

No Other “Alternatives”:
Why Canadian Legal Regulators Must Adopt an Alternative
Business Structure Model

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The legal regulators in Canada have maintained a prohibition on non-lawyer ownership of law firms, otherwise known as “Alternative Business Structures.” The conventional justification for this prohibition focuses on the preservation of ethical lawyering. Supporters of the prohibition state that by permitting Alternative Business Structures, lawyers practicing in these business models would be forced to consider a new duty to their shareholders while practicing law. This new duty would necessarily be in unresolvable conflict with a lawyer’s two recognized duties to the client and to the court. The conflict between these three duties would make it very challenging, if not impossible, to effectively regulate lawyers and to preserve ethical lawyering.

Conversely, critics of this prohibition have loudly complained that an outright ban on Alternative Business Structures is nothing more than a thinly veiled attempt at maintaining protectionist policies. The continued failure to allow non-lawyer ownership is stymieing innovation in the legal industry, perpetuating barriers to access to justice, and preventing law firms from adopting business practices that make sense.

This paper promotes the viewpoint that the Law Society of Upper Canada and its sister regulators in other Canadian jurisdictions should permit non-lawyer ownership and other Alternative Business Structures. First, the global legal market is rapidly changing, and innovative business structures will allow for innovation, and most importantly, domestic and global competitiveness. Secondly, regulatory reform can address the valid ethical concerns raised by critics of these structures. Finally, this paper will draw parallels to the end of self-regulation in Australia and the UK to show that the Law Society’s continued failure to authorize business practices that benefit the consumer and promote access to justice calls into question its ability to regulate in the public interest. This may put the Law Society’s self-regulatory mandate at stake.

Through these arguments, I aim to show that the introduction and regulatory approval of Alternative Business Structures is the only logical choice before the Law Society of Upper Canada and the other Canadian legal regulators at this crucial juncture. There is no better time to introduce and approve Alternative Business Structures, and Canadian regulators should seize this opportunity.

Part I: The Rapidly Changing Global Marketplace

Moving Away From Leverage Financing

The current regulatory systems in Canada and the United States constrains the business practices of lawyers and law firms. These regulatory models prohibit law firms from enjoying sustainable and practical funding models, and they force law firms to rely on riskier methods such as leverage financing to obtain working capital. Both jurisdictions prohibit non-lawyer ownership of law firms. In Ontario, the Law Society of Upper Canada prohibits non-lawyer ownership of law firms under Rule 3.6-7 of the Rules of Professional Conduct:

3.6-7 A lawyer shall not

- (a) directly or indirectly share, split, or divide their fees with any person who is not a licensee, or
- (b) give any financial or other reward to any person who is not a licensee for the referral of clients or client matters.¹

In the United States of America, most jurisdictions regulate lawyers with instruments that are largely in line with the American Bar Association's *Model Rules of Professional Conduct*.²

The *Model Rules* contains similar prohibitions against non-lawyer ownership of law firms under

¹ Law Society of Upper Canada, *Rules of Professional Conduct*, Toronto: The Law Society of Upper Canada r 3.6-7 [*LSUC Rules*].

² American Bar Association, *Model Rules of Professional Conduct*, r 5.4 [*Model Rules*].

Rule 5.4.³ While, in the United States of America, it is ostensibly the judiciary of each state that regulates law firms, almost all regulators in the US incorporate a provisions based on this rule.⁴

In practice, these prohibitions force law firms to rely on very limited funding models. Most law firms obtain both their start-up and working capital through two means: equity shares sold to lawyers joining the partnership, and financing and leveraging work-in-progress. Both of these capital-raising strategies have serious inherent sustainability issues.

Partnership equity is the traditional model of law firm financing. At its simplest, the partnership model allows a lawyer to “buy-in” to a firm by handing over a determined sum of money. This sum of money, in turn, purchases the lawyer a certain percentage of the profits of the firm. Almost always, the law firm expects the new partner practice law under the umbrella of the firm. The firm distributes the accumulated profits according to equity points and other conditions as set forth in the partnership agreement. According to negotiated conditions contained in the agreement, or on agreement between members of the partnership, the partnership may retain some of the profits to provide for working capital, that is, money to float the firm’s operating expenses. At any time, and subject to any conditions within the partnership agreement, a partner may exit the partnership. If the partner were to do so, she would be entitled to recover her initial investment into the partnership. A sudden exodus of a handful of partners or an economic downturn could imperil the ability of a law firm to continue to practice law. This is precisely what happened in 2007 and 2008, when the global financial markets experienced the

³ *Ibid*, r 5.4.

⁴ Katherine H. Reardon “It’s Not Your Business: A Critique of the U.K. Legal Services Act of 2007 and Why Nonlawyers Should Not Own or Manage Law Firms in The United States” (2012) 40 *Syracuse J Int’l L & Com* 155 at 172-173.

worst financial crisis since the Great Depression.⁵ This financial crisis had global effects, involving bank failures in the United States, Europe, and Iceland. The global legal markets fared no better, and several venerable US firms have collapsed outright, such as Heller Ehrman LLP, Thacher Proffitt & Wood LLP, and Thelen LLP.⁶ Domestically, Canada witnessed the winding-up of Heenan Blaikie LLP, the largest law firm collapse in Canadian history.⁷

