

Incorporated Law Firms: The Practical and Ethical Considerations

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I INTRODUCTION

Approximately every twenty five years, New Zealand's Parliament passes legislation that seeks to regulate the legal profession in this country. This process represents an opportunity to modernize fundamental elements of the profession and address the challenges posed by modern-day legal practice. To this end, the Lawyers and Conveyancers Act 2006 ("the Act") has brought in a number of highly significant changes that will alter the way in which law is practised in New Zealand.

This article addresses just one of these changes. For the first time, Parliament has permitted law firms to practise in the form of an incorporated company. However, apart from several inconsequential exceptions, the Act restrains anyone other than an actively involved lawyer from holding shares in an incorporated law firm. The objective behind this restriction is to ensure that legal practices are not subject to the potentially profit-oriented motives of non-lawyer investors.

Drawing upon the less restrictive legislation that exists in New South Wales, this article argues that this constraint on the shareholding of an incorporated law firm in New Zealand is both unnecessary and unfortunate. It is no longer appropriate to attempt to protect law firms from the supposedly corrupting forces of commerce by heavily regulating business structures. Instead, Parliament and the New Zealand Law Society ("the Law Society") should accept that legal practice and commercial considerations are now inextricably associated. While this relationship does pose some problems, it also represents an opportunity to change the focus of professional regulation in New Zealand.

As commercial considerations are now a central part of a law firm's existence, it makes sense that law firms be legally required to implement internal systems that reduce the possibility of breaches of professional or ethical standards occurring. By fostering an environment that provides guidance as to how ethics and profit can successfully coexist, it is law firms rather than individuals that are best placed to assume greater ethical responsibility in the 21st century. In light of this argument, this article ultimately concludes that the Act was a missed opportunity for the New

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Zealand legal profession to follow its New South Wales equivalent into the modern age of legal practice.

II LEGAL PRACTICE IN NEW ZEALAND

The Structure of Legal Practice in New Zealand

A prohibition on law firms operating as incorporated companies has existed throughout New Zealand's legal history, leaving practitioners with no choice but to practise as sole practitioners or within a partnership structure. The rationale behind this prohibition can be found in the American case of *In re Cooperative Law Co*, as stated by the New York Court of Appeals:¹

The practice of law is not a business open to all, but a personal right, limited to a few persons of good moral character, with specific qualifications ascertained and certified after a long course of study No one can practice law unless he has taken an oath of office and has become an officer of the court, subject to its discipline, liable to punishment for contempt in violating his duties as such, and to suspension or removal As these conditions cannot be performed by a corporation, it follows that the practice of law is not a lawful business for a corporation to engage in.

The Traditional Prohibition on Incorporated Legal Practices

Historically, there has been no express prohibition on lawyers entering into partnership with non-lawyers in New Zealand. However, the Law Practitioners Act 1982 and the New Zealand Law Society's Rules of Professional Conduct ("Rules of Professional Conduct") make it clear that such arrangements are not permitted. The Law Practitioners Act 1982 states that it is an offence to practise as a solicitor or barrister without holding the appropriate qualifications.² Furthermore, Rule 2.03(3) provides that a practitioner shall not become a partner of a firm that practises a profession other than law.³ This was confirmed in the case of *Black and Another v Slee*.⁴ In this case, Black, a solicitor, and Slee, an accountant, purchased a law practice from Molony. The capital of the partnership was set at £1000 and was to be contributed to by Black and Slee in equal shares. Johnston J in the Supreme Court had little difficulty in finding this partnership agreement to be in contravention of the Law Practitioners Act 1931, on the

1 *In re Cooperative Law Co* (1910) 198 NY 479, 483.

2 Law Practitioners Act 1982, ss 54, 64, 65, 66.

3 New Zealand Law Society, *Rules of Professional Conduct for Barristers and Solicitors* (7th ed, 2006) Rule 2.03(3).

4 [1934] GLR 334.

basis that it provided for income sharing with a non-lawyer. This decision is representative of the determination of Parliament, the courts, and the Law Society to ensure that the ownership and control of legal practices resides solely with lawyers.

Reasons for the Prohibition of Incorporated Legal Practices

1 Joint and Several Liability in a Partnership Structure

Commentators have suggested that there are three fundamental reasons for confining legal practices to either a sole practice or partnership structure.⁵ First, partners in a legal partnership assume joint and several liability for the frauds, fiduciary breaches and malpractice of fellow partners.⁶ New South Wales Attorney-General Jeff Shaw QC considers that this potential liability has the effect of ensuring that partners maintain a direct interest in the work undertaken by the partnership and in the conduct of its solicitors.⁷ This is a particularly strong argument in the context of smaller partnerships where partners work in close proximity and have a smaller number of employees to supervise. Partners will obviously be anxious to avoid joint or several financial liability for the shortcomings of their fellow partners or employees. Thus, they are likely to interact more closely with the work undertaken by the firm, notwithstanding the fact that they have no personal involvement in a particular matter.

However, the limited liability that characterises an incorporated company is arguably inconsistent with the personal responsibility for professional, legal, and ethical obligations owed by lawyers to their clients and the courts. Limited liability can be considered a consequence of the separate legal personality that a company enjoys. As an entity that is separate from its directors and shareholders, it is the company, and the company alone, against whom its creditors have rights.⁸ By removing the deterrent of joint and several liability that exists under a partnership structure, it is arguable that partners will pay less attention to the work of their colleagues as there is no prospect of personal liability for the fraud, fiduciary breaches or malpractice of another.

On the other hand, it is not altogether clear that the limited liability and accompanying joint monitoring justifications for the prohibition of incorporated legal practices are universally accepted. Ian Ramsay submits that many lawyers protect their personal assets from malpractice claims by shifting ownership to their spouses or family trusts.⁹ This has the effect

5 Parker, "Law Firms Incorporated: How Incorporation Could and Should Make Firms More Ethically Responsible" (2004) 23 U Queensland LJ 347, 349.

6 Partnership Act 1908, ss 12-15.

7 Shaw, "Incorporation of Legal Practices Under the Corporations Law" (1999) 37 LSJ 66, 68.

8 Grantham and Rickett, *Company and Securities Law: Commentary and Materials* (2002) 251.

9 Ramsay, "Should Law Firms be Permitted to Incorporate? An Analysis of the Trade Practices Commission Recommendation" (1994) 10 AJLS 245, 253-254.

of limiting the liability of a lawyer, as creditors and claimants will not be permitted to trace assets that are in the legal ownership of another person or entity. A lawyer who takes this course of action lacks the same financial incentives to monitor the quality of a partner's work in comparison to a lawyer who does not transfer his or her assets in this way.

There are further problems associated with the concept of inter-partner monitoring for large firms that practise in several centres. The practicalities of undertaking joint monitoring today are very different from the likely monitoring that occurred at the time the Partnership Act 1908 was passed. For example, a partner of a national law firm who specializes in taxation law and practises in Auckland is unlikely to have the skills or practical means to adequately monitor the work of an employment law partner who practises in Wellington. Despite these impracticalities, the threat of liability remains a theoretical concern for both partners, yet neither is properly capable of influencing the quality of the other's work. This is a strong argument suggesting that the partnership business structure has lost relevance in the modern era of large national firms.

2 *Non-Lawyer Capital Investment in Legal Practices*

The second reason for the long-standing prohibition on incorporated legal practices in New Zealand is that incorporation would inevitably result in the sharing of fees with non-lawyer investors in the legal practice. A legal practice incorporated as a company would theoretically be able to offer shares to the public as a method of raising capital. As previously discussed in the case of *Black and Another v Slee*,¹⁰ Parliament and the courts have consistently refused to permit non-lawyer ownership and investment in legal practice.

This prohibition is aimed at ensuring that the ethical responsibilities owed by a lawyer to his or her client are not compromised by the financial interests of non-lawyer investors, who themselves are not bound by the same ethical obligations as lawyers.¹¹ Rule 1.01 of the Rules of Professional Conduct states that "the relationship between practitioner and client is one of confidence and trust, which must never be abused".

