

Business structures — ‘law practices’

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Introduction

The question of how different business models might impact on the responsibilities and liabilities of those who provide legal services has been a controversial issue in the past. For this reason, Incorporated Legal Practice and Multi-Disciplinary Partnerships are subject to their own regulatory regimes in the Model Bill. As there is now more confidence in different business structures, and in accordance with the Taskforce’s desire to simplify the legislation, the Taskforce proposes a new system that applies consistent standards to law practices of all kinds, while seeking to ensure that legal service providers cannot hide behind the corporate veil.

Should law practice business structures be regulated?

With the advent of new law practice business structures, the regulation of certain structures was introduced to resolve tensions and inconsistencies between the duties and obligations of legal service providers as members of the legal profession and the duties and obligations of, and options available to, legal service providers as business operators in a lucrative industry.

The role of the legal profession in Australia is a fundamental component of the administration of justice and the rule of law. This unique role bears obligations above and beyond those of service providers generally:

- members of the legal profession owe their primary duties first to the court and the administration of justice and then to their clients; and
- the legal profession is an independent profession and so its members also bear the obligations to maintain the independence and integrity of the profession.

Those obligations are not fully consistent with those of service providers who operate in the form of a corporation, especially a listed corporation. For instance, sections 180 and 181 of the *Corporations Act 2001* (Cth) require directors and officers of corporations to make their business judgements, exercise their powers and discharge their duties ‘in the best interests of the corporation’ (among other requirements). However, the best interests of the corporation may not always be consistent with the interests of the client or the duty to the court. A practical example that is often cited is that of early settlement in litigation matters: it would be in the interests of the corporation to proceed with the litigation as this would generate more capital for the corporation, whereas it would be in the interests of the client and the administration of justice to settle the matter (if the client wishes to do so).

Moreover, incorporation allows for the liabilities of the principals of a corporation to be limited. Under corporations law, this benefit is balanced by reporting, disclosure and other requirements that are more stringent than those placed on partners in a partnership. Those requirements relate to the financial and general business management of the corporation. However, they do not address the implications for limited liability in the context of legal profession regulation. For this reason, legal profession regulation includes provisions that attempt to strike a similar

balance to that under corporations law for the purposes of liabilities relating to the provision of legal services.

Issues concerning the distinctive obligations of members of the legal profession also arise in relation to multi-disciplinary partnerships. One of the most pertinent issues relates to both multi-disciplinary and law practices in the form of corporations or ‘Incorporated Legal Practices’: Those controlling the business decisions that affect the provision of legal services by a law practice must be those who bear the duty to provide legal services in accordance with legal professional obligations. If that were not the case, there would be a risk that a decision that is inconsistent with legal professional obligations will be made. Where that eventuates, the decision-maker would not be responsible for the failure to discharge the obligations as the duty to do so would not fall on him or her and the person(s) on whom the duty would fall could be absolved of any responsibility as he or she had no control of the decision.

The need to resolve such tensions and ensure that legal professional obligations are upheld warrants the regulation of law practice business structures. However, such regulation must be targeted at resolving these issues and must be proportionate to the risk of those issues causing problems and the consequences of such problems should they eventuate. It must also ensure that the overarching legal professional obligations that fall upon principals of one law practice business structure are the same as those that fall upon principals of another law practice business structure, although the actions and caution that would need to be taken to discharge those obligations may indeed differ between the principals.

What needs to be regulated?

It is proposed that the national legal profession law regulate the provision of legal services by stipulating the obligations of members of the legal profession and providing for the regulation of the conduct that is required to discharge those obligations. The proposed law would also specify those areas in which the obligations fall upon the law practice as opposed, or in addition, to the individual Australian legal practitioner. It is therefore not necessary that the regulation of business structures reiterate the obligations themselves. Rather, the regulation should ensure that the business structure of a law practice does not hinder the fulfilment of those obligations and that the responsibility for ensuring that rests on the appropriate persons. Regulation should also be aimed at achieving those objectives without necessarily prohibiting the provision of legal services by business structures other than the traditional partnership and without imposing a disproportionate regulatory burden on law practices operating in particular business structures.