It was not simply a revenue problem that led to the collapse of Heenan Blaikie; it was a variety of problems, including an inability to “lock-in” working capital.⁸ Despite the fact that the firm was profitable in its final year, clearing profits of \$75 million, and billing \$37.5m during the month of December 2013, one of its best months ever, a sudden exodus of partners initiated a cash-crunch.⁹ Heenan Blaikie partner John Craig remarked: “So you’re in the process of trying to realign priorities, restructure the practices, restructure the offices in the various cities, and if everything had been stable you might have been able to turn the ship around, ...but you have too many people leaving at the same time.”¹⁰ This inability to “lock-in” any capital requires a firm to precisely balance exactly how much capital to reserve for operational needs and how much capital to pay out to its human assets. Reserving too much money may cause the firm’s partners to look for positions that are more lucrative; paying out too much capital to equity partners may

⁵ “Three top economists agree 2009 worst financial crisis since Great Depression; risk increase if right steps not taken”, *Reuters* (27 February 2009) online: Reuters <<http://www.reuters.com>>.

⁶ Erin J Cox, “An Economic Crisis is a Terrible Thing to Waste: Reforming the Business of Law for a Sustainable and Competitive Future” (2009) 27 *UCLA L Rev* 511 at 515-516.

⁷ Janet McFarland, Kathryn Blaze Carlson & Sean Fine, “Storied law firm Heenan Blaikie sunk by a shifting legal landscape”, *The Globe and Mail* (5 February 2014) online: The Globe and Mail. <<http://www.theglobeandmail.com>>.

⁸ Sandro Contenta, “How the Heenan Blaikie law firm collapsed”, *The Toronto Star* (8 February 2014) online: The Toronto Star <<http://www.thestar.com>>.

⁹ *Ibid.*

¹⁰ *Ibid.*

leave the firm in a difficult position to cope with unexpected turns in the business cycle, or the unexpected departure of a handful of partners.

Without an ability to lock in capital, and the market pressure to pay value-producing equity partners as much as possible, law firms have traditionally leveraged their work-in-progress in order to maintain the ability to function in lean times. However, as seen by the recent global economic downturn and the disastrous consequences to large and venerable, but highly leveraged firms in the legal industry, law firms are starting to realize the dangers of operating in a highly leveraged position.¹¹

With an ability to “lock-in” capital by selling equity shares of the firm to non-lawyers, either on the open market, or to private equity, law firms would have an ability to raise operating capital without the substantial risks inherent to leverage financing. This locked-in capital, aside from insulating firms from financial downturns and partner departures, will also allow firms to grow; or as explored more fully below, to develop innovative solutions to better compete in a global market.

Innovation and Competition in a Global Market

In the new economy, clients are becoming cost-conscious, and are demanding better value for their money; or “more for less.”¹² Some entrepreneurs have realized this business opportunity and are innovating to offer legal solutions at a cheaper price through disruptive technologies, such as Shelby Austin, founder of ATD Legal Services, an e-discovery legal process outsourcer. ATD Legal Services uses technology to highly routinize and commoditize the formerly labour

¹¹ Cox, *supra* note 6 at 520.

¹² Bruce MacEwen, “You Can’t Argue With 100 Years of Success: Navigating Beyond the Inflection Point” *Canadian Bar Association Legal Futures Initiative* (June 2013) at 9-10 online: Canadian Bar Association Legal Futures Initiative <<http://www.cbafutures.org>>.

intensive legal process of discovery, and is able to offer their services to clients at prices far below the traditional market rates as set by the traditional law large firms.¹³ One legal process outsourcer has remarked, “for every \$1.00 in revenue I gain, BigLaw loses \$3.00.”¹⁴ Deloitte ultimately acquired Austin’s ATD Legal Services in January 2014,¹⁵ which hampers ATD’s ability to practice law and provide legal advice.¹⁶ We can only speculate the reasons that drove ATD to yield to acquisition; but I submit that ATD had a thirst for capital to invest in further developing their disruptive innovations. Alternatively, it is possible that ATD wanted to bring an external, non-lawyer manager on as partner, in order to acquire project and business management skills at a level that are only available outside of the legal profession. MacEwan remarks in his report that:

Axiom, one of the first, smartest, and most aggressive, now has 900 employees, 200 of whom are not lawyers, and is taking senior executives from firms such as McKinsey, Amex, IBM, and Boston Consulting Group, to manage business process re-engineering in sophisticated ways¹⁷

One could only imagine the innovation and disruption ATD and similar service provides could provide to the actual provision of legal advice at actual market prices, should the Law Society of Upper Canada permit them to bring in outside non-lawyer capital or hire outside non-lawyer expertise at a partnership level.

Unfortunately, for Canadian incumbents in the legal marketplace, this innovation is already occurring in jurisdictions that have de-regulated ownership restrictions. Two examples in

¹³ See generally *ibid* at 10-11.

¹⁴ *Ibid* at 10.

¹⁵ Deloitte, News Release, “Deloitte acquires ATD Legal Services”, (20 January 2014) online: Deloitte Press Releases <<http://www2.deloitte.com/ca/en/pages/press-releases/>>.

¹⁶ If ATD continued to provide legal services, the Law Society of Upper Canada would likely view any lawyer working for them to be splitting their fees with Deloitte’s non-lawyer owners in violation of *LSUC Rules* r 3.6-7.