3 *The Effect on the Image of the Legal Profession*

In addition to compromising the ability of clients to seek recourse for malpractice, limited liability puts the confidence of the public in the aptitude and ethics of the legal profession at greater risk. When New Zealanders are asked to identify the professions and industries that they consider to be most trustworthy, lawyers inevitably rate alongside politicians and real

¹⁰ Refer to the discussion of the prohibition on the incorporation of legal practices in section II.

¹¹ Parker, *supra* note 5, 349.

estate agents as being particularly untrustworthy.¹² A shift to a limited liability business structure for legal practices would have the effect of reducing the potential for lawyers to be held financially responsible to their clients for frauds, fiduciary breaches and malpractice. It seems highly unlikely that the public image of the legal profession would be enhanced by lawyers being seen to use the law to diminish their own professional accountability.

Having examined the fundamental professional and ethical concerns that exist in respect of incorporated law firms, it is relatively easy to understand why Parliament has retained the partnership form as the pre-eminent business structure for the legal profession. The existence of joint and several liability for the actions of partners under the Partnership Act 1908 provides significant incentives for partners to involve themselves in the wider operations of their firm. Similarly, the absence of non-lawyer capital investment under the partnership structure removes some of the inevitable tension that exists between the duties lawyers owe to a client and the goal of profitability in a modern law firm.

III THE LAWYERS AND CONVEYANCERS ACT 2006

On 24 June 2003, the Hon. Phil Goff, then Minister of Justice, introduced the Lawyers and Conveyancers Bill to Parliament. Upon receiving royal assent on 20 March 2006, the Act had swollen to 393 sections and contained some of the most dramatic changes in the history of the New Zealand legal profession. The title of Queen's Counsel, for example, had been replaced by the title of Senior Counsel, with appointment being open to lawyers in all forms of practice, and not just barristers sole.¹³ Secondly, a new profession of conveyancing practitioners was created to carry out conveyancing work in competition with lawyers.¹⁴ Thirdly, the Act removed the compulsion on lawyers to retain membership of their District Law Society.¹⁵ However, arguably the most significant practical change ushered in by the Act has been the removal of the prohibition on lawyers practising in an incorporated structure.¹⁶ For the first time in New Zealand's legal history, owners of multi-lawyer firms now have the choice of practising in either a partnership or an incorporated company structure.

12 "Who do we Trust Most? 2005 Winners and Losers" *Readers Digest*, Auckland, New Zealand, 30 June 2005.

13 Lawyers and Conveyancers Act 2006, s 118.

14 Lawyers and Conveyancers Act 2006, s 77.

15 Lawyers and Conveyancers Act 2006, s 64.

16 Lawyers and Conveyancers Act 2006, s 6.

Incorporation of Law Firms in New Zealand

1 Parliamentary Reaction

The provisions in the Act permitting lawyers to incorporate their practices enjoyed widespread support from the political parties represented in Parliament. The Hon. Phil Goff confirmed that “lawyers have pushed for the freedom to determine their own practice structures. This enables them to compete more effectively with other businesses in the market for legal services or in closely related areas”.¹⁷ National Party MP and member of the Justice and Electoral Select Committee, Kate Wilkinson, suggested that “by allowing incorporation, this bill certainly brings law firms into the 21st century. It allows lawyers to structure their affairs and to incorporate — to form a more sensible and commercial business structure”.¹⁸

2 Incorporated Law Firms in Practice

Before this article considers the ethical tensions that exist between an incorporated legal practice and the tortious and equitable duties owed by a lawyer, it is necessary to determine whether the provisions in the new Act offer adequate benefits to entice law firms away from the traditional partnership structure. If the incorporated structure is unable to offer sufficient incentives, lawyers are likely to remain rooted to their partnerships, and the ethical dilemmas posed by incorporated legal practices will exist in theory only. To this end, a number of potential advantages can be identified for a firm considering whether to incorporate.

(a) Limited Liability

One of the fundamental advantages of practising through the medium of an incorporated company is that shareholders of the company are liable only to contribute towards the payment of its debts to a limited extent. A shareholder’s liability to contribute is measured by the nominal value of the shares he or she holds, so that once he or she has paid that nominal value, the shareholder is no longer liable to contribute further towards meeting the company’s debts and liabilities.¹⁹ Limited liability ultimately has wider benefits for society as it makes it easier and less risky for investment to be made in businesses. To this end, shareholders will not risk being personally liable to the company’s debtors if the business is unsuccessful.

The Act provides several constraints on the availability of limited liability for incorporated legal practices. The starting point in determining the potential liability for a shareholder under the new Act is section 17(1). This section states that “a practitioner who is a director or shareholder of

17 Phil Goff et al. “Lawyers and Conveyancers Bill” [2003] NZLJ 331, 332.

18 (28 February 2006) 629 NZPD 1506 (Kate Wilkinson).

19 Pennington, *Company Law* (8th ed, 2001) 71-72.

an incorporated firm is not liable, on a joint or several basis ... for any act or omission of any other director or shareholder of the firm; or ... for the debts or liabilities of the firm". In essence, section 17(1) sets out the standard limitation of liability which follows from the incorporation of a normal company. This marks a dramatic shift from the partnership paradigm where partners in a law firm are jointly and severally liable for the frauds, breaches of fiduciary duty and malpractice of fellow partners.²⁰

In opposition to this generous provision is section 17(2) which states that "subject to section 17(1), a practitioner who is a director or shareholder of an incorporated firm is subject to all the professional obligations to which he or she would be subject if he or she were in practice on his or her own account". Hence it follows that while individual lawyers in an incorporated legal practice will obtain an overall limitation of liability for the actions of other lawyers under section 17(1), they remain personally liable for breaches of their own individual obligations under section 17(2).

(b) Incorporated Legal Practice Management

The second major advantage offered by an incorporated legal practice in comparison to a partnership is greater flexibility. A law firm that chooses to incorporate will be subject to the provisions of the Companies Act 1993. When preparing to transfer from a partnership structure to an incorporated legal practice, a firm will likely have to arrange for a sale and purchase agreement, valuation of the partnership, partnership and company minutes, a shareholders' agreement and a constitution of the new company.²¹

In drafting the constitution, directors and shareholders may be given any combination of ownership rights, control and distribution rights in the company's profits by choosing the types of shares that will constitute the company. The potential options available to an incorporated legal practice include voting or non-voting shares, fixed dividend, or preference shares for shareholders.²² The flexibility provided by this structure is useful for differentiating between shareholders who have injected varying levels of capital and expertise into the company, and may even be used as part of an employee incentive scheme.²³ For example, directors may offer shares or share options in order to counter the flow of intermediate-level lawyers leaving a firm for the higher salaries of the United Kingdom and the United States. This will allow employees to feel a greater sense of ownership in the legal practice, which is likely to increase the level of performance by employee lawyers.

20 Partnership Act 1908, ss 12-15.

21 MacLennan, *Insufficient Benefits for Incorporation of Law Firms Contained Within New Bill* (2004) Auckland District Law Society Website
<<http://www.adls.org.nz/profession/legislation/insufficientbenefitsforincorporationoflawfirms.asp>> (at 24 July 2007).

22 Mark and Cowdroy, "Incorporated Legal Practices — A New Era in the Provision of Legal Services in the State of New South Wales" (2004) 22 *Penn St Int'l L Rev* 671, 677.

23 King, "Legal Practice: Should your Firm Incorporate?" (2001) 39(2) *LSJ* 44, 46.

A further advantage of an incorporated structure is the relative ease with which shares in a legal practice can be transferred in comparison to the more rigid structure of a partnership. Subject to a shareholders' agreement, a shareholder in a legal practice will be able to buy additional shares or sell their shares when they no longer wish to practise law with the company. This is likely to make the process of owner entry or exit from a law firm much simpler than under a partnership structure.²⁴ Existing shareholders will simply sell their shares to a new shareholder, or alternatively, sell the shares back to the legal practice itself in accordance with the valuation terms of the shareholder agreement.

