examples of technological advances already being used by lawyers, such as paperless practice, setting up virtual offices in under-served areas and MDPs.<sup>335</sup> It is important to reiterate two things in response to this argument: first, the Ontario context is very different from that of the Prairie provinces, as MDPs have been permitted there for some time; second, technology is more available to larger firms with more capital, and while those firms have already enjoyed many technological advances, the same is not true for a vast majority of lawyers.

The OTLA also argues that technology might enable more innovation but does not guarantee it, and that the degree of innovation in jurisdictions where ABS has been permitted has been overstated.<sup>336</sup> Iacobucci and Trebilcock concluded that the introduction of the ABS model should facilitate innovation, but would not cause dramatic change to the way in which legal services are provided in Ontario.<sup>337</sup> It is true that ABS is not necessary for innovation, but as previously discussed in this paper, any regulation that proves to be overly burdensome and likely to hinder innovation is not justifiable. In any event, there are many examples of innovative legal practices that likely would not exist if not for the ABS being permitted to secure outside investment, many of which have been previously mentioned in this paper.

For additional examples, please see the CBA’s “Reaching Equal Justice<sup>338</sup>” and “Transforming the Delivery of Legal Services in Canada<sup>339</sup>” Reports, “Innovations in Regulation – Responding to a Changing Legal Services Market” by Steven Mark and Tahlia Gordon<sup>340</sup> and Devlin and Morison’s paper.<sup>341</sup>

### C. New funding sources

Much has already been said about the potential for law firms to access new sources of capital, expertise and diversification, and the tendency for lawyers to be fairly risk-averse. Gillian Hadfield describes the prohibitions against non-lawyer ownership as being an antiquated mechanism used in the late-nineteenth century before the advent of the modern corporation. She writes that the prohibition on non-lawyer ownership eliminates the basic mechanisms used to fuel innovative activity and distribute risk in most markets which she describes as being essential to the modern economy, such as diversified portfolios, large-scale and liquid capital markets, and

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<sup>332</sup> Jordan Furlong, “The Incidental Lawyer,” Law21, April 24th, 2014. Online at <<http://www.law21.ca/2014/04/incidental-lawyer/>>.

<sup>333</sup> McGinnis & Pearce, *supra* note 330 at 3059-3064.

<sup>334</sup> “Innovations in Legal Services: 14 Eye-Opening Case Studies,” CBA Legal Futures Initiative, June 2013, at 26: <<http://www.cbafutures.org/CBA/media/mediafiles/PDF/Reports/Innovations-Paper-Summary-Linked-eng.pdf?ext=.pdf>>.

<sup>335</sup> OTLA, *supra* note 235 at 12-13.

<sup>336</sup> OTLA, *supra* note 235 at 15-16.

<sup>337</sup> Iacobucci & Trebilcock, *supra* note 221 at 23.

<sup>338</sup> CBA Access to Justice, *supra* note 288.

<sup>339</sup> CBA Futures Initiative, *supra* note 75 at 34-38.

<sup>340</sup> Mark & Gordon, *supra* note 112 at 515-519.

<sup>341</sup> Devlin & Morison, *supra* note 2 at 505-506 and 524-525.

tailored financial instruments.<sup>342</sup>

Hadfield also argues that restrictions on the financing of law firms impede further basic mechanisms of the modern economy that drive innovation and cost reduction. For example, there are no incentives for analysts to develop expertise in spotting important developments in legal products or business strategies, or for business schools to produce expertise in law firm management. Finally, there are no incentives for venture capitalists to network with entrepreneurs who may develop better legal products and services.<sup>343</sup>

In an article in the LSUC's Gazette, lawyer and global firm consultant Jordan Furlong identifies several causes for dwindling capital for law firms. Furlong asserts that historical capital bases such as partner contribution and bank loans are becoming decreasingly viable due to looming widespread retirement of boomer partners, fading interest by associates in achieving partnership and more caution from banks about how much they're lending or to whom they're lending and under what conditions.<sup>344</sup>

### iii) Proportionality, risk and likely outcomes

Based on a review of the developments in Australia and the UK, some of the potential benefits of allowing ABS may be slow to materialize. Given the traditional nature of the practice of law, it would not be surprising if many lawyers need time to assess and adjust to new options for their practices. As Noel Semple has pointed out, the rules on ABS have been very liberal for over a decade in Australia, yet the legal profession has not undergone a radical transformation. For example, he observes that in NSW, where liberal rules have been in place the longest, the number of sole practitioners and small firms has grown in the last ten years.<sup>345</sup> In fact, in Australia, England and Wales, many of the firms that have taken advantage of ABS rules did so as small or sole practices, and have remained as such within the ABS environment.<sup>346</sup>