¹⁷ *Supra* note 12 at 11.

the United Kingdom are Probate Wizard, which utilizes technology to help individuals complete the legal steps in the probate process, and the RBS' Mentor Live, which provides online legal services to small and medium sized enterprises.¹⁸

As mentioned, legal process outsourcing is already occurring. Document review, due diligence, research, and e-discovery are being outsourced from large Bay Street firms and in-house departments at cut rates to Canadian and global service providers.¹⁹ Technology-assisted provision of legal advice is readily available on routine matters in jurisdictions that have deregulated ownership restrictions.²⁰ It is only a matter of time until increasingly cost-conscious North American clients begin to seek innovative and cost-efficient solutions to their justiciable issues through these technological means. In an increasingly globalized economy, where many legal issues are international in scope, those solutions do not necessarily have to come through Canadian law firms. The globalized economy will force Canadian law firms to adopt the same innovations their global competitors are pioneering. Failing to do so could prove to be disastrous:

Simply put, the vast majority [of commercial entities that fail to adapt to disruptive change] have ended up finding themselves caught flat-footed and unable to mount a timely, persuasive response, leading them to marginalization and irrelevance, followed by drastic shrinkage or, more commonly, outright failure.²¹

Unfortunately, though, under the current regulatory structure prohibiting non-lawyer ownership, law firms are not well equipped to innovate or implement disruptive technologies:

This hobbles producers of legal products and services with the triple weights of restricted expertise (lawyers are experts in law, not management), limited access to capital (the only assets are cash flow), and lack of diversification (partners who leave profits in the firm see their investments rise and fall on the basis of the success of this one firm). These

¹⁸ Richard Susskind, *Tomorrow's Lawyers: An Introduction to your Future* (Oxford: Oxford University Press, 2013) at 44.

¹⁹ Heather Timmons, "Outsourcing to India draws western lawyers", *New York Times* (4 August 2010) Online: [New York Times <http://www.nytimes.com>](http://www.nytimes.com).

²⁰ Susskind, *supra* note 18 at 44.

²¹ MacEwan, *supra*, note 12 at 13.

weights limit not only the growth of legal businesses, they stymie the potential for substantial innovation by ruling out innovations that require more sophisticated forms of financing.²²

External investments will not only help law firms succeed in an increasingly disrupted global market; it will also serve to benefit the individual consumer of legal services at what are truly market rates. It is no secret that Canada is facing an access to justice crisis. It is a tired joke that many lawyers themselves would be unable to afford their own services. The Supreme Court of Canada Chief Justice Beverley McLachlin has made the access to justice crisis in this country a priority item for the judiciary, calling the crisis “the most pressing challenge facing the administration of justice in this country.”²³ A recent empirical study of access to justice issues in Canada undertaken by Ab Currie indicates that of all Canadians facing “justiciable events”, only 11.7% of people acquired legal assistance with the aim of resolving that problem.²⁴ 22.1% of individuals with justiciable events in their life sought non-legal assistance and 44% attempted to handle the problem themselves.²⁵ Must shockingly, a full 22.2% *took no action whatsoever*.²⁶ Of those who took no action, 10% thought it would take too much time, and 6.4% thought it would cost too much.²⁷ Clearly, there is much room for improvement in these areas.

The fact that the legal profession in Canada is not serving 77.8% of people that could use its help is unsettling. However, it is *prima facie* evidence that there is an untapped market for lawyers to enter. Some lawyers in this country are entrepreneurially attempting to bridge this

²² Gillian K Hadfield, “Legal Barriers to Innovation: The Growing Economic Costs of Professional Control Over Legal Markets” (2008) 60 *Stan L Rev* 1689 at 1727.

²³ “Canada’s top judge slams ‘inaccessible justice’”, *CBC News* (18 August 2013) online: CBC News <<http://www.cbc.ca/news>> [*Inaccessible Justice*].

²⁴ Ab Currie, “The Legal Problems of Everyday Life: The Nature, Extent and Consequences of Justiciable Problems Experienced by Canadians” (2007) Department of Justice Report at 56, online: Department of Justice. <<http://www.justice.gc.ca>>.

²⁵ *Ibid.*

²⁶ *Ibid.*

²⁷ *Ibid.*

divide. For instance, Wal-Mart has just launched a legal pilot project, rolling out four in-store (lawyer-owned) legal centres in the Toronto area.²⁸ These legal centres (aptly named “Axess”) specialize in wills (\$99) and real-estate deals (\$1,288).²⁹ Co-founder Lena Koke remarks on the commoditization strategy Axess employs: “The type of law that we do right now are things that we can commoditize, that we know we can do perfectly, again and again. Similar to a Tim Hortons: You go to a Tim Hortons, you know you are going to get the same cup of coffee no matter where you go.”³⁰ Through significant investment in commoditizing certain legal functions, Axess can offer more for less, breaking into an untapped market.

Ironically, though, it was prospect that “... Sears & Roebuck will be able to open a law office” that put the final nail in non-lawyer ownership’s coffin when the American Bar Association considered the issue in 1984.³¹ In light of the access to justice issue in Canada, it seems the opposite may hold true. The access to justice implications of commoditized legal work being performed cost-effectively at large retail chains with significant market presence might be non-lawyer ownership’s saving grace.

Non-lawyer ownership could lead to a surge in increasing innovation and disruptive technologies in the legal market. While this will not only increase Canadian law firms’ competitiveness on a global scale, the increased domestic competition and innovation would stand to benefit the traditionally disenfranchised.