Because the incorporated legal practice has its own identity and existence, it will continue regardless of the personal circumstances of its directors and shareholders. At the present time, there is often confusion amongst partners in a law firm when a partner is incapacitated, retires or dies.²⁵ A reconstitution of the partnership is required, together with amendments to the ownership details of the partnership's assets.²⁶ For modern law firms that have upwards of 35 partners situated in several cities, the expense and inconvenience associated with the regular turnover of partners is likely to be significant. Thus, the continuity of existence provided by an incorporated law firm, confirmed in section 15 of the Act, is likely to be particularly beneficial to larger legal practices.

(c) Capital Investment

Law firms in common law countries have traditionally experienced significant difficulty in securing adequate funds for working capital, capital expansion and practice development.²⁷ The partnership model restricts the firm's capital to that provided by the partners themselves. The only other avenue open to under-capitalized firms or firms with ambitions of expansion has been borrowings from banks or other lending institutions. This is particularly ironic as lawyers giving commercial advice rarely recommend to client companies that they expand using debt capital means.²⁸ This sentiment was expressed by the managing partner of Minter Ellison, one of Australia's largest firms, who stated, "if we let our clients run a \$200 million business on a capital base of zero we'd be totally irresponsible, and yet it's what we all have to do".²⁹

When the Lawyers and Conveyancers Bill was first mooted in the early 1990s, there was hope from some lawyers that incorporated legal practices would have a more comprehensive range of options available to

24 Parker, *supra* note 5, 351.

25 King, *supra* note 23, 44.

26 Mark and Cowdroy, *supra* note 22, 678.

27 *Ibid* 675.

28 *Ibid* 678.

29 Burrell, "We Only Want to Join the Club", *The Australian Financial Review*, Sydney, Australia, 17 September 1999, 52.

raise capital. For example, an incorporated company in its truest sense could grant security over its assets, issue unsecured debentures, or raise equity capital by floating on the stock exchange.³⁰ However, these capital-raising facilities would require non-lawyers gaining an element of ownership and control of the law firm, which would inevitably raise tension between the firm's obligations to its clients and its shareholders. Moreover, Parliament and the Law Society would need to make a dramatic shift in their long-standing policy that ownership of law firms be confined to lawyers only.³¹

Throughout the extensive debates on the Lawyers and Conveyancers Bill, neither Parliament nor the Law Society showed any motivation to reverse the historic prohibition on non-lawyer investment in law firms. This was expressed by the Law Society in its comprehensive submissions to the Justice and Electoral Select Committee:³²

[T]he provisions allowing incorporated law firms are welcomed. They will allow a degree of flexibility in the operation of a law firm while preserving control where it should be, i.e. with lawyers actually involved in the practice.

Parliament was similarly unequivocal in its support of the status quo, as the possibility of non-lawyer capital investment was not properly canvassed in any of the readings of the Bill. Indeed, the only mention of such a possibility during the parliamentary debates came from ACT Party MP Stephen Franks who vehemently opposed the restrictive provisions relating to incorporation. During the course of the Bill's passage, Franks suggested that the incorporation model set out in the Act is a "crock of rubbish" and noted that "New South Wales law firms have incorporated for years now without any of the pages of nonsense that go along with incorporation in this Bill".³³

While the concept of non-lawyer investment in law firms may not have enjoyed any significant degree of support in Parliament, the idea had been given greater consideration at the very preliminary planning stages of the Bill. In 1996, Dr Alan Bollard and Paul Scott of the Commerce Commission expressed their jointly held opinion that the unavailability of "true" incorporation for the legal profession may no longer be appropriate. Bollard and Scott opined that the partnership structure "increasingly restricts the services lawyers can offer in more sophisticated commercial transactions for more sophisticated clients".³⁴ Despite this enthusiasm for structural change to the legal profession, the Law Society was successful in lobbying Parliament to retain the status quo in relation to non-lawyer investment in law firms.

30 Mark and Cowdroy, *supra* note 22, 678.

31 Refer to the earlier discussion of the prohibition of incorporated legal practices in section II.

32 New Zealand Law Society, *Submission to the Justice and Electoral Select Committee on the Lawyers and Conveyancers Bill* (8 October 2003) 3.

33 (30 March 2005) 624 NZPD 19503 (Stephen Franks).

34 Bollard and Scott, "Competition and the Legal Profession" [1996] NZLJ 275, 277.

In considering the final form of the legislation, it is clear that Parliament ignored the pleas of Stephen Franks, Dr Alan Bollard and Paul Scott by placing significant restrictions on who would be permitted to hold shares in an incorporated legal practice. Section 6 of the Act states that only lawyers actively involved in the provision of regulated services may be directors or hold voting shares in an incorporated legal practice. While a very limited exception to this law exists for relatives and administrators of the estates of lawyers, Parliament has evidently withstood the temptation to permit non-lawyer investment in law firms. The practical consequence of this decision is that law firms will face restrictions on their ability to raise capital that do not apply to normal companies. While this may limit the expansionist ambitions of some firms, Parliament has impliedly considered that the ethical tension that would arise if non-lawyers were permitted as shareholders outweighs the financial interests of these firms.

Accountants

The legal profession has often been compared to the accounting profession in respect of the strict professional obligations that are owed by practitioners to clients.³⁵ Just as the legal profession assumes responsibility for much of the legal interaction between citizens and the state, accountants are entrusted with responsibility for the financial affairs of citizens. Individuals place tremendous faith in lawyers and accountants alike, due to the potential repercussions that can arise from substandard advice. This was expressed by ACT Party MP Stephen Franks during a debate on the Bill:³⁶

There is no significant difference between the role lawyers perform in maintaining confidence in the integrity of the justice system and the role auditors perform in maintaining confidence in the integrity of financial reporting.

The New Zealand Institute of Chartered Accountants (“the Institute”) fulfils a regulatory role for the accounting profession in a manner very similar to that of the Law Society. These similarities ensure that the regulation of the accounting profession is a valuable point of reference for analysis of the recent changes to the legal profession.

The Institute of Chartered Accountants Act 1996 devolved much power to the Institute itself, which accounted for the relatively succinct nature of the Act.³⁷ Using its power to make rules in respect of the accounting profession, the Institute has chosen to permit incorporated accounting

35 Franks et al, “Lawyers and Conveyancers Bill” [2003] NZLJ 362.

36 (8 March 2005) 624 NZPD 19025 (Stephen Franks).

37 Institute of Chartered Accountants Act 1996, s 5.

practices in this country for the first time.³⁸ Of special importance for the purposes of this article is the fact that non-accountant investors are permitted to hold voting shares in an incorporated accounting practice. Provided the majority of vote-conferring shares remain with approved chartered accountants, accountancy practices are free to seek an injection of equity capital from sources outside the profession.³⁹ In addition, the rules stipulate that no resolution may be passed unless it is agreed upon by a majority of shareholders who are chartered accountants.⁴⁰ While there are no statistics available to gauge the number of accounting firms that have opted to take advantage of this funding opportunity, its very existence is a significant development for the regulation of professions in New Zealand.

IV INCORPORATED LEGAL PRACTICES IN NEW SOUTH WALES

The National Competition Policy Review 1998

In 1998 the Australian Attorney-General's Department undertook a National Competition Policy Review in relation to Australia's legal profession. The review took place as a mandatory requirement of the Competition Principles Agreement, which the legal profession had agreed to be regulated by in a 1993 amendment to the Legal Profession Act 1987. The Competition Principles Agreement dictates that legislation should not restrict competition unless it can be demonstrated that the benefits of the restriction to the community outweigh the costs, and that the objectives of the legislation can only be achieved by restricting competition.⁴¹ These principles are based on the idea that the development and performance of all markets is enhanced by the removal of restrictions which hinder market performance.⁴²

The National Competition Policy Review was undertaken in respect of the Legal Profession Act 1987 and Legal Profession (Solicitor Corporations) Amendment Act 1990. The latter Act had the effect of creating "solicitor corporations" that permitted law firms to incorporate by applying to the New South Wales Law Society for a certificate of approval. In this regard, the New South Wales legal profession was approximately 16

38 Institute of Chartered Accountants of New Zealand, *Rules of the Institute of Chartered Accountants of New Zealand* (Revised 2006), Appendix (x) <http://www.nzica.com/AM/Template.cfm?Section=Professional_standards_files&Template=/CM/ContentDisplay.cfm&ContentID=2460> (at 26 July 2007).

