



TAB 4

Report to Convocation February 27, 2014

Professional Regulation Committee

Committee Members

Malcolm Mercer (Chair)
Paul Schabas (Vice-Chair)
John Callaghan
Robert Evans
Julian Falconer
Janet Leiper
William C. McDowell
Kenneth Mitchell
Ross Murray
Jan Richardson
Susan Richer
Peter Wardle

Purpose of Report: Decision and Information

**Prepared by the Policy Secretariat
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COMMITTEE PROCESS

1. The Professional Regulation Committee (“the Committee”) met on February 13, 2014. In attendance were Malcolm Mercer (Chair), Paul Schabas (Vice-Chair), John Callaghan, Robert Evans, Janet Leiper, Ross Murray, and Jan Richardson. Stindar Lal, Complaints Resolution Commissioner, participated in the meeting. Staff members attending were Zeynep Onen, Jim Varro, Naomi Bussin, Miriam Weinfeld, and Margaret Drent.

ALTERNATIVE BUSINESS STRUCTURES WORKING GROUP REPORT TO CONVOCATION

MOTION

2. That Convocation approve continued exploration of Alternative Business Structures by the Alternative Business Structures Working Group (“the Working Group”), the development of recommended models for firm or entity regulation in the shorter term and related regulatory reforms, including compliance-based regulation, as follows:
 - a. approval of a consultation with the professions and other interested stakeholders on the delivery of legal services through alternative business structures (ABS) based on the four ABS options described at paragraphs 162 to 179 of this Report, and a report to Convocation following the consultation on the results of the consultations and any recommendations;
 - b. approval of the further development of a framework for the regulation of firms, including entities, providing legal services;
 - c. approval of the Law Society’s consideration of the implementation of compliance-based regulation and referral of the issue to the Professional Regulation Committee, with input from the Professional Development and Competence and Paralegal Standing Committees; and
 - d. approval of the Working Group’s consideration of potential revision of Law Society Rules and By-Laws regarding fee-sharing, referral fees, direct supervision and ownership restrictions, with a view to ensuring that they are proportionate to the risk they seek to mitigate and, if appropriate, a referral of proposed revisions to the Professional Regulation and Paralegal Standing Committees.

ALTERNATIVE BUSINESS STRUCTURES WORKING GROUP REPORT TO CONVOCATION

EXECUTIVE SUMMARY

The Working Group

The Alternative Business Structures Working Group was established by Convocation in September 2012 pursuant to its strategic priorities approved in December 2011.

The Working Group is chaired by Malcolm Mercer and Susan McGrath. Initially the Working Group membership consisted of Susan Elliott, Kenneth Mitchell, James Scarfone, Baljit Sikand, Alan Silverstein, Harvey Strosberg, and Peter Wardle. Since June 2013 Constance Backhouse, Marion Boyd, and Jacqueline Horvat have replaced Baljit Sikand and Harvey Strosberg as members of the Working Group.

The mandate of the Working Group is to explore various possible options available for the delivery of legal services, including structures, financing and the related regulatory processes, and to recommend specific models and arrangements it determines are suitable for the Canadian and Ontario contexts. The full text of the terms of reference is available at **Tab 4.1.2.1**.

The Issues Identified by the Working Group and its Conclusions

As the Working Group started its examination of the issues raised by alternative business structures (ABS), it became clear early on that the development of alternative business structures in other jurisdictions has necessarily included related issues focusing on changes to the regulation of legal services concerning ethical compliance and complaints. Changes in how legal services were delivered to the public, or how legal practices were structured, necessarily raised issues concerning how fundamental ethical obligations to the public, the courts and the legal services community could be ensured. Based on these early observations, the Working Group's work focused on four related issues:

1. **Alternative business structures (ABS)**

Clients in Ontario are overwhelmingly served by firms that are 100% licensee-owned and that provide only legal services. These firms have limited, if any, external economic relationships except for bank debt and for purchased goods and services. Licensees are required to directly supervise all tasks and functions assigned to non-licensees. This is the traditional business structure in Ontario for the delivery of legal services.

The Working Group extensively reviewed the experience of legal services regulation in other jurisdictions as well as experience of legal services regulation in Ontario and elsewhere. It studied structures within which legal services are delivered, the supply of such services with other consumer services, and options for ownership and financing legal services. The Working Group also reviewed the Ontario and Canadian experience to identify current gaps and risks, with a view to establishing what, if any, reason there is to amend the current regulatory foundation for business structures in Ontario.

Early in its work, the Working Group determined that the term “alternative business structures” may be used to refer to any form of non-traditional business structure, as well as alternative means of delivering legal services and may include, for example,

- (a) alternative ownership structures, such as non-lawyer or non-paralegal investment or ownership of law firms, including equity financing;
- (b) firms offering legal services together with other professionals; and
- (c) firms offering an expanded range of products and services, such as “do it yourself” automated legal forms as well as more advanced applications of technology and business processes.

Conclusion and Recommendation: The Working Group concluded that there are negative consequences inherent in current regulatory limitations on the delivery of legal services in Ontario that could be addressed with the thoughtful liberalization of business structures and the related liberalization of what non-legal services can be provided by entities providing legal services. The Working Group identified four structural and services models as options for consideration as permissible regulatory structures, and for consultation:

- (a) entities that provide legal services only, and in which non-licensee owners are permitted an ownership share of up to 49 percent;
- (b) entities that provide legal services only, and in which there are no restrictions on non-licensee ownership;
- (c) entities which may provide both legal services and non-legal services (except those identified by the Law Society as posing a regulatory risk), and in which non-licensee owners are permitted an ownership share of up to 49 percent; and
- (d) entities which may provide legal services as well as non-legal services (except those identified by the Law Society as posing a regulatory risk), and in which there are no restrictions on non-licensee ownership.

The Working Group recommends that these four models be the subject of consultation with interested groups and individuals prior to a decision as to which is the preferred option for recommendation to Convocation. The four models are described in greater detail at paragraphs 162 to 179 of the report.

2. **Firm or entity based regulation**

As part of its consideration of ABS and outcomes based regulation, the Working Group considered the merits of firm or entity based regulation for Ontario. This is a necessary element of effective ABS regulation and it is already permitted in Ontario in part. The *Law Society Act* currently authorizes the full regulation of professional corporations including compliance requirements, investigations and discipline. The Working Group also considers that firm or entity based regulation is advisable whether or not ABS liberalization occurs.

Conclusion and Recommendation: The Working Group recommends that the Law Society seek statutory amendment granting express authority to regulate firms and other entities providing legal services in addition to its current authority to regulate individuals and professional corporations.

3. Compliance based regulation

Significant regulatory change was introduced in Australia beginning in 2001 and in England and Wales in 2007. These changes were introduced at the same time as alternative business structures were introduced in these jurisdictions. The changes introduced in these jurisdictions differed from one another in many ways; however they were alike in that forms of firm or entity regulation were introduced together with regulation with a view to requiring compliance and complaints response from firms where necessary. This is sometimes referred to as ‘compliance based regulation’. A range of regulatory approaches are included in this term, however they have a general common methodology which sets out expected outcomes for firms and individuals and to which they must comply. Generally, in a compliance based approach, the licensees¹ have flexibility in how they meet those objectives (as compared to the proscriptive and detailed rules based regulation found in our primarily complaints driven system).

Conclusion and Recommendation: In conjunction with the implementation of both firm and entity regulation, the Working Group recommends the Law Society give further consideration to the implementation of compliance oriented regulation for existing and alternative business structures and that the issue be immediately referred to the Professional Regulation Committee, with input obtained from the Professional Development and Competence and Paralegal Standing Committees. The Working Group further recommends that compliance based regulation commence with a requirement that licensees and firms have in place a process for responding to complaints.

The Working Group recommends that the issue of compliance based regulation of existing licensees and firms be considered by Convocation to supplement the existing rule based regulation.

4. More immediate regulatory improvements

As part of its work, the Working Group reviewed the regulatory context in Ontario to consider gaps, risks and barriers to innovation and flexibility in the provision of legal services to the

public. The Working Group`s research showed that the legal services market in Ontario for retail or consumer services is very competitive. With some geographic and practice area exceptions, there are many lawyers and paralegals available to provide services to clients in areas such as family law, real estate and civil litigation. The Working Group noted however that there are constraints on innovation that prevent the development of more efficient and effective means to provide legal services. Some of these regulatory constraints are legislative and would require a shift in regulatory orientation such as the adoption of an ABS model. This would be a longer term solution to these issues.

However there may also be shorter term solutions. A review of current requirements (rules and by-laws) shows that there may be room for greater flexibility in how practice is organized by lawyers and paralegals and that these changes are within the authority of the Law Society to make. Amendments to some of the current requirements, where appropriate, could provide some greater flexibility to practitioners, permitting them to find more efficient ways to deliver their services to the public.

Conclusion and Recommendation: The Working Group recommends that Convocation authorize Working Group to continue consideration of the fee-sharing, fee-splitting and referral fees, supervision rules, and ownership restrictions in By-Law 7 and elsewhere.

The review of Law Society Rules and By-Laws would be conducted with a view to ensuring that the rules are proportionate to the regulatory risks which they seek to mitigate. Any changes to these rules would require the approval of Convocation.

ALTERNATIVE BUSINESS STRUCTURES WORKING GROUP REPORT TO CONVOCAATION

BACKGROUND

3. The Alternative Business Structures Working Group was established by Convocation in September 2012 pursuant to its strategic priorities approved in December 2011.
4. The Working Group is chaired by Malcolm Mercer and Susan McGrath. Initially the Working Group membership consisted of Susan Elliott, Kenneth Mitchell, James Scarfone, Baljit Sikand, Alan Silverstein, Harvey Strosberg, and Peter Wardle. Since June 2013 Constance Backhouse, Marion Boyd, and Jacqueline Horvat have replaced Baljit Sikand and Harvey Strosberg as members of the Working Group.
5. The mandate of the Working Group is to explore various possible options available for the delivery of legal services, including structures, financing and the related regulatory processes, and to recommend specific models and arrangements it determines are suitable for the Canadian and Ontario contexts. The full text of the terms of reference is available at [Tab 4.1.2.1](#).

Research and Consultations: The Working Group`s Activities September 2012 to January 2014

6. The Working Group`s work during this period consisted of three distinct activities:
 - a. Research: Included reviews of reports and papers, and in person and teleconference meetings with experts. It also included the analysis of information about business structures and the current status of legal practice in Ontario.

- b. Consultation meetings with licensees: Held in August 2013 to find out the views of the professions generally about the information collected by the Working Group.
- c. ABS Symposium: All day meeting with 70 attendees representing various aspects of the practice of law and legal services to hear from experts and to discuss the relative merits of alternative business structures.

Research

- 7. The Working Group initially embarked on a fact-finding exercise to inform itself on the subject of ABS. This included reviewing and collecting a significant amount of written material including reports and scholarly articles on the subject. At the same time the Working Group met with acknowledged experts on ABS and related subjects, from various jurisdictions including New South Wales, England and the United States. These individuals included academics, practitioners and representatives of the various regulators implementing change. The meetings took place in person as well as by teleconference, and were extensive, based on a pre-determined agenda and questions.
- 8. The meetings conducted by the ABS Working Group are summarized in **Tab 4.1.2.2 of this report**.
- 9. In its June 2013 report, the Working Group set out the results of its research into ABS and the related issues. The following excerpt from the June 2013 report provides useful background for this report.

Results of Research: Excerpt from First Report to Convocation, June 2013

Canadian Approaches

10. In Canada, each of the fourteen Canadian law societies regulates their members in the public interest. Certain Law Societies restrict the delivery of legal services to sole practitioners and lawyers practicing in partnership or under the auspices of a professional corporation. It is beyond the scope of this report to review all regulatory practices in Canada; however, the Working Group found that developments in Quebec, British Columbia and Nova Scotia are of particular relevance to the Working Group, and some of these are highlighted below.

Quebec

11. The Barreau du Quebec, aside from traditional forms of practice, permits an advocate to practice law in a limited liability partnership, a professional corporation and a multidisciplinary practice. Regulations require law firms in these practices to provide a detailed undertaking, as follows:
- a. The entity must ensure that members who engage in professional activities within the firm have a working environment that permits compliance with any law applicable to the carrying out of professional activities.
 - b. The entity must ensure that the partnership, corporation and all persons who comprise the partnership, corporation, or are employed there are in compliance with legislation and regulations.
12. In Quebec, ownership of professional corporations practicing law, for example, is open to members of other regulated professions and to others so long as at least 50% of the voting shares of the professional corporation are owned by lawyers or other regulated professionals.¹

¹ Regulation respecting the practice of the profession of advocate within a limited liability partnership or joint-stock company and in multidisciplinary, RRQ, c B-1, r 9.

Nova Scotia

13. Since 2005, the Nova Scotia Barristers Society has had express statutory authority to regulate law firms. In Nova Scotia:
- a. Complaints may be made to the regulator regarding a law firm for professional misconduct.
 - b. Law firms must designate a lawyer to receive communications from the Barristers Society and assist with investigations.
 - c. A firm found guilty of professional misconduct may be fined, and if a Law Society discipline panel makes an adverse finding against a law firm, the panel may order any other condition as is appropriate; and,
 - d. An inter-jurisdictional law firm must comply with all law firm regulations, and a practicing lawyer may only practice law as a member of an inter-jurisdictional law firm if the firm complies with the Nova Scotia Barristers' Society regulations.²

British Columbia

14. The Law Society of British Columbia permits multi-disciplinary practices ("MDPs"). In June 2012, the Society approved rules changes to allow paralegals (supervised by lawyers) to perform additional duties. The Law Society, B.C. Supreme Court and B.C. Provincial Court have also embarked upon a two-year pilot project to permit designated paralegals to appear in court.³
15. British Columbia has also given preliminary consideration to alternative business structures. In October 2011, its Independence and Self-Governance Advisory Committee presented *Alternative Business Structures in the Legal Profession: Preliminary Discussion and Recommendations*. At that time, this Committee concluded as follows:

² *Legal Profession Act*, S.N.S. 2004, c. 28.

³ The term "designated paralegal" in this context refers to a paralegal who can perform additional duties under a lawyer's supervision (see <http://www.lawsociety.bc.ca/newsroom/highlights.cfm#c2663>).

There are many calls for significant changes in the way that legal services are offered. The current model does not seem to be working in a way that allows people who need to access legal advice to obtain it in an affordable way. There will be considerable pressure to adopt new models for the delivery of legal services, and the Law Society as the regulator of lawyers and the body charged with the responsibility of protecting the public interest in the administration of justice in British Columbia must be prepared to give them serious consideration. However, core values of the legal profession and important rights that clients who need legal advice are entitled to expect must not be lost in a rush to adopt new ideas simply because business and competition models argue in their favour. Many of the protections that the legal profession offers clients have been obtained at significant cost over the centuries and to abandon them lightly would be undesirable for all concerned. However, where benefits to the consumer can be attained with proper regulation to ensure that professional values are not lost, the Law Society must develop proper regulation to allow for changes to the profession through which improved access to legal services can be attained.⁴

16. Since the release of the above report, statutory amendments have been made that confer new powers on the Law Society of B.C. to regulate law firms, similar to those available to the regulator in Nova Scotia. The Legal Profession Amendment Act, 2012 (“LPAA”) provides that the Law Society of B.C. may:
- a. receive complaints against law firms;
 - b. investigate law firms;
 - c. commence a discipline hearing against a law firm; and
 - d. if a Law Society discipline panel makes an adverse finding against a law firm, discipline the firm by reprimand, fine, or other order or condition as is appropriate.⁵

⁴ Law Society of British Columbia, *Alternative Business Structures in the Legal Profession: Preliminary Discussion and Recommendations*, October 2011, pp. 21-22.

⁵ *Legal Profession Act*, S.B.C. 1998, c. 9.

Australia and New South Wales

17. Australia was an early adopter of ABS regulation. Since 2000, New South Wales has permitted full incorporation as have other Australian states and territories. Legal practices may incorporate under ordinary company law without any restrictions on who may own shares or on what type of business may be carried on.⁶ In May 2007, Australia was the first jurisdiction in the world to permit the public listing of a law firm. Slater & Gordon, a national firm listed on the Australian Stock Exchange.⁷
18. The New South Wales regulatory system is based in part on entity regulation. The Office of the Legal Services Commissioner (OLSC), New South Wales may audit Incorporated Legal Practices (ILPs) for their compliance pursuant to the Legal Profession Act 2004 and the Legal Profession Regulations 2005. ILPs are encouraged to complete annual voluntary self-assessments regarding the entity's ethical and management infrastructures. Each ILP must have a "Legal Practitioner Director" who is responsible for implementing "appropriate management systems". This term is not defined in the legislation, although the OLSC has developed ten objectives of a sound legal practice with which ILPs must comply.⁸ Failure by the Legal Practitioner to implement appropriate management systems could be the basis of a finding of professional misconduct.⁹

⁶ Susan Fortney and Tahlia Gordon, "Adopting Law Firm Management Systems to Survive and Thrive: A Study of the Australian Approach to Management-Based Regulation", Hofstra University School of Law Legal Studies Research Paper No. 13-02 (2013).

⁷ Integrated Legal Holdings became the second listed firm on the ASX on August 17, 2008.

⁸ The ten areas are negligence, communication, delay, liens/file transfers, cost disclosure/billing practices/termination of retainer, conflict of interests, records management, undertakings, supervision of practice and staff, and trust account regulations. Susan Fortney and Tahlia Gordon, "Adopting Law Firm Management Systems to Survive and Thrive: A Study of the Australian Approach to Management-Based Regulation", Hofstra University School of Law Legal Studies Research Paper No. 13-02, (2013), p. 15.

⁹ *Legal Profession Act 2004*, (NSW), s. 140(5).

19. The approach taken by New South Wales is outcomes-based – rather than requiring ILPs to adhere to proscriptive regulations and requirements, regulation is based on their systems. ILPs have the freedom to structure their practices in new and innovative ways that are suitable to them, as long as their systems comply with the ten principles of appropriate management systems.

20. In addition, the approach in New South Wales is based on an assessment of the risk posed by each ILP. The requirement to implement and maintain “appropriate management systems” is complemented by a comprehensive risk-profiling program and audit, or practice review program, that is conducted by the Office of the Legal Services Commissioner.¹⁰

England & Wales

21. England & Wales is experiencing rapid changes in how legal services are regulated and provided to the public. Following the Clementi Report, which recommended major reforms to the regulation of legal services in England & Wales, the *Legal Services Act 2007* (“LSA”) was enacted. Under the LSA, the objectives of the regulation of legal services have been broadened. In addition to protecting the public interest and improving access to justice, the regulation of legal services is also founded on objectives such as protecting and promoting consumer interests and competition. The LSA expressly permits the provision of legal services through ABSs in furtherance of these objectives.

22. Under the LSA, “legal activities” are regulated by eight separate “approved regulators”. ABSs may be approved by certain approved regulators. The first ABSs were approved by the Council of Licensed Conveyancers in October 2011, and by the Solicitors Regulatory Authority (“SRA”) in early 2012. Since then,

¹⁰ Susan Fortney and Tahlia Gordon, “Adopting Law Firm Management Systems to Survive and Thrive: A Study of the Australian Approach to Management-Based Regulation”, *supra* note 6 at 11.

the SRA has approved over 100 ABSs.

23. As in Australia, ABSs in England & Wales are regulated in part through entity regulation. For example, in order to be approved by the SRA, ABS applicants generally need to provide the SRA with the following information:
- a. the firm's regulatory history and the type of legal work to be conducted,
 - b. business practices (including policies and procedures, the applicant's proposals to meet the regulatory objectives and proposed governance structure), details of personnel, indemnity insurance, client money (including how the applicant protects client money), and;
 - c. a suitability declaration.

The SRA assesses ABS applicants and maintains the authority to deny ABS licenses.

24. ABSs approved to date have varied in size, structure and expertise. Some of the entities include:
- a. ABSs in which non-lawyer staff have become equity partners.
 - b. ABSs in which family members, including spouses, become part owners of a law firm.
 - c. Co-operative Legal Services ("CLS"), part of the Co-Op Group, the UK's largest mutual business, whose businesses include, among others, a national chain of food stores, banking, insurance, pharmacy, and funeral services. The Co-Op Group operates 4,800 retail outlets, and employs over 106,000 people. CLS currently provides fixed fee legal services in conveyancing, family, wills and probate, personal injury, and employment law.
 - d. Insurance defense firm (Keoghs LLP), which became an ABS and obtained a 22.5% private investment from LDC, a part of Lloyds Banking Group;

- e. Russell Jones & Walker a 425 person, 10 location firm with most of its revenue earned from personal injury matters, which was acquired by Australia's Slater & Gordon, and converted into an ABS; and
 - f. Firms combining legal expertise with other expert services, such as an ABS firm providing human resources services together with related legal services.
25. It is important to note that new business structures were introduced in England and Wales as part of regulatory reform that included entity and outcomes-based regulation. The overall objective was to permit greater latitude for regulated entities to organize their delivery of legal services and their business models to permit flexibility to enhance competition. The regulatory model is based on principles and outcomes as requirements set out by the regulator. Firms are required to provide information to the SRA to enable that office to assess the risk posed by the firm to its regulatory objectives.¹¹ Firms are monitored to determine outcomes, and they are also risk rated to determine the nature of the monitoring. It is still too early to know whether this approach will reduce the number of complaints in England and Wales, and whether it will enhance competition such that access to legal services is improved.