²⁸ Jeff Gray “Law Mart: Pick up a will with your TV at Wal-Mart” *The Globe and Mail* (19 November 2014) online: *The Globe and Mail* <<http://www.theglobeandmail.com>>.

²⁹ *Ibid.*

³⁰ *Ibid.*

³¹ Cox, *supra* note 6 at 528.

No Better Time than Now

As shown above, traditional business models relying on leverage financing are not conducive for driving competition in the marketplace. In fact, these financing models often leave both large and small law firms in precarious positions and exposed to the dangers of unexpected partner departures or economic downturns. Other jurisdictions have experimented with non-lawyer ownership of law firms, and through this outside investment of talent and capital, foreign law firms have been able to build practices on innovation. This global trend in regulation has ultimately increased the competition between law firms, and it is only a matter of time before Canadian clients start considering cheaper, international competitors for their legal issues. Some Canadian legal entrepreneurs have begun experimenting with offering commoditized legal work through technological advances; however, as shown by the case study of ATD Legal Services, if they wish to accept any form of outside investment (either capital or talent) to continue to innovate, the rules force them to stop providing legal services. The increased competition in the globalized economy as well as the pressing access to justice issues in this country dictate that we cannot wait any longer to allow outside investment.

Part II: Overcoming Ethical Challenges

Critics of non-lawyer ownership often indicate that even in spite of the benefits of increased innovation, competitiveness, and the access to justice implications, the ethical risks of allowing non-lawyers to have ownership stakes in law firms ultimately poses a serious risk to the continued ethical functioning of the profession. These critics are mostly concerned with the prospect of a lawyer in a non-lawyer owned firm placing the interests of the shareholders above the other traditional duties owed by lawyers. In order to understand the rationale behind this

criticism, it is necessary to explore the duties of the Law Society and the duties the Law Society imposes on lawyers.

The Duties of the Law Society, the Duties of the Lawyer, and How the Law Society Enforces its Mandate

The *Law Society Act*,³² the statutory instrument that sets out the regulation of the legal profession in Ontario, is explicit in giving the Law Society its mandate. Simply put, the Law Society of Upper Canada regulates lawyers with an eye to advancing the cause of justice and the rule of law, facilitating access to justice, and protecting the public interest.³³ The Law Society is to be timely, open, and efficient in doing so, and the standards and discipline imposed by the Law Society is to be proportional to the significance of the regulatory objectives.³⁴ In order to administer this three-fold objective, the Law Society enforces the *Rules of Professional Conduct*.³⁵ The *LSUC Rules* are broken down into six headings: Integrity; Relationship to Clients; The Practice of Law; Relationship to the Administration of Justice; Relationship to Students, Employees and Others; and Relationship to the Law Society and Other Lawyers. Should a lawyer violate any of these rules, the Law Society may place a variety of sanctions against her, ranging from a simple reprimand, to a fine not exceeding \$10,000, to an order revoking her license.

A simple glance at the aforementioned headings of the *LSUC Rules* indicates that the main objective of these rules and regulations are to protect the public from professional negligence and misconduct. Put another way, the rules and the penalties exist as a means for the

³² RSO 1990 c L.8

³³ *Ibid* ss 4.1(1), (2), and (3).

³⁴ *Ibid* ss 4.1(4) and (5).

³⁵ *Supra* note 1.

Law Society to ensure that lawyers practice law to a minimally acceptable ethical standard.

Through codified rules and a rigid enforcement schema, the Law Society lives up its their three-fold mandate of protecting the public, facilitating access to justice, and advancing the cause of justice and the rule of law.

These rules, above all, ensure that a lawyer under the Law Society's purview abides by the twin duties to the client and to the court.³⁶ The Law Society of Upper Canada has verbosely codified these two duties in the *LSUC Rules*³⁷. For instance, rule 2.1-1 states "A lawyer has a duty to carry on the practice of law and discharge all responsibilities to clients, tribunals, the public and other members of the profession honourably and with integrity."³⁸ Rule 2.1-2 states, "A lawyer has a duty to uphold the standards and reputation of the legal profession and to assist in the advancement of its goals, organizations and institutions."³⁹ Dubin JA, in *Re: Regina and Spied*, sums up these duties, and the necessary simultaneous respect for both:

Mr. Spied has a right to counsel. He has a right to professional advice, but he has no right to counsel who, by accepting the brief, cannot act professionally. A lawyer cannot accept a brief if, by doing so, he cannot act professionally, and if a lawyer so acts, the client is denied professional services. In the case of *United States of America v. Dolan* (1978) 570 F. 2d 1177 at p. 1184, the court stated: Accordingly, we hold that when a trial court finds an actual conflict of interest which impairs the ability of a criminal defendant's chosen counsel to conform with the ABA Code of Professional responsibility, the court should not be required to tolerate an inadequate representation of a defendant. Such representation...constitutes a breach of professional ethics and invites disrespect for the integrity of the court... Under such circumstances, the court can elect to exercise its supervisory authority over members of the bar to enforce the ethical standard requiring an attorney to decline representation.⁴⁰

³⁶ A duty to the court can also be considered a duty to uphold the administration of justice, or a duty to respect the rule of law.

³⁷ *LSUC Rules*, supra note 1.

³⁸ *Ibid* at r 2.1-1.

³⁹ *Ibid* at r 2.1-2.