A provision capturing these regulatory objectives should be included in the proposed national law. The proposed regulatory objectives are:

The regulatory objectives of this Part are:

- (1) to facilitate the provision of legal services through a range of business structures;
- (2) to ensure that any particular type of business structure does not impede a law practice and the legal practitioners within it from complying with the National Law, National Rules and other professional obligations of Australian legal practitioners; and
- (3) to ensure that consumers of legal services are not disadvantaged as a result of the business structure through which a law practice provides legal services.

It is proposed that these regulatory objectives can be achieved through regulatory provisions that:

- identify the persons on whom the legal professional obligations fall within the law practice business structures;
- establish those persons' responsibilities and liabilities with respect to the provision of legal services by the practice;
- address any conflicts between those responsibilities and liabilities and obligations under other laws; and
- ensure that consumers are clear about the types of services they will be receiving when they seek to engage a business that offers legal and non-legal services.

How can it be regulated simply?

Regulatory Principles

In keeping with the Taskforce's proposed principles-based approach to legislation, it is proposed that regulatory principles addressing the abovementioned aims be included in the national law. As the legal professional obligations of legal practitioners are in essence the same for principals of partnerships as for principals of other law practice business structures, it is proposed that the principles establishing the responsibility to ensure that a law practice discharges those obligations be applicable to all principals — not only principals of incorporated legal practices and multi-disciplinary partnerships.

Principle 1: A legal practitioner must comply with the National Law, the National Rules and his or her professional obligations,¹ regardless of the business structure in which he or she engages in legal practice.

Principle 2: An incorporated legal practice or multidisciplinary partnership must have at least one principal² who has an unrestricted practising certificate (i.e. a legal practitioner director' or a 'legal practitioner partner').

Principle 3: Each principal of a law practice³ is deemed responsible for a contravention by a law practice⁴ of the National Law or the National Rules [*subject to those exceptions outlined in the Model Bill provision on liability of principals (s 8.1.2)*].

Principle 4: Regardless of the type of business structure, each principal of a law practice is responsible for ensuring that all reasonable action is taken to ensure that:

- all Australian legal practitioners within the law practice comply with their obligations under the National Law and National Rules and their professional obligations; and

¹ The Model Bill defines 'professional obligations' of an Australian legal practitioner as including: duties to the Supreme Court; obligations in connection with conflicts of interest; duties to clients, including disclosure; and ethical rules required to be observed by the practitioner.

² The Model Bill defines 'principal' as an Australian legal practitioner who is: a sole practitioner (in the case of a law practice constituted by the practitioner); a partner in the law practice (in the case of a law firm); a legal practitioner director in the law practice (in the case of an incorporated legal practice); or a legal practitioner partner in the law practice (in the case of a multi-disciplinary partnership).

³ The Model Bill defines this as: an Australian legal practitioner who is a sole practitioner; a law firm; a multi-disciplinary partnership; or an incorporated legal practice.

⁴ The relationship between the obligations on the individuals in a law practice and the law practice itself will be given further consideration in the drafting of the proposed national law.

- the legal services provided by the law practice are provided in accordance with the National Law, National Rules and the professional obligations of an Australian legal practitioner.

Principle 5: A contravention of Principle 4 is capable of constituting unprofessional conduct or professional misconduct by each principal of the law practice.

Principle 6: A law practice cannot avoid liability for conduct engaged in by the practice or its officers or employees merely as a result of its business structure.⁵

Principle 7: If the Board considers it necessary to do so, the Board may conduct an audit of the compliance of a law practice with the National Law or the National Rules, and the management of the provision of legal services by the law practice.

Principle 8: If the Board considers it necessary to do so, the Board may require a law practice to:

- ensure that an appropriate management system is implemented and maintained to enable the provision of legal services by the law practice in accordance with the National Law, National Rules and the professional obligations of legal practitioners within the law practice; and
- provide periodic reports on its compliance with the appropriate management system.