The United States

26. In the United States, currently, only the District of Columbia permits limited non-lawyer ownership or management of law firms, similar to the Law Society's multi-disciplinary partnership model.
27. In 2009, the American Bar Association ("ABA") established the ABA Commission on Ethics 20/20 (the "Commission") to review the ABA Model Rules of Professional Conduct and American models of lawyer regulation in the

¹¹ Jane Hunter, "Outcomes-Focussed Regulation in England & Wales: The Compliance Officer Roles", Quality Assurance Review, Winter 2012, p. 10.

context of the globalization of legal services and technological advancements. In November 2009, the Commission's Preliminary Issues Outline noted that "core principles of client and public protection [can] be satisfied while simultaneously permitting U.S. lawyers and law firms to participate on a level playing field in a global legal services marketplace that includes the increased use of one or more forms of alternative business structures."¹²

28. The Commission established a Working Group on Alternative Business Structures (the "ABA Working Group") to study this issue. By June 2011, the ABA decided against certain forms of ABSs, including MDPs, publicly traded law firms, and passive non-lawyer investment or ownership of law firms. Although the ABA Working Group continued to consider a proposal to permit non-lawyer employees of a firm to have a minority financial interest in the firm and share in the firm's profits, in April 2012, the Commission announced that it would not propose changes to ABA policy prohibiting non-lawyer ownership of law firms.
29. Despite the current regulatory restrictions in law firm ownership structures, more aggressive efforts are being taken by several U.S. based companies seeking to reshape how certain legal products and legal services are delivered to consumers in the United States and globally. Such private corporate innovators include, for example:
 - a. Rocket Lawyer and Legal Zoom, which are developing websites which combine "do-it-yourself" legal form services and traditional legal services, to serve individuals and corporate clients.
 - b. Axiom Law, which offers in-house counsel legal secondments, legal outsourcing services, and project management expertise, recently obtained a further \$28 million in funding from a growth equity firm.

¹²ABA Commission on Ethics 20/20, *Issues Paper Concerning Alternative Business Structures* (April 5, 2011).

30. There are also pressures by traditional law firms seeking to compete in broader legal services markets. For example, the New York firm of Jacoby & Myers commenced litigation in 2011 to challenge regulations in New York, New Jersey and Connecticut prohibiting non-lawyer ownership in law firms. In October 2012, the firm began marketing online legal forms in addition to providing traditional legal services provided by an attorney.

Information obtained about Compliance Based Regulation

31. As part of its research, the Working Group obtained information about compliance based regulation, which has flowed from ABS and entity regulation. A summary of this information is set out below.
32. The term “compliance based” refers to the regulation of law firms and other types of business structures that provide legal services.
33. In Ontario, lawyers and paralegals with whom the Working Group has spoken believe that the Society should carefully examine the potential benefits ABS may offer. One of these may be a reduction in the number of complaints received by the regulator. An analysis of the experience in the jurisdictions which have implemented ABS suggests that this may be one significant benefit.
34. This complaint reduction does not appear to be the result of the introduction of ABSs *per se* but rather the introduction of the entity-level regulation designed to ensure that ABSs provide legal services in a manner reflecting professional values. Two conclusions may be taken from this evidence. The first, independent of whether ABS are permitted, is that entity-based (or firm-based) regulation is a valuable complement to licensee-based regulation. The second is that the existing evidence does not indicate that permitting ABSs creates risk to the public. Indeed, the risk appears to be less than currently exists when introduction of ABSs is combined with entity-based regulation.

35. In England and Wales the *Legal Services Act 2007* created the Legal Services Board (LSB) as a new regulator with responsibility for overseeing the regulation of legal services in England and Wales. The LSB oversees eight approved regulators.
36. The LSB has published a series of reports monitoring the impact of reforms. In 2012, the LSB published a discussion paper on approaches to measuring access to justice. More recently, in October 2013, the LSB published a report assessing changes to competition in the legal services marketplace as a result of the introduction of ABS. This study, conducted between April and August 2013, suggests that alternative business structures have a better record regarding the resolution of complaints about service. During the period 2011-2013, which coincides with the issuance of the first ABS license in March 2012, the number of complaints received by the Legal Ombudsman, or LEO, which is the single organization for all customer complaints, fell by fifteen percent.¹³
37. The LSB's findings are similar to research regarding the impact of the introduction of ABS on complaints in Australia. In New South Wales, Australia, ILPs are required to implement and maintain "appropriate management systems". This term was not defined in the legislation, but the Office of the Legal Services Commissioner (OLSC) of New South Wales identified ten areas to focus regulatory attention. These include negligence, communications, delay, retainer and billing practices, conflicts of interest, management of records and undertakings and the management of books and records.
38. Once the OLSC has received notification that a practice has incorporated, a self-assessment form must be completed. The self-assessment form lists the ten objectives described above. Legal Practitioner Directors are required to rate the

¹³ Legal Services Board, *Evaluation: Change in Competition in Different Legal Markets: An Empirical Analysis*, October 2013, online at <https://research.legalservicesboard.org.uk/wp-content/media/Changes-in-competition-in-market-segments-REPORT.pdf>.

ILP's compliance with each of the ten objectives listed above. The Legal Practitioner Director then sends the form to the OLSC for review. The OLSC has developed an online portal to enable Legal Practitioner Directors to submit these forms online.¹⁴

39. The requirement to implement and maintain appropriate management systems is augmented by a comprehensive risk-profiling program and audit (practice review) program conducted by the OLSC. The regulator works with law practices that appear to be experiencing difficulties. The ultimate objective in conducting a practice review is compliance with ethical obligations under the law and ultimately a reduction in complaints.¹⁵
40. A study conducted in 2008 found that complaint rates for ILPs went down by two-thirds after the ILP conducts the self-assessment. The study concluded that “it appears to be the learning and changes prompted by the process of self-assessment that makes a difference, not the actual (self-assessed) level of implementation of management systems”.¹⁶
41. A second study, conducted by Professor Susan Fortney of Hofstra University, New York, involved the use of an anonymous online questionnaire which asked ILPs with two or more solicitors to assess the impact of appropriate management systems and self-assessment on these firms. The survey results revealed that the majority of respondents recognized the value of requiring firms to implement and maintain appropriate management systems, as well as to engage in self-

¹⁴ New South Wales Office of the Legal Services Commissioner, “Self-Assessment Process”, online at http://www.olsc.nsw.gov.au/olsc/lsc_incorp/olsc_self_assessment_process.html.

¹⁵ Susan Fortney and Tahlia Gordon, “Adopting Law Firm Management Systems to Survive and Thrive: A Study of the Australian Approach to Management-Based Regulation”, Hofstra University School of Law Legal Studies Research Paper No. 13-02 (2013), p. 11.

¹⁶ Tahlia Gordon, Steve A. Mark, and Christine Parker, “Regulating Law Firm Ethics Management: An Empirical Assessment of the Regulation of Incorporated Legal Practices in NSW”, J.L. & Soc. (2010), Legal Studies Research Paper No. 453.

assessment. Further, the process of self-assessment had a positive impact on firm management, risk management, and client services issues.

42. Professor Fortney concluded that “the results from this study and earlier research should inspire regulators to consider proactive partnerships with lawyers, rather than resorting to the traditional paradigm of reactive complaints-driven regulation of firms”.¹⁷
43. The Law Society of Upper Canada currently engages in some proactive regulatory activity. An example is practice management review for lawyers and paralegals. Lawyers in private practice who have been practicing between one to eight years may be referred to the program either because of random selection by the Society, re-entry to practice, or as a regulatory response to a pattern of complaints. Paralegals holding a P1 license may also be referred to Practice Management Review.
44. In addition to the Practice Management Program, lawyers may be subject to a spot audit, which addresses financial record-keeping requirements.
45. In Ontario the regulatory scheme is predominantly reactive rather than proactive. Issues are more often identified through complaints rather than audits or reports by licensees. In contrast, in conjunction with the implementation of ABS, other regulators have adopted a compliance-based scheme. Compliance-based regulatory models are characterized by the imposition of mandatory affirmative duties and reporting obligations on professionals and monitoring and audits for compliance, with investigations and discipline in response to complaints.¹⁸
46. In addition to New South Wales, discussed above, the Solicitors Regulation Authority of England and Wales published a Handbook for Solicitors which took

¹⁷ Susan Fortney and Tahlia Gordon, “Adopting Law Firm Management Systems to Survive and Thrive”, *supra* note 6, p. 43.

¹⁸ Adam M. Dodek, “Regulating Law Firms in Canada”, (2012), 90 C.B.R. 383 at 406.

effect on October 6, 2011 and uses an outcomes-based regulatory approach.¹⁹ In Nova Scotia, benchers are considering the appropriateness of an outcomes-focused regulatory scheme.²⁰

47. There has been activity in Canada concerning a more proactive approach to the management of ethical and related practice issues. The CBA Ethics and Professional Responsibility Committee has developed an ethical practices self-evaluation tool which may be accessed online.²¹

Meetings with Members of the Professions in August 2013

48. Following its report of June 2013, the Working Group held four consultation meetings with members of the lawyer and paralegal professions in August 2013. These meetings were intended to share the information the Working Group had collected as a result of its research, and to engage in dialogue concerning these emerging regulatory structures in other jurisdictions and their applicability in Ontario. The participants in the consultations included the Law Society's Equity Advisory Group, sole practitioners from a variety of practice and geographic areas, the managing partners or representatives of large and medium sized law firms, and representatives of lawyer and paralegal associations. The full list of these meetings is set at **Tab 4.1.2.2**.

Results of August 2013 Meetings

49. Participants in these meetings expressed support for the Law Society's study of alternative business structures.

¹⁹ Laurel Terry, "Trends in Global and Canadian Lawyer Regulation", Sask. Law Rev. 2013 Vol. 76, p. 179.

²⁰ Nova Scotia Barristers Society, *Transforming Regulation and Governance in the Public Interest*, online at <http://nsbs.org/sites/default/files/cms/news/2013-10-30transformingregulation.pdf>, pp. 41-46.

²¹ CBA Internet site at <http://www.cba.org/CBA/activities/pdf/ethicalselfevaluation-e.pdf>.

50. Lawyers from sole and small firms in particular indicated that in their view, alternative business structures could enable them to better focus on the practice of law. These lawyers also expressed an interest in enhanced administrative support that could be provided through franchising, as well as other ownership arrangements. They also liked the idea of offering valued employees a share in the firm.
51. Participants from large firms told the Working Group that that there were already extensive efforts underway to outsource legal services to other jurisdictions in order to reduce costs, subject to Law Society supervision rules.
52. The participants in the August 2013 meetings told the Working Group that traditional delivery of legal services, while necessary in some practice areas, is increasingly being replaced or enhanced by other means of delivering legal services. Legal services are being outsourced. Technology is being used to perform certain tasks formerly done by lawyers with faster, less expensive, and more accurate results. Lawyers and law firms are developing processes to bring efficiencies to the delivery of certain legal services.
53. In sharing their observations regarding the Ontario legal services marketplace, the participants in the summer meetings confirmed the Working Group's findings from its review of the literature. Author Richard Susskind describes a continuum of legal services, which he categorizes under five different headings ("bespoke", or customized, "standardized", "systematized", "packaged", and "commoditized").
54. According to Professor Susskind, "bespoke", or customized services are at one end of the legal services continuum. One example of a bespoke service is advocacy in the court room. Commoditized services are at the other end of the continuum; these services are offered online and are easily available in the

marketplace at very competitive prices. Material on legal websites often consists of legal commodities.²²

55. Some participants in the summer meetings described a process of commoditization of certain legal services in Ontario. Others emphasized the highly bespoke nature of their work, for example certain specialized types of litigation, or criminal law.
56. The Working Group was also told that lawyers, and particularly sole and small practitioners, are spending a great deal of time on project management, law firm management, and supervision, rather than on purely legal tasks.
57. The requirements inherent in the delivery of some areas of law sometimes mean that lawyers must provide both legal services and services ancillary to law (for example, family lawyers told the Working Group that often, they are required to deploy non-legal skills, such as social work, to meet the needs of their clients).
58. Finally, the participants discussed issues with the Working Group regarding non-licensees who are offering various products, such as online legal forms, which may constitute the provision of legal services, despite disclaimers indicating otherwise.

The Symposium – October 2013

59. Together with the Treasurer of the Law Society of Upper Canada, the Working Group hosted a Symposium on alternative business structures in October 2013. The Symposium was a full day meeting attended by lawyers and paralegals with diverse practice areas from different regions of Ontario and representatives of lawyer and paralegal associations. Panels of experts provided presentations on ABS in other jurisdictions, the economic implications of practice structures and

²² Richard Susskind, *The End of Lawyers: Rethinking the End of Legal Services* (Oxford: Oxford University Press, 2010), pp. 28-33, and *Tomorrow's Lawyers; An Introduction to Your Future* (Oxford: Oxford University Press, 2013), p. 25.

examined how ethical issues can be addressed in a changing environment. The purpose of the day was to engender a discussion among those attending as to the relative merits of the various new regulatory approaches to practice structures and legal services emerging in other jurisdictions. A Symposium agenda, including the list of speakers and their presentations is appended to this report at **Tab 4.1.2.3.**

60. The Symposium was an opportunity to exchange views, obtain new information, and examine the subject of ABS and alternative ways of delivering legal services. A significant feature of the Symposium was the presentation of a paper prepared for the Law Society by Professors Edward Iacobucci and Michael Trebilcock analysing current law practice in Ontario in the context of the economic theory of the firm, with a discussion as to the advantages and disadvantages of various models for permitting capital input for law firms or legal practices.
61. The Symposium was also an opportunity to examine how any structural changes to legal practice would affect client services, obligations to the administration of justice, services for clients and ethical obligations relating to these relationships. The Working Group was very interested in the results of these discussions. They clearly identified solicitor client privilege, confidentiality and conflict as central obligations that must be preserved in making any changes. Nevertheless, as those attending worked through various scenarios to test how ethical requirements could be met in alternative structures, they generally concluded that ethical issues are not barriers to making such changes.
62. As described earlier, approximately seventy lawyers, paralegals, representatives of legal organizations and others (including representatives from the Legal Futures project of the Canadian Bar Association as well as regulators and legal technology innovators) participated in this event.

63. The Symposium program included a series of panels on a range of subjects connected to ABS and the changing environment for the delivery of legal services. The panels were moderated by Professor Pamela Chapman of the University of Ottawa.
64. Following the panel presentations, the participants broke out into groups and considered four different ABS scenarios from the perspective of ethics and professional responsibility principles (competence, confidentiality, and conflicts of duty), the potential risks and benefits and appropriate regulatory approaches. Each of the groups reported back to the Symposium as a whole.²³
65. The following summarizes the presentations of the three panels. The first panel featured Professors John Flood (University of Westminster), Paul Paton (Pacific McGeorge) and Laurel Terry (Penn State). Professor Flood discussed changes in England and Wales since 2007.
66. Professor Terry discussed legal innovation and the theory of “disruptive technologies” and its influence on the legal services marketplace.²⁴ The theory of “disruptive technologies” is concerned with why, and how, new firms and technologies drive incumbents out of the marketplace. During the symposium, Professor Terry asked the audience to consider whether this theory was applicable to the Canadian legal services marketplace.²⁵

²³ The symposium was described by Malcolm Mercer in a post on the Legal Ethics Listserv on October 5, 2013.

²⁴ Ray Worthy Campbell, “Rethinking Regulation and Innovation in the U.S. Legal Services Market” 9 N.Y.U.J.L. & Bus. 1 (Fall 2012) online at papers.ssrn.com/sol3/papers.cfm?abstract_id=2018056 . Professor Terry published a blog post regarding this article which may be viewed at http://legalpro.jotwell.com/creative-destruction-and-the-legal-services-legal-education-markets/?utm_source=feedburner&utm_medium=email&utm_campaign=Feed%3A+Jotwell+%28Jotwell%29.

²⁵ The applicability of Campbell’s article to the Canadian legal services marketplace is discussed by Malcolm Mercer in “Utopia, Dystopia and Alternative Business Structures”, November 11, 2013, online at <http://www.slaw.ca/2013/11/11/utopia-dystopia-and-alternative-business-structures/>.

67. Professor Paton discussed the debate in the United States on ABS. He noted that the American Bar Association (ABA) announced in April 2012 that it would not pursue ABS, but the issue appears to still be under discussion based on a recent ethics opinion, published in August 2013 by the ABA Standing Committee on Ethics and Professional Responsibility, suggesting that the debate regarding ABS may be ongoing.
68. The information about the ABA is significant because although regulatory responsibility for U.S. lawyers lies with the judiciary in each of the states, the ABA has an important role in lawyer regulation with the ongoing development and review of its *Model Rules of Professional Conduct*.
69. Under the August 2013 ABA opinion, lawyers who are subject to the *Model Rules* may divide fees with other lawyers or law firms practicing in jurisdictions with rules that permit sharing legal fees with non-lawyers, provided that there is no interference with the lawyer's independent professional judgment.²⁶
70. The second panel featured Professors Iacobucci and Trebilcock (University of Toronto), James Peters (Vice-President, New Market Initiatives at Legal Zoom) and Professor Jasminka Kalajdzic (University of Windsor).
71. Professors Edward Iacobucci and Michael Trebilcock discussed the economic implications of ABS and presented a paper they had prepared for the symposium. This paper provided an economic analysis of business structures with respect to the "theory of the firm"²⁷ and firm capital structure. The paper is at **Tab 4.1.2.4**.

²⁶ ABA Standing Committee on Ethics and Professional Responsibility, Formal Opinion 464, "Division of Fees with Other Lawyers Who May Lawfully Share Fees with Nonlawyers", August 19, 2013, online at http://www.americanbar.org/content/dam/aba/administrative/professional_responsibility/formal_opinion_464.authcheckdam.pdf.

²⁷ Ronald Coase, "The Theory of the Firm" (1937) 4 *Economica* 386.

72. Professors Iacobucci and Trebilcock explained that the theory of the firm considers when it is economically more efficient for an entity to provide goods and services from within the firm and when it is more efficient to access goods and services from third parties in the market place. According to this analysis, expressly limiting what may be supplied by legal practices can create economic inefficiencies, as can effectively limiting the nature of expertise available within the firm. With respect to capital structure, limiting equity investment can constrain firm development and innovation. With debt financing, firm owners are limited by the security that they are willing and able to provide and by the personal risk that they are prepared to assume. In contrast, equity financing permits risk diversion; the potential prospects for the firm, rather than the current business of the firm, becomes more relevant as equity investors share in future growth.
73. During their presentation, Professors Iacobucci and Trebilcock reviewed the advantages and disadvantages of existing business structures. According to the theory of the firm, ABS should lead to greater efficiency because there will be lower transaction costs associated with the provision of complementary services within the firm, rather than referral arrangements between firms. Further, lawyers may benefit from the professional management skills of a non-lawyer owner.
74. The authors explained that some possible disadvantages of non-lawyer ownership include greater transaction and coordination costs within the firm, and a perception that referrals are not as credible because they are internal. From a capital structure perspective, an Alternative Business Structure can be advantageous because the innovation would be less constrained by the limited financial capacity and risk tolerance of the partners. On the other hand, an overly diminished financial stake in the firm can diminish incentives to invest in the firm.
75. There is no optimal structure for legal practice from an economic perspective. Different structures may be preferable depending upon, amongst other things, the

business of the firm, the context in which the firm operates and the strategy pursued by the firm. However, according to Professors Iacobucci and Trebilcock, there are potential gains from ABS that provide an economic justification for liberalization. Lawyers, clients and investors could experience these advantages. Further, greater efficiency and innovation in the delivery of service by lawyers and paralegals should lead to lower fees for clients while permitting profitable practices.

76. Although the focus of their paper was an economic analysis, Professors Iacobucci and Trebilcock noted the access to justice implications of their work.²⁸
77. According to Professors Iacobucci and Trebilcock, due to the large number of lawyers and paralegals, the legal services market is highly competitive,²⁹ so that the liberalization of business structures would not have much impact on the extent of competition, although it could lead to greater economic efficiency.
78. Legal Zoom offers online legal services, including assistance from an attorney on a non-hourly fee basis. James Peters told the audience that in the United States, Legal Zoom is primarily interested in the legal services needs of individuals and small businesses, perceived as distinct from the legal services needs of large corporations. Mr. Peters described the proliferation of legal start-ups that do not

²⁸ The cited work of Gillian Hadfield and Noel Semple provide useful insight into some of these implications.

Gillian K. Hadfield, 2013. "The Cost of Law: Promoting Access to Justice through the (Un)Corporate Practice of Law, The Selected Works of Gillian K. Hadfield. Available at <http://works.bepress.com/ghadfield/49>.

Noel Semple, "Access to Justice: Is Legal Services Regulation Blocking the Path?" (July 30, 2013), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2303987 or <http://dx.doi.org/10.2139/ssrn.2303987>.

²⁹ See Edward Iacobucci and Michael Trebilcock, "The Competition Bureau's Report on Competition and Self-Regulation in the Canadian Legal Profession: A Critical Evaluation", *Canadian Competition Record*, Winter 2009.

meet regulatory requirements to be a law firm but are increasingly providing services to in-house legal departments as well as to individuals. In the future, according to Mr. Peters, law firms will increasingly be forced to outsource to entities which are not law firms to respond to cost pressures. Mr. Peters observed that lawyers who want to be significant innovators often leave legal practice in order to do so.