⁴⁰ (1983) 8 CCC (3d) 18 (Ont CA) at paras 15-17.

It is clear from Justice Dubin's perspective that a lawyer must have a simultaneous respect for both, and that neither of these duties be placed above one another.

The Traditional Argument against Alternative Business Structures

The main concern regarding non-lawyer ownership or other Alternative Business Structures is that by permitting these structures, the Law Society would be introducing a third type of fiduciary duty, as lawyers must now consider their professional actions and the impact these actions have on the shareholders of their legal enterprises. This third duty, the duty to the shareholders, would necessarily be in conflict with these other duties. The drive to generate revenue to please the shareholders could cause lawyers to forego and concede their attorney-client privilege and confidentiality, relax their stance on accepting conflicts of interest, and compromise the objectivity of their professional judgment in the face of corporate ownership.⁴¹

Reardon, in her critique, notes that commentators raised these concerns in both Australia and The United Kingdom when these jurisdictions were considering regulatory non-lawyer ownership.⁴² State regulators, however, ultimately decided that introduction of further regulatory reforms could mitigate these otherwise valid ethical concerns. Reardon, in her critique, does not consider the regulatory measures employed by both Australia and the UK and their apparent success in mitigating these concerns.

The English and Australian Approach to Conflicting Duties

In order to mitigate these ethical concerns, both the United Kingdom and Australia have undertaken direct regulation of law firms, involving the mandatory implementation of "ethical

⁴¹ See generally Reardon, *supra* note 4 at 176-182.

⁴² *Ibid* at 167 - 168.

infrastructure” with an outcome-based orientation.⁴³ This differs from the mainly complaints-driven, rules-based, and lawyer-focused regulatory process in Canada.⁴⁴ The Law Society of Upper Canada does occasionally conduct both practice and financial audits to proactively ensure compliance with the rules, but the main enforcement mechanism is to reactively respond to complaints made by members of the public to ensure that individual lawyers have not breached the *LSUC Rules*, or if they have, to sanction them appropriately and proportionately.⁴⁵

The UK and Australian regulatory models, however, draw heavily on the “ethical infrastructure” formulation set out by Ted Schneyer in his seminal 1991 paper on the subject.⁴⁶ After identifying five incidents of ethical wrongdoing that are not attributable to one specific lawyer, but rather a firm culture, Schneyer argues for the implementation of an ethical infrastructure that becomes part of the firm’s culture and management systems: “Large law firms are typically complex organizations. 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.”⁴⁷

In the United Kingdom, the state regulator has turned away from a reactive, rules-based system that focuses on a lawyers compliance with codified rules – a system that closely resembled the current Canadian regulatory paradigm. Fortney notes that the newly installed regulator emphasizes an:

⁴³ Susan Saab Fortney “The Role of Ethics Audits in Improving Management Systems and Practices: An Empirical Examination of Management-Based Regulation of Law Firms” (6 January 2014) St. Mary’s LJ Symposium on Legal Ethics and Malpractice, 2014 Hofstra Univ. Legal Studies Research Paper, No. 2014-01 at 3-4.

⁴⁴ “The Future of Legal Services in Canada: Trends and Issues” *Canadian Bar Association Legal Futures Initiative* (June 2013) at 36, online: Canadian Bar Association Legal Futures <<http://www.cbafutures.org>>.

⁴⁵ *Ibid.*

⁴⁶ Ted Schneyer “Professional Discipline For Law Firms?” (1991) 77 *Cornell L Rev* 1.

⁴⁷ *Ibid* at 10.

[o]utcomes-based regulation that focuses on high-level principles and outcomes that drive the provision of legal services to consumers. The [UK regulatory rules] now require firms to appoint compliance personnel to oversee risk management and governance matters. ... In describing effective compliance arrangements the [regulatory body] urges solicitors to consider the “infrastructure” of the firm.⁴⁸

Similarly, in the Australian state of New South Wales, regulatory changes made it mandatory for any firm engaging in non-lawyer ownership to appoint a director to oversee the implementation and maintenance of appropriate management systems.⁴⁹ These appropriate management systems, while undefined in statute, are evaluated through a self-audit assessment performed by the incorporated entities that seeks to measure the effectiveness of the ethical infrastructure in ten fields.⁵⁰

Scholars conducted an empirical study of the self-assessment process in NSW, utilizing completed self-assessment forms and consumer complaints, to test whether this self-assessment tool ultimately led to compliance with ethical principles; or whether the self-assessment tool was simply a “box-ticking” exercise.⁵¹ The study had surprising results: complaints against incorporated law firms dropped, on average, a full two thirds after completion of the self-assessment.⁵² Incorporated law practices have a lower rate of complaints than non-incorporated law firms do.⁵³ Most surprisingly, the study found that the self-rated effectiveness of the ethical infrastructure in the law firm had no bearing on the number of complaints received.⁵⁴ It is as if

⁴⁸ Fortney, *supra* note 43 at 3.

⁴⁹ *Ibid* at 3-4.

⁵⁰ *Ibid*.

⁵¹ Christine Parker, Tahlia Gordon & Steve Mark, “Regulating Law Firm Ethics Management: An Empirical Assessment of an Innovation in Regulation of the Legal Profession in New South Wales” (2010) 37 JL & Soc’y 466.

⁵² *Ibid* at 485.

⁵³ *Ibid* at 487.