Principle 9: The following applies in relation to an incorporated legal practice:

- Nothing in the National Law or National Rules is intended to derogate from the obligations or liabilities of a director of an incorporated legal practice under the Corporations Act 2001 (Cth) or any other law. However, in the event of a conflict, the obligations under the National Law or National Rules should prevail.
- A corporation may be disqualified from providing legal services in specified circumstances, and a person may be disqualified from managing a corporation that is an ILP in specified circumstances.
- The National Law may make provision for external administration proceedings under any other legislation, and in relation to an incorporated legal practice that is subject to receivership and external administration.

Principle 10: A legal practitioner may be prohibited from being a partner of a specified person in a business that includes the provision of legal services in specified circumstances.⁶

Principle 11: The National Rules may make provision for matters relating to the provision of legal services by, and the application of provisions of the National Law to, various types of business structures, including incorporated legal practices and multidisciplinary partnerships.

This approach would simplify and streamline the provisions of the Model Bill that relate to business structures.

⁵ For example, s 2.7.19 of the Model Bill, which extends vicarious liability relating to a failure to account, pay or deliver and dishonesty to incorporated legal practices.

⁶ The circumstances specified in the Model Bill.

National Rules

Fulfilling the responsibility to discharge the obligations of the law practice is likely to necessitate different action to be taken by the principals of one type of law practice business structure as opposed to another. For this reason, it is proposed that the National Legal Services Board be given the power to issue National Rules stipulating any further regulatory prescription that is deemed necessary to give full effect to the principles.

Guidelines

The Board would also be free to provide further guidance in the form of national guidelines on how principals of all law practices can discharge their duties, including through risk management and taking measures to prevent possible contraventions of legal professional obligations.

The New South Wales Legal Services Commissioner's 'Ten Commandments' and corresponding self-assessment tools are testament to the merits of this approach. Those guidelines and tools were developed by the Commissioner to assist principals of incorporated legal practices and multi-disciplinary partnerships to ensure that their management systems are robust enough to minimise the risk of contraventions of legal professional obligations and the risk of negligence. Incorporated legal practices have reported the usefulness of the tools and the Commissioner has praised the co-operation of incorporated legal practices and multi-disciplinary partnerships to improve their systems where necessary. Due to its success, the Queensland and Victorian Legal Services Commissioners have also adopted this approach, and there has been a concerted call for it to be used to assist *all* law practices — not only incorporated legal practices and multi-disciplinary partnerships.

Compliance audits

In addition to any national guidelines, it is proposed that the National Legal Services Board be vested with the power to conduct a compliance audit of any law practice, if it considers it necessary to do so. The compliance audit could include auditing the management of the provision of legal services by a law practice.

The Board would have the same investigatory powers conferred on it for other investigation purposes. The Board would also have same powers as those conferred on the Australian Securities and Investments Commission by Division 2 of Part 3 of the *Australian Securities and Investments Commission Act 2001* (Cth), with some modifications as set out in the Model Bill.⁷

The audits would place greater emphasis on the risk management and prevention rather than waiting until a contravention has occurred and then invoking disciplinary and remedial action.

Other provisions that will need to appear in the legislation

Definitions

The following terms will need to be defined: 'law practice', 'principal', 'incorporated legal practice' and 'multi-disciplinary partnership'.

⁷ This is an equivalent approach to that taken in the Model Bill (s 2.7.23 and Part 6.4).

It is proposed that we adopt the Model Bill definitions of those terms⁸, with some possible additions to the definition of ‘law practice’. The proposed objectives and principles do not represent a shift in the policy underpinning the definitions of those terms. Moreover, adopting the Model Bill definitions will allow for the retention of any case law on those terms and minimise the disruption to this area of regulation.

Giving notice of commencing or ceasing practice as an incorporated legal practice or multi-disciplinary practice

At present, corporations intending to engage in legal practice and legal practitioner partners intending to enter a multi-disciplinary partnership are required to notify the relevant regulatory authority of their intention to do so.⁹ Incorporated legal practices ceasing to engage in legal practice are required to give notice of that intention also.¹⁰ This ensures that the regulatory authority is well placed to assist those business structures by providing information and guidance on their obligations and how to manage the risk of contraventions of those obligations. It also allows the regulatory authority to take preventative measures against future contraventions of legal professional obligations. It is proposed that these notification requirements be adopted, with notification to be directed to the National Legal Services Board.