39 Ibid Appendix (x), rule 3.1.

40 Ibid, rule 3.2(c).

41 "National Competition Policy Review of the Legal Profession Act 1987" (1998) New South Wales Law Society Website <http://www.lawlink.nsw.gov.au/report%5C1pd_reports.nsf/pages/ncp_summ> (at 24 July 2007).

42 Ibid.

years ahead of its New Zealand equivalent in embracing business structure options beyond the traditional partnership model. However, it is important to appreciate that the New South Wales Law Society placed strict controls on “solicitor corporations” in a manner that bears a close resemblance to New Zealand’s *Lawyers and Conveyancers Act 2006*.

The Attorney-General’s final report on the state of competition within the Australian legal profession was both forthright and critical of elements of the *Legal Profession (Solicitor Corporations) Amendment Act 1990*. The Attorney-General concluded that the Amendment should be repealed and solicitors should be permitted to practise in corporations with no restrictions on the qualification of shareholders in the corporation. This recommendation was based upon three fundamental reasons, all of which are persuasive in suggesting that New Zealand’s *Lawyers and Conveyancers Act 2006* is excessively restrictive on the legal profession in this country.

First, the partnership model is characterized by a horizontal management structure that usually results in partnership decisions being made equally by all partners. However, as large firms often operate out of several cities, partners rarely meet, interact or communicate as a full partnership. Accordingly, the Attorney-General considered that the partnership structure was unable to provide for sound decision making on the basis that it was impractical and not in keeping with modern commercial practices.⁴³

Secondly, partnerships are unable to seek capital from non-lawyer investors in order to fund expansion and enter new markets, both interstate and internationally. It was considered that this inability to raise equity capital placed an unfair restriction on partnerships looking to grow into large commercial enterprises able to compete with other professional service businesses.⁴⁴ However, there was little discussion from the Attorney-General in respect of the inevitable ethical tension that would arise between a lawyer’s tortious and equitable duties to his or her clients, and the fiduciary duty owed by a director to a shareholder in an incorporated structure.

Finally, it was considered that permitting law firms to incorporate would bring about greater transparency of the management and operations of legal practices.⁴⁵ As a partnership is merely an association of individuals who come together to operate a business, the partnership’s financial and management affairs are largely private. The logical result of this privacy is that partnerships are not subjected to the same public and governmental scrutiny as other business structures. The Attorney-General subsequently considered that if true incorporation was permitted for law firms, there would be greater public transparency in Australian law firms.⁴⁶

43 Mark and Cowdroy, *supra* note 22, 675.

44 *Ibid* 675.

45 *Ibid*.

46 New South Wales (2000) *New South Wales Legislative Council Hansard*, 7624 (Jeffrey Shaw).

Incorporated Legal Practices in New South Wales

1 *The New South Wales Legal Profession Amendment (Incorporated Legal Practices Act) 2000*

The ultimate result of the Attorney General's recommendations was the passing of the New South Wales Legal Profession Amendment (Incorporated Legal Practices) Act 2000 and its accompanying regulations.⁴⁷ As a result of the passing of this Act, law firms in New South Wales now have the option of incorporating under the Corporations Act 2001 as a normal company, and are able to experience benefits that are unavailable to partnerships. However, of more significance for the purposes of this article is the development relating to non-lawyer investment in legal practices.

2 *Non-Lawyer Investment in Legal Practices*

The most controversial aspect of the position taken in New South Wales is the removal of the long-standing prohibition on non-lawyer capital investment in legal practices. Law firms in New South Wales now have access to a full range of fundraising activities that had previously been unavailable to both partnerships and "solicitor corporations". The consequence of allowing this broad array of debt and equity capital options is that non-lawyers now have the opportunity to invest in a New South Wales legal practice. Indeed, law firms can even publicly list on the Australian Stock Exchange ("ASX") and attract a myriad of different investors who have no legal training or qualification.

In May 2007, the prominent litigation firm Slater & Gordon became the first Australian law firm to list on the ASX.⁴⁸ The Melbourne-based firm raised A\$35 million in an initial share sale that attracted significant interest from institutional traders.⁴⁹ Indeed, ten days after the firm listed on the ASX, its shares were trading at A\$1.70 — in comparison to the A\$1.00 issue price.⁵⁰ At a more practical level, the firm's Managing Director, Andrew Grech, said the firm was well prepared to handle potential conflicts of interest between its duties to the courts, its clients and to shareholders.⁵¹ To this end, Slater & Gordon has explicitly set out in its constitution that its primary duty is to the courts, then to its clients and finally to its shareholders.⁵² In addition, the firm's prospectus warns that there may be

47 While reference is made to the Legal Profession Amendment (Incorporated Legal Practices) Act 2000, the provisions of the Act are now found in the Legal Profession Act 2004, which governs the conduct of lawyers in New South Wales.

48 "Legal firm first to list on exchange" *The New Zealand Herald*, Auckland, New Zealand, 22 May 2007 <http://www.nzherald.co.nz/topic/story.cfm?c_id=246&objectid=10440984> (at 30 July 2007).

49 *Ibid.*

50 ASX Website <<http://www.asx.com.au/asx/research/CompanyInfoSearchResults.jsp?searchBy=asxCode&allinfo=on&asxCode=SGH>> (at 24 July 2007).

51 "Legal firm first to list on exchange", *supra* note 48.

52 *Ibid.*

times when it will act contrary to the interests of its shareholders in order to fulfil its responsibilities to the courts and to the firm's clients.⁵³

It is clear that the practical advantages of "true" incorporation are significant for law firms with expansionist ambitions.⁵⁴ While larger multi-state firms practising in New South Wales have been less reluctant to take advantage of the incorporation provisions,⁵⁵ many smaller and medium size practices have chosen to move away from traditional partnership structures.⁵⁶ This dramatic development in the context of common law legal practice raises ethical issues that need to be assessed. It is necessary to ask whether the ethical tension between a lawyer's duty to his or her client and the duty owed to a shareholder in the practice can be reconciled as easily as Slater & Gordon suggests.

The legislation itself explicitly states that the Legal Profession Act 2004 prevails over the Corporations Act 2001 if there is any inconsistency.⁵⁷ This would suggest that the duties directors owe to shareholders will be subservient to the duties that lawyers owe to their clients. Despite this provision, the New South Wales Legal Services Commissioner Steven Mark admits to having some reservations where firms are publicly listed on the ASX:⁵⁸

While the perceived conflict between professional ethics and profit is an ongoing concern in the regulation of at least some present partnerships, in publicly listed incorporated legal practices, shareholder pressure for commercial gain will introduce a dynamic for solicitor-directors which was non-existent in partnership structures.

This is a bold statement when one considers that Mark has been responsible for overseeing the transition to non-lawyer investment in legal practices. However, it is important to note that he considers that there is an irreconcilable conflict only where law firms choose to publicly list on the ASX. At the present time, the overwhelming majority of incorporated Australian law firms have decided not to take this step and are closely monitoring who they allow to invest in their legal practice.

53 Slater and Gordon Prospectus <<http://www.slatergordon.com.au/docs/prospectus/Prospectus.pdf>> (at 24 July 2007).

54 The author appreciates that this consideration must be weighed against the interests of the public who rely on the probity and competence of lawyers.

55 Steven Mark and Molly Hutcherson suggest that the absence of "true" incorporation provisions in several Australian States has contributed to the slow movement towards "true" incorporation by large inter-state firms. Mark and Hutcherson, "New Structures for Legal Practices and the Challenges they bring for Regulators" (Speech delivered at the 14th Commonwealth Law Conference, London, September 2005).

56 As at September 2005, there were 452 incorporated legal practices in existence in New South Wales. Mark and Hutcherson, *supra* note 55, 3.