⁵⁴ *Ibid* at 489.

the completion of the self-auditing exercise itself is the most significant metric in lowering the number of complaints received.⁵⁵

Further study from other scholars revealed that completing the self-assessment tool led to 71% of incorporated law firms in NSW revising their firm's ethical procedures.⁵⁶ Forty-seven percent adopted new internal systems, policies and procedures, and 42% "strengthened firm management."⁵⁷ Fortney concluded that the "education towards compliance" approach works in providing firm directors the incentives, tools, and authority to take steps to improve the delivery of legal services. A smaller percentage of respondents noted that the [self-assessment process] enhanced awareness of ethical issues.⁵⁸ Clearly, the mandatory completion of the self-audit exercise has a positive effect on how a firm considers their ethical obligations when conducting their business.

Unfortunately, there are no published studies at this time relating to an empirical analysis of the United Kingdom model. It appears that, at least in the Australian state of New South Wales, an outcomes-based ethical infrastructure approach is largely successful in mitigating ethical concerns with non-lawyer ownership, at least from a complaints based and self-assessment perspective.

Duty to the Shareholder and the Canadian Stakeholder Model of Business Regulation

This ethical infrastructure approach to mitigate competing duties may not satisfy some of the more ardent critics of Alternative Business Structures. These critics may take the view that the duty to the shareholders is, on its face, completely irreconcilable with the functions of a

⁵⁵ *Ibid.*

⁵⁶ Fortney, *supra* note 43 at 6.

⁵⁷ *Ibid.*

⁵⁸ *Ibid.*

lawyer. However, the Supreme Court of Canada has questioned whether this fiduciary duty even exists. When tasked to consider whether Canadian businesses have any duty to the shareholder, Major and Deschamps JJ of the Supreme Court of Canada famously held in *Peoples Department Stores Inc. (Trustee of) v Wise*:

Insofar as the statutory fiduciary duty is concerned, it is clear that the phrase the "best interests of the corporation" should be read not simply as the "best interests of the shareholders." From an economic perspective, the "best interests of the corporation" means the maximization of the value of the corporation: ... We accept as an accurate statement of law that in determining whether they are acting with a view to the best interests of the corporation it may be legitimate, given all the circumstances of a given case, for the board of directors to consider, inter alia, the interests of shareholders, employees, suppliers, creditors, consumers, governments and the environment.⁵⁹

It falls that under this line of reasoning, a line of reasoning that gives credence to the complex situations involving a wide variety of stakeholders that businesses often find themselves in, the Canadian judiciary is prepared to grant wide latitude to the business judgment of the corporation. All that is imperative is that the directors and the business act in the best interests of the corporation. Applying this holding to a hypothetical incorporated legal entity, we can see that it could be in the best interest of the corporation to put the shareholders' interests last. If it were in the best interests of the corporation to perform legal functions ethically, to carry out their established duties to the client and to the court, or otherwise risk regulatory sanctions and a tarnished reputation, this jurisprudence would seem to permit a business decision that does not deliver the best value the shareholders.

If Canadian Alternative Business Structures wanted to be even clearer regarding how they view their duty to the ultimate shareholder, they can take the approach of Slater & Gordon, the

⁵⁹ 2004 SCC 68 at para 42 [*Peoples v Wise*].

world's first law firm to list themselves publically on the open market.⁶⁰ When Slater & Gordon prepared their materials for their IPO, they explicitly ranked their fiduciary duties hierarchically in their prospectus, with a duty to the court first, a duty to the client second, and all other corporate responsibilities including the duty to the shareholder last.⁶¹

It is clear, that even if a duty to the shareholder exists in Canada (which it likely does not), law firms that wish to accept outside, non-lawyer investment, can make their priorities clear through their infrastructure, and through statements they make to those investors.

The Proposed Canadian Model

Since there are no *a priori* ethical difficulties with Alternative Business Structures that cannot be addressed through ethical infrastructure, we must consider what a Canadian regulatory model that permits alternative business structures should look like. The Canadian Bar Association has made recommendations to the various Law Societies in Canada to approve Alternative Business Structures with strict regulatory controls preserving the ethical functioning of lawyers.⁶² In particular, the Association recommends (i) direct regulation of law firms, (ii) rules-based regulation for individual lawyers working within non-lawyer owned entities, (iii) that “material owners of ABS shares should be deemed to be clients for the ABS for the purpose of applying the conflict rules,” and (iv) that “privileged information should not be accessible for purposes of the ABS, including by the management and directors of the ABS....”⁶³ Additionally,

⁶⁰ Lindsay Fortado, “Slater & Gordon lifts curtain on global law firms going public”, *Bloomberg*, (12 June 2007) online: Bloomberg News <<http://www.bloomberg.com>>.

⁶¹ Slater & Gordon Limited Prospectus (13 April 2007) at 12.

⁶² “Futures: Transforming the Delivery of Legal Services in Canada” *Canadian Bar Association Legal Futures Initiative* (August 2014) at Chapter 6 online: Canadian Bar Association Legal Futures <<http://www.cbafutures.org>>.

⁶³ *Ibid* at 42.

the Association recommends proactive compliance-based regulation as a supplement to the existing reactive rules-based regime.⁶⁴

These recommendations, when viewed in conjunction with the empirical evidence supporting compliance-based outcomes-oriented regulation in Australia⁶⁵ and the Supreme Court's "stakeholder" views regarding businesses' fiduciary duties,⁶⁶ should be sufficient to overcome the ethical concerns raised by some commentators and scholars.⁶⁷ By combining reactive rules-based lawyer regulation with proactive outcome-oriented and compliance-based entity regulation, the Law Society of Upper Canada would be able to get the best of both worlds in regulation, and do their best to ensure ethical compliance from Alternative Business Structures.