79. Professor Jasminka Kalajdzic of the University of Windsor spoke about litigation funding, which she described as a form of ABS already present in Ontario. Litigation funding may in some cases include private sector funding of litigation for profit, but does not include contingency fee arrangements, legal aid plans, or funding provided by liability insurers. The litigation funding arrangements studied by Professor Kalajdzic are used in class actions, personal injury litigation, and commercial arbitration. Currently, these arrangements are unregulated, subject to supervision by the courts.
80. The third panel was comprised of Amy Salyzyn of the University of Ottawa and Noel Semple, post-doctoral research fellow of the Center for the Legal Profession, University of Toronto. Amy Salyzyn provided the symposium with a framework for analysis of the legal ethics implications of the ABSs and discussed entity regulation/ethical infrastructure as regulatory tools.³⁰ Noel Semple discussed the possible legal ethical advantages and disadvantages of the ABS liberalization.
81. Following the panel presentations, the participants broke out into groups and considered four different ABS scenarios from the perspective of ethics and professional responsibility principles (competence, confidentiality, and conflicts

³⁰ During her presentation, Ms. Salyzyn referred to the CBA's Ethical Practices Self-Evaluation Tool" which may be accessed at <http://www.cba.org/cba/activities/code/ethical.aspx>.

of duty), the potential risks and benefits and appropriate regulatory approaches.

Each of the groups reported back to the Symposium as a whole.³¹

A Summary of the Ontario Context

Current Law Society Environment

82. In order to put the Working Group's conclusions and recommendations in context, it is instructive to review the current status of key information concerning the regulatory environment in Ontario.
83. In November 2013 there were 46,089 lawyers and 5,623 licensed paralegals in Ontario. The table below describes the practice settings of lawyers and paralegals in private practice.³²

| | Lawyers | | Paralegals | |
|---------------------------|---------|------|------------|------|
| 1 Sole | 7,090 | 15% | 1,348 | 24% |
| 2 – 5 small | 4,564 | 10% | 621 | 11% |
| 6-9 | 1,723 | 4% | 134 | 2% |
| 10-25 | 2,626 | 6% | 128 | 2% |
| 26-49 | 1,441 | 3% | 64 | 1% |
| 50-99 | 998 | 2% | 30 | 1% |
| 100-149 | 843 | 2% | 5 | 0% |
| 150-199 | 1,046 | 2% | 2 | 0% |
| 200-249 | 1,767 | 4% | 5 | 0% |
| 250 + | 839 | 2% | 1 | 0% |
| Total in Private Practice | 22,938 | 50% | 2,338 | 42% |
| Total in Other areas | 23,151 | 50% | 3,285 | 58% |
| Total Licensees | 46,089 | 100% | 5,623 | 100% |
| As at November 17, 2013 | | | | |

84. Attached to this report at [Tab 4.1.2.5](#) is a description of business structures that are currently permitted by the Law Society of Upper Canada. In summary, they

³¹ The symposium was described by Malcolm Mercer in a post on the Legal Ethics Listserv on October 5, 2013.

³² This information was provided by the Corporate Services Department of the Law Society of Upper Canada on November 18, 2013.

include sole practice, partnerships, limited liability partnerships, multi-discipline practices and partnerships and professional corporations. It is important to understand the current available structures as they establish the context for the changes that the Working Group is proposing.

85. It is also important to understand the current legislative framework regarding the regulation of legal services. In 2006 the *Law Society Act* was amended to authorize the Law Society to regulate “legal services” rather than the regulation of lawyers only. This was related to the amendments required for the regulation of paralegals.
86. The term “provision of legal services” was added to the Act for the first time. The legislation provides that “a person provides legal services if the person engages in conduct that involves the application of legal principles and legal judgment with regard to the circumstances or objections of a person”. The Act describes various examples of the provision of legal services in section 1(6).
87. Other amendments to the Act at that time provide that the Law Society may audit, investigate and prosecute professional corporations as well as individuals.³³
88. In the Working Group’s view, these legislative provisions provide the framework that enables and legitimizes a discussion about the structures through which legal services are provided and the regulation of services within them.

Current Developments in Ontario

89. As part of its research and consultations, the Working Group learned of various developments suggesting that the impact of ABS is already being felt in Ontario.
 - a. As noted earlier, legal practice is becoming globalized as a result of the merger of Canadian law firms with international law firms. In 2011 and 2012,

³³ *Law Society Act*, section 61.0.4(2).

respectively, Canadian law firms Ogilvy Renault LLP and Macleod Dixon merged with the international law firm Norton Rose LLP, and Fraser Milner Casgrain announced the intention to merge with SNR Denton and Salans to form a law firm with 2500 lawyers and 79 offices worldwide.

- b. In addition to significantly expanding the global reach of Canadian law offices, these mergers will likely have a broad impact here in Ontario by heightening awareness of regulatory developments in other countries.³⁴
- c. Another factor influencing the current discussion in Ontario is the debate in the United States, where ABS continues to be discussed since the ABA's 2012 announcement that the *status quo* would be maintained. Formal Opinion 464 of the ABA Standing Committee on Ethics and Professional Responsibility, referred to above and issued in August 2013, concluded that fee-splitting in jurisdictions that permit the sharing of fees with non-lawyers was technically compliant with the *Model Rules of Professional Conduct*, since lawyers in U.S. firms would be dividing fees only with lawyers in another jurisdiction. In addition, litigation involving Jacoby & Myers, a law firm that has challenged the restrictions on non-lawyer investment in law firms of the New York State Bar, is ongoing. In August 2013 Jacoby & Myers announced its intention to enter the UK market.³⁵
- d. Participants in the Summer 2013 meetings told the Working Group about initiatives at some Toronto law firms to identify particular tasks within a range of legal work and to outsource them to offshore service providers, subject to Law Society supervision rules, in an effort to control costs.

³⁴ Laurel Terry, "Trends in Global and Canadian Lawyer Regulation", *supra* note 19, p. 149.

³⁵ Dan Bindman, "Ambitious' Jacoby & Myers targets major recruitment drive in race to become UK legal brand", *Legal Futures*, November 8, 2013, online at <http://www.legalfutures.co.uk/latest-news/ambitious-jacoby-meyers-targets-thousands-lawyers-race-become-national-uk-legal-brand>.

- e. During the symposium, Professor Jasminka Kalajdzic described litigation funding as a form of ABS which is already present in Ontario.

DISCUSSION AND CONCLUSIONS

Criteria for Analysing and Comparing Options

- 90. The Working Group's Terms of Reference require that it adopt criteria to evaluate the relative merits of proposals concerning alternative business structures. The criteria were identified based on key principles engaged in any evaluation of ABS including access to justice, public protection and ensuring that regulatory requirements are proportionate to regulatory objectives. It was intended that these criteria provide standards against which to measure the merits of any proposal for change relating to ABS. Clearly not all criteria will apply to all options, or they may apply at different stages of the ABS project, however where relevant, they are of assistance to promote a comprehensive analysis.
- 91. In developing these criteria, the Working Group was guided by the *Law Society Act*, section 4.2 which states:
 - 4.2** In carrying out its functions, duties and powers under this Act, the Society shall have regard to the following principles:
 - 1. The Society has a duty to maintain and advance the cause of justice and the rule of law.
 - 2. The Society has a duty to act so as to facilitate access to justice for the people of Ontario.
 - 3. The Society has a duty to protect the public interest.
 - 4. The Society has a duty to act in a timely, open and efficient manner.
 - 5. Standards of learning, professional competence and professional conduct for licensees and restrictions on who may provide particular

legal services should be proportionate to the significance of the regulatory objectives sought to be realized.³⁶

Working Group Evaluation Criteria

92. The consideration of options for the implementation of alternative business structures is an important exercise with potentially broad and deep implications for legal services in Ontario. As a result, it is important that identified criteria based on fundamental principles be relied upon to assist in such considerations.

The criteria identified by the Working Group are:

- a. Access to justice: Any structural and related regulatory changes concerning alternative business structures should be reviewed to determine their effect on access to justice. Solutions that provide potential improvements for access to justice should be given more weight on that basis.
- b. Responsive to the Public: In promoting access, the new structures and processes should be responsive to the needs of the public for legal services including greater flexibility in cost, location and availability of legal and other services with appropriate quality and adequate financial assurance of legal services.
- c. Professionalism: The fundamentals of professionalism, including independence, confidentiality, avoidance of conflict of interest, and candour should be safeguarded in any move to liberalize ownership and structure.
- d. Protection of Solicitor-Client Privilege: Any change proposed to implement alternative business structures must not jeopardize the protection of solicitor-client privilege.³⁷

³⁶ Ibid.

³⁷ Legislation in New South Wales and England and Wales speaks to the application of solicitor-client privilege in an ABS context. Section 143(3) of the *Legal Profession Act 2004* (New South Wales) provides that the law relating to client legal privilege, or other legal professional privilege is not excluded because an Australian legal practitioner is acting as an officer or director of an LLP. Section 190(4) of the

- f. Promote Innovation: New business structures and processes should be designed to promote innovation which may include, among other things, the adoption of technology and/or other business processes that will enable them to adapt to the legal services marketplace and to better serve the public.
- g. Alignment of requirements with new directions taken: The Law Society's current rules and by-laws should be aligned with the objective to promote innovation and flexibility in the provision of legal services to the public. Rules and other requirements should be proportionate to the significance of the regulatory objectives.
- h. Orderly Transition: The preferred alternative business structures or related solutions options should be amenable to an orderly and thoughtful transition to new regulatory models. Any plan for new structures or service models should be inclusive, responsible, and mindful of any necessary disruptions that may be occasioned.
- i. Efficient and Proportionate Regulation: Any changes should improve the Law Society's ability to effectively protect and promote the public interest in competent and ethical practices, including appropriate responses to client complaints. Restrictions on who may provide legal services should be proportionate to the significance of the regulatory objectives.

Legal Services Act 2007 provides that where an individual who is not a barrister or solicitor provides advocacy, litigation, conveyancing, and probate services, "any communication, document, material or information relating to the provision of legal services in question" is privileged from disclosure in the same way it would have been if the individual had been acting as the client's solicitor.

Alternative Business Structures – The Working Group’s Conclusions

Discussion

Defining “ABS”

93. As stated earlier, the impetus for the Working Group was the emergence in other jurisdictions of new regulatory models governing alternative means of practicing law and delivering legal services.
94. In Ontario, clients are overwhelmingly served by firms that are 100% licensee-owned and that provide only legal services³⁸. These firms have limited, if any, external economic relationships except for bank debt and for purchased goods and services.³⁹ Licensees are required to directly supervise all tasks and functions assigned to non-licensees.⁴⁰
95. Early in its work, the Working Group determined that the term “alternative business structures” may be used to refer to any form of non-traditional business structure, as well as alternative means of delivering legal services and may include, for example,
- a. alternative ownership structures, such as non-lawyer or non-paralegal investment or ownership of law firms, including equity financing;
 - b. firms offering legal services together with other professionals; and

³⁸ These firms are all sole proprietorships, partnerships and professional corporations. Professional corporations are not permitted to carry on any business other than providing legal services other than related or ancillary activities. The *Rules of Professional Conduct* prohibit direct or indirect fee-sharing with non-licensees other than in a multi-discipline practice (an “MDP”) and in inter-jurisdictional law firms. MDPs must be effectively controlled by licensees and may only provide additional services that support or supplement the licensed activity. Fees may only be shared within an MDP with MDP partners who provide client services.

³⁹ The *Rules of Professional Conduct* prohibit payment of referral fees to non-licensees as well as prohibiting fee-sharing.

⁴⁰ Rule 5.01 of the *Rules of Professional Conduct*.

- c. firms offering an expanded range of products and services, such as “do it yourself” automated legal forms as well as more advanced applications of technology and business processes.
96. This definition is based on our observations of ABS in the jurisdictions in which it is now implemented. In these jurisdictions, the term ABS encompasses a variety of structures. In England and Wales for example, these include the following:
- a. Quality Solicitors, a network of over 200 independent law firms with access to national branding strategies, website support, and buying power;⁴¹
 - b. Co-operative Legal Services, which provides a range of legal services as part of the member-owned Co-operative Group. The Co-operative Group operates a family of businesses including food, financial services, pharmacy, funeral care, and online electrical as well as legal services.⁴²
 - c. Scott Moncrieff and Associates, a virtual law firm whose fifty consultant lawyers work from home on a wide variety of private client matters;⁴³
 - d. Natalie Gamble and Associates, a firm with expertise in fertility law offering related services such as donor conception and adoption;⁴⁴
 - e. Winn Solicitors, an accident management firm; its services include compensation, repairs, replacement vehicles, and rehabilitation;⁴⁵ and
 - f. Rocket Lawyer, which combines on-line legal document assembly with on-line legal information and advice as well as pre-paid legal service packages.⁴⁶

⁴¹ <http://files.qualitysolicitors.com/QualitySolicitors%20Info%20Pack.pdf>, discussed by Edward M. Iacobucci and Michael J. Trebilcock in “An Economic Analysis of Alternative Business Structures for the Practice of Law”, p. 23, September 20, 2013. This paper was commissioned by the ABS Working Group for the symposium held on October 4, 2013.

⁴² <http://www.co-operative.coop/legalservices/>.

⁴³ Legal Futures, “Law Society President embraces ABS status”, online at <http://www.legalfutures.co.uk/latest-news/law-society-president-embraces-abs-status>.

⁴⁴ www.nataliegambleassociates.co.uk

⁴⁵ <http://www.winnsolicitors.com/>.

97. In Australia, the first jurisdiction to adopt ABS, Slater & Gordon became the first law firm in the world to be publicly listed on a stock exchange on May 21, 2007. The firm employs 1350 staff in 69 locations with a focus on personal injury and class action litigation on the plaintiff side.⁴⁷
98. Other Canadian Law Societies are considering ABS. On October 15, 2013, the Nova Scotia Barristers Society Council considered a report which asks, among other things, whether ABS should be permitted in that jurisdiction.⁴⁸
99. The Working Group has observed that one of the key factors in the development of ABS is the enhanced and, in some cases, the direct use of technology to deliver services in a new way.
100. The Canadian Bar Association Legal Futures Initiative report identifies the following technologies that are transforming the practice of law:
- a. the proliferation of online dispute resolution (Smartsettle and equibbly.com are two Canadian examples)⁴⁹;
 - b. the development of a technology-enabled marketplace where sellers of legal services can present their offerings, credentials, and fee structures, and buyers can choose the type of services they wish to purchase); and
 - c. intelligent systems/artificial intelligence (ultimately, intelligent systems may be able to offer advice based on comprehensive analysis of data and risk

⁴⁶ <https://www.rocketlawyer.co.uk/>

⁴⁷ Noel Semple, "Access to Justice: Is Legal Services Regulation Blocking the Path?", *supra* note 29. Since then, two other firms have been listed on the Australian Stock Exchange.

⁴⁸ Nova Scotia Barristers Society, *Transforming Regulation and Governance in the Public Interest*, *supra* note 20, online at <http://nsbs.org/sites/default/files/cms/news/2013-10-30transformingregulation.pdf>, p. 5.

⁴⁹ www.smartsettle.com and www.equibbly.com.

factors, which could surpass the human capabilities to manage information, resolve issues, and draw conclusions).⁵⁰

Legal Services Regulation should facilitate Innovation

101. The Working Group is of the view that the proliferation of activity in the Ontario legal services marketplace beyond the Law Society's jurisdiction requires thoughtful consideration by the Society, particularly in light of the broad definition of the term "legal services" in the *Law Society Act*. To facilitate access to justice and in the public interest, the Law Society should examine the extent to which the current scheme of the Act encompasses activity in the online legal services marketplace requiring regulatory oversight.
102. The Working Group concluded that generally it is preferable that new business structures emerge in the regulated sphere. This may not always be practically feasible or reasonable. For example some unregulated services are provided from other jurisdictions over the internet. Others involve support services for legal practices and the reach of regulation into these support services may on balance not be cost effective.
103. During his presentation at the symposium, James Peters contrasted the legal needs of corporations with those of individuals and small businesses targeted by Legal Zoom. According to Mr. Peters, there is a growing presence of non-regulated service providers in the U.S. who are able to access sources of capital and expertise to enhance their market share that are not available to lawyers.
104. The emergence of these new unregulated services is an important factor in favour of permitting lawyers and paralegals greater latitude in the way in which they structure and organize their businesses and services. The emerging unregulated

⁵⁰ CBA Legal Futures Initiative: *The Future of Legal Services in Canada: Trends and Issues*, (June 2013), online at <http://cbafutures.org/trends>, p. 27.

activities have attracted a significant number of clients and this public should be able to access regulated services with similar ease where that is possible.

105. The question of whether and how the Law Society might regulate some of these newer forms of legal services is an question that likely merits further discussion separate and apart from the issue of ABS. This issue has significant policy and resource implications and deserves further consideration.

The Relationship between the Introduction of ABS and Access to Justice

106. The issue of access to legal services has been primarily identified as relating to the cost of these services.⁵¹ One of the key criteria adopted by the Working Group for the evaluation of ABS is whether a specific ABS model promotes access to justice. Having carefully reviewed the emerging evidence from jurisdictions that have implemented a form of ABS, the Working Group considers that the implementation of ABS could afford improvements in access to legal services.
107. While there is not yet clear evidence that the introduction of ABSs materially affects access to justice, there is reason to think that there is real potential for enhanced access. The need for access to justice for individuals arises in two quite different contexts. Individuals face legal issues in day-to-day life for example as tenants entering into leases, testators wanting to deal with their estates, older people wanting to protect their assets and health decisions by powers of attorney and injured persons dealing with private or public income protection. Individuals can also experience a serious legal problem, such as marriage break-down, a major personal injury or a criminal charge.
108. For serious legal issues, the cost of legal services is commonly more expensive than can be afforded even by middle class individuals. Alternative business models may provide lawyers and paralegals with enhanced access to

⁵¹ Gillian K. Hadfield, “The Cost of Law: Promoting Access to Justice Through the Corporate Practice of Law”, *supra* note 28, p. 10, in which Professor Hadfield observes that “conventional legal services are simply beyond the means of most Americans”.

technological and business innovation. This can include the ability to partner with a business manager whose contribution may improve the efficiency of the delivery of services and the marketing of those services. With more diversified ownership and greater access to additional capital, a lawyer or paralegal could provide legal services more efficiently through access to specialized technology or support services including for books and records. ABSs may also provide new ways of accessing existing services from lawyers and paralegals.

109. The Working Group's review of the information collected shows that for day-to-day legal needs, individuals are well served in many respects by lawyers and paralegals. It is also clear however that there are gaps and that in many cases significant legal needs not being served. This is sometimes referred to as latent demand for legal services, usually in circumstances where those seeking the services are middle income earners, but the cost of some of the services are beyond their ability to afford. The results of the Working Group's research shows that a second reason members of the public may seek services from the unregulated marketplace is ease of access in terms of hours operation, location or client services. It appears that these unmet legal needs are not effectively serviced by existing business structures whether as a matter of ease of access or cost of service.⁵²
110. The Law Society Treasurer, Thomas C. Conway, has identified access to justice as a key priority for the Society.⁵³ The Action Committee on Access to Justice in Civil and Family Matters recently released a report on this subject (*A Roadmap for Change*).⁵⁴ The Law Society, through the Treasurer's Advisory Group on

⁵² Michael Trebilcock, Anthony Duggan and Lorne Sossin, eds. *Middle Income Access to Justice*, (Toronto/Buffalo/London: University of Toronto Press, 2012), Part 2: "Defining the Problem: What are the Unmet Legal Needs?"

⁵³ Law Society of Upper Canada, "Access to Justice: Creating a Climate for Change", Treasurer's Blog, *Gazette*, online at <http://www.lawsocietygazette.ca/treasurers-blog/creating-climate-for-change/>.

⁵⁴ Online at http://www.fcj-fcjc.org/sites/default/files/docs/2013/AC_Report_English_Final.pdf.

Access to Justice, has committed to ensuring that the recommendations in this report are realized.

111. As part of the Treasurer's Advisory Group Initiative, the Law Society held a symposium on Access to Justice on October 29, 2013. In an address to the symposium, Chief Justice Anne-Marie Bonkalo of the Ontario Court of Justice noted that fewer and that fewer family lawyers are offering service in important areas such as child protection. Chief Justice Bonkalo also noted the growth of interdisciplinary initiatives such as a program offered by the Community and Legal Aid Services Program at Osgoode Hall Law School and the School of Social Work at York University which offers clients the services of both law students and students of social work.

112. A recent study of 259 self-represented litigants in family and civil law matters in Ontario, British Columbia and Alberta reported that the most consistently cited reason for self-representation was the inability to afford to retain, or continue to retain, a lawyer.⁵⁵ Eighty-six percent of participants in the survey indicated that they had attempted to access legal advice services in some form. Further, virtually every one of the 14% of participants who neither retained a lawyer to represent them at any stage in their case nor sought free legal advice indicated that their reason for not trying to obtain assistance was concern about the cost.⁵⁶

113. In 2009, the Law Commission of Ontario (LCO) embarked upon a study of family justice in Ontario, issuing a final report in February 2013. The LCO noted that members of the public facing family law issues are often confronting other challenges, including financial and mental health concerns.

⁵⁵ Julie Macfarlane, "The National Self-Represented Litigants Project: Identifying and Meeting the Needs of Self-Represented Litigants", online at <http://www.representing-yourself.com/PDF/reportM15.pdf>, p. 8.

⁵⁶ *Ibid.*, p. 82.