57 Legal Profession Act 2004 (NSW), s 162(2).

58 Mark and Cowdroy, *supra* note 22, 679.

V THE MODERN NATURE OF LEGAL ETHICS

The Obligations of a Solicitor

1 Tortious and Equitable Obligations

The relationship between a lawyer and his or her client is characterized by overriding duties of loyalty, frankness and confidence owed by the lawyer.⁵⁹ These obligations are derived from the fiduciary relationship that exists between a lawyer and his or her client. Such relationships are often marked by an imbalance of power, vulnerability of the client and an assumption that the lawyer will act in the best interests of the client. At a more practical level, the fiduciary relationship requires lawyers to:⁶⁰

- avoid conflicts of interest between the client and himself or herself, former clients or existing clients;
- not make a personal gain (aside from professional fees) from the relationship;
- disclose all matters to the client that are material to the client's interest;
- maintain all information disclosed or gained in the course of the relationship as confidential; and
- account for all monies held on behalf of the client.

It is important to note that in addition to these fiduciary obligations, a lawyer will also be bound by a tortious duty of care. As part of this duty, lawyers are required to exercise a reasonable degree of care and skill when advising clients.⁶¹ While the tortious duty is expansive and fact specific, it can include consulting with clients on all questions of doubt that do not fall within the lawyer's authority, keeping the client informed to a reasonable extent and complying with reasonable requests from clients in regard to their affairs.⁶²

The fiduciary and tortious obligations owed by a lawyer to his or her client must be considered to be of the utmost importance irrespective of any changes that occur to the practical structure of the legal profession. Those who utilize the services of lawyers are usually vulnerable in terms of their lack of legal skill and knowledge.⁶³ Moreover, due to the nature of the work undertaken, many clients are unable to determine whether their lawyer has handled their affairs with proficiency and care, and thus rely

59 Webb, *Ethics, Professional Responsibility and the Lawyer* (1st ed, 2000) 150.

60 Dal Pont, *Lawyers Professional Responsibility in Australia and New Zealand* (1st ed, 1996) 115.

61 *Bannerman Brydone Folster & Co v Murray* [1972] NZLR 411, 429.

62 *Groom v Crocker* [1939] 1 KB 194, 222.

63 Rickett, "Legal Ethics in General Practice" in Legal Research Foundation (ed), *Legal Ethics* (1994) 42.

upon the lawyer to take their fiduciary and tortious duties seriously. While elements of the legal profession are becoming increasingly successful in their push for commercialization and deregulation, it is critical that this shift does not come at the expense of ethical and professional obligations.

The Issue of Causation

By choosing not to implement the “true” New South Wales model of incorporation for law firms, Parliament and the Law Society have impliedly considered that allowing “true” incorporation would have the effect of diminishing these fundamental professional values. The risk that allowing “true” incorporated legal practices would see the legal system overtaken by commercial and business values is one that has been deemed to be too great for 160 years. Subsequently, it appears that Parliament was content to assume a continued causal connection between “true” incorporated legal practices and persuasive ethical concerns.

However, it is not clear that this causal assumption is necessarily correct. The fundamental issue to be examined is whether law firms that incorporate become more business-like, or whether incorporation is an issue because lawyers and their clients already treat legal practice as a business.⁶⁴ Christine Parker argues that regardless of whether “true” incorporated legal practices are permitted or not, the ethical dangers that are associated with incorporation already exist in legal practice.⁶⁵ Thus, rather than worrying about how to separate law from the corrupting influences of commerce, the incorporation debate represents an opportunity to spread the ethical standards associated with proper legal practice into the increasingly dominant business-like legal practice structures.⁶⁶

The Modern Legal Practice

1 The Modern Legal Practice

Commentators have suggested that the conditions under which many practitioners now practise closely resemble those of their corporate clients. Professor Charles Rickett considers that although larger law firms have been limited to the “body” of a partnership business structure, the “mind” of such firms is that of a corporation.⁶⁷ Law firms compete with each other for the most lucrative work, the brightest legal talent and promote intense competition for advancement within the firm itself.⁶⁸ A lawyer’s success is often measured by productivity, which creates significant pressure to bill

64 Parker, *supra* note 5, 357.

65 *Ibid* 357-358.

66 *Ibid* 380.

67 Rickett, *supra* note 63, 53.

68 *Ibid* 53.

large units of time to clients. Indeed, most national firms have implemented billing systems where firms charge their lawyer's time to clients in six minute units. A survey of over 2000 lawyers in New South Wales and Victoria that focused on the nature of law firm management concluded that law firms:⁶⁹

[H]ave a preoccupation with billable hours, budgetary targets and fees billed ... there is a fixation with quantitative measurement along a single financial dimension of a business — revenue. These findings suggest that in many instances the profitability of a legal services business is understood and pursued primarily in terms of getting more money by sending out bigger and bigger bills.

2 *Where Does the Problem Lie?*

In his 1995 presentation to the Legal Research Foundation, Professor Charles Rickett was highly sceptical of the ability of large law firms to balance ethical responsibilities with the pursuit of profit. Rickett suggested that junior lawyers within large organizations struggle to accept that they are in a position of personal responsibility to clients whom they rarely, if ever, have contact with.⁷⁰ In addition, Rickett noted that due to the bureaucratic nature of larger firms, it is difficult to “set one's agenda, even when one moves towards the top of the ladder”.⁷¹ This environment is likely to hinder the exercise of independent ethical judgment, and permit the dominant consideration of billable hours to supersede any ethical misgivings. To this end, Rickett concluded that there is “need for radical redefinition of the ethic of the professional lawyer”.⁷²

(a) Case Study One: *Law Society of New South Wales v Foreman*⁷³

Carol Foreman was a family law practitioner operating within the partnership structure of the large Australian firm Clayton Utz. Foreman forged a time sheet that was to be used as evidence in the Family Court as part of a costs recovery action against a client. She forged the time sheet in order to add weight to her assertion that she had given the client a costs agreement at the beginning of the engagement. If the court had failed to accept that there had been a costs agreement, Clayton Utz would probably have been unable to recover its fees of more than A\$500,000 for acting in the divorce application.

The fee charging policy of Clayton Utz was based on a model that

69 Herron et al, *Facing the Future: Gender, Employment and Best Practice Issues for Law Firms. Volume 1: The Job Satisfaction Study* (1996) 60.

70 Rickett, *supra* note 63, 53.

71 *Ibid* 54.

72 *Ibid* 53.

73 (1994) 34 NSWLR 408.

expected every division of the firm to collect fees at a level the firm collected from one of its largest clients, the Tobacco Institute. Unsurprisingly, the Tobacco Institute accumulated substantial legal bills on a regular basis, yet had no difficulty settling its account with the firm at the end of every billing period. It seems grossly unfair on the part of Clayton Utz to expect a family law practitioner like Foreman to conform to a business model based on the defence of a tobacco company in civil litigation. Family law disputes usually require significantly less resources than litigation involving multinational corporations, and thus result in lower fees being charged to the client. Moreover, the client in the *Foreman* case would ultimately bear the tremendous financial cost of Clayton Utz's fee charging model. Kirby P commented that "it seems virtually impossible to credit that legal costs in a dispute between a married couple ... could properly run up to the figures that are mentioned here [in excess of \$500,000]".⁷⁴

The *Foreman* case is an example of how the "true" incorporation of legal practices is unlikely to dramatically alter the business-orientated models adopted by many legal practices today. Whether Clayton Utz operated as a partnership or a "true" incorporated legal practice would not have made any difference to the firm's commercially-orientated billing policy or the decision of Carol Foreman to forge time sheets. Indeed, the corporate model adopted by Clayton Utz for the management and operation of its legal practice in the *Foreman* case had been in place for many years. As law firms have continued to grow in size and scope since this time it is likely that the influence of commercial practices on law firms has become even greater.