Therefore, it is unlikely that a sweeping revolution would result should the rules respecting business structures be liberalized in the Prairie provinces. However, this should not be an argument in favour of restricting the choices available to legal practices. The analysis by Iacobucci and Trebilcock reveals that the potential for economic gains and increased access is real. Even if only some firms attempt to adopt new models, those changes could present new options for consumers and be of economic advantage to lawyers, their investors, and ultimately, clients.<sup>347</sup> Given that the risks of liberalization appear to be quite low based on developments in Australia and the UK, regulators should strongly consider allowing lawyers to have greater flexibility in the way they choose to deliver legal services.

LSUC's ABS Working Group concluded that the existing evidence indicates that the introduction of ABS in Australia, England and Wales has not posed a risk to the public. In fact, the evidence shows that the public might be even better protected if ABS is combined with compliance-based entity regulation, than it is under the current system.<sup>348</sup> Even where an ABS has been permitted to have unlimited non-lawyer ownership and to provide any other services in conjunction with legal services, the Working Group concluded that, "experiences of other jurisdictions suggest that regulatory risk resulting from this type of liberalization may be managed."<sup>349</sup>

Recently, one of the smaller ABSs located in the UK and acquired by Slater & Gordon in early 2015, Quindell Solicitors, has become the subject of a major fraud investigation, due to fraudulent accounting practices. This turn of events caused a drop in Slater & Gordon's stock prices by approximately 50 per cent over a period of a few months. Some commentators immediately called this a failure of non-lawyer ownership of law firms and declared that it had doomed any possibility of regulators liberalizing rules respecting business structures in Canada.<sup>350</sup> However, a closer examination of the story reveals that declarations of failure are premature. Mitch Kowalski

<sup>342</sup> Hadfield 2, *supra* note 327 at 1726.

<sup>343</sup> *Ibid* at 1727.

<sup>344</sup> LSUC Article, *supra* note 187.

<sup>345</sup> Semple 2, *supra* note 291.

<sup>346</sup> LSUC Discussion Paper, *supra* note 4 at 16.

<sup>347</sup> Iacobucci & Trebilcock, *supra* note 221 at 58.

<sup>348</sup> LSUC Working Group Report, *supra* note 98 at para 34.

<sup>349</sup> *Ibid* at para 178.

<sup>350</sup> Drew Hasselback, "That proposal to open Canadian law firm ownership to non-lawyers is probably toast," The Financial Post (August 13, 2015) <<http://business.financialpost.com/legal-post/drew-hasselback-that-proposal-to-open-canadian-law-firm-ownership-to-non-lawyers-is-probably-toast>>.

observes that, although a major reporting fraud may have occurred, no client information was compromised, no client funds were misappropriated and there were no conflicts of interest.<sup>351</sup>

Further, Kowalski argues that the fraud was likely detected sooner under the ABS audit program than it would have been under the traditional regulatory model, and that the investigation will be conducted in a more transparent and expedient manner. He refers to the current regulatory approach as being painfully slow and shrouded in secrecy, including from the police and other regulators until a determination has been made. He also points out that many traditional law firms are guilty of fraud, but no one would suggest that the traditional model is inherently flawed.<sup>352</sup> Just like all business, there are going to be some ABSs that behave unethically or fail economically. This doesn't mean all ABSs will fail.

LSUC's ABS Working Group's final conclusion was that "the preponderance of the information available argues against maintaining the status quo... Having carefully examined the copious information that the Working Group has available to it, the Working Group is satisfied that there is significant evidence to recommend the introduction of a form of ABS in Ontario."<sup>353</sup> The Working Group went on to predict that it is unlikely that a liberalized approach to business structures in Ontario would lead to revolutionary change, but that such changes "would encourage innovation and the development of new ways to deliver legal services which otherwise will be more likely to emerge in the unregulated, rather than the regulated sphere." They suggest that unregulated innovation will pose a greater risk to the public than the innovation that falls under the Law Society's purview.<sup>354</sup>

Even opponents of allowing ABS have acknowledged that risks to professionalism and independence and risks of legal services becoming increasingly institutionalized are equally present, and possibly even greater, should the current rules remained unchanged. Renee Newman Knake writes:

The economic realities of twenty-first century law practice pose a host of challenges to lawyer independence, ranging from the pressure of massive educational debt held by many recent law graduates to the mounting inefficiency of the billable hour. Indeed, external investment may be the very thing that preserves lawyer independence—especially given the burdens of law school debt, billing inefficiencies, and leveraging of overhead costs—thereby allowing for meaningful pro bono representation because the lawyer no longer needs to worry about maintaining a case-by-case cash flow.<sup>355</sup>

Malcolm Mercer, who acted as Chair of both the LSUC ABS Working Group and the CBA Futures Inquiry's Ethics and Regulatory Issues Team, has reiterated that, in his opinion, the risk of significant harm as a result of ABS is probably remote and capable of mitigation.<sup>356</sup> Mercer's recommendation is that evolution in the way legal services are delivered should be encouraged, and that ABS should be implemented pragmatically and incrementally. He advocates for a considered, proportionate degree of regulation based on common sense rather than grand vision. Whatever decision the Prairie provinces make with regard to ABS, Mercer recommends taking a hard look at the Rules to determine whether there might be less restrictive alternatives. He ends his opinion piece with the following quote: "Being unwilling to reform for fear of revolution fails to achieve attainable advantages but also ultimately risks radical change imposed by others."<sup>357</sup>

Jordan Furlong also warns against overstating the potential risks of ABS. While he believes that concerns about the risks are legitimate and should be closely considered, he suggests that many of the arguments against ABS center on possibilities rather than probabilities, and worries rather than evidence. He suggests that many arguments against ABS are based on theoretical risks to lawyer independence, which indicates that there is no concrete evidence that significant harm will result from the risk of liberalizing ABS.<sup>358</sup>

<sup>351</sup> Mitch Kowalski, "Why one scandal shouldn't doom a new twist on law firm ownership," The Financial Post (August 17, 2015) <<http://business.financial-post.com/legal-post/why-one-scandal-shouldnt-doom-a-new-twist-on-law-firm-ownership>>.

<sup>352</sup> *Ibid.*

<sup>353</sup> LSUC Working Group Report, *supra* note 98 at para 141.

<sup>354</sup> *Ibid* at para 179.

<sup>355</sup> Knake, *supra* note 295 at 43-44.

<sup>356</sup> Malcolm Mercer, "Utopia, Dystopia and Alternative Business Structures," SLAW, November 11, 2013 [Mercer 2]. Available at: <<http://www.slaw.ca/2013/11/11/utopia-dystopia-and-alternative-business-structures/>>.

<sup>357</sup> *Ibid.*

<sup>358</sup> Jordan Furlong, "Law firm ownership and lawyer independence," Law21, November 7th, 2014 [Furlong 2]. Available at: <[http://www.law21.ca/2014/11/law-firm-ownership-lawyer-independence/?utm\\_content=buffer63f31&utm\\_medium=social&utm\\_source=twitter.com&utm\\_campaign=buffer](http://www.law21.ca/2014/11/law-firm-ownership-lawyer-independence/?utm_content=buffer63f31&utm_medium=social&utm_source=twitter.com&utm_campaign=buffer)>.

For example, with regard to the fear that professionalism and independence will be eroded, Furlong writes that, while it is reasonable to be concerned that the potential influence of non-lawyer owners could pose a threat to ethical duties, simply because this risk is real and serious doesn't mean that identifying it is enough to end the discussion. Furlong points out that the presence of non-lawyers in the ownership and financial structure of in-house and public-sector law departments has not been fatal to the independence of the lawyers working in those organizations.<sup>359</sup>

Liberalizing rules respecting business structures does not mean that traditional firm structure will be abandoned; in fact, in all the jurisdictions that have allowed ABS, it remains the most popular choice. It simply means that it will no longer be the only choice available to lawyers. If the Prairie provinces are unable to justify maintaining the restrictions on the business structures of law firms, they must consider reducing those restrictions. Traditional firms already face competition from large corporate firms and other service providers encroaching on the legal market. Many of these developments cannot be undone, nor should they. Regulators must look ahead and develop a fair, reasonable and proportionate approach to rules respecting the entities that provide legal services.

#### **f) Establishing a regulatory framework**

Should the Prairie provinces decide they would like to pursue the liberalization of the rules respecting business structures in each jurisdiction, two steps need to be considered. The first is identification of the existing regulatory impediments to ABS in the legislation and rules in each province, as well as in the Model Code. While changes to the rules can be accomplished relatively easily, each province will be required to seek legislative amendments as necessary, and the Prairie provinces will need to lobby the Federation of Law Societies of Canada for the necessary changes to the Model Code.