114. In its final report, one of LCO's recommendations was the establishment of multidisciplinary centres in which lawyers would provide service to the public alongside other professionals. In this regard, the report suggested that "the ease of structuring multidisciplinary centres in a way that is truly collaborative may be affected by [Law Society] rules." The report refers to By-Law 7 and Rule 6.10 of the *Rules of Professional Conduct*.⁵⁷
115. This argues in favour of permitting non-legal services to be delivered within the same entity that also delivers legal services. This may well provide ease of access to a combination of expert services which may be customized with the creation of multidisciplinary expertise within the entity offering the services, and economies of scope and scale. These opportunities may enable lawyers and paralegals to harness the power of the existing brand for one service to develop market share for other services and vice versa.
116. In England and Wales, the Legal Services Board announced on September 12, 2012 that it plans to monitor the impact of ABS and other reforms on access to justice using the following measures:
- a. demand for legal services;
 - b. paths to justice (that is, whether individuals take no action in regard to their legal needs, handle them alone or seek legal advice);
 - c. use of legal services (analysis of the ways in which consumers use legal services i.e. do they seek information, advice or representation);
 - d. perception of legal services (that is, whether consumers perceive that legal services are affordable);
 - e. cost of legal services;
 - f. number of agents of delivery (the number of authorized persons compared to the population);

⁵⁷ Law Commission of Ontario, *Increasing Access to Family Justice Through Comprehensive Entry Points and Inclusivity*, Final Report, February 2013, p. 85, online at <http://www.lco-cdo.org/family-law-reform-final-report.pdf>.

- g. scope of delivery (the range of categories of work in which regulated entities report turnover and the proportion of consumers getting advice on clusters of problems from the same providers);
- h. geography of services (proportion of agents of delivery by geographic location and the methods of communication used to interact with clients);
- i. access to the courts (volumes of trials, the number of days sat by judges per trial and the length of time between court proceedings); and
- j. trends in satisfaction with the justice system.⁵⁸

117. An analysis of these measures is forthcoming from the LSB in 2014.

118. Professor Richard Devlin of Dalhousie University suggests that ABS could contribute to access to justice in Canada in various ways, including enabling members of the public to access services more conveniently, by, for example, offering financial and legal services in the same place, as well as enabling the public to access legal services in a manner they may find less intimidating than a lawyer or paralegal's office. He also suggests that the public may also benefit from an increased willingness by practitioners to take on cases perceived as risky because of an enhanced access to capital.⁵⁹

119. While it would be wrong to suggest that ABSs are a panacea, ABSs may play a part in addressing these legal needs. ABSs may also more efficiently serve these legal needs by allowing clients to better access existing legal services together with other needed services such as, for example, social work and psychological services.

⁵⁸ Legal Futures, "LSB releases plan to monitor impact of ABSs on access to justice", September 13, 2012, online at <http://www.legalfutures.co.uk/latest-news/lb-releases-plan-monitor-impact-abss-access-justice>.

⁵⁹ Richard Devlin, "Access to Justice and The Ethics and Politics of Alternative Business Structures", (2014) 91 Canadian Bar Review (forthcoming).

120. Permitting new models for the delivery of legal services and the practice of law is not the sole, nor likely the most important, solution to issues of access to justice. Lawyers and paralegals will still need to spend time to provide services for their clients, with an attendant cost. ABS models, however, have the potential to enhance access by providing new means of access in addition to the current models, and by providing lawyers and paralegals with additional means to gain efficiency and flexibility, with possible impacts on cost.

Providing Lawyers and Paralegals with more Choice in how their Practices are Structured

121. The substantial majority of firms providing legal services to individuals and small businesses are sole practitioners and small partnerships. Small firms generally serve individuals and small businesses. The main areas of small firm practice are real estate, civil litigation, wills, estates, trusts, corporate and commercial and family.⁶⁰
122. While many lawyers and paralegals no doubt prefer to be the owner/managers of their own small practices, it was clear from the consultations undertaken by the Working Group that many practitioners consider the business and marketing aspects of their practice to be a burden. For them, practicing, even as a sole practitioner, in a structure which facilitated access to business expertise and infrastructure was attractive.
123. Experience in other jurisdictions suggests that sole practitioners and practitioners in small firms may benefit from the advantages associated with participating in a larger entity or organization, including access to technology and infrastructure, the opportunity to share business costs, access to business and other expertise,

⁶⁰ LSUC *Final Report of the Sole Practitioner and Small Firm Task Force*, 2005, online at <http://www.lsuc.on.ca/media/convmar05solepractitioner.pdf>, particularly paragraphs 36 to 37 and 39 to 41. See also, Noel Semple, "Access to Justice: Is Legal Services Regulation Blocking the Path?" (2013), *supra* note 28.

ethical infrastructure, association with a known brand, and greater market power in dealing with suppliers and other market participants.

124. The discussions at the ABS Symposium suggested that enabling alternative ways to practice including as part of a franchise, or in similar types of affiliations or larger structures may be advantageous for some, and particularly for those who still wish to maintain some elements of a sole practice, while also receiving the supports that a larger organization can provide. Law Society regulatory experience suggests that such supports can be advantageous to clients as well as lawyers.
125. The LSB study published in October 2013 and referred to earlier in this report revealed that ABS firms are more likely to use technology than non-ABS firms. Ninety-one percent of ABS firms surveyed indicated that they had a website to deliver information and other services to clients, as opposed to 52% of non-ABS solicitors' firms. The President of the Law Society of England and Wales has recently commented that, despite the natural fear of the unknown, the Law Society has "discovered that the choice ABS offer is benefiting many of our members ..."⁶¹
126. The Working Group notes that the introduction of ABS models in other jurisdictions has not necessarily meant that sole and small practices reduced in numbers. In New South Wales, many of the firms taking advantage of ABS were small or sole practices, and remained so within the ABS environment. Nor does the experience in other jurisdictions suggest that introduction of ABSs will transform practice. While considering that introduction of ABSs should facilitate innovation, Professors Iacobucci and Trebilcock also indicated during the October

⁶¹ Legal Services Board, *Evaluation: Change in Competition in Different Legal Markets: An Empirical Analysis*, *supra* note 13 at 9 and "Alternative Business Structures: The View from England and Wales", January 7, 2014, online at <http://cbafutures.org/FoL-Blog/Blog/January-2014/Alternative-business-structures-the-view-from-Engl#>

ABS Symposium that, in their view, introduction of ABSs would not cause dramatic change to the way in which legal services are currently provided in Ontario.

127. With respect to non-lawyer ownership, the Working Group notes that new sources of capital may permit a law firm to reorganize or innovate, expand (which may entail a merger with another firm, open a new location, and begin delivery of services in new practice areas). It may also permit a firm to invest in talent (hiring of new legal and non-legal staff). Further, enhanced access to capital would permit lawyers and paralegals to reward long-standing key employees with a share in the firm. Access to new sources of capital could enable licensees to invest in knowledge management and technology.
128. Alternative sources of capital may also enable investments in business process and technological innovations, which may lead to enhanced quality, and may enable a licensee to scale operations, thereby moving away from the billable hour to a new structure. Reliance on outside capital may encourage and enable licensees to professionalize their business processes.
129. Based on the foregoing, the Working Group concludes that ABS would provide practitioners with greater flexibility to seek out the type of business model that most suits their circumstances, and would likely promote greater financial viability for the small and sole practitioners who provide retail services to the public.

Duty to the Rule of Law and Administration of Justice Supersedes Duty to Owners

130. A key component of ABS is partial or complete ownership of the entity by non-lawyers. This raises a question as to how a lawyer or paralegal working within that entity deals with the potentially competing interests of the non-lawyer owners (who are likely primarily seeking profitability) and the duty to clients and the administration of justice.

131. This issue has been addressed in other jurisdictions which implemented non-lawyer ownership. The Working Group particularly notes the approach taken to this issue in New South Wales.
132. During a visit to the Law Society of Upper Canada on July 16, 2012, Steve Mark, former Legal Services Commissioner, New South Wales, described the role of the regulator in that jurisdiction when Slater & Gordon's first public listing. The OLSC worked with the firm to ensure that the prospectus specified a hierarchy of duties according to which the legal practitioner's first duty is to the Court, the second is to the client and the third is to the shareholder. In that case, the interests of clients were protected through the prospectus to inform future share holders. Mr. Mark recommended to the Working Group that it would be preferable that this hierarchy of duties be enshrined in legislation to afford the public full protection.⁶²
133. Currently there is some statutory protection for the public and clients in New South Wales. Section 162(2) of the *Legal Profession Act 2004* provides that in the event of an inconsistency between that legislation and that *Corporations Act, 2001*, under which an ILP is established, the *Legal Profession Act 2004* prevails.⁶³
134. While the experience over the last decade in Australia should not be taken to demonstrate that there would no regulatory risk if ABSs were permitted in Ontario, it is clear that there have not been any significant regulatory issues arising from ABSs in Australia. The adoption of compliance-oriented entity

⁶² Steve Mark, "A short paper and notes on the listing of law firms in New South Wales". Online at http://www.olsc.nsw.gov.au/agdbasev7wr/olsc/documents/pdf/notes_for_joint_nobc_aprl_aba_panel.pdf.

⁶³ *Legal Profession Act 2004*, s. 162(2), online at <http://www.legislation.nsw.gov.au/inforcepdf/2004-112.pdf?id=6482819c-be12-4fb9-de1c-f6e1ac7ab25b>, Mr. Mark and Ms. Tahlia Gordon, previously the Research and Projects Manager of the Office of the Legal Services Commissioner, New South Wales, visited the Law Society of Upper Canada on July 16, 2012.

regulation in Australia appears to be part of the reason for this success as does the establishment of the hierarchy of duties.

135. Reframing this hierarchy of duties in terms that could apply in Ontario, an ABS providing legal services should be required (as must lawyers and regulated paralegals) to subordinate the interests of its owners to the interests of its clients and to the interests of rule of law and administration of justice. This is a key tenet of any reform of structures to ensure the legal advice provided is fully independent, and client confidentiality and privilege are protected.

Consideration of ABS models suitable for Ontario

136. The ABS Working Group considered the full range of potential ABS options and noted that the questions for decision are:
- a. whether the Law Society should undertake any change respecting alternative business structures,
 - b. the degree to which non-licensees are permitted an ownership in the entity;
and
 - c. the extent to which non-legal services may be provided to clients within the entity.
137. In any regulatory environment, entities providing legal services may be subject to strict ownership restrictions, or, as in jurisdictions such as New South Wales or in England and Wales, there may be much less restriction on ownership.
138. The Working Group recognizes that while changes to either ownership rules or to the permitted range of non-legal services can be considered, most potential options would involve the lifting of both ownership restrictions as well as limitations on the type of service which may be offered by the entity.
139. In order to arrive at a set of recommendations concerning alternative business structures and the services they offer, the Working Group considered a range of ABS models.

(i) Should the status quo be maintained?

140. The current Ontario regulatory model permits four types of business structures (sole practitioner, partnership, limited liability partnership and professional corporation). All require full ownership and control by the regulated licensee. There is some limited permission to provide related non-legal services through an affiliation or a multi disciplinary practice.
141. The Working Group concluded that the preponderance of the information available argues against maintaining the *status quo*. Earlier in this report there was a discussion of the advantages and risks attendant on the introduction of ABS in Ontario. Having carefully examined the copious information that the Working Group has available to it, the Working Group is satisfied that there is significant evidence to recommend the introduction of a form of ABS in Ontario.
142. As noted earlier, the introduction of ABS is not a panacea to address issues such as access to justice and the economic viability of legal practice. There is cogent evidence however to show that ABS may well contribute to the development of more accessible, flexible and viable legal services in Ontario. The introduction of alternatives will provide licensees with added options that should promote greater innovation in the provision of legal services, including potentially greater accessibility for the public seeking those services.
143. The Working Group concluded that the existing tight regulatory restrictions on business structures are not justifiable given the lack of evidence that regulatory liberalization will cause harm. This is coupled with substantial evidence that business structure liberalization combined with entity regulation is likely to provide greater flexibility and more options for both licensees and the public.

(ii) Should limited non-licensee ownership be permitted for entities providing legal services?

144. The Working Group considered whether a modest amendment to current ownership restrictions of legal practices in Ontario permitting family members to hold shares in a legal services entity was advisable.
145. In Ontario, physicians and dentists may establish health professional corporations in which family members may be shareholders.
146. In New South Wales and in England and Wales, as a result of the regulatory liberalization of ownership restrictions, many sole practitioners converted to ILPs (incorporated legal practices) in order to enable family ownership in the firm. There has been some discussion of the advantages of seeking legislative amendments to enable licensees to establish a professional corporation in which family members could own shares.
147. The Working Group recognizes that permitting family investment in smaller law firms could have beneficial tax consequences for licensees and their family members. More favourable tax treatment could benefit sole and small practitioners in particular, and might serve as a means of encouraging sole and small practitioners to continue to engage in their practices.
148. Greater tax efficiency by permitting family investment does not do more than reduce the taxes paid by licensees and received by government. These tax savings may, or may not, be passed on to clients. It is certainly arguable that the existing prohibition against family ownership for licensees is unfair. However, merely reducing tax payments does not address the economic and business issues created by restricting business structures. Accordingly, the Working Group does not recommend that ownership liberalization be limited to permitting family investment.

149. The Working Group concluded that any amendment to permit ownership by family members is too limited in scope to be of any significant benefit in the public interest. The Working Group noted however that if only a modest or incremental change to ownership is desired, the better model is to permit ownership of the entity by non-licensees up to 49%, in order to provide greater scope for investment opportunities including by employees.

(iii) Should entities be permitted non-licensee ownership but without any ability to provide non-legal services?

150. The Working Group considered recommending an ABS model with varying degrees of permitted non-licensee ownership which would not be permitted to provide any non-legal services. The advantage of such a model is that it avoids any possible risk related to the provision of non-legal services. As noted earlier, these possible risks include the loss of client confidentiality and privilege, increased risk of conflicts, and the decreased quality of legal services. At the same time, it provides lawyers and paralegals with increased access to investment in their practices to allow them to implement efficiencies.

151. The disadvantage of this approach is that it restricts the ability of lawyers and paralegals to more fully collaborate with other service providers to offer more innovative and comprehensive services to the public.

152. The Working Group questions whether a valid regulatory objective is achieved by restricting the entity to solely providing legal services. MDPs have already combined the provision of legal services and other professional services to establish a limited form of 'one-stop shopping' for consumers of legal and other professional services in Ontario.

153. The Working Group notes that the structuring of an entity which provides only legal services would not provide lawyers and paralegals with sufficient ability to be innovative in developing new ways to provide services to consumers.

154. The Working Group concluded that an ABS model which prohibits the ability to provide any non-legal services is too restrictive, and would be unlikely to achieve the objectives of greater accessibility and flexibility in the provision of legal services. Moreover, the Working Group noted the absence of any demonstrated risk or harm in combining legal and non-legal services so long as appropriate regulatory requirements are in place.

(iv) Should liberalized ownership be permitted together with liberalization of the provision of non-legal services?

155. The Working Group considered various models for liberalizing ownership and the non-legal services provided by the entity.

156. In its deliberations, the Working Group noted that there may be risk in permitting any services without any restrictions on the range of those services. It was noted that there may well be types of services that are inappropriate and likely to increase risk, if provided together with legal services through the same entity. The Working Group considers that effective client representation and protection of our land titles system requires particular examination with respect to legal services involving residential real estate.

157. Accordingly, the Working Group concluded that any liberalization of the provision of non-legal services should include an initial and on-going analysis by the Law Society of restrictions on the provision of non-legal services required on the basis of regulatory risk.

158. As indicated earlier in this report, jurisdictions in which ABS has been implemented, there is a more permissive approach to ownership. In Ontario, only four specified models of ownership are permitted. As noted earlier in this report, in Australia, ILPs do not impose restrictions on individuals who may hold shares in the firm. In England and Wales, the *Legal Services Act 2007* allows non-lawyers to own and run legal businesses.⁶⁴
159. With respect to the services the ABS may offer, the *Legal Profession Act* (N.S.W.) allows an incorporated legal practice to provide any service or conduct any business that the corporation may lawfully provide or conduct, with the exception of a “managed investment scheme”.⁶⁵ In England and Wales, entities that have obtained ABS licenses offer a range of services in addition to legal services including human resources assistance, claims handling, rehabilitation management, and access to health professionals.
160. The Working Group concluded that an orderly transition for the implementation of new structures may benefit from an incremental approach to liberalization of ownership. Nevertheless, there was considerable interest by most of the members of the Working Group in models of ABS that include unrestricted ownership.
161. The Working Group recommends consultation on both liberalization of ownership and unrestricted ownership by non-licensees. Partial liberalization of existing Rules would allow the Society to carefully consider whether additional changes are in the public interest, however an incremental approach takes longer, and would no doubt restrict opportunities for innovation and access.

⁶⁴ Richard Susskind, *Tomorrow’s Lawyers: An Introduction to Your Future*, *supra* note 22, p. 6.

⁶⁵ *Legal Profession Act 2004* (N.S.W.), s. 135, online at http://www.austlii.edu.au/au/legis/nsw/consol_act/lpa2004179/s135.html. Section 135(3) provides that the regulations may prohibit an Incorporated Legal Practice from providing a service or conducting a business of a kind specified by the regulations.

RECOMMENDATIONS

Alternative Business Structures: the Working Group's Recommendations

162. Based on its work to date, the Working Group has identified four possible options for alternative business structures reform. The Working Group recommends consultations on these four options before the Working Group makes a final recommendation as to the appropriate model. The consultations will be undertaken with a view to testing the options to establish their suitability for Ontario.
163. **The Working Group recommends focussed as well as generalized consultation with the profession and interested stakeholders. This would include notice and invitation to comment through the Law Society's website and the Ontario Reports, as well as direct communication with all of the stakeholders who were invited to the 2013 consultations and/or the Symposium as well as others.**

Option #1: Permitting Up to 49% Ownership by Non-Licensees in Entities Only Providing Legal Services

164. Under this option, the licensee would maintain majority ownership of the entity, and would be responsible for its provision of legal services. At best, such ownership structure might generate only a near doubling of the equity investment available to the entity.
165. The Working Group noted the doubt expressed by many participants in its summer and fall meetings that arms-length investors would be interested in assuming up to a 49% ownership in a law firm. An outside investor may not perceive sufficient potential growth in the business to justify an equity investment in which the investor may only obtain a minority interest. A doubling of equity capital is unlikely to provide the resources necessary to achieve material innovation in the delivery of legal services. Nevertheless, permitting minority

equity interests for non-licensees would permit key employees to be rewarded by equity participation.

166. The Working Group concluded that, with respect to an entity only providing legal services, a minority ownership rule would likely restrict the interest in outside investment. That said, allowing up to 49% equity ownership by non-licensees is viewed as some improvement over the *status quo*. Some consider, as was the case in Australia and England, that permitting 49% non-licensee ownership provides a cautious first step towards further liberalization.

Option #2: Entity restricted to providing legal services, but with unrestricted ownership

167. This option would permit the entity to provide legal services, with unrestricted ownership. Under this option, the entity would only provide legal services, but would be free to seek capitalization in any way it sees fit. The entity could be capitalized through licensee or non-licensee ownership or any combination thereof. Nonetheless, the provision of legal services would remain under the control and supervision of licensees.
168. This option would focus the entity on delivering legal services, and increased capitalization could therefore be directed solely at enhancing the delivery of legal services. As the entity would not offer other non-legal services, the potential risks of conflicts and to confidentiality and loss of privilege which may exist in a multi-disciplinary/service environment are minimal. The requirement that licensees control and supervise the provision of legal services together with entity regulation should effectively ensure independent judgment in the delivery of legal services.
169. The importance of preserving solicitor-client privilege would require that non-licensee owners would not be permitted to access confidential information about the identity of clients and the work being done for them. The ABS entity and the licensees within the ABS would be subject to Law Society Rules and sanctions.

Further, the entity as a whole would be required to identify an individual or individuals, similar to the Legal Practitioner Director in New South Wales, who would be responsible for ensuring compliance by the entity and its owners, directors, officers and employees with the Law Society Rules. In the New South Wales scheme, failure by the Legal Practitioner Director to ensure the regulatory compliance of the entity may be the basis of a finding of misconduct. The Legal Practitioner Director may be sanctioned, or disqualified from further service in this capacity, as a result.⁶⁶

170. However, the Working Group questions whether a valid regulatory objective is achieved in restricting such an entity to solely providing legal services. The Working Group notes that this reflects the status quo in Ontario with MDPs, which would not be very useful.

Option #3: Entity permitted up to 49% non-licensee ownership and permitted to provide both legal services and non-legal services except those identified as posing a regulatory risk

171. The Working Group considered the feasibility of permitting up to 49% ownership in an entity, and permitting the entity to provide both legal services and non-legal services except those identified by the Law Society as posing a regulatory risk.
172. As discussed at paragraphs 156 – 157, liberalized ownership may permit increased capitalization to be invested to enhance the delivery of legal services, but restrictions on non-licensee ownership are likely to restrict the amount of interest in outside investment. It is questionable whether this will achieve the innovations which may result from unrestricted non-licensee ownership.
173. Regulators in Australia and in England and Wales, permit unrestricted ownership and few if any restrictions on the pairing of legal and non-legal services. The

⁶⁶ Ted Schneyer, “Thoughts on the Compatibility of Recent U.K. and Australian Reforms with U.S. Traditions in Regulating Legal Practice”, (2009) *Journal of the Professional Lawyer* 13, p. 31.

Working Group is of the view that the experiences of regulators in other jurisdictions will be instructive in identifying areas of regulatory risk.

174. This option is potentially attractive, as compared to permitting only ancillary services, on the basis that the regulator should be careful not to make assumptions about which innovations may prove valuable over time and on the basis that restrictions on what services may be provided should be determined by assessed regulatory risk.
175. It should be recognized that permitting a broader range of services to be offered by an ABS will require attention to the avoidance of conflicts and the protection of confidentiality and privilege simply because a broader range of activities would be permitted to be delivered within the ABS including by non-licensees. However, these matters appear to be capable of being addressed. For example, the law of privilege already addresses the provision of legal and non-legal services by in-house counsel⁶⁷ as well as the participation of non-lawyer experts where required for the provision of legal services without loss of privilege.⁶⁸
176. Permitting non-licensees to become owners in an entity without requiring that they be subject to control and supervision by the licensees (as is currently the case with respect to multi-disciplinary partnerships) may encourage further innovation. It is important to note, however, that the entity as a whole would be subject to Law Society requirements.