Powers of the Court to disqualify unsuitable persons or corporations

The Model Bill and Legal Profession Acts¹¹ vest the Supreme Courts with the powers to:

- disqualify a corporation from providing legal services (s 2.7.24, Model Bill);
- disqualify a person from managing an incorporated legal practice (s 2.7.25, Model Bill);
- prohibit an Australian legal practitioner from continuing a partnership with a person who is not an Australian legal practitioner (s 2.7.50, Model Bill);
- prohibit an Australian legal practitioner from entering into partnership with a person who is not an Australian legal practitioner and who was at some point in partnership with an Australian legal practitioner (s 2.7.50, Model Bill);
- prohibit an Australian legal practitioner from being a partner of a corporation that has been or should be disqualified from providing legal services (s 2.7.50(c)).

Under these provisions, the Court considers such matters on application from the regulating authority. Operating alongside these provisions are prohibitions on doing business with a disqualified person or corporation, including sharing income with a disqualified person, employing a disqualified person and entering into a partnership with a disqualified corporation.¹²

These provisions align with the aims of legal profession regulation to ensure the administration of justice and uphold the integrity of the legal profession. They allow the regulating authority and the Courts to put an end to contraventions of legal professional obligations or prevent future contraventions that are likely arise due to business relationships with unsuitable persons or corporations. It is proposed that these provisions be retained.

⁸ The Model Bill definitions of those terms are at Attachment C.

⁹ Sections 2.7.6(1) and 2.7.38, Model Bill.

¹⁰ Section 2.7.8(1), Model Bill.

¹¹ Except for South Australia’s Act—South Australia has yet to adopt the Model Bill.

¹² Sections ss 2.7.21 and 2.7.49, Model Bill.

Conflicts of interests or obligations

Principals of law practices are obliged to avoid conflicts of interests generally, as part of their professional obligations as legal practitioners. However, there are particular situations that are known to give rise to conflicts of interests or obligations. The Model Bill identifies one of those situations: incorporated legal practices or related bodies corporate conducting a managed investment scheme. Section 2.7.4(2) prohibits an incorporated legal practice from conducting such a scheme. The prohibition makes the matter unequivocal, providing clarity for incorporated legal practices. It is proposed that this provision be retained.

To allow for similar situations to be identified and clarified for law practices, the Model Bill allows for regulations to specify and prohibit an incorporated legal practice (or a related body corporate) from providing a service or conducting a business of other kinds (s 2.7.4(3)). This may not be necessary if no other situation can be identified as one which will always give rise to a conflict of interests or obligations. However, if this provision is to be retained, consideration should be given to, and the views of the Consultative Group should be sought on, whether it would follow that this provision should extend to all law practices, not only incorporated legal practices.

The Model Bill also provides for the regulations to prohibit an Australian legal practitioner from being in partnership with a person providing a particular service or conducting a business of a particular kind (s 2.7.37(3)). An example of this being invoked is Regulation 22 of the Northern Territory Legal Profession Regulations, which provides that ‘an Australian legal practitioner who acts as the conveyancing lawyer for the purchaser of a property must not be in partnership with a person who acts as the real estate agent for the vendor in the sale of the property; or as the finance broker for the purchaser.

It is proposed that this would be an unambiguous conflict of interest and therefore does not need to be prescribed. If such a level of prescription is to be adopted, it would follow that all such conflicts of interests should be prescribed.

External administration under the *Corporations Act 2001* (Cth) or other laws

Chapter 5 of the Corporations Act provides for the external administration of corporations through application to the Court¹³. Where that process is commenced concerning an incorporated legal practice, the proceedings may impact the legal services provided by the practice and the clients of that practice, which would affect other legal proceedings and/or the legal rights and liabilities of parties to those proceedings. To ensure that these impacts are considered and remedied where appropriate, it is important to vest the relevant courts with jurisdiction to consider such matters and have the corresponding interests represented. This is equally necessary for external administration of bodies corporate under any other law.