(b) Case Study Two: Russell McVeagh

A further and more recent example of the undeniably commercial nature of modern legal practice can be seen in the prominent New Zealand law firm, Russell McVeagh. The firm's Chief Executive Officer, Gary McDiarmid, insists that Russell McVeagh's partners are "parity zealots" who share profits equally rather than on an "eat-what-you-kill" basis.⁷⁵ As such, the partner who commands the highest level of legal fees has a vested interest in the reasons why lower-performing partners are unable to bring the same level of fees into the partnership.⁷⁶

Russell McVeagh's response to the recent shrinking of the New Zealand legal market has been to discard partners who have been performing at the lower end of the financial scale. From a maximum of approximately 60 partners in the late 1990s, the partnership at Russell McVeagh had dropped to 38 in June 2007, with less profitable divisions such as equity and trusts

⁷⁴ Ibid 422.

⁷⁵ Matt Philp, "Hard Times on Mahogany Row" *Metro*, Auckland, New Zealand, July 2004, 47.

⁷⁶ Deborah Hill Cone "Law Firms Adapt to New Environment" *The National Business Review*, Auckland, New Zealand, 4 August 2006) 22-23.

ceasing to exist at the firm.⁷⁷ Furthermore, during this period of massive partner reduction, the firm employed approximately fifty new lawyers in order to increase its partner-to-lawyer gearing ratio to approximately one to six.⁷⁸ This is consistent with Marc Galanter and Thomas Palay's assertion that firms placing a strong emphasis on profitability will seek to redefine their leveraging model.⁷⁹ By increasing the number of salaried employees, partners are able to profit by charging out the employees at a significantly higher rate than the firm will pay its employees in their often generous salaries.

These relatively recent decisions by Russell McVeagh should not be considered unique or isolated to a small number of national firms. Instead the Russell McVeagh situation is clearly representative of the notion that while New Zealand law firms have an overriding interest in providing quality legal advice, the consideration of profit remains very important in the minds of many partners.⁸⁰ This trend suggests that legal practices are treated as businesses, with firms anxious to reduce unnecessary costs that detract from the income to be divided amongst the firm's partners.

The Choices Facing Parliament and the Legal Profession

1 The Status Quo

As this trend is likely to become more prevalent in the future, Parliament and the legal profession itself will be faced with a choice. First, we can continue with the idea that as legal practice is a profession, restrictive practices that seek to protect legal professionals from the forces of commerce should be continued with. Many within the legal profession appear to presume that if commercial elements and frameworks were recognised, as has occurred in New South Wales, any possibility of achieving satisfactory ethical conduct in legal practice would be impossible.⁸¹ However, these ideals are simply no longer a reality for many within the legal profession. Numerous economic studies of the professions have found that professionals share the same profit-maximizing interests as those working in vocations.⁸² By refusing to even properly consider the New South Wales model of "true" incorporation, it seems that Parliament is content to cling to these slightly naïve ideals.

77 Philp, *supra* note 75, 46.

78 It must also be noted that a significant number of partners have left Russell McVeagh of their own accord to practise at the bar or establish high-end specialist practices such as Mayne Wetherell and Harmos Horton Lusk.

79 Galanter and Palay, *Tournament of Lawyers: Transformation of the Big Law Firm* (1991).

80 Philp, *supra* note 75, 46. Philp discusses the efforts of one large Auckland firm who sent a delegation of partners to pitch for a major corporate's legal business dressed in the potential client's livery.

81 Parker, *supra* note 5, 366.

82 First, "Competition in the Legal Education Industry" (1978) 53 NYUL Rev 311, 332.

2 *The Entwinement of Law and Commerce*

Alternatively, we could face the reality that modern law firms are regularly subjected to commercial pressures such as those in the examples of *Foreman* and *Russell McVeagh*. While this modern trend towards muddying the waters between law and commerce may not be universally welcomed, it is counter-productive to ignore this development. Rather than continuing to impliedly assert that market values have not entered the legal profession, we should begin to tailor regulation of the legal profession to the commercial environment within which it now exists. In particular, greater regulatory guidance must be offered as to how lawyers should reconcile their various professional responsibilities with the demands of competition.

The commercialization of legal practice, signified by the allowance of “true” incorporation in New South Wales, represents a real opportunity for a revision of the way in which the legal profession is regulated. It is becoming increasingly clear that it is no longer appropriate to use business structures as the dominant method of regulating legal practice.⁸³ Instead, greater responsibility should be placed on lawyers and their firms to ensure that they meet professional standards, regardless of the business structure within which they choose to practise. This sentiment is shared by Russell G. Pearce:⁸⁴

In the end, the so-called decline of law firms from a profession is not a problem. Rather, it is an opportunity to take a dramatic step to improve the delivery of legal services and make our legal system more just.

Ethics in the Legal Profession

1 The Focus on the Individual

This article has advanced the view that forces of commerce have become increasingly prevalent in the legal profession, regardless of the business structure employed by legal practices. Consequently, the commercially driven ethical dilemmas that arise for normal businesses will likely become even more of a reality that the legal profession must confront. While lawyers are bound by strict tortious and equitable duties to their clients, the increased emphasis placed on profit by sectors of the legal profession will inevitably place lawyers in more difficult situations than in the past. The challenge for the legal profession and those who seek to regulate it is to implement a regulatory framework that has relevance to the modern practice of law, together with reconciling the tension existing between ethics and profit. In an age of incorporated law firms, in-house

83 Shaw, *supra* note 7, 68.

84 Pearce, “Face the Facts: Law is Business” (1996) 19 (12) *Nat'l LJ* 19.

counsel, and close entwinement between law and commerce, it should not necessarily be presumed that established regulatory systems will be able to resolve this tension. This article seeks to assert that the best way to resolve this tension in the legal profession is to implement a greater focus on ethical responsibility within the law firm as an entity. This idea represents a dramatic shift away from the tradition of placing ethical responsibility solely on individual practitioners.

Professional regulation in common law legal systems has historically placed ethical responsibility on individual lawyers rather than the firm within which they practise. New Zealand has been no different in this respect. The Law Practitioners Act 1982 and Rules of Professional Conduct place an obligation on practitioners to act according to accepted ethical standards. A failure to meet these standards under the Law Practitioners Act 1982 had the potential consequence of the responsible lawyer having his or her name struck off the roll by the High Court.⁸⁵ Significantly, there was no scope for discipline to be taken against a firm that had expressly or impliedly encouraged a breach of professional standards. The Rules of Professional Conduct share a similar focus on the responsibility of individual practitioners rather than firms. The approach of the Rules of Professional Conduct is best expressed by the foreword to the Rules themselves. This passage states that “the preservation of the integrity and reputation of the profession is very much a matter for individual members”.⁸⁶

2 *The Lawyers and Conveyancers Act 2006*

The Lawyers and Conveyancers Act 2006 has continued to place primary responsibility for ethical conduct on individual lawyers, while slightly increasing the scope for legal practices themselves to be the subject of sanctions. For example, individuals can now make a complaint about either an individual practitioner or an incorporated law firm to the Standards Committee.⁸⁷ While there is no provision for an order that an incorporated law firm be prohibited from operating, the Standards Committee does have the power to order fines of up to \$15,000 against a law firm or require the owners of the law firm to take advice in relation to its management.⁸⁸

3 *Criticisms of the Status Quo*

(a) Ignoring the Roles of Firms

This individual-focused approach to ethical regulation of the legal profession has been criticized for three reasons by theorists suggesting that

85 Law Practitioners Act 1982, s 92.

86 *Rules of Professional Conduct for Barristers and Solicitors*, supra note 3.

87 Lawyers and Conveyancers Act 2006, s 132.

88 Lawyers and Conveyancers Act 2006, s 156.

a dramatic change in the direction of ethical regulation is required.⁸⁹ First, as has been outlined above, the long-standing approach of common law legislatures to legal regulation has been that only individuals should be the subject of obligations and discipline. While this is entirely appropriate for sole practitioners or even small partnerships, it ignores the pressure that modern law firms place on lawyers, which can cause acts of ethical misconduct. If the owners of profit-driven law firms choose to expressly or impliedly put commercial pressure on their employees, it is unrealistic that the firm should not itself be subject to the adverse consequences of this pressure.