⁶⁷ *Pritchard v. Ontario (Human Rights Commission)*, [2004] 1 SCR 809, paragraphs 19-21, online at <http://scc-csc.lexum.com/decisia-scc-csc/scc-csc/scc-csc/en/item/2144/index.do>

⁶⁸ *Barrick Gold Corporation v. Goldcorp Inc.*, 2011 ONSC 1325, paragraph 19, online at <http://www.canlii.org/en/on/onsc/doc/2011/2011onsc1325/2011onsc1325.html>, and *Camp Development Corporation v. South Coast Greater Vancouver Transportation Authority*, 2011 BCSC 88, paragraph 64, online at <http://www.canlii.org/en/bc/bcsc/doc/2011/2011bcsc88/2011bcsc88.html?searchUrlHash=AAAAAQALU291dGggQ29hc3QAAAAAAQ>.

Option #4: Entity permitted unlimited non-licensee ownership and permitted to provide legal services and any other services, except where there is a sufficient regulatory risk identified

177. The Working Group considered an ABS in which the services provided in addition to legal services would not be subject to restriction, except in circumstances where the Law Society has identified a sufficient regulatory risk. The Law Society would develop criteria governing the assessment of sufficient regulatory risk.
178. The comments made regarding Option #3 regarding the provision of non-legal services and the identification of regulatory risk apply equally to this option. The distinction in Option #4 is that unrestricted ownership by non-licensees will likely increase the entities access to capitalization, as discussed previously in this Report. The experiences of other jurisdictions suggest that regulatory risk resulting from this type of liberalization may be managed.
179. With respect to all of the options described above, the Working Group has concluded that it is unlikely that a more permissive approach to business structures in Ontario will lead to revolutionary change; however, such changes will encourage innovation and the development of new ways to deliver legal services which otherwise will be more likely to emerge in the unregulated, rather than the regulated sphere. The public may be at greater risk if innovation emerges solely in the unregulated sphere outside the Law Society's purview.

Firm and Entity Regulation: the Working Group's Recommendations

180. The Working Group has recommended that a form of alternative business structures regulation be introduced in Ontario. In the Working Group's view, this is a long term modification in regulatory approach which requires careful attention to decisions, design and implementation. It should be developed in tandem with the Law Society seeking legislative authority for regulation of entities providing legal services. As noted earlier, several other jurisdictions in

Canada are taking steps to regulate law firms, or have implemented this form of regulation. Legislation in Nova Scotia and British Columbia has already been amended for this purpose. The Barreau du Québec regulates law firms through compliance measures, but not through discipline.⁶⁹

181. In Ontario, there is statutory authority to regulate professional corporations, but not partnerships or sole practices. This results in a gap and imbalance in regulatory authority that should be addressed. Moreover, the regulation of entities or firms provides the Law Society with greater ability to engage in proactive and preventative regulation that can reduce risk for the public. This report has described the results of proactive or compliance based regulation in New South Wales, which demonstrated a marked reduction in complaints for firms.

Recommendations: Firm and entity regulation

- 182. The Working Group recommends that the Law Society seek statutory amendment granting it express authority to regulate entities providing legal services in addition to its current authority to regulate individuals and professional corporations.**

Compliance Based Regulation: the Working Group's Recommendations

183. The Working Group notes that the Law Society of Upper Canada currently engages in some proactive regulatory activity. An example is practice management review for lawyers and paralegals. Lawyers in private practice who have been practicing between one to eight years may be referred to the program either because of random selection by the Society, re-entry to practice, or as a regulatory response to a pattern of complaints. Paralegals holding a P1 license may also be referred to Practice Management Review.

⁶⁹ For a further discussion, see Adam Dodek, "Regulating Law Firms in Canada", *supra* note 18, p. 411. Also see Amy Salyzyn, "Regulating Law Practices as Entities: Is the Whole Greater than the Sum of Its Parts?", November 29, 2013, online at <http://www.slw.ca/2013/11/29/regulating-law-practices-as-entities-is-the-whole-greater-than-the-sum-of-its-parts/>.

184. In addition to the Practice Management Program, lawyers may be subject to a spot audit, which addresses financial record-keeping requirements.
185. The Working Group acknowledges that in Ontario the regulatory scheme is predominantly reactive rather than proactive. Issues are more often identified through complaints rather than audits or reports by licensees. In contrast, in conjunction with the implementation of ABS, other regulators have adopted a compliance-based scheme. Compliance-based regulatory models are characterized by the imposition of mandatory affirmative duties and reporting obligations on professionals and monitoring and audits for compliance, with investigations and discipline as a component of the proactive scheme.⁷⁰

Recommendations: Compliance based regulation

- 186. In conjunction with the implementation of both firm and entity regulation, the Working Group recommends the Law Society immediately consider implementation of compliance based regulation and refer the issue to the Professional Regulation Committee, with input from the Professional Development and Competence and Paralegal Standing Committees. The Working Group further recommends that compliance based regulation commence with a requirement that licensees and firms have in place a process for responding to complaints.**

Review of Law Society Rules and By-Laws: the Working Group's Recommendations

187. In its June 2013 Report, the Working Group noted the existing constraints on business structures that arise from the Law Society By-Laws and *Rules of Professional Conduct*. As set out in the Working Group's June 2013 Report, the Law Society is required to ensure that conduct standards are proportionate to regulatory objectives, and the Working Group believes that existing constraints on business structures should be reviewed.

⁷⁰ Adam M. Dodek, "Regulating Law Firms in Canada", *supra* note 18 at 406.

188. The principal rules and by-laws governing business structures for the delivery of legal services in Ontario which the Working Group recommends for review are set out in a schedule to this report at **Tab 4.1.2.4**.
189. Several specific rules may be highlighted by way of example:
- a. Rule 2.08(8)(a) provides for an absolute prohibition against directly or indirectly sharing, splitting, or dividing fees with any person who is not a licensee.
 - b. Rule 2.08(8)(b) provides for an absolute prohibition against giving any financial or other reward to any non-licensee for the referral of clients or client matters.
 - c. Rule 5.01(2)(b) requires that a lawyer directly supervise non-lawyers to whom particular tasks and functions are assigned. This requirement may be seen to limit that which may be provided by business and technological processes that are effectively but not directly supervised.
 - d. Sections 16 and 17 of By-Law 7 prohibit licensees from providing services of non-licensed persons except for services that support or supplement the provision of legal services.
 - e. Sections 18, 19 and 20 of By-Law 7 substantially limit partnership between licensees and service providers permitted under sections 16 and 17 including by the requirement that the licensee have effective control over the non-licensee even in respect of non-legal services and that the non-legal services provided be subject to compliance with all Law Society by-laws, rules etc. It is unclear that these limitations are required. As a practical matter, there are only approximately a dozen multi-discipline practices presumably as a result of these tight constraints.
190. The Working Group concluded that these and other related rules should be subject to further study both to encourage innovation and more effective service while protecting professional values.

191. While permitting ABSs as discussed in the paragraphs that follow is an important part of the reform proposed by the Working Group, the Working Group considers that reforms to existing rules could provide flexibility that is achievable in the shorter term. The Working Group recognizes that the development of the regulatory jurisdiction, processes and infrastructure required to support the implementation of the recommendations in this report will take substantial time and effort such that intermediate steps along the path may be appropriate.

Recommendations: Review of Law Society Rules and By-Laws

192. **The Working Group recommends that the Working Group be authorized to consider potential revision of Law Society Rules and By-Laws regarding fee-sharing, referral fees, direct supervision, and ownership restrictions and, if thought appropriate, to refer proposed revisions to the Professional Regulation and Paralegal Standing Committees.**
193. **The review of Law Society Rules and By-Laws would be conducted with a view to ensuring that the rules are proportionate to the regulatory risks which they seek to mitigate. Any changes to these rules would require the approval of Convocation.**

TERMS OF REFERENCE OF THE LAW SOCIETY OF UPPER CANADA WORKING GROUP ON ALTERNATIVE BUSINESS STRUCTURES

On September 27, 2012, the Working Group reported its Terms of Reference to Convocation.

These Terms of Reference provide that the Working Group will

- (a) inform itself on developments in Canada and abroad on new and existing alternative legal service delivery models and structures, financing arrangements, and the related regulatory process;
- (b) consider these developments in light of regulatory requirements and develop a set of criteria to assess the prioritize these new models and structures. Criteria may include access to the services by the public (access to justice), public protection (risk assessment of various models), and other principles that inform the Law Society's public interest mandate, including the requirement that standards of professional conduct be proportionate to the significance of the regulatory objectives sought to be realized; and
- (c) determine the range of legal service delivery models and financing arrangements that should be explored and examine the existing regulatory constraints on delivery models and financing arrangements;
- (d) create a Work Plan that will include identification of the legal services delivery models and regulatory changes that should be considered by the Law Society for possible implementation based on
 - (i) an initial assessment of their impacts based on the criteria developed earlier;
 - (ii) a high level consultation; and
 - (iii) report the results of its work to Convocation, including, as appropriate, proposals and recommendations for next steps.

Meetings Held by the Alternative Business Structures Working Group

Australia Background Meetings – July 16, 2012 and November 6, 2012

- Steve Mark, Legal Services Commissioner, New South Wales (by telephone Nov. 6, 2012)
- Tahlia Gordon, Research and Projects Manager, Office of the Legal Services Commissioner, New South Wales (by telephone Nov. 6, 2012)

England & Wales Background Meeting – December 10, 2012

- Chris Kenny, Chief Executive, Legal Services Board, England and Wales (by telephone)
- Samantha Barrass, Executive Director, Solicitors Regulation Authority¹ (by telephone)

United States Background Meeting – January 8, 2013

- Professor Paul Paton, Professor, and Director, Ethics Across the Professions Initiative, Pacific McGeorge School of Law (by telephone)
- Professor Laurel Terry, Harvey A. Feldman Distinguished Faculty Scholar and Professor of Law, Penn State Dickinson School of Law (by telephone)

Legal Futures Meeting – February 12, 2013

- Mitch Kowalski, author of Avoiding Extinction: Reimagining Legal Services for the 21st Century
- Jordan Furlong, strategic consultant and author of Law21 blog

Meeting with the Equity Advisory Group (“EAG”) – August 14, 2013

- 12 participants – individual and organizational representatives

Meeting with Sole Practitioners and Small Firms from Various Regions – August 26, 2013

- 9 participants

¹ Samantha Barrass will become the Chief Executive of the Gibraltar Financial Services Commissioner in February 2014.

Meeting with Legal Organizations – August 26, 2013²

The following organizations were represented:

- Association of Corporate Counsel Canada
- County & District Law Presidents' Association
- Criminal Lawyers Association
- Family Lawyers Association
- Ontario Bar Association
- Ontario Trial Lawyers Association
- Paralegal Society of Ontario
- The Advocates Society
- Toronto Lawyers Association

Meeting with Large Law Firm Representatives – August 27, 2013

The following law firms were represented:

- Blake, Cassels & Graydon LLP
- Borden Ladner Gervais
- Dentons Canada LLP
- Gowling, Lafleur Henderson LLP
- McMillan LLP
- Miller Thomson LLP
- Norton Rose Fulbright LLP
- Stikeman Elliott LLP

Meeting with Representatives of Law Firms With 25-100 Lawyers – August 27, 2013

The following law firms were represented:

- Fogler Rubinoff LLP
- Gardiner Roberts LLP

² The Licensed Paralegal Association of Ontario was also invited to attend, but was unable to participate due to scheduling issues.

- Siskinds LLP
- Thomson Rogers
- Weir Foulds LLP

ABS Symposium – October 4, 2013

- 42 participants from firms, legal organizations, and others



Symposium on Alternative Business Structures for Delivery of Legal Services

Symposium Agenda

The Law Society of Upper Canada | Barreau du Haut-Canada

Co-Chairs: Malcolm Mercer and Susan McGrath

Friday, October 4, 2013

Donald Lamont Learning Centre, The Law Society of Upper Canada, Toronto, Ontario

8:00 – 9:00 a.m. REGISTRATION AND BREAKFAST

8:45 – 9:00 a.m. OPENING REMARKS

- Thomas G. Conway, Treasurer, The Law Society of Upper Canada

Panel 1: Survey of the ABS landscape in England and Wales, Australia, the U.S. and Canada

9:00 – 10:30 a.m.

- Professor John Flood (University of Westminster)
- Professor Laurel Terry (Penn State Dickinson School of Law)
- Professor Paul Paton (Pacific McGeorge School of Law)

10:30 – 10:45 a.m. MORNING BREAK

Panel 2: The effect of regulating business structures on the supply and cost of legal services

10:45 a.m. – 12:15 p.m.

- *Economic Implications of ABS:*
Professor Edward Iacobucci/Professor Michael Trebilcock (Faculty of Law, University of Toronto)
- *Access to Justice and current issues in litigation financing:*
Jasminka Kalajdzic, Associate Professor (Faculty of Law, University of Windsor)
- *Innovation in Legal Service Delivery:*
James Peters, Vice-President, New Market Initiatives, Legal Zoom

12:30 – 1:30 p.m. LUNCH

Panel 3: Can we liberalize regulation and still protect legal ethics?

1:30 – 3:00 p.m.

- Discussion of current regulatory restrictions and alternative approaches to referral fees, fee splitting, supervision, law firm ownership, and whether legal professional corporations should be limited to performing legal services.
- *Facilitator:*
Professor Pamela Chapman, University of Ottawa Faculty of Law, Common Law Section.
- *Presenters:*
Amy Salyzyn (J.S.D. candidate, Yale Law School)
Noel Semple (post doctoral research fellow, University of Toronto and visiting Scholar in Residence, Centre for the Legal Profession, University of Toronto Faculty of Law)

3:00 – 3:15 p.m. AFTERNOON BREAK

3:15 – 4:00 p.m. WRAP UP

**AN ECONOMIC ANALYSIS OF ALTERNATIVE BUSINESS STRUCTURES FOR THE
PRACTICE OF LAW**

**Edward M. Iacobucci and Michael J. Trebilcock
University of Toronto
Faculty of Law**

September 20, 2013

This paper was commissioned by The Law Society of Upper Canada ("Law Society") for the Alternative Business Structures symposium held on October 4, 2013. All opinions expressed in the paper are those of the authors alone and not of the Law Society.

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I. INTRODUCTION

In this Report, we consider the economic advantages and disadvantages of alternative business structures for the practice of law. The question of the form that a legal practice takes undoubtedly engages a wide variety of policy considerations, including ethical questions, that are not necessarily confined to the economic realm. We set these other considerations to the side and focus only on the prospective economic benefits and costs of different structures. Our analysis, then, does not attempt to provide final answers to policy questions associated with alternative business structures, but rather simply offers insights from the realm of economic analysis that may be helpful in reaching an overall policy conclusion about alternative business structures. Of course, economic and non-economic concerns may be related in important ways. For example, to the extent that economic efficiencies from alternative structures lead to lower costs of providing legal services, and lower costs lead to lower prices for buyers of legal services, alternative structures may promote access to justice.¹ Our focus, however, is on the economic considerations, with only occasional reference to other, potentially very important, non-economic policy concerns.

We begin in Part II by discussing economic thinking on two related matters. The first is the economic theory of the firm. This body of thought concerns the question of what economic activities are best situated within a firm, and what economic activities are best situated outside the firm. For example, should an auto manufacturer produce its own sound systems, or should the company buy systems from a third party? This turns out to be a more difficult question than it may initially appear to be. The second issue we discuss in Part II is the economics of capital

¹ See, e.g., Gillian Hadfield, “The Price of Law: How the Market for Lawyers Distorts the Justice System” (2000) 98 Michigan Law Review 953. We return to access to justice in the Conclusion.

structure. What considerations affect the economically optimal capital structure (e.g., distribution of equity ownership, the debt-equity ratio) of a firm?

In Part III we outline various business structures that legal service providers might consider adopting. In this section we review not only the kinds of structures that are permissible under Ontario law, but also structures that are not permitted here but are elsewhere.

Part IV builds on the foundation laid in Parts II and III by offering an economic analysis of alternative business structures for legal practice. This section essentially applies the economic analysis of Part II to the array of alternative business structures outlined in Part II in order to gain insight into the economic advantages and disadvantages of different structures. Part V concludes by summarizing, and by touching on the politics of reform, noting that even if liberalization of the choice of form for legal practice led to the demise of certain business structures, it would not necessarily be a bad thing, especially in the longer run, for lawyers at such doomed structures.

II. THE THEORY OF THE FIRM

Ronald Coase posed a deceptively vexing question in a seminal article in 1937²: why are some transactions consummated in the market between two separate parties, and why are some transactions consummated within a firm?³ This question has spawned a host of responses without a single right answer, but with certain strains of thought emerging as prominent pieces of the puzzle. It is essential when attempting to gauge the economic impact of regulatory restrictions on the structure of legal firms to understand as a preliminary matter the considerations that help determine the optimal economic structure of a firm. This section

² He actually posed the question as an undergraduate student in 1932: see Phillippe Aghion and Richard Holden, “Incomplete Contracts and the Theory of the Firm: What Have We Learned over the Past 25 Years?” (2011) 25 *The Journal of Economic Perspectives* 181 at 181.

³ Ronald Coase, “The Nature of the Firm” (1937) 4 *Economica* 386.

introduces the basic ideas behind the theory of the firm that have emerged in the economic literature.

There is a related question that this section will also canvass. One can crudely think of the theory of the firm as seeking to identify what economic activity will take place within a firm. There is a related question. Assuming that there are a range of passive investors in the firm (not just owner-managers), how is their investment to be structured? For example, how much debt versus equity should a firm issue? This question is also more complex than may meet the eye. This section will review some of the basics of this matter in order to lay a foundation for discussion of the optimal ownership structure of law firms in Section III.

a) Theory of the Firm

i) Lower Transaction Costs vs. Market Pricing

Coase himself began to answer the question of why some transactions take place within a firm and some outside it by considering a key difference between the transactions.⁴ Transactions that arise within the firm result from managerial exercise of authority, while transactions that take place outside the firm rely on contracts and consequential haggling between arm's length parties. There are advantages and disadvantages to each.

To illustrate, consider an example that we will return to throughout the discussion. Suppose there is a car manufacturer, General Motors, that requires sheet metal auto body forms to assemble its cars.⁵ It has two basic options at polar extremes. It could itself build a factory capable of producing the sheet metal forms that are necessary for its cars. Or it could instead enter into a contract to buy the forms from an arm's length sheet metal manufacturer. There are

⁴ Coase, *supra*.

⁵ The relationship between GM and Fisher Auto Body is a famous example in the literature on the theory of the firm beginning with the discussion in Benjamin Klein, Robert Crawford and Armen Alchian, "Vertical Integration, Appropriable Rents, and the Competitive Contracting Process" (1978) 21 *Journal of Law and Economics* 297.

a range of options in between these basic possibilities. For example, GM could not vertically integrate the body supplier completely, but could take an equity interest in it, perhaps a minority interest that helps align the economic interests of GM and its supplier. Relatedly, GM and the supplier could form a joint venture of some kind. For example, GM and the supplier could each take a significant ownership stake in an organization, another corporation, or a partnership, that is specifically created to supply GM with auto body forms. These intermediate options, which are neither complete integration nor arm's length contracting, may in certain circumstances optimally resolve the competing economic tensions that arise, and that we will describe, when deciding how best to integrate activities within a form. To illustrate the basic considerations that motivate decisions on firm scope, however, we will focus on the basic choice of full integration or arm's length contracting.

An important advantage of building the sheet metal bodies in-house is that the managers at GM do not need to haggle over price, or over changes in design over time. Rather, they can build the appropriate factory, and hire the appropriate employees with the appropriate instructions to build the metal forms necessary for the cars. Coase observed that building the input in-house reduces transaction costs associated with the production of the metal.

On the other hand, the price mechanism is a vitally important source of information for economic decision-makers. While entering into a contract with a third party for the production of the metal forms may create transaction costs, the price that GM enters into for the metal forms gives GM information about the opportunity costs of using that sheet metal. If the price is \$X per sheet, GM has precise confidence about the opportunity costs of that input in its automobile.

If the sheet metal is sourced in-house, in contrast, it may be much more difficult to discover exactly what the opportunity cost of sheet metal is. For one, GM must attribute

overhead costs to the production of the metal. For another, GM must calculate the opportunity cost of assigning an employee to produce an additional piece of sheet metal rather than some other input, like a windshield. Determining the economic cost of the input is much more difficult when the price mechanism is suppressed in an in-house transaction than when purchased at arm's length.

Thus, Coase identified a trade-off: the firm will weigh the advantages of lower transaction costs against the disadvantages of losing the information provided by the price mechanism, and the boundaries of the firm will be set accordingly. For some matters, the transaction costs of contracting out will exceed the benefits of information provided by the price mechanism, while for others the reverse will be true.

ii) Relationship-Specific Investments

Oliver Williamson identified another important consideration in the theory of the firm: the importance of relationship-specific investments.⁶ In many longer term economic relationships, parties must make investments that maintain their value only if the relationship continues. To explain, consider again the GM example. Suppose that GM needs sheet metal of certain dimensions and shape to assemble bodies for a particular model of a car. To build that sheet metal body, suppose that specific moulds must be created at significant cost. Now consider a third party, call it Fisher, that vies to supply GM with the specific sheet metal forms. The supplier, before it can sell anything to GM, must build the moulds. The problem Fisher faces is that the moulds are virtually worthless outside the relationship with GM: they are specific to the relationship with GM. The supplier faces a dilemma: build the moulds and then hope GM buys its sheet metal, or do not build the moulds and be incapable of selling these parts to GM.