The Model Bill provides for this by allowing the regulator to intervene in external administration proceedings, unless the court determines that the proceedings do not concern or affect the provision of legal services by the incorporated legal practice concerned. Provisions in the Model Bill also allow the court to have regard to the interests of the relevant clients of the incorporated

¹³ ‘Court’ is defined in s 58AA of the Corporations Act to mean: the Federal Court; the Supreme Court of a State or Territory; the Family Court of Australia; and a court to which section 41 of the *Family Law Act 1975* applies because of a Proclamation made under subsection 41(2) of that Act.

legal practice.¹⁴ It is proposed that provisions to the effect of those in the Model Bill be included in the proposed national law.

Offences

The Model Bill and Legal Profession Acts¹⁵ create a number of offences that relate specifically to business structures:

- (1) It is an offence for a corporation disqualified from providing legal services to provide legal services.¹⁶
- (2) It is an offence for an incorporated legal practice to do business with a disqualified person, where the disqualified person is:
 - an employee or officer of the practice or a related body corporate;
 - is in partnership with the practice in the provision of legal services;
 - shares income arising from the provision of legal services by the practice;
 - is engaged by the practice in connection with legal service provision.¹⁷

The equivalent provision for multi-disciplinary partnerships in the Model Bill (s 2.7.49) is not an offence — it is phrased as a prohibition without a penalty. This inconsistency has been overcome by most jurisdictions by making both provisions offences: Some jurisdictions, eg NSW, Tas and WA, have prescribed the same penalty despite adopting the variation in wording between the two, Core Uniform Model Bill provisions. Other jurisdictions, eg ACT, have amended the wording and made it clear that both are offences.

- (3) It is an offence for a person (whether or not an officer or employee or a partner of a law practice) to cause, induce or attempt to cause or induce a principal or an employee of an incorporated legal practice or multi-disciplinary partnership to contravene the Act, regulations or other legal professional obligations.¹⁸

It is proposed that the first offence be adopted in the proposed national law in the interests of the administration of justice and consumer protection. In relation to the second offence, it is proposed that the inconsistency between incorporated legal practices and multi-disciplinary partnerships be resolved by covering both business structures in the offence provision.

In relation to the third offence, the views of the Group are welcome on whether it should be appropriate to apply this offence consistently regardless of the business structure involved, ie should it be an offence to cause a contravention by a principal or an employee of any law practice, not only an incorporated legal practice or a multi-disciplinary partnership?

The penalties for these are currently not uniform across Australia, but are monetary penalties in all jurisdictions. The draft national law will propose a consistent regime of offences and penalties.

¹⁴ Sections 2.7.27-2.7.30, Model Bill.

¹⁵ Except for South Australia's Act—South Australia has yet to adopt the Model Bill.

¹⁶ Section 2.7.24(6), Model Bill.

¹⁷ Section 2.7.21, Model Bill.

¹⁸ Sections 2.7.35 and 2.7.51.

What if there is conflict between legal profession obligations and the *Corporations Act 2001* (Cth)?

Sections 5G and 5F of the Corporations Act allow for State or Territory law to override the Corporations Act where the State or Territory law declares the matter it addresses a matter excluded from the Corporations Act or part thereof, and where there is direct inconsistency between the two laws and concurrent operation is not possible.

The Model Bill invokes these sections by declaring the relevant provisions matters excluded from parts of the Corporations Act, and by providing for the legal profession regulations to declare any other provision for the purposes of sections 5G and 5F of the Corporations Act. This approach must be adopted by the national law to give full effect to the regulation of business structures under legal profession legislation.

One potential conflict in particular may not be addressed by this approach and the related legislative principle (Principle 6) alone: the possibility that pro bono legal services be considered a breach of directors' duties under the Corporations Act. To resolve this, the Model Bill makes it clear that:

(t)he directors of an incorporated legal practice do not breach their duties as directors merely because legal services are provided pro bono by an Australian legal practitioner employed by the practice.¹⁹

It is proposed that this provision be retained to ensure that this potential conflict is resolved.

¹⁹ Subsection 2.7.12(4).