Part III: Failing to Adopt New Ownership Models Could Spell the End of Self-Regulation

As shown above, Alternative Business Structures allow for increased innovation and competitiveness in the legal marketplace. This, in turn, broadens overall access to justice and benefits the public interest. This section explores the Law Society's self-regulatory status compared to other jurisdictions that have adopted state regulation. By studying how these other jurisdictions lost their self-regulatory mandate, we can see that legal self-regulators must do more than pay lip-service to regulating in the public interest, or otherwise risk state intervention and regulation.

The End of Self-Regulation in Australia and the United Kingdom, and the Canadian Implications.

⁶⁴ *Ibid* at 47.

⁶⁵ See Parker, *supra* note 51 and Fortney, *supra* note 43.

⁶⁶ *Peoples v Wise*, *supra* note 59.

⁶⁷ For a good overview of the ethical concerns see generally Reardon, *supra* note 4, and Renee Rayne "Do U.S. Firms Need External Equity Investments to Remain Competitive?" 2014 Texas Int'l LJ 559 at 567-570.

In Canada, lawyers regulate themselves. With the exception of eight appointed lay-people, the Law Society of Upper Canada is composed of forty lawyer benchers and five paralegals elected by lawyers and paralegals from their ranks.⁶⁸ These benchers comprise the various committees, make policy, and issue regulatory decisions, all without direct government scrutiny.⁶⁹ Canada, however, may soon be the last commonwealth nation to retain a self-regulatory legal profession.⁷⁰ Most notably, the two jurisdictions that currently permit non-lawyer ownership of law firms, Australia and the United Kingdom, only permitted Alternative Business Structures after adopting state regulation.

In Australia, reforms have been taking place across its various states to create a uniform system of regulation across all states.⁷¹ The reforms have created, in each state, a government-appointed regulator to handle complaints and discipline; whereas the Law Society has authority to set the regulatory rules and standards of practice, subject to government supervision.⁷²

In light of the sweeping changes of Australia, the UK parliament commissioned a report on the current state of regulatory affairs by Sir David Clementi.⁷³ Taking the recommendations from this report into consideration, the government also adopted state-regulation and established a state-run Legal Services Board that would oversee the complaints process as well the regulation of the legal profession.⁷⁴

⁶⁸ Law Society of Upper Canada, by-law No 3, *Benchers, Convocations and Committees*, (1 May 2007).

⁶⁹ *Ibid.*

⁷⁰ Richard F Devlin & Porter Hefernan, "The End(s) of Self-Regulation?" (2008) *Alta L Rev* 169 at 183.

⁷¹ *Ibid.*

⁷² *Ibid.*

⁷³ Sir David Clementi, "Review of the Regulatory Framework for Legal Services in England and Wales" report for the Legal Services Review of the UK Ministry of Justice (December 2004) Online: UK National Archives <<http://webarchive.nationalarchives.gov.uk>> [*Clementi Report*].

⁷⁴ Devlin, *supra* note 70 at 183-184.

The reasons for the reforms in both nations are varied, but the common thread between the two seems to be an increase in government intervention owing to a failure of both nations' prior self-regulatory structure to fully consider the interest and well-being of the public.⁷⁵ As pointed out in the *Clementi Report*:

I do not believe that the [current regulatory regime] results in the public interest being consistently placed first. I do not believe that the combination provides the right incentives to encourage competition. I do not believe that it provides a framework for promoting innovation. Finally, I do not believe that at the Bar the arrangements between the Bar Council and the Inns are satisfactory, and they are plainly not transparent.⁷⁶

Both the UK and Australian government have dealt, at least somewhat, with their respective access to justice issues through state appropriation of the Bar's formerly self-regulatory mandate. The freshly minted regulators in both jurisdictions quickly took measures to allow for non-lawyer ownership with an eye to generating competition and innovation. These measures succeeded in making the legal process more accessible. If our commonwealth partners can teach us anything, it is that if the Law Society allow access to justice issues to perpetuate, the writing is on the wall for self-regulation.

There is an important distinction when comparing the Canadian regulatory model to the prior self-regulatory models in Australia and the UK. In both of these jurisdictions, the legal regulators also simultaneously and overtly acted as industry associations, tasked with promoting the industry's interests. In Canada, these roles are split between the Law Societies as regulators and the Canadian Bar Association as industry association. I contend, however, that if the Law Society fails to adopt radical measures that can realistically address the access to justice crisis,

⁷⁵ Paul D Paton, "Between a Rock and a Hard Place: The Future of Self-Regulation – Canada Between the United State and the English/Australian Experience" (2008) J Prof Law Symp 87 at 91-92 and 104-105.

⁷⁶ *Supra* note 73 at 31-32.

the legislature and, more importantly, the public could perceive them as promoting protectionist policies and ultimately confusing their mandate.