⁶ For his best-known work, see Oliver Williamson, *Markets and Hierarchies: Analysis and Antitrust Implications* (New York: The Free Press, 1975).

The dilemma is made worse by the realization that once it has built the moulds, GM can lowball it on price. Fisher would only want to build the moulds and sell to GM if it anticipated prices for the products that compensate it not only for the per-unit costs of each additional sheet metal form (eg, steel costs, employee's time, etc.), but also for the up-front costs in building the specific moulds. Once Fisher has undertaken the investment in the moulds, however, GM is in a position to offer prices that cover only the variable costs of producing the steel: Fisher would accept because the costs of the moulds is sunk, and Fisher makes more money going forward accepting than rejecting the lowball offer.

Before investing in the moulds, Fisher would anticipate the future "hold-up" problems that result from having made sunk, relationship-specific investments. There are two basic ways of dealing with the so-called hold-up problem. One, before Fisher invests, Fisher and GM can enter into a long-term contract that specifies GM's obligations, including prices and quantity demanded, over time. While such contracts can, and often do in practice, resolve some of the concerns about ex post opportunism by GM, they are not easy contracts to write and enforce. Take something as simple as pricing. Many factors would influence the appropriate market-mimicking price over time, such as the price for raw materials, and demand for the moulded sheets. Long-term, detailed contracts are costly to write and enforce, and may result in prices or other conditions that are out of alignment with other market forces, which may create tensions and disputes.⁷

An alternative option is vertical integration. Rather than GM and Fisher attempting to strike a contract that protects the interests of both parties, they can instead choose to combine their operations within a single firm. The single entity, call it GM-Fisher, can build the moulds

⁷ See, e.g., Victor Goldberg and John Erickson, "Quantity and Price Adjustment in Long-Term Contracts: A Case Study of Petroleum Coke" (1987) 30 *Journal of Law and Economics* 369.

itself, and simply transfer them to the car construction arm of the entity. This avoids the hold-up problems that sunk, up-front investments otherwise invite. Williamson's analysis provides another important reason why economic activity would be organized within a single firm rather than on the market.

iii) Private Investment in Joint Gains

A third theory, attributed in large part to Grossman and Hart,⁸ also concerns incentives to invest associated with firm ownership of an asset. This theory concerns incentives to invest in an asset that will enhance the value of the asset. The investments are valuable, but are not susceptible of contracting; efforts could be impossible to verify in court, for example. The asset could be a physical asset, or it could be intangible. Of the latter type, Grossman and Hart provide the example of a customer list. Should the list of an insurance salesperson be owned by an insurance firm, or by the salesperson herself? There is a trade-off in that both the firm and the salesperson can make investments to improve the list, but the incentives to do so vary with ownership of the list. If, for example, the company owns the list, it will have stronger incentives to advertise broadly and grow the list; as the list grows, the company will profit, not the salesperson, because the salesperson would only have access to the list with the company's permission. Conversely, if the salesperson owns the list, she will have stronger incentives to knock on doors in order to grow the list and knows that such investments are profitable to her personally; if the company refuses to compensate for her efforts, she can take the list elsewhere. Grossman and Hart predict that whether the list will be owned by the firm or not will depend on the relative importance of the incentives to make investments in the list. If the insurance provider's incentives matter more to the value of the list, it will own the list. This may in turn

⁸ See Sanford Grossman and Oliver Hart, "The Costs and Benefits of Ownership: A Theory of Vertical and Lateral Integration" (1986) 94 *Journal of Political Economy* 691.

affect the boundaries of the firm; a natural implication might be in-house sales staff, for example. On the other hand, if the salesperson's efforts and incentives matter more, it would be more natural to have an independent sales force that owns its customer lists.

iv) Culture and Reputation

These theories illustrate the basic economic approaches to firm boundaries that emphasize the gains or losses that result from integrating economic activity within a firm rather than coordinating the activity through a contract between arm's length actors. There are many nuances within this approach, and moreover many theories that do not depend so heavily on the contract-integration divide. Space does not permit development of these alternatives in detail, but one alternative is worth mentioning. The term "firm culture" can be thought of as capturing the informal norms that prevail at the firm,⁹ which are independent of formal contracts between different members of the firm, but may interact with these formal contracts. Employees may, for example, have formal contracts with the employer, and informal understandings may inform the enforcement of those contracts. Certain kinds of activity may best be promoted within a certain culture, and mixing cultures, which would be implied by integrating the different activities within a single firm, may not be appropriate. For example, if an individual's output is easily measured, perhaps because quality is easy to discern, and because teamwork is relatively unimportant, it may be suitable for the firm to have an individualistic culture that stresses individual rewards for individual performance. If, however, teamwork is vital to production, such a culture would be inappropriate.

A related consideration that may affect the boundaries of the firm concerns reputation. If a single firm develops a reputation for behaving a certain way, perhaps it is known to provide

⁹ See, e.g., Ronald Daniels, "The Law Firm as an Efficient Community" (1991) 37 McGill Law Journal 801.

high quality products, for example, there may be a risk to that firm's reputation by extending into other economic activities.¹⁰ Selling a second product may tempt the firm to renege on its reputational commitments because selling the additional product may change the short run gains from "cheating," making this the profitable strategy, not providing more costly high quality. On the other hand, it is also possible that engaging in multiple economic activities may *enhance* the incentives to maintain a good reputation with buyers. If a firm sells different products in different periods of time, for example, then selling multiple products strengthens the commitment to provide high quality: in any point in time, the firm's whole reputation is on the line for the sale of only a subset of products; better to provide high quality and protect the firm's reputation across product lines than to chisel and realize only modest short run gains from selling only a subset of the firm's products.¹¹

b) Capital Structure

We have reviewed some of the general theories of the firm, which attempt to explain why some economic activity takes place inside the firm and other activity outside the firm. There is a related, though distinct, question of how the firm structures its financing. That is, given a set of economic activities within a firm, how does the firm finance those activities? In some settings, the theory of the firm and of capital structure are intimately related.¹² If two lawyers form a general partnership, for example, such a decision would affect both the boundaries of the firm, and the capital structure of the firm – there would be two partners that own the equity interest in the firm. But in general the choice of whether to combine economic activities within a firm, and

¹⁰ See, e.g., Hendrik Hakenes and Martin Peitz, "Umbrella Branding and the Provision of Quality" (2008) 26 *International Journal of Industrial Organization* 546.

¹¹ Edward Iacobucci, "Reputational Economies of Scale, with Application to Law Firms" (2012) 14 *American Law and Economics Review* 302.

¹² Michael Jensen and William Meckling, "Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure" (1976) 3 *Journal of Financial Economics* 305.

the choice of capital structure of that firm, raise distinct questions. GM may integrate with Fisher, but that does not answer important questions about debt-equity ratios, the concentration of equity ownership, bank debt versus public debt, etc. In what follows, we outline some considerations that influence the optimal capital structure of a firm.

i) The Irrelevance Benchmark

Modigliani and Miller (“M&M”) demonstrated that, under certain conditions, including an absence of taxation, perfect competition and perfect information about investments, the choice of capital structure, debt versus equity financing for example, is irrelevant to firm value.¹³ The result is not especially important in predicting real world outcomes since the assumptions are not realistic, but it is a helpful benchmark against which to assess why capital structure may affect value in practice. The basic intuition behind the M&M theorem is as follows. A firm will have a certain pattern of cash flows over time, patterns that will not be influenced by capital structure since capital structure simply divides proceeds of economic activity and does not (as a consequence of assumptions of market perfections) affect the proceeds. Capital structure merely divides the cash flows across different investors and does not affect overall value. As Miller observed, the logic of the M&M irrelevance theory is indicated by a famous Yogi Berra observation: when asked whether he wanted a pizza sliced into four or eight slices, he replied eight since he was hungry that night.¹⁴

ii) Debt Financing

In reality, capital structure matters. This is because there is taxation, and because there are information problems that manifest themselves in two ways. Outside investors do not have

¹³ Franco Modigliani and Merton Miller, “The Cost of Capital, Corporation Finance and the Theory of Investment” (1958) 48 American Economic Review 261.

¹⁴ Dun Gifford Jr., “After the Revolution” CFO Magazine, July 1, 1998: http://pages.stern.nyu.edu/~adamodar/New_Home_Page/articles/MM40yearslater.htm.

as good an information set about the firm's prospects as insider managers, and because outsiders have only imperfect information about their managerial decisions, managers of a firm may be able to make decisions that are valuable from their selfish perspective, but may reduce overall value; this self-interested behaviour leads to so-called "agency costs."¹⁵ In this section, we briefly review some of the key considerations that make the choice of debt financing more attractive to entrepreneurs.

Tax creates an important bias in favour of debt over equity financing. Firms can write off interest payments to creditors, interest which provides creditors with the returns necessary to induce them to invest in the first place, as an interest expense for tax purposes. The returns that are paid to shareholders, such as dividends, in contrast cannot be treated as an expense for tax purposes. There is a structural advantage to debt financing: all things equal, distributions to investors as interest increases the after-tax value of the corporation relative to dividends.

There are also informational advantages associated with debt financing.¹⁶ Suppose that outside investors cannot tell whether a particular enterprise will return \$15 or \$30, but inside managers have good information about the venture's worth. If the firm seeks to sell shares, which results in existing shareholders sharing in the proceeds with new shareholders, new shareholders will be suspicious that the true value is more likely to be \$15, since old shareholders with good information about firm value would be reluctant to share with new if the value were \$30.¹⁷ To avoid suspicion about old shareholders only being willing to sell shares when values are low, old shareholders can instead issue debt. Creditors do not share in the upside of the firm's performance, and thus it will be easier, as a general rule, for them to value

¹⁵ Jensen and Meckling, *supra*.

¹⁶ Stewart Myers and Nicholas Majluf, "Corporate Financing and Investment Decisions When Firms Have Information That Investors Do Not Have" (1984) 13 *Journal of Financial Economics* 187.

¹⁷ This logic was originally outlined in George Akerlof, "The Market for 'Lemons': Quality Uncertainty and the Market Mechanism" (1970) 84 *Quarterly Journal of Economics* 488.

the debt even if insiders are better informed typically. In the example, creditors would be willing to lend \$15 without concern, knowing that in either state of the world, they will be paid in full.

Other advantages of debt relate to disciplining managers. Managers, once they no longer hold all the financial stakes in a business, may be tempted to make self-interested, yet value-reducing decisions, such as overconsuming perquisites on the job, empire-building, or avoiding risks that jeopardize their positions. Debt can help discipline managers in different ways. For one thing, debt obligations to pay out steady streams of cash flow may address a manager's temptation to otherwise keep cash in the company, perhaps as a buffer against risk, perhaps to help build empires, or both.¹⁸ For another, the more debt financing there is, the easier it will be for equity ownership to be relatively concentrated, rather than dispersed.¹⁹ A relatively-cash poor entrepreneur that finances an enterprise through debt may be able to retain a significant percentage of shares. Concentrating share ownership in the hands of management, as we discuss further below, tends to provide management with stronger incentives to increase the value of shares. Debt may thus be valuable by allowing such concentration. Finally, creditors may monitor management, which helps reduce agency costs directly, and may reveal information to other monitors such as equity-holders so that they can act to discipline management.²⁰ For example, if a bank refuses to extend a line of credit, this may signal problems at the firm to other stakeholders.

There are, of course, disadvantages to debt finance. For one, there are bankruptcy costs. If the firm cannot pay its debts, it will enter a bankruptcy or reorganization process, which is costly and will reduce the value of the firm as a result. For another, the presence of debt may

¹⁸ Michael Jensen, "Agency Cost of Free Cash Flow, Corporate Finance, and Takeovers" (1986) 76 *American Economic Review* 323.

¹⁹ Jensen and Meckling, *supra*.

²⁰ George Triantis and Ronald Daniels, "The Role of Debt in Interactive Corporate Governance" (1995) 83 *California Law Review* 1073.

induce excessive risk on the part of managers who are looking to maximize share value.²¹ This is because downside risk is shared with creditors, while upside risk is realized by shareholders; creditors have only a fixed claim. To take an extreme case, if a firm owes \$100 in debt, but has only \$5 in assets, a manager might well prefer to invest in a lottery ticket that is a negative expected value investment, but will pay off generously to shareholders in the very unlikely chance it is a winner. A miniscule chance of realizing value for shareholders is better than a zero chance. Debt thus tends to create perverse incentives for shareholders to engage in excessive risk that lowers the overall value of the company.

There is an important qualification to this discussion of the risk-inducing properties of debt: it is premised on limited liability for shareholders. If, for example, equity-holders had unlimited liability for the firm's debt, this would mitigate the incentives to assume excessive risk: if the risky debt does not pay off, equity-holders remain personally on the hook to creditors, which reduces their incentives to take on excessive risk. Limited liability is thus an important consideration in evaluating the economic costs and benefits of different capital structures. Limited liability puts more risk on creditors and less on equity-holders, which may have positive effects if creditors are better able to bear risk, but may also be negative by inviting excessive risk-taking.

iii) Equity Financing

While not all for-profit businesses carry debt (though most do), all for-profit businesses have equity-holders who are the residual financial claimants: they get paid after all other fixed claimants have been paid in full. The economic question with equity investment is therefore not so much whether it should be issued, but how it should be structured.

²¹ Jensen and Meckling, *supra*.

One question is the extent to which equity should be concentrated or diffuse. There are three basic models with advantages and disadvantages. Equity could be concentrated in the hands of very few investors. This has the advantage of creating strong incentives for these investors to monitor management, since each has a significant stake in the value of the enterprise. It has the disadvantage, however, of exposing these investors to potentially significant risk, which is not desirable all else equal. Concentrated ownership may also be problematic, or at least difficult to achieve, if the principals behind a business require outside capital, and debt financing is problematic.

An intermediate structure would have a controlling shareholder, along with diffuse minority shareholders. Such a structure allows the controlling investor to mitigate some of its exposure to the company's risk by selling minority equity stakes, but maintains the presence of an investor with strong incentives to monitor the company's progress. A further advantage of this structure is that the market in the firm's equity provides information to investors about the performance of management. If, for example, shares in all bank firms but one are rising, this would tend to indicate less than stellar management at the one firm. The problem, however, is that with such structure, management is irreplaceable without consent of the controlling shareholder. Especially where the manager is the controlling shareholder, such consent may not be forthcoming. As a consequence, the controlling shareholder may be able to extract value from the minority without fear of consequence.

A final possibility is widely held equity. This structure creates the most opportunity for risk diversification, since no single shareholder owns a significant percentage of shares. There is also the prospect of forcing underperforming management out, perhaps through a hostile takeover (perhaps invited by underperforming shares), perhaps through a proxy contest. On the

other hand, with no single shareholder owing a significant percentage of the company, there is a danger that there will be little monitoring of management, especially given the costs and therefore relative rarity of proxy contests and hostile takeovers.

III. ALTERNATIVE BUSINESS STRUCTURES FOR THE PRACTICE OF LAW

In a voluntary survey of lawyers in 2009 by the Law Society of Upper Canada, which attracted a response rate of 51 percent, the survey found that of lawyers working in private practice:

- 18 percent reported as working as sole practitioners
- 11 percent report working at firms of 2 to 5 lawyers
- 4 percent reported working at firms of 6 to 10 lawyers
- 4 percent reported working at firms of 11 to 20 lawyers
- 3 percent reported working at firms of 21 to 50 lawyers
- 2 percent reported working at firms of 51 to 100 lawyers
- 4 percent reported working at firms of 101 to 200 lawyers
- 6 percent reported working at firms of 201 or larger²²

Assuming that that these numbers are broadly representative, it is clear that a disproportionate percentage of private legal practitioners in Ontario operate as sole practitioners or work at small firms. We now set out below the principal business structures that have emerged in Ontario for the provision of legal services, and describe alternative business models that have emerged in jurisdictions beyond Ontario that are presently restricted in this jurisdiction.

²² *Statistical Snapshot of Lawyers in Ontario: From 2009 annual report*, online: The Law Society of Upper Canada <<http://www.lsuc.on.ca/WorkArea/DownloadAsset.aspx?id=2147485403>>.

a) Unincorporated Sole Proprietorships

A sole proprietor or sole practitioner owns and operates his or her professional practice alone in unincorporated form, and is subject to very few formal business registration requirements. As noted above, sole proprietorships remain today a prominent feature of the legal landscape in Ontario, but are not mandated in any context. This is in contrast to the traditional rules that have applied in the UK, and some other jurisdictions, with a divided legal profession of solicitors and barristers (or advocates), where barristers have often been required to operate as sole practitioners (albeit often operating in group chambers, with shared overheads). The UK Office of Fair Trading has been critical of prohibitions on barristers forming partnerships with other barristers, or forming partnerships with solicitors, and recent regulatory changes have liberalized the rules in this respect, including liberalizing the rules pertaining to rights of audience of solicitors in most UK courts and tribunals. Obviously, an unincorporated sole proprietorship, with unlimited liability, entails risks to the personal assets of the sole proprietor from liabilities (such as professional negligence) incurred in the course of his or her legal practice, and can only draw on external sources of debt capital.

b) General Partnerships

Lawyers entering into a partnership with other lawyers may do so under the *Partnership Act*²³, and indeed historically this has been the most common form of group practice. With a general partnership, every partner in the law firm is liable jointly with the other partners for all debts and obligations of the firm incurred while the person is a partner, including liability for the negligence of other partners. While this obviously entails risks for each partner with respect to errors and omissions of other partners, including risks to personal assets, in principle it creates

²³ *Partnership Act*, RSO 1990, c P.5.

strong incentives for mutual monitoring by partners of each other's integrity and competence. Because all partners must be lawyers, the only source of external capital is debt capital (e.g., bank loans). In limited contexts, third party financiers (e.g., hedge funds) may finance litigation undertaken by a law firm in return for a share of any ultimate award or settlement, in effect shifting some of the litigation risks from lawyers and their clients to an external entity.²⁴ Often general legal partnerships form management companies to hold most assets of the legal practice and hire support staff and provide agreed space and services to the legal partnership as determined by contract (thus shielding assets from partnership liabilities).

c) Limited Liability Partnerships

As of 1998, lawyers in private practice in Ontario have been able to form limited liability partnerships with other lawyers, subject to minimum mandatory errors and omissions insurance coverage, and many law firms have subsequently adopted this legal form. Limited liability partnerships amongst lawyers have now also been widely permitted in many other Canadian and foreign jurisdictions. In the case of a limited liability partnership, a partner can generally still be held liable for his or her own negligent or wrongful act or omission; the negligent or wrongful act or omission of a person under the partner's direct supervision; or the negligent or wrongful act or omission of another partner or an employee of the partnership not under the partner's direct supervision if a) the act or omission was criminal or constituted fraud, or b) the partner knew or ought to have known of the act or omission and did not take the actions that a

²⁴ See Jasminka Kalajdzic, Peter Cashman and Alana Longmoore, "Justice for Profit: A Comparative Analysis of Australian, Canadian, and US third Party Litigation Funding" (2012) 61 *American Journal of Comparative Law* 93; Michael Trebilcock and Elizabeth Kagedan, "An Economic Assessment of Third Party Litigation Funding of Ontario Class Actions" (*Canadian Business Law Journal*, symposium issue, forthcoming).

reasonable person would have taken to prevent it. However, with these exceptions a partner is not liable for the debts, liabilities or obligations of the partnership or any partner.²⁵

d) Professional Corporations

The *Law Society Act*²⁶ permits the incorporation of legal entities to provide legal services, provided that all the shareholders are members of the Law Society of Upper Canada and also directors of the entity. In Alberta, spouses and children of lawyer-shareholders may own non-voting shares.²⁷ Family members of physicians and dentists in Ontario also may own shares in a professional corporation.²⁸ This is not so for lawyers in Ontario. The *Ontario Business Corporations Act*²⁹ that provides for the creation of professional corporations states that the liability of a member for a professional liability claim is not affected by the fact that the member is practicing a profession through a professional corporation and remains jointly and severally liable with a professional corporation for all professional liability claims made against the corporation while the person was a shareholder. Hence, the risks borne by shareholders in a professional legal corporation are essentially the same as those borne by partners in a general partnership, and are more expansive than those associated with limited liability partnerships. The principal advantage of a professional corporation for lawyers appears to relate to tax liability.

e) Business Corporations with Limited Liability

²⁵ See Poonam Puri, "Judgment Proofing the Profession" (2001) 15 *Georgetown J. of Legal Ethics* 1.

²⁶ *Law Society Act*, RSO 1990, c L.8.

²⁷ See *Legal Profession Act*, RSA 2000, c L.8 s 131(3)(f).

²⁸ Since January 1, 2006, O. Reg. 665/05 has exempted physicians and dentists from the requirement under the *Business Corporations Act* that the shares in a professional corporation be owned by members of the regulated profession. See http://www.e-laws.gov.on.ca/html/regs/english/elaws_regs_050665_e.htm

²⁹ *Business Corporations Act*, RSO 1990, c .16.

Ontario does not currently permit ordinary business corporations with limited liability to provide legal services. They are, however, permitted in other professions in Ontario. Professional engineers, for example, can and do form corporations with limited liability in Ontario.³⁰ Moreover, legal service corporations with limited liability are permitted in other jurisdictions.