(b) The Changing Nature of the Profession

Secondly, substantive conduct rules for practitioners continue to rest on the traditional assumption that business practices should not influence the practice of law. Legislatures and many commentators continue to hold the view that if elements of business were permitted in legal practices, ethical standards would deteriorate to a level akin to ‘arm’s length’ business ethics. While restrictions have been lifted in recent years in relation to the prohibition of advertising and prescription of the content of premises signage, Parliament and the Law Society have not properly addressed how lawyers should deal with the substantive tension that can exist between ethical duties and commercial considerations.⁹⁰

(c) The Illusory Threat of Joint and Several Liability

Thirdly, the legislative response to the undeniable influence of commerce within the legal profession has been to continue to restrict legal practice to partnership form. By using business structure as a method of ethical regulation, a system has been created where partners are theoretically accountable to one another owing to the existence of joint and several liability. This article has already asserted that the threat of joint or several liability is largely illusory for partners who transfer their assets to trusts or spouses, while joint monitoring of work is also seldom carried out for practical reasons.⁹¹ Christine Parker considers that the focus on the partnership structure may have stultified development of other forms of regulation that may “promote entity responsibility better or more appropriately”.⁹² In this respect, it is clear that the individually-focused legal ethics framework in this country is in need of revision.

89 Wilkins, “Everyday Practice is the Troubling Case: Confronting Context in Legal Ethics” in Sarat et al (eds), *Everyday Practices and Trouble Cases* (1998) 68.

90 Webb, *supra* note 59, 22.

91 Ramsay, *supra* note 9.

92 Parker, *supra* note 5, 366.

The Alternative of “Meta-Regulation”

1 *Creating an Ethical Infrastructure*

Calls for an alternative approach to legal ethics in the modern commercialized legal profession can be traced back to the early 1990s.⁹³ This sentiment has been seized upon by Elizabeth Chambliss and David Wilkins in recent years, who have argued that because lawyers are increasingly practising in large, profit-driven firms, professional regulation depends on structural controls within firms such as conflict avoidance systems, internal reporting procedures and billing guidelines.⁹⁴ Ted Schneyer has expressed a similar belief:⁹⁵

A law firm’s organisation, policies, and operating procedures constitute an “ethical infrastructure” that cuts across particular lawyers and tasks. Large law firms are typically complex organisations. Consequently, their infrastructures may have at least as much to do with causing and avoiding unjustified harm as do the individual values and practice skills of their lawyers.

The approach to ethical regulation taken by Chambliss, Wilkins and Schneyer represents a marked departure from the present individually focused ethical framework of the legal profession. By placing greater emphasis on the responsibilities of the firm, they seek to address the structural pressure that contributes to individuals acting unethically. A prime example of this pressure for which the individual lawyer was ultimately punished was the *Foreman* case detailed in Part V of this article. While it is clear that striking Carol Foreman from the roll was completely justified, Chambliss, Wilkins and Schneyer would likely argue that Clayton Utz should also have been sanctioned for fostering an environment that contributed to such behaviour. Moreover, their respective theories would suggest that had Clayton Utz instituted greater internal ethical control, the possibility of a *Foreman* type scandal would have been dramatically reduced in the first instance. While there is no doubt that individual practitioners should continue to be subject to existing personal ethical obligations and discipline, this should be considered a response akin to an “ambulance at the bottom of the cliff”. Internal compliance systems provide a real opportunity to ensure that *Foreman* type situations can only occur where a practitioner deliberately circumvents the protective arrangements put in place by firms.

This “meta-regulation” of ethical and professional responsibilities is

93 Schneyer, “Professional Discipline for Law Firms?” (1991) 77 Cornell L Rev 1.

94 Chambliss and Wilkins, “A New Framework for Law Firm Discipline” (2003) 16 Geo J Legal Ethics 335, 337–338.

95 Schneyer, *supra* note 93, 10.

becoming increasingly commonplace in the commercial world.⁹⁶ The idea behind meta-regulation is that firms implement internal controls, procedures and cultures for complying proactively with professional conduct and ethical obligations.⁹⁷ The ultimate goal is to ensure that responsible law firms, like responsible individuals, have “an inner commitment to moral restraint and aspiration”.⁹⁸ These steps are designed to act as a foil to the commercially derived pressure that can have the effect of encouraging unethical conduct by individual practitioners. Many non-legal commercial businesses have embraced the concept of meta-regulation by establishing ethics committees and providing ethical training for employees amongst other measures.⁹⁹ Given that legal ethics should assume greater importance than business ethics, it makes sense for the legal profession to follow this trend of greater internal provision for ethical considerations.

Chambliss and Wilkins have taken the concept of meta-regulation one step further by proposing that all law firms, regardless of size, be required to designate one or more partners to be responsible for monitoring the firm’s ethical infrastructure.¹⁰⁰ Law firms would be legally obligated to take this role seriously, and encouraged to compensate the partner fulfilling this position at a level identical to other partners practising within the firm.¹⁰¹ While this is not a compulsory requirement in the United States, anecdotal evidence suggests that a number of larger firms have appointed “conflicts czars” who serve full-time as in-house ethics advisors.¹⁰² While the comparatively small nature of New Zealand firms makes this possibility distinctly unrealistic, there is no reason why firms cannot require one of their partners to take part-time responsibility for the ethical compliance aspect of the firm.

2 *Meta-Regulation Within the Legal Profession*

Despite this anecdotal example, a recent study of law firms in the United States established that the vast majority of firms have inadequate structural control of ethical matters, and are content to delegate responsibility for ethical conduct to individual practitioners.¹⁰³ For example, only 40 per cent of respondents to the survey noted that their firms have formal billing guidelines, while over one quarter had never received any billing guidelines

96 The term “meta-regulation” was first coined in Parker, *The Open Corporation: Effective Self-Regulation and Democracy* (2002).

97 Parker, *supra* note 5, 367.

98 Selznick, *The Moral Commonwealth: Social Theory and the Promise of Community* (1992) 345.

99 Parker and Connolly, “Is there a Duty to Implement a Corporate Compliance System in Australian Law?” (2002) 30(4) *ABLR* 273.

100 Chambliss and Wilkins, *supra* note 94, 345.

101 *Ibid* 345.

102 Hricik, “Uncertainty, Confusion and Despair: Ethics and Large Firm Practice In Texas” (1997) 16 *Rev Litg* 706.

103 Fortney, “Soul for Sale: An Empirical Study of Associate Satisfaction, Law Firm Culture and the Effects of Billable Hours Requirements” (2000) 69 *UMKC L Rev* 239

upon joining the firm.¹⁰⁴ Moreover, only 10 per cent of firms surveyed had formal procedures for reviewing the work of partners.¹⁰⁵ While no formal study has been undertaken in respect of internal ethical safeguards put in place by New Zealand law firms, there is little evidence to suggest that voluntary meta-regulation is taking place on a scale that is likely to provide real benefit to the legal profession and its clients. It is therefore submitted that at least some elements of meta-regulation should be made compulsory for all legal practices in this country.

3 New South Wales Experience with Meta-Regulation

As a counter-balance to its decision to permit “true” incorporated legal practices, the New South Wales legislature has embraced the concept of meta-regulation in respect of the legal profession. While individual responsibility for ethical and professional obligations remains a cornerstone of the New South Wales profession, there has been greater recognition that profit-oriented law firms are often contributors to the misconduct of individual lawyers. To this end, incorporated legal practices in New South Wales are required to appoint at least one “legal practitioner director” who is compelled to ensure that the practice, its directors, and its employees comply with all legal and professional requirements in relation to the legal practice.¹⁰⁶ Moreover, legal practitioner directors must also ensure there are “appropriate management systems” within the firm to ensure that these legal and professional requirements can be met.¹⁰⁷

According to the New South Wales legislation, it is possible that a legal practitioner director could potentially be found guilty of unsatisfactory professional conduct for the misconduct of an individual lawyer if the misconduct could be partially attributed to the shortcomings of the firm.¹⁰⁸ However, the New South Wales Legal Services Commissioner, whose office is responsible for enforcing these obligations, notes that he would be loath to enforce liability in this situation owing to the absence of mens rea from the legal practitioner director.¹⁰⁹ Instead, the aim of the legislation is to force the legal practitioner director to ensure that the firm places a strong emphasis on ethical responsibility. If a legal practitioner director was not satisfied that his or her firm was complying with its ethical responsibilities, they could offer their resignation from the position. This would force the firm to either alter its behaviour or risk losing its licence to practise if it failed to appoint a new legal practitioner director within seven days.¹¹⁰

104 Ibid 253.

105 Fortney, “Are Law Firm Partners Islands Unto Themselves? An Empirical Study of Law Firm Peer Review and Culture” (1997) 10 *Geo J Legal Ethics* (1997) 271, 290.