In some cases, new authority will need to be established in the legislation and rules, to allow members to form new types of business structures, and to allow the law societies to regulate the business entities that develop. This goes hand-in-hand with entity and compliance-based regulation, but will also require an additional framework specific to the inclusion of non-lawyers in legal practices, and the manner in which legal practices can be structured and financed.

The Prairie provinces will want to consider whether and how to incorporate the following concepts into this new regulatory framework:

- Licensing and approval requirements of entities and individual service providers;
- Application of conflicts, privilege, confidentiality and other ethical rules to non-lawyers, the entity as a whole and responsible lawyers;
- Conduct assurance measures for non-lawyers and the entity as a whole;
- Lawyer responsibility for non-lawyers; and
- Preserving the supremacy of the duties to the client, the court and to uphold the rule of law and administration of justice over duties to shareholders.

The CBA included recommendations respecting ABS in its Legal Futures Initiative Report, "Transforming the Delivery of Legal Services in Canada."<sup>360</sup> Those recommendations are comprehensive and should be used as a guideline by the Prairie provinces when considering the measures they wish to adopt with respect to ABS. The recommendations are as follows:

1. Non-lawyer investment in legal practices should be permitted, but only on a carefully regulated basis as follows:
  - a. a business or not-for-profit corporation should be eligible for registration as an ABS within which the fee-sharing rule would not apply;
  - b. an ABS should be permitted to deliver legal services on the following basis:

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<sup>359</sup> *Ibid.*

<sup>360</sup> CBA Futures Initiative, *supra* note 75 at 43.

- i. the ABS itself would have fiduciary and legal ethics obligations in respect of clients receiving legal services through the ABS. The legal advice should be provided to clients solely in the interests of the client and not in the interests of the ABS or its owners;
  - ii. the ABS would be subject to law society entity regulation;
  - iii. the ABS would be subject to other existing FLSC Model Code rules, such that:
    - A. the confidentiality rules apply;
    - B. the conflicts rules apply, including where other services are offered by the ABS to clients receiving legal services; and
    - C. the candour rule applies, including with respect to any conflicts of interest that may exist.
  - iv. the lawyers working within an ABS should continue to be regulated persons;
  - v. the provision of legal services would be required to be carried out by lawyers or other regulated legal professionals as permitted, or provided by legal or non-legal professionals who are effectively supervised and controlled by lawyers;
  - vi. material owners of ABS shares should be deemed to be clients for the ABS for the purpose of applying the conflicts rules;
  - vii. privileged information should not be accessible for purposes of the ABS, including by the management and directors of the ABS, without informed express client consent and then only for the benefit of the client;
  - viii. the ABS would be required to purchase insurance covering claims from clients in respect of legal services with current per-claim coverage and with aggregate limits being no less than currently required for lawyers but increasing with the size of the ABS.
2. The FLSC Model Code Rules should be amended to permit fee-sharing with non-lawyers and paying referral fees to non-lawyers, subject to the following:
- a. the conflict rules apply;
  - b. the confidentiality rules apply and privilege must be protected;
  - c. the candour rule applies, meaning full disclosure of the shared fee and of the nature of the relationship with the entity with which the fee is shared must be made to the client;
  - d. the referral fee must be fair and reasonable and fully disclosed;
  - e. shared fees may not be contingent on the revenue or profitability of specific matters or as the result of such matters;
  - f. the lawyer shall not accept the referral unless the lawyer and the client discuss any client expectations arising from the referral and mutually agree on the basis of the retainer;
  - g. an accounting record is required of referral fees paid and received indicating the amounts and counterparties to each payment; and
  - h. referral fees shall not be accepted where the lawyer is aware that the referral is exploitive.
3. MDPs and other forms of ABS should be permitted to deliver non-legal services together with legal services on the basis that the rules should require protection of privileged information by requiring that non-lawyers, including partners/owners, not have access to privileged information except with express informed client consent. The rule or the commentary should provide that:
- a. the confidentiality rules apply and privilege must be protected;
  - b. the conflicts rules apply, including where other services are offered by the MDP to clients receiving legal

services;

- c. the candour rule applies, including with respect to any conflicts of interest that may exist.

## VI. CONSIDERATIONS

### a) Entity Regulation

Currently, there is a gap in our regulatory framework. Essentially, we investigate and sanction the conduct of individual lawyers following receipt of a complaint. As regulators, we tend to react rather than be proactive.