A number of US states allow Limited Liability Companies (LLC's). LLC's combine elements of a limited liability partnerships and corporations. Stock in the company is held by lawyers, who may or may not participate in management. States vary in allowing lawyers to form LLC's. The LLC is still subject to vicarious liability, but the owners' personal assets are protected, and individual lawyers are subject in many states to continuing supervisory liability (much as is the case with limited liability partnerships in Ontario).³¹

The Australian states and territories and the UK, in recent reforms, have authorized incorporated legal practices, with full limited liability, and recent estimates suggest that more than 20 percent of all legal practices have now been incorporated as limited liability entities.³² Shares in these corporations need not be owned exclusively by lawyers (in the case of Australia, typically one director must be a lawyer), although individual lawyers working for such entities remain responsible for compliance with professional codes of conduct and continue to be subject to civil liability for their own errors and omissions, and presumably the corporate entity itself is

³⁰ See, e.g., *Professional Engineers Act* R.S.O. 1990, c. P.28, s. 13: "A corporation that holds a certificate of authorization may provide services that are within the practice of professional engineering."

³¹ Larry Ribstein, "Ethical Rules, Law Firm Structure and Choice of Law" (2001) 69 *University of Cincinnati Law Review* 1161 at 1170-1171; See also Bryan Smith, "The Professional Liability Crisis and the Need for Professional Limited Liability Companies: Washington's Model Approach" (1995) 18 *Seattle UL Rev* 557 at 575-576.

³² In NSW Incorporated Legal Practices make up 18% of all law firms. See Steve Mark, *A short paper and notes on the issue of listing of law firms in New South Wales*, online: Office of the Legal Services Commissioner New South Wales <http://www.olsc.nsw.gov.au/agdbasev7wr/olsc/documents/pdf/notes_for_joint_nobc_april_aba_panel.pdf> [Steve Mark].

also vicariously liable for errors and omissions of its professional and other employees.³³ The issue of non-lawyer ownership of business entities providing legal services is sufficiently important, recent, and contentious as to warrant separate discussion.

f) Non-Lawyer Ownership of Corporate Entities Providing Legal Services³⁴

The great majority of incorporated legal practices that have emerged in the UK and Australia in recent years with non-lawyer ownership have been small entities where non-lawyer employees or family members become shareholders or managers. In some cases insurance companies or claims adjusters have acquired law firms that were previously on retainer to them. However, there have been a few striking exceptions to the predominantly small scale of incorporated legal practices in these jurisdictions. For example, in Australia Slater and Gordon became the first firm of lawyers to be floated on a stock exchange when in 2004 it issued AUD \$35 million of AUD \$1 shares. Subsequently, Slater and Gordon began acquiring legal practices across Australia, and in 2012 and 2013 acquired significant English personal injury firms.³⁵ It now employs 1,350 staff in 69 locations, and serves predominantly the civil legal needs of individuals, such as conveyancing, family law, estate law, and plaintiff-side personal injury matters.³⁶ Two other Australian law firms have now been listed on a stock exchange.³⁷

In the case of the UK, Cooperative Legal Services, the legal arm of the Cooperative Group, which includes Britain's fifth largest supermarket chain as well as banking and insurance

³³ Steve Mark, *ibid*; *Legal Services Act, 2007* c.29.

³⁴ This section draws heavily on Frank Stephen, *Lawyers, Markets and Regulation* (Edward Elgar, forthcoming), chap. 8 and Noel Semple, "Access to Justice: Is Legal Service Regulation Blocking the Path?" (Draft Paper, University of Toronto Law School, 2013).

³⁵ <http://www.legalfutures.co.uk/latest-news/slater-gordon-set-acquire-fentons-extend-reach-uis/print/>.

³⁶ Stephen, *ibid* at 176; Semple, *ibid* at 28.

³⁷ Shine Corporate and Rockwell Olivier, ASX, *ASX Welcomes Shine Corporate Limited*, online: <<http://www.asx.com.au/documents/research/shine-corporate-limited-new-listing-media-release.pdf>>; Lawyers Weekly, *Listed Firm Rockwell Olivier launches in OZ*, online: <<http://www.lawyersweekly.com.au/news/listed-firm-rockwell-olivier-launches-in-oz>>.

businesses, was authorized as an Alternative Business Structure in 2012. The Cooperative Group is owned by 6 million consumer members. It provides legal services to individuals, including extensive online advisory services, and plans to open branch offices in many of the 300 offices of Cooperative Bank and the Britannia Building Society, with plans to employ 3,000 lawyers by 2017.³⁸ Another significant firm in the UK, Riverview Law, which serves commercial law clients, has proposed doubling in size over the next year by hiring up to 100 new employees.³⁹ BT Law, part of BT Group, a major UK telecommunications and internet service provider, has also been issued an Alternative Business Structures license. BT Law will be associated with BT Claims, the motor claims subsidiary of the group. Several other major brands or chains are expected to be licensed as ABSs in the course of 2013, including the major motoring breakdown and insurance provider, which currently has 16 million members.⁴⁰

In Finland, banks and insurance companies, as well as other private and non-governmental organizations, can provide legal advice to their customers, although they cannot litigate on their clients' behalf. Simple civil matters, particularly in family and property law, are handled by bank lawyers on behalf of their non-business customers.⁴¹

In various western European jurisdictions, including most prominently Germany, France and Spain, major international accounting firms have acquired legal affiliates, which have in turn acquired a significant share of corporate legal services in these markets. However, this development is more conveniently discussed (below) as a separate business model involving multidisciplinary professional practices in contrast to the other examples of non-lawyer

³⁸ Stephen, *ibid* at 181.

³⁹ <http://www.legalfutures.co.uk/latest-news/riverview-plots-major-expansion>.

⁴⁰ *Ibid*, at 182.

⁴¹ *Ibid*, at 179-180.

ownership of legal service entities discussed above, which all involve the provision exclusively or predominantly of legal services, as opposed to multidisciplinary professional services.⁴²

g) Franchising

While not accorded much prominence in contemporary discussions of alternative business structures in the provision of legal services,⁴³ it is not difficult to imagine the emergence of franchising networks that may be non-lawyer owned. Such networks might grant franchises to owners and operators of local franchise branches (who may also be non-lawyers), and would provide headquarters support in terms of marketing, advisory and research services, somewhat analogously to H&R Block franchises in tax advisory and preparation services. Both the head office of the franchisor and the larger franchise offices might well employ lawyers on their staffs, but may also rely heavily on online and paralegal frontline services. Presumably, lawyers so employed would remain individually responsible for compliance with professional obligations, including supervisory obligations, as well as being subject to civil liability for their own errors and omissions; the franchisor and franchisees would also presumably be vicariously liable for errors and omissions of legal and other personnel employed by them.

An example of independently owned and operated firms working within a branded network is found in the UK with QualitySolicitors.⁴⁴ The network promises its over 200 member firms (and growing) access to national branding strategies, as well as other benefits of membership, including website support and buying power, but firms remain independent.⁴⁵

h) Multidisciplinary Professional Practices

⁴² *Ibid.*, at 92-99.

⁴³ But see Gillian Hadfield, “The Cost of Law: Promoting Access to Justice through the Corporate Practice of Law” (2012) unpublished, found at <http://works.bepress.com/cgi/viewcontent.cgi?article=1057&context=ghadfield>.

⁴⁴ See their website at <http://www.qualitysolicitors.com/>.

⁴⁵ See <http://files.qualitysolicitors.com/QualitySolicitors%20Info%20Pack.pdf>.

As noted above, multidisciplinary professional practices have emerged in a number of western European jurisdictions, typically involving international accounting firms acquiring local legal affiliates. By virtue of the *Legal Services Act* of 2007 in the UK, multidisciplinary professional practices may now also qualify for an ABS license.⁴⁶ Where legal services are involved, the authorization of the Solicitors Regulatory Authority is required. Some multidisciplinary firms of accountants and lawyers have been approved. In Ontario, in contrast, under Law Society rules adopted in 1999 and 2000, multidisciplinary practices involving lawyers and non-lawyers are subject to two major constraints: first, the lawyer partners must be “in control” of the work undertaken by non-lawyer partners, and second, the services provided by the latter may only support or supplement the provision of legal services. In the case of a law firm that is affiliated with a non-legal entity (such as an accounting firm), the rules require that a legal licensee shall own the professional business through which the licensee practices law; maintains control over the professional business through which the licensee practices law; and carries on the professional business through which the licensee practices law from premises that are not used by the affiliated entity for the delivery of its services, other than those that are delivered by the affiliated entity jointly with the delivery of the services of the licensee. An affiliated law firm cannot share revenues, cash flows, profits, or provide compensation for referrals with the non-legal entity with which it is affiliated.⁴⁷ More generally, Law Society rules prohibit fee-splitting between lawyers and non-lawyers outside the exception for multidisciplinary partnerships.

⁴⁶ Charles Plant, *Our Proposals for Alternative Business Structures*, online: Solicitors Regulation Authority <<http://www.sra.org.uk/sra/news/plant-abs-proposals-speech.page>>.

⁴⁷ *Rules of Professional Conduct* Rule 2.08(8), online: Law Society of Upper Canada <<http://www.lsuc.on.ca/WorkArea/DownloadAsset.aspx?id=2147489377>>.

Similar rules have been adopted across a number of Canadian and US jurisdictions.⁴⁸ Both recent UK and Australian reforms on non-lawyer ownership of firms providing legal and other professional services stand in sharp contrast to the much more restrictive rules that prevail in North America. While the full or partial integration of accounting, related financial and management consulting, and legal services have attracted most of the attention in policy debates to date, many other combinations of professional practices are readily conceivable, including, for example, real estate agents, surveyors, mortgage financing providers and legal service providers in the provision of bundles of real estate-related services; or lawyers, financial advisors, and family counsellors in the family law area.

IV. THE POTENTIAL ECONOMIC ADVANTAGES OF ALTERNATIVE BUSINESS STRUCTURES

Part II of our paper reviewed two key economic areas of analysis that relate to organizational structure. First, we discussed the theory of the firm, which concerns the question of what kinds of economic activities will be organized within a firm, and what economic activities will take place outside firm boundaries. Second, we examined the economic advantages and disadvantages of various kinds of capital structures. Part III reviewed different business structures that are permitted within the present Ontario landscape, as well as alternatives that are permissible outside Ontario. In this section we bring the insights of the economic questions discussed in Part II to bear on the question of organizational structure of legal practice discussed in Part III. The goal of the analysis is to gain greater understanding of the potential economic advantages of alternative business structures from a theory of the firm and capital

⁴⁸ See Michael Trebilcock and Lila Csorgo, "Multidisciplinary Professional Practices: Consumer Welfare Perspective," (2001) 24 *Dalhousie Law Journal*, page 1; Kent Roach and Edward Iacobucci, "Multidisciplinary Practices in Partnerships: Prospects, Problems and Policy Options," (2000) 79 *Canadian Bar Review* at page 1.

structure perspective. In particular, we consider the typical models of firm practice both presently allowed, as well as alternatives that are not permitted in Canada but are elsewhere, with a view to understanding the economic advantages and disadvantages of each.

Before turning to a case-by-case examination of alternative models, we offer a number of preliminary observations. To begin with, from a purely economic perspective, it is not difficult to arrive at the conclusion that the optimal legal approach to the question of alternative structures for legal practice is to be broadly permissive. As is apparent from Part I, there are a host of factors that affect the economic optimality of a given structure, factors that will vary in importance across business contexts, and even conceivably across individuals (some lawyers may be more risk-averse than others, for example). Economics would therefore tend to recommend wide latitude for choice: let the principals in a given practice adopt the model that works best in their circumstances. (As we discuss further below, in making such choices, the principals would have economic incentives to account both for their own preferences but also those of their clients: all else equal, clients would not want to deal with a firm that has a structure that is not good for clients.)

To some extent, therefore, the analysis that follows is unnecessary to establish the policy proposition that, from an economic perspective, there should be no restrictions on the business structures of legal practices. Even if it turned out that in practice individuals continued to voluntarily adopt conventional structures that are presently permitted, this would not be an argument in favour of restricting choice; rather, it would simply be an argument that choice may not lead to radical change or radical improvement in economic performance. The analysis that follows should be understood as providing the affirmative case for liberalization in that it offers concrete reasons to suppose that some particular structures may have advantages over others,

depending on context, which in turn suggests that liberalization would bring economic advantages. In other words, it is not just that there is no economic argument opposed to liberalization, but also that there are reasons to expect economic gains from liberalization. The analysis does not claim to offer precise predictions about what structures would emerge in practice, or what the precise economic gains would be as an empirical matter. Rather, it offers reasons to suppose that liberalization has the potential to bring about real economic gains.

We appreciate, of course, that policy-makers may (and indeed should) consider factors other than economic gains when assessing optimal policy towards business structures. The rule of law has a fundamental role to play in society, and to the extent that business structures affect how lawyers support the rule of law, there are considerations related to the structure of legal practice that extends beyond dollars and cents. In what follows, we offer only a view of the economic costs and benefits of different structures, recognizing that there are other values that the law should take seriously. Our analysis is intended only to offer an input into answering the broad question of whether liberalization ought to be permitted, not an answer to that question.

That said, we note that some of the kinds of ethical considerations that have influenced policy towards business structures fit easily within an economic analysis. Take, for example, basic concerns about who bears liability for negligent legal services. It may be that the legal requirement of a partnership, and consequential personal joint and several liability for partners, including liability for negligence, is designed to promote the ethical performance of the lawyer's obligations. But there is an economic lens through which to view the requirement: clients want to ensure that the lawyer personally has incentives to ensure that the advice she and her partners gives is not arrived at negligently.

There will be economic incentives for a lawyer to adopt a form and liability status that maximizes the joint value of the relationship for lawyer and client. To explain, suppose that lawyers are not required by regulation to adopt a form that leads to unlimited liability for the lawyer, but that unlimited liability and the reassurance it provides is worth \$100 to a client. If the risk that the lawyer faces as a consequence of unlimited liability costs her personally less than \$100, say it costs \$40, she would prefer to have unlimited liability: she can charge the client up to \$100 more having adopted such status, while bearing costs of only \$40. There is a joint gain of \$60 from unlimited liability that will be divided between client and lawyer. On the other hand, if the risk of unlimited liability costs the lawyer \$120, she and the client are jointly better off with limited liability: the maximum price that the client will pay for the lawyer falls by \$100, but better this for the lawyer than incurring costs of \$120 by adopting a partnership and unlimited liability. While it will depend on the circumstances, it is possible that lawyers would have economic incentives to adopt unlimited liability. To the extent that unlimited liability is desirable in promoting ethical behaviour, economics and ethical considerations align with one another.

It is clearly not true, however, that economic actors always have private economic incentives to pursue what amounts to an ethical course of action. For example, there may be weak private economic incentives to fulfill ethical obligations to third parties, such as the courts and the public, since by definition the client is not willing to pay for such conduct. But the example demonstrates two important points. One, ethical considerations may also be relevant for economic decision-makers, especially where they concern the lawyer-client relationship. Two, parties have private incentives to adopt terms in their relationship, including the form of the law firm and corresponding liability features, that maximize joint value. Obviously the form

that a lawyer adopts will affect all clients that it interacts with so the lawyer cannot maximize value from the business form in respect of all clients at all times, but the lawyer has incentives to choose the best form from a value perspective across clients.

Before embarking on the structural analysis, it is also worth observing that the strength of the case for liberalization will depend on other significant institutional questions. To take an example, consider how standardized substantive law is across varying circumstances. One could imagine rules of broad, mechanical application on the one hand, versus narrow standards that depend significantly on all the facts of a particular case, and ultimately on the judgment of a legal decision-maker, on the other hand. Now consider the efforts of a legal services provider to establish a technological means to provide legal advice. If the law is broadly applied and depends on mechanical application of clear criteria, it would be relatively straightforward for a provider to invest in a web-based application that could provide advice.⁴⁹ This in turn might call for a certain kind of firm structure that would be suitable for relatively significant investment in technological capital, and less need for human capital (we discuss this further below). On the other hand, if the law is idiosyncratic and depends on an exercise of judgment that may be difficult to predict, technological solutions, and the kinds of structures that are suitable for such solutions, are less likely to emerge in a liberalized environment.

Another, more prosaic consideration that will influence the choice of structure in practice is tax law. Tax law may favour some structures more than others. Incorporation, for example, can in effect allow principal shareholders to defer paying personal taxes on income by allowing retained earnings to accumulate within the corporation without tax at the shareholder level. We cite the tax and the technology examples not because they necessarily have special importance

⁴⁹ Existing online service providers, such as LegalZoom, tend to focus on less idiosyncratic legal questions, such as incorporating a business, though also offer individualized services where applicable.

but simply because they illustrate the kinds of considerations that will influence the choice of structure. The choices are not made in an institutional vacuum.

As a further observation on the specific question of tax, we in general will not spend much time assessing the tax implications of different business structures. This is not because tax is an insignificant consideration in practice when actors are establishing different business structures. Rather, we focus on non-tax considerations because they are, in our view, more important as a policy matter. Policy should be concerned about real economic gains to society, while tax minimization may not do anything positive for society. For example, it could be that the corporate form would better allow lawyers to minimize their tax bills relative to partnerships, but we would not view this, as a public policy matter, to be an advantage of the corporate form.⁵⁰

There is one final observation that we will make before turning to an economic analysis of particular structures. The case for liberalization of business structures is sometimes said to rest in part on the effect of such liberalization in enhancing competition among legal service providers. In Australia, for example, it was the competition authority that was largely responsible for pressing the case for liberalizing the rules on law firm structures; in the UK, the Office of Fair Trading had adopted a similar stance. In our view, however, the relationship between the rules restricting the structure of permissible legal practice and competition are tenuous.⁵¹ As a preliminary observation, it is important to distinguish between two related, but conceptually distinct restrictions on legal practice. First, there are restrictions on who is authorized to practice law. Second, there are restrictions on the kinds of business structures that

⁵⁰ As a possible corollary to this point, in our view there is a good argument that tax law should not induce firms to choose one structure over another, but rather should be neutral across forms. See, e.g., Benjamin Alarie and Edward Iacobucci, "Tax Policy, Capital Structure and Income Trusts" (2007) 45 Canadian Business Law Journal 1.

⁵¹ See Edward Iacobucci and Michael Trebilcock, "Self-Regulation and Competition in Ontario's Legal Services Sector: An Evaluation of the Competition Bureau's Report on Competition and Self-Regulation in Canadian Professions" (2008).

those who practice law may adopt. It is not difficult to see how these two kinds of restrictions are related to one another, but they should not be elided. They are related most clearly in the case of a multi-disciplinary practice. If there were, for example, no restrictions on who could practice law, then a lawyer and another professional (or non-professional) would be better able to form a business structure in which they both provide services without inviting concern about the unauthorized practice of law. Thus, the demand for alternative business structures would presumably grow if there were no restrictions on who is qualified to give legal advice.

The fact that restrictions on who is authorized to practice law and restrictions on alternative business structures are related does not imply that they raise the same issues. It could be entirely defensible, for example, to maintain licensing restrictions on the practice of law while liberalizing business structures. Some of the economic gains from liberalizing structure may not be realized fully with such licensing restrictions in place, but the benefits of a licensing regime, such as protecting the public from incompetent legal advisors, may justify such an approach.

It is apparent that liberalizing the permitted structures of legal practices does not itself enhance the competitiveness of the legal services market. Consider two states of the world: one in which business structures of legal practice are restricted; and another where they are liberalized. In the illiberal state of the world, there are a certain number of lawyers in a certain jurisdiction that are authorized to practice law. This number does not change with the liberalization of the choice of business structure, which in turn implies that the number of competitors for a particular service is unlikely to change significantly with the choice to liberalize. Indeed, if anything, it is conceivable that traditional restrictions on the structure of legal practice, such as restrictions on equity investment by passive outsiders, tend to keep firms relatively small, and with liberalization it would be conceivable that firms that provide legal

services could become much larger. If legal firms were to grow post-liberalization, it would be conceivable that liberalization could *reduce* competition because of a diminution in the number of firms competing for business.

We would add that, as we have outlined in a different report, we are sceptical that the legal services market in Ontario suffers significantly from an absence of competition.⁵² As we observed, there are thousands of lawyers in Ontario seeking to provide legal services, and thousands of law firms as well. In addition, both para-legals and online legal forms providers⁵³ are plentiful and compete in at least some dimensions with lawyers. The rates for providing certain legal work range considerably, from less than \$100 per hour for certain kinds of basic legal services, to more than \$1,000 per hour for services with more nuance and need for highly specialized human capital. The rates do not vary because of a lack of competition, but rather in large part because certain kinds of human capital are rare, and those who possess certain qualities will realize significant returns to those qualities. Such returns, known by economists as scarcity or Ricardian rents, result whenever a resource is scarce and do not amount to market power. For example, certain hockey players might realize vast scarcity rents, but this is not because there is a lack of competition to become such hockey players.

Indeed, because there are such significant competitive pressures in the existing legal services industry, the liberalization of business structure regulation is more likely to have a positive impact. Given that there is robust competition among firms, any innovation that allows the firm to economize in its provision of services would provide the innovator with returns that they would not realize under the status quo. Other firms will quickly imitate, also in pursuit of rare economic profits, and competition is likely to result in the diffusion of productivity-

⁵² Iacobucci and Trebilcock, *supra*.