106 Legal Profession Act 2004 (NSW), s 140(1).

107 Legal Profession Act 2004 (NSW), s 140(3).

108 Legal Profession Act 2004 (NSW), s 719.

109 Mark and Cowdroy, *supra* note 22, 687.

110 Legal Profession Regulation 2002 (NSW), cl 37.

While there has been little legislative guidance offered as to what amounts to “appropriate management systems” in the context of a legal practice, the Legal Services Commissioner has issued a list of “ten commandments” that his office seeks to encourage and monitor.¹¹¹ These include the adequate supervision of employees, implementation of systems to identify and deal with conflicts of interest, and appropriate safeguards for the firm’s trust account. Moreover, it appears that the New South Wales meta-regulatory experience is proving to be successful. Statistics suggest that practitioners employed by incorporated legal practices are less likely to be the subject of consumer complaints than sole practitioners or lawyers employed by partnerships.¹¹² Unsurprisingly, Steven Mark and Molly Hutcherson of the New South Wales Legal Services Commissioner’s Office believe that the mandatory implementation of “appropriate management systems” by legal practitioner directors within incorporated legal practices is responsible for this significant trend.¹¹³

The increased emphasis placed on meta-regulation in New South Wales has proven to be successful in coexisting beside the traditional individually-focused ethical model. The New South Wales legislature has accepted that law firms are often guilty of impliedly encouraging ethically dubious behaviour in the pursuit of profit, and thus places an obligation on firms to ensure that internal systems are put in place to minimize the risk of this occurring. However, while the rationale behind this legislation is undoubtedly well-intentioned, the model put in place to execute it could be further refined. The fundamental concern with the New South Wales regime is its focus on individual responsibility in contrast to responsibility placed on an incorporated firm as an entity. The model is based solely around the legal practitioner director who assumes ethical responsibility on behalf of the firm and is thus subject to penalty for the deficiencies of the firm.

In this respect, it seems clear that the New South Wales Legislature has not been prepared to break completely from the traditional individually focused ethical framework of the legal profession. This is in accordance with the Law Council of Australia’s long-standing policy:¹¹⁴

The regulation of legal practice should focus on ensuring that individual lawyers comply with ethical standards and professional duties rather than on the regulation of business entities. The Law Council ... considers that the regulatory regime should be directed to individual lawyers.

111 Mark and Hutcherson, *supra* note 55, 7-8.

112 *Ibid* 11.

113 *Ibid*.

114 Law Council of Australia, *Policy Statement on Lawyers’ Business Structures* (2001), Law Council of Australia Website <<http://www.lawcouncil.asn.au/get/policies/2067361651/0.pdf>> (at 24 July 2007).

4 *Taking Meta-Regulation a Step Further*

In contrast, Christine Parker considers it “odd” that there is no possibility for a penalty against an incorporated legal practice as an entity, in light of her observation that inappropriate management systems do contribute to misconduct by a firm’s practitioners.¹¹⁵ Parker points to the recent example of the Queensland firm Baker Johnson, whose billing practices came under scrutiny by the Queensland Law Society.¹¹⁶ The firm was alleged to routinely overcharge, advertise misleading “no win, no fee” agreements, and offer legal advice by unqualified people. The result of the investigation was the suspension of one individual from legal practice for holding himself out as a qualified lawyer, but nothing more than a stern rebuke for the firm. It is difficult to accept that Baker Johnson should assume no responsibility for its management systems, which permitted this conduct to occur. Despite this recommendation, no Australian state has considered that firms themselves should be subject to disciplinary action.

While some may consider it unduly onerous for law firms as entities to face the prospect of penalty for failing to provide adequate ethical infrastructure, the author considers that these costs are outweighed by their benefits. Consumers of legal services will receive an added layer of protection in addition to the existing deterrents that seek to discourage individual lawyers from acting unethically. Owners of legal practices, including non-lawyer shareholders in New South Wales practices, will have a financial interest in ensuring that the firm avoids being sanctioned for failing to provide for adequate management structures. This would deter aggressive non-lawyer shareholders from pressuring lawyers to relegate their ethical and professional duties in the pursuit of profit. Moreover, the legal practitioner director established in the New South Wales jurisdiction will not assume sole responsibility for his or her firm’s failure to comply with professional standards. This places an onus on everyone working within the firm or investing in the firm to avoid the possibility of either individual liability or liability for the firm as an entity.

115 Parker, *supra* note 5, 374.

116 *Ibid* 375.

VI CONCLUSION

An examination of New Zealand's legislative history reveals that Parliament chooses to grapple with the regulation of the legal profession very irregularly. If historical trends prove to be consistent, the legal profession can expect a new Act to be put in place by approximately 2031. The purpose of each piece of legislation is to ensure that the framework governing the legal profession retains relevance in light of the changing perceived needs of the legal profession. In a world that is increasingly characterized by freer markets and globalization, Parliament has been required to carefully consider the future course of the profession in this country.

While it is acknowledged that the Lawyers and Conveyancers Act 2006 has ushered in several changes that will likely prove to be of significance, the stance taken in respect of legal practice structure can generously be described as conservative. Parliament should be lauded for recognizing that the partnership structure has lost some of its relevance as a tool for regulating the legal profession. However, it is not clear that artificially incorporated law firms provide an appropriate long-term solution to the problem. Regardless of whether or not firms choose to take advantage of incorporation, the majority are likely to continue to treat legal practice as a profit-oriented commercial venture.

It is submitted that a more realistic and beneficial option would have been to follow the lead of the New South Wales legal profession in permitting legal practices to enjoy the benefits of "true incorporation". This would be tempered by a qualification similar to that in the Institute of Chartered Accountants Act 1996, requiring the majority of vote-conferring shares to be held by practitioners actively involved in the practice. This would enable legal practices to seek additional equity capital from non-lawyer sources, allowing greater opportunity for expansion and increases in efficiency. Concerns of commercially minded non-lawyer investors dominating the legal practice would be alleviated by the restriction requiring all significant decisions to be made by a majority of actively involved lawyers.

Critics would argue that permitting legal practices to incorporate with minimum restrictions would be to encourage a further deterioration of ethical standards within the profession. Non-lawyer investors who are free from fiduciary obligations may, for example, exert undue commercial pressure over practising lawyers. These concerns are convincing and represent a real challenge to regulators in "true" incorporation jurisdictions such as New South Wales. Indeed, the author argues that the regulatory provisions of the Lawyers and Conveyancers Act 2006 are ill-equipped to cope with the undoubted influence of commerce in law.

Rather than ignore this influence as Parliament has largely chosen to do, a modern and pragmatic solution is required. This can be found

by looking to the New South Wales jurisdiction where there has been recognition that placing ethical responsibility on legal practices is now the most appropriate method of maintaining ethical standards within the legal profession. By creating a system that maintains traditional individual ethical obligations and introduces compulsory internal meta-regulation, the inherent tension between profit and ethics can be reduced. Values that are crucial to the integrity of the legal system will become institutionalized within law firms. Moreover, rather than existing as one of the main contributors to individual ethical misconduct, law firms will be forced to implement systems that act as a bulwark against misconduct. In this regard, law firms have the potential to be the solution rather than the problem.