It is recognized that entities delivering legal services often set out the approach as to how those services are delivered. Firm cultures are developed and promoted. Some aspects of a firm culture can be positive (such as valuing community and pro bono work), but others (such as an over-emphasis on billing) can lead to harm to clients and the public.

Our law societies would benefit from acknowledging the important benefits, which could arise from harnessing the power of entity structure to advance regulatory goals. For example, firms have a unique ability to influence behaviours and create firm cultures that can align with ethical standards as articulated by law societies.

Prior to establishing a framework for entity regulation, we must consider and make decisions about the kinds of entities we wish to regulate (define legal entity for these purposes).

We would then need to consider various models of entity regulation and make decisions as is appropriate having regard to our statutory mandates and the desire to be fair, efficient and effective in our regulation.

### b) Compliance-based Regulation

The existing regulatory framework is designed to regulate individual lawyers on the basis of prescriptive rules, complaints and discipline. This is a reactive system designed to punish the lawyer for the conduct, rather than to educate and prevent the lawyer from engaging in the alleged conduct in the first place.

However, the regulatory focus solely on the individual lawyer is beginning to shift as there is growing recognition of the significant influence a law firm environment has on the ethical behaviour of lawyers. This shift recognizes that law firms should implement ethical infrastructures – or measures – to foster an ethical environment in which lawyers are encouraged and supported to conduct their duties ethically in the delivery of legal services.

Compliance-based regulation of the entity using an outcomes-based approach supports the development of a firm's ethical infrastructure and is a flexible and proactive approach to regulation. This regulatory approach to entity regulation represents a fundamental shift from the traditional reactive model grounded in complaints, prescriptive rules and a focus on the individual lawyer to a proactive model that focuses on outcomes, flexibility and firm culture and behaviour.

A compliance-based regulatory approach to law firms is proactive and preventative in nature. Allowing a law firm to develop its own internal systems and processes for an ethical infrastructure that best allows it to meet regulatory objectives educates the law firm to raise the standards for the ethical conduct of lawyers. The benefit of compliance-based regulation is better ethical practices, which improves the delivery of legal services to the clients and ultimately benefits and protects clients.

### c) ABS Regulation

The decision of whether to liberalize the rules respecting business structures does not have to be all or nothing. There are many aspects to ABS, and many ways to approach each aspect. For example, as MDPs have been permitted in other parts of Canada for some time now, the Prairie provinces should, at a minimum, consider permitting MDPs, fee-sharing with non-lawyers, and perhaps referral fees between lawyers and non-lawyers. There have not been any significant difficulties with MDPs in the jurisdictions that permit them.

The fact that there also has not been a great deal of uptake in those jurisdictions should not be a reason to dismiss MDPs as a permitted business structure, either. As technology and other aspects of legal practice develop, members may be more inclined to experiment with new ideas. As with any tradition, it may be that it will take time for members to adjust to the change and to develop those new ideas.

However, the Prairie provinces should not feel constrained by the restrictions placed on MDPs in Ontario and

B.C. which only permit non-legal services that support or supplement legal services. Noel Semple is very critical of this approach, arguing that MDPs are useless if they are too tightly controlled as there is no incentive for lawyers to form such partnerships. He asserts that these restrictions are one of the reasons that very few MDPs have developed in those jurisdictions.<sup>361</sup>

The Prairie provinces should consider whether any restrictions on the type of services that can be provided in conjunction with legal services are necessary. If the public interest demonstrably requires that some non-legal services should not be provided together with legal services, the rules could provide exceptions for those services. Another possibility is to require ABSs to disclose to the public which services are legal and which are non-legal, as well as any other relevant statutory obligations, as the OTLA has recommended.<sup>362</sup>

While non-lawyer ownership of law firms tends to be the most controversial aspect to ABS regulation, the Prairie provinces should keep in mind that ABS includes more than that, and also that non-lawyer ownership could be permitted in a variety of different ways. If the Prairie provinces are not comfortable allowing unlimited non-lawyer ownership, restrictions can be placed on the percentage of voting shares that can be owned by non-lawyers, as well as the “type” of non-lawyers that can own shares.

For example, non-ownership could be limited to family members, other regulated professionals, and employees of the firm. Other possibilities include allowing non-lawyer ownership to be limited to non-voting shares, as is the case with professional legal corporations in most jurisdictions in Canada. Non-lawyer ownership could also be introduced incrementally, by first allowing restricted ownership and then increasingly liberalizing the rules.

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<sup>361</sup> Semple 1, *supra* note 167, Section V. at 64.

<sup>362</sup> OTLA, *supra* note 235, Section V. at 30.