The Constitutionality of Self-Regulation in Canada

The Law Society of Upper Canada, if their self-regulatory mandate is challenged, will likely state that self-regulation is a protected principle in Canadian jurisprudence. The Supreme Court of Canada has previously stated, “independence of the Bar from the state in all its pervasive manifestations is one of the hallmarks of a free society.”⁷⁷ Some scholars have taken a hardline view that the freedom to self-regulate, that this independence from the state, is a constitutionally protected principle.⁷⁸

Wooley, however, argues that even if independence from the state is a constitutionally protected principle, it does not guarantee self-regulation.⁷⁹ She further argues “[i]ndependence of the bar is simply an abstract principle, like freedom, liberty, democracy, or, relatedly, the rule of law, invoked by the Court on its way to making a determination on some particular matter at issue, such as the ability of law societies to regulate advertising.”⁸⁰ The crux of her position is that any regulatory system should ultimately seek to balance the five goals of: (i) encouraging zealous advocacy (ii) within the bounds of the law, (iii) avoiding discouraging zealous advocacy, (iv) avoiding and preventing lawyers exceeding the bounds of the law, and (v) ensuring measures to promote access to justice.⁸¹ So long as the system fulfills these principles, “[r]egulation by

⁷⁷ Canada (Attorney General) v Law Society of British Columbia, [1982] 2 SCC 307 at 335.

⁷⁸ Alice Wooley, “Rhetoric and Realities: What Independence of the Bar Requires of Lawyer Regulation” (2012) UBC L Rev 145 at 145 citing Patrick J Monahan “The Independence of the Bar as a Constitutional Principle in Canada” in *In the Public Interest: The Report and Research Papers of the Law Society of Upper Canada’s Task Force on the Rule of Law and the Independence of the Bar* (Toronto: Law Society of Upper Canada, Irwin Law, 2007) 117.

⁷⁹ Wooley, *supra* note 78 at 148-149.

⁸⁰ *Ibid* at 152.

⁸¹ *Ibid* at 162-163.

lawyers or by non-lawyers, with a degree of government oversight or with no government oversight, could, at least theoretically, each be consistent (or inconsistent) with ensuring lawyers' satisfaction of their ethical obligations."⁸² While independence of the bar likely enjoys constitutional protection, self-regulation likely does not.

Should the provincial government wish to begin state regulation of the legal profession, it is my opinion that the Law Society would be fighting a losing battle in trying to remain a self-regulating entity. The notion that a Canadian provincial government would wish to appropriate this regulatory power for their own administration is not so far-fetched. Both the Australia and the United Kingdom government expressed concerns regarding the accessibility of justice, lack of competition, and lack of innovation in the legal field;⁸³ the very same issues that are facing the Canadian justice system. Given the Chief Justice of the Supreme Court of Canada's public stance on the current lack of accessibility of justice,⁸⁴ it would certainly cast doubt on the judiciary's willingness to continue to constitutionally protect a self-regulatory regime that fails to adopt business models that are proven to engender competition, innovation, and access to justice. With the constitutional protection of self-regulation in doubt, the legal regulators in Canada may find themselves on proverbial thin ice if they brush aside Alternative Business Structures under the guise of tenuous ethical arguments.

Conclusion

Canadian legal regulators need to put immediate, serious consideration to permitting non-lawyer ownership and Alternative Business Structures. Non-traditional ownership structures drive innovation, competition, and access to justice. There is a pressing need for all three in

⁸² *Ibid* at 166.

⁸³ Paton, *supra* note 75 at 91-92 and 104-105.

⁸⁴ *Inaccessible Justice*, *supra* note 23.

Canada. Other jurisdictions have begun permitting these non-traditional ownership structures, and unless Canada prepares to adapt to a changing global marketplace, they may lose out to an increasingly competitive global legal market. Marketplace disruption is not around the corner; it is here, and it is threatening Canada's place in the global legal market. If Canada fails to act, it will soon begin to resemble Eastman Kodak the days after the first digital camera appeared on the market.

Critics of non-lawyer-ownership do have valid concerns regarding the ethical impact of non-lawyer ownership. However, the concern regarding the addition of a third conflicting "duty to the shareholder" to a lawyer's traditional two duties owed to the client and to the court has no footing in Canadian jurisprudence. The Supreme Court of Canada has made their stakeholder view of corporations' fiduciary duties clear in *Peoples v Wise*. Empirical research has shown that other ethical concerns can be properly addressed through the addition of measures to regulate law-firms through an outcomes-oriented and compliance-based regulatory framework. The mere act of requiring law firms to self-assess their internal ethical infrastructure ultimately leads to increased ethical performance.

A lack of regulatory concern regarding the competitiveness of the legal industry, the failure to consider the public interest, and the failure to innovate was the impetus culminating in the end of self-regulation in other jurisdictions. These jurisdictions have subsequently addressed these concerns by implementing Alternative Business Structures almost immediately after the state began regulating the legal industry. Canada is experiencing these same pressures, and the legal regulators in this country are in a unique opportunity to become the first self-regulatory jurisdiction to implement non-lawyer ownership. The argument that self-regulation is a constitutionally protected principle in Canada may not be entirely accurate; and like our

commonwealth sisters of Australia and the United Kingdom, the legal profession's ability to self-regulate may be contingent on allowing more competitive and innovative business practices.

All of these arguments point to one conclusion: it is imperative that all Canadian Law Societies strongly consider wide-ranging regulatory change to drive innovation and competitiveness, and provide actual and substantial relief to the growing middle class that can no longer access justice in this country. Alternative Business Structures and non-lawyer ownership have all the hallmarks of a solution that can drive this change.

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