⁵³ See, e.g., <http://www.lawdepot.ca/contracts/canada/Ontario/>.

enhancing innovation across the legal services market. Because of competition, the fruits of the innovations will typically be passed along to the buyers of legal services. This not only produces the usual creation of consumer surplus, which results when a buyer of a product pays less than her maximum willingness to pay for that product, but also has the potential to enhance access to justice, which may have non-economic positive effects.⁵⁴

A final word on competition. Traditional restrictions on the financing of legal firms prevent firms from going to equity markets or issuing public debt. Firms finance through bank borrowing or partners' equity investment. Some have suggested that firms are likely to suffer from these restrictions in part because the bank lenders will appreciate that they face less competition from other capital sources and can charge higher rates as a consequence.⁵⁵ This is conceivably true, but will not be true as a general matter. If the banking sector is competitive, which is highly probable at least for loans to sophisticated law firms who could borrow from a wide range of banks, not just local ones, there will not be room for a given bank to charge supra-competitive rates. Only if there is a lack of competition within banking itself will the confinement of financing to banks result in supra-competitive prices for loans.

The gains that result from opening up financing choices thus do not in general rest on greater competition, but instead from a more suitable capital structure for the firm. Capital structure affects value in a number of ways, and choosing one instrument rather than another has implications for firm value. Liberalizing financing choices would not necessarily have a positive impact on competition, but rather a positive impact from better calibrated capital structures.

With these initial observations as background, we turn now to the economic analysis of different business structures for legal practice. We begin with traditional, and legally

⁵⁴ See Noel Semple, "Access to Justice: Is Legal Services Regulation Blocking the Path?" (2013).

⁵⁵ Semple, *supra*.

permissible, forms, and then consider alternatives. In each case we review the advantages and disadvantages of the form from a theory of the firm and capital structure perspective. We assume initially that lawyers must associate only with other lawyers within the firm and consider the advantages of different forms on this assumption. We then turn to examining the relative merits of multi-disciplinary organizations and firms in which non-lawyers may make financial investments.

a) Sole Proprietorship

The most common form of business practice in Ontario is a sole proprietorship. The sole proprietorship has advantages and disadvantages from a theory of the firm and a capital structure perspective. On the theory of the firm, the sole proprietor has the strongest possible incentives to invest in the value of the firm. She does not share the proceeds of her investment with other members of the firm, and thus realizes fully the fruits of her investment. If, for example, she provided especially good service to a particular client in the hopes of improving the firm's reputation for high quality legal work, she would realize entirely the benefits of that investment and would not have to share it with partners. This enhances the incentives to make such investments. Similarly, any investment in growing the firm's client list is realized by her alone.

Having only one lawyer in the firm also reduces coordination costs within the firm. Coase's analysis of the theory of the firm observed that extra-firm transactions invite haggling and other costs, and observed that these costs are lower within a firm. While this may be true, within-firm costs are not zero, especially where there are multiple equity owners (such as within a partnership) and no single authority that can impose decisions on others within the firm. A sole proprietor thus minimizes intra-firm transaction costs.

There are, however, significant disadvantages of the sole proprietorship from a theory of the firm perspective. For one, clients with legal problems to solve often will have different requirements for specialization from their lawyer. The sole proprietor can either become a generalist to some extent and attempt to provide as wide a range of service as possible, or will play a role simply in referring clients to other specialists. In the latter case, there is a Coasean problem: the sole proprietor may wish to realize some benefit from the lawyer to whom she has referred business, but it may not be straightforward to enter into an arm's length agreement on how best to compensate for such referrals. Moreover, there may be legal restrictions on referral fees. The sole proprietor may settle for an informal reliance on reciprocity to deal with referrals outside the firm, which may not be optimal. At the very least, informal reciprocity may not provide the sole proprietor with strong incentives to invest in the relationship with the outside lawyer, especially where the referring relationship is likely to be asymmetric.

There may also be reputational incentive disadvantages to the sole proprietorship.⁵⁶ When performing services as a sole proprietor, the lawyer potentially suffers a reputational loss if she provides low quality advice; on the other hand, she realizes fully the benefits of shirking on service (e.g., saving time, lower exertion, savings on on-line research tools, etc.). In a partnership with other partners, in contrast, when providing services, the lawyer gets a benefit from shirking, but risks a reputational loss to other lawyers in the firm, not just herself, by so acting; outsiders may blame lawyers in the firm generally for poor performance. The relative costs of shirking may therefore be lower for a sole proprietor than a partner. Clients that recognize these incentives may be less willing to deal with a sole proprietor. There is a disadvantage from a reputational theory of the firm perspective to a sole proprietorship.

⁵⁶ See Iacobucci, *supra*.

Turning to considerations of capital structure, there is one striking advantage of a sole proprietorship from a financing perspective. Because she owns 100% of the equity of the firm, the sole proprietor does not have incentives to make decisions that are good for her as an individual, but bad for equity investors as a whole. She bears entirely the economic effects of her decisions on the value of equity. The incentives to overconsume perquisites, for example, fall away entirely, while they would be more prominent if a decision-maker owned only a small fraction of a firm's equity.⁵⁷

On a related point, within a sole proprietorship, there is obviously no need for equity owners to monitor management to deter self-interested, wasteful decisions. The equity owner *is* the manager. This is itself an advantage of the sole proprietorship because investments in monitoring management are themselves costly.⁵⁸ That they are unnecessary in a sole proprietorship is an advantage of the form.

There are, however, significant disadvantages to the capital structure associated with a sole proprietorship. A sole proprietor bears entirely the risk of the firm's performance herself. If, for example, she specializes in an area such as real estate law, there will be significant fluctuations in business that are beyond her control. She would also bear the risk entirely if she were to make a positive net present value, but uncertain, investment. Consider the kinds of investments that are increasingly common in the legal landscape: investments in technology to provide better service to clients. For example, consider investing in a web-based tool that allows the sole proprietor to serve a significantly greater number of clients at significantly lower costs per client in providing advice about a will. There may be a significant capital cost associated with such an investment, and there may be significant risk that the cost will not be recovered if

⁵⁷ Jensen and Meckling, *supra*.

⁵⁸ *Ibid*.

the application fails to catch on with clients. Even good investments in expectation do not necessarily turn out well. The sole proprietor bears all the risk of the investment paying off. Since individuals are typically averse to risk (this is why they buy insurance), the risk associated with sole proprietorships is a disadvantage from a capital structure perspective.

There is a related financing problem that sole proprietors face. Clients may sometimes have valid legal claims, but they are costly to litigate and outcomes are not certain. Lawyers can in effect invest in their clients' claims by adopting a contingency fee arrangement. Such a fee shifts significantly the risk of an unsuccessful suit from the client to the lawyer. This is another kind of risky investment for the lawyer: she gets paid, perhaps handsomely, if the suit is successful, but is not compensated for her costs and efforts at all if the suit is lost. A sole proprietor who accepts a contingency fee arrangement bears the risk of the investment in the lawsuit herself; this is not desirable, all things equal, for a risk-averse individual.

There is also a problem for sole proprietors who are capital-constrained. Suppose that a sole proprietor has a positive net present value investment, such as the web-based application discussed above, but has little capital herself. The only outside funding that is available for a sole proprietor under present legal constraints is bank debt. For many kinds of capital, such debt may be entirely suitable. If the sole proprietor wishes to purchase the real estate where her office is located, for example, bank debt is a common source of financing for such transactions, in part because banks are in a good position to take security that allows them to assess their risks with some accuracy. But for other kinds of investments, bank debt will not be suitable. The business prospects of the risky web-based application is not something that the bank will be in an especially good position to assess, nor would there be much in the way of physical assets to treat as collateral, which would make it reluctant to lend to a capital-constrained sole proprietor.

Moreover, such an investment may have a decidedly uneven pattern of returns, which makes traditional debt financing less appropriate. For example, if the investment fails 90% of the time, but pays off so lavishly 10% of the time that it is worthwhile overall, steady repayment of bank debt may be impossible. Rather, the bank will either receive a payment 10% of the time, or very little 90% of the time. This resembles more of an equity investment than a loan (indeed, the required interest rate to make the loan profitable for the bank despite a 90% failure rate may be so high that it could be usurious), but the bank would not have the same governance levers over the firm associated with typical equity investments, and may not be willing to make such a loan. At the very least, the fact that bank debt almost never finances analogous risky ventures that do not face legal constraints on their financing (venture capital, for example, is typically structured with equity investments) suggests that the requirement that the sole proprietor only raise outside capital through bank debt is costly. This is especially true as the risk of the potential investments the sole proprietor might make increases.

Note that there is an advantage to the sole proprietorship from a debt financing perspective that is the positive flip side of the disadvantages of risk. Sole proprietors are personally liable for all the debts of the practice; there is no separate legal entity and the debt of a sole proprietorship is the debt of the sole proprietor. This liability, while exposing the lawyer to greater risk, has its advantages. For one, unlimited liability mitigates concerns of lenders that the borrower will take on excessive risk. As discussed above, if a firm owes a significant amount of debt to creditors, equity-holders enjoying limited liability may be tempted to exercise their control over the direction of the firm by assuming significant risk: if the risk pays off, equity-holders largely realize the upside; while if the risk fails to pay off, equity-holders impose losses on creditors. With unlimited liability in place, the temptation to assume excessive risk is

mitigated. If a sole proprietor increases the risk of the firm in the face of debt, she herself faces the risk of losing all her personal wealth in paying back creditors.

Of course, the strength of unlimited liability in disciplining the sole proprietor depends on the amount of her personal capital. If she has little in the way of personal assets, then the commitment to pay her personal assets to creditors matters less for her incentives to ensure that creditors are paid (though the commitment will always matter to some extent given that personal bankruptcy is costly, especially for lawyers who may suffer as a professional matter from such an outcome). This implies that concerns about excessive risk because of debt would be more likely to arise in the particular circumstances where borrowing is most important: where the sole proprietor herself has little in the way of capital to contribute.

Another, related advantage of unlimited liability concerns the sole proprietor's clients. Clients will want the lawyer to bear costs from providing services negligently. If the sole proprietor faces unlimited liability, she in effect offers her personal assets as a kind of bond to the client: in the event of malpractice of some kind, the client is able to recover in any civil action from the lawyer's personal assets beyond any required or assumed liability insurance. Unlimited personal liability may not be the optimal way of providing assurance to clients (liability insurance may be more transparent, for example, since clients do not have to determine themselves what the lawyer's personal assets are worth), but it is an advantage of the sole proprietorship, all things equal.

b) Partnership

The legal framework governing legal partnerships is similar to that of sole proprietor, the difference simply resting in the number of lawyers in the firm. The difference in numbers, however, may have significant effects from a theory of the firm and capital structure perspective.

In this subsection, we review the factors discussed in the context of the sole proprietor, noting how the addition of partners affects the analysis.

Consider first the theory of the firm. With a legal partnership, rather than a sole proprietor, responsibility for making investments in the value of the firm (e.g., its reputation, or its client list) is spread across individuals, rather than resting with a single lawyer. Moreover, governance of the firm is spread across lawyers, it being a hallmark of a general partnership that each partner is presumed to have a role to play in management. This increases intra-firm transaction costs. The combination of diffuse incentives to invest in the firm and diffuse authority creates trade-offs. If left to their own managerial discretion, each partner has too little incentive to make investments in the partnership's productivity: she bears the costs of the investment, but shares the benefits with her partners. Centralizing authority, and monitoring the investments of each partner in the partnership, may mitigate the underinvestment problems, but at the same time will consume resources in order to coordinate authority.

In light of the importance of individual investments in the firm's productivity, firms may strive to achieve certain cultures.⁵⁹ Such a culture may usefully indicate to each partner (and associate, for that matter) how it is that she is expected to behave, and the existence of such a culture also allows for informal monitoring to ensure that partners are compliant with the norms of the firm. To the extent that a firm is successful in generating such a culture, this reduces the costs of governing the firm, and better ensures that each lawyer has good incentives to make private investments in the value of the firm.

While not insuperable, as the existence of major national and international law (and accounting) firms demonstrates, the difficulties of coordinating governance grow as the firm grows. At the limit, a sole proprietor is able to invest and otherwise make decisions while fully

⁵⁹ See, e.g., Daniels, *supra*.

internalizing the value to the firm of such choices, and is able to do so without coordination and managerial costs. The more partners that are added to the firm, the less does each partner internalize the value of her investments in the firm, and the more difficult is the firm to manage. Successful firm cultures may mitigate these problems, but such cultures may be more difficult to develop and maintain the larger the partnership.

There are also, however, advantages from a theory of the firm perspective the larger a firm is. Since lawyers tend to be specialized, the more lawyers a firm has, the wider the potential scope of the firm's expertise. To the extent that clients have different kinds of legal problems, a partnership will be able to provide a wider range of services to a client than a sole proprietor.

There is another way of putting this point about specialization. A sole proprietor would often have to refer clients to other lawyers that are able to provide service that she cannot. As noted above, it may not be straightforward for the sole proprietor to realize the value of such referrals. In contrast, partners that in effect refer work to one another are better able to realize the value of such referrals by sharing in the firm's profits.

As a final point on the theory of the firm, partners may be better able to sustain reputations for quality service than sole proprietorships. As discussed, when a partner performs her work, she would realize short run gains from shirking on that work, but would jeopardize the reputations of all lawyers in her firm, whereas a sole proprietor only has her own reputation at stake. As a consequence, there are stronger incentives for the firm as a whole to maintain a reputation for good quality work.

From a capital structure perspective, in general, each additional partner dampens the connection between the partner's efforts on behalf of the firm and the personal profits that she realizes. As the partnership grows, each partner's average percentage equity stake in the firm

falls, which implies that she will in general realize an ever smaller personal return from her efforts to grow the value of the firm. Partnership agreements can be struck in a manner that results in imperfect sharing, but to the extent that costs and revenues are spread across partners, the more partners there are, the weaker the connection between any given partner's efforts and her share of the firm's profits. This, all things equal, dampens incentives for partners to make efforts to maximize the firm's profits, and is thus a disadvantage of the partnership relative to a sole proprietorship from a capital structure point of view. The firm will either suffer from inefficient, self-interested decisions by its partners from time to time, or it will incur expenditures in establishing some sort of governance system that helps discipline partners. Either way, the firm suffers costs as a consequence of the diffusion of equity ownership across partners.

That said, partnerships nevertheless maintain some incentives for performance by allocating equity interests to the partners. Each partner is at least a part-owner of the firm, and as a consequence benefits to at least some positive extent from good performance. This contrasts with other organizational forms, such as corporations, in which managers within the firm need not have any ownership interest at all.

A key advantage of more diffuse equity ownership in a partnership is that partners are better insulated against risk than they are in a sole proprietorship. As Gilson and Mnookin observed, there is little reason to suppose that partners within a firm are all likely to have the same demand for their services at any point in time.⁶⁰ Certain specializations will be in higher demand than others at any point in time because of the business cycle; for example, securities lawyers will be in higher demand in boom times, while bankruptcy lawyers will be busier when the economy is slower. By forming a partnership in which partners agree to share annual profits,

⁶⁰ Ronald Gilson and Robert Mnookin, "Sharing Among the Human Capitalists: An Economic Inquiry into the Corporate Law Firm and How Partners Split Profits" (1985) 37 Stanford Law Review 313.

securities lawyers and bankruptcy lawyers can spread the risk associated with their relatively narrow specialties. In general, one can think of the law firm as allowing lawyers to diversify their risks across the business of the partners as a group. Each lawyer will not suffer from extremes of boom or bust, but rather will share some of the profits of the boom with their partners, while benefiting from their partners' business when their business is weaker. Since individuals tend to be risk-averse, a steady return is better than realizing extremes. This is a significant advantage of a partnership over a sole proprietor.

An offsetting consideration is that sharing across partners may discourage individual lawyers from working as hard as they would if they realized profits for themselves from their efforts. Moreover, a sharing rule may tempt the successful lawyers realizing significant profits to split from the firm and form another firm. These are clearly costs associated with the risk-spreading effect of sharing among partners. Gilson and Mnookin suggest, however, that departing partners would potentially suffer by losing the reputational advantages that partnership at a respected firm provides; this may induce them to stay.⁶¹ In addition, other considerations, such as firm culture,⁶² may help respond to the shirking temptations that are associated with sharing. Sharing also avoids the opposite temptation for partners that would arise with individually-based compensation to hoard clients and profits to themselves, even if the client were better served by a different partner.

The pooling of risk that the larger partnership allows also better supports risky investments by the firm. Consider the example of a significant capital investment in a web-based software application for writing a will, or of investing in a client's costly lawsuit by accepting a contingency fee arrangement. Setting aside debt for the moment, a sole proprietor would have to

⁶¹ *Ibid.*

⁶² Daniels, *supra*

devote her own capital to fund the project, which exposes her to considerable risk even if the project is a good one in expected terms. Partners, on the other hand, are able to share the costs of the project, which reduces their exposure to risk. To take a simple example, suppose that the investment requires \$100,000. Suppose further that each of ten lawyers has \$100,000 that they could invest. If each were a sole proprietor, they would each bear the full risk of the investment. But if the ten lawyers are in a partnership, each can invest \$10,000 in the project, and invest \$90,000 in other, diversified investments. While in both cases they have invested \$100,000 in potentially risky investments, only in the latter case are they diversified. Risk averse investors are better off with diversification, and this is an advantage of a partnership relative to a sole proprietorship.

Another advantage of partnerships relative to sole proprietorships is that there will be more equity capital available with a pool of equity partners to draw upon. The example just discussed assumed that each lawyer had \$100,000 to invest. If the lawyers do not have so much capital to invest, then there is another advantage of partnerships: they are less likely to be capital-constrained. Without equity investment available, the firm would have to borrow from a bank, but, as noted above, risky, illiquid capital investments such as the web-based application are not typically suitable for bank loans. Sole proprietors are more likely to have to forgo positive net present value investments than partnerships.

There is an advantage of partnerships when it comes to debt financing that is similar to that of sole proprietors: partners are jointly and severally liable for the debts of the partnership, which mitigates the incentives that the firm would have to make risky choices after they borrow. If there is limited liability, creditors bear downside risk, which can lead to excessive risk by managers looking out for the interest of equity investors. With unlimited liability, on the other

hand, partners bear downside risk as well as upside, the temptation to invest in risky investments is mitigated, and lenders, anticipating this, may be more willing to lend.

As with the analysis of the sole proprietor, the commitment to lenders that unlimited liability provides depends significantly on the assets that are available from the partners. All else equal, it would be reasonable to expect that a larger partnership of lawyers will have more assets in total available for creditors than a sole proprietorship, which is another advantage of the partnership. Of course, if some partners have fewer assets than others, there may be differing attitudes within the firm itself about risk, which in turn may create governance frictions within the firm. But for a lender, more partners, and thus more assets to back a loan, will be welcome.

Clients may also benefit from unlimited liability of the partnership. They are better assured that if a lawyer at the firm engages in misconduct, and the client sues as a consequence, there will be assets available to compensate them. This is welcome from the client's perspective because the fact that the lawyer's personal assets are at stake is likely to induce the lawyer to take greater care both in her own work and in monitoring her partners. Moreover, the client is more likely to be made whole if there is such a suit because the partnership has multiple lawyers' assets available to creditors, including judgment creditors. The presence of unlimited liability is not necessarily superior to liability insurance, and in fact may be less reassuring to clients given opacity around the partnerships' personal assets, but it does serve as a useful commitment to clients and other potential creditors.

c) Limited Liability Partnership

A key difference between a limited liability partnership and a general partnership is that in the former case, lawyers are not jointly and severally liable for the negligence of their partners. Another is that while the property of the partnership is available to satisfy the

partnership's debts generally, there is limited liability to creditors with respect to the partner's personal assets. We will discuss each feature in turn.

All else equal, the limitations on partner liability are less attractive to clients for two reasons. First, since they do not have personal assets at stake, it lessens the incentives of partners to monitor their partners to ensure that they are providing quality service. Second, it reduces the assets available to compensate clients who have received negligent service (because of this feature, mandatory insurance requirements are in place in Ontario and elsewhere as a professional requirement for forming an LLP). On the other hand, a limited liability partnership has the merit of reducing risk that lawyers are subjected to from their partners' misconduct, over which they may have relatively minimal control, while ensuring that each lawyer continues to stake her personal assets to her own clients. The LLP will be adopted where the gains to the lawyers from lower exposure to risk exceed the losses to clients from having a smaller pool of assets available to compensate for negligence. In such cases, clients may insist on lower fees to compensate for the smaller "bond" that personal assets provide, but lawyers would be willing to offer this discount because the reduction in risk that they enjoy makes it value-enhancing to do so.

Turning to limited liability with respect to creditors other than negligently-served clients, there are again economic benefits and costs for lawyers and creditors. An advantage of limited liability is that the lawyer does not bear the risk of pledging personal assets to creditors. A lawyer has whatever personal assets she has invested in the partnership at risk, but does not have to go further and put all of her personal assets at risk. Individuals are risk-averse, and unlimited liability imposes costs of risk on the lawyer. Within an LLP in which lawyers are not committed

to unlimited liability, the lawyer caps risk and avoids these costs. This is an economic benefit of the LLP relative to a general partnership.

The economic benefit of limited liability may manifest itself in different ways. For example, the lawyer might behave in exactly the same way in making investments, but does not bear as much cost from risk as she would without limited liability. But the lawyer may also be able to invest in intrinsically riskier projects knowing that her personal assets are not at stake when she does so.⁶³ Consider again the investment in a web-based application. Suppose that the firm has a line of credit for working capital, but cannot obtain bank debt for reasons given above for the application investment. If the firm invests its capital into the application but it fails, thus jeopardizing the firm's ability to pay off its line of credit, a partner in an LLP will not be liable personally on the firm's line of credit. This better encourages the partnership to make the risky investment than would be the case in the face of unlimited liability.

This is not to say that limited liability is therefore optimal. Limited liability simply shifts the risk from the partners to creditors; the question of optimality turns on who is better equipped economically to bear this risk. Creditors will be concerned that, since they do not incur the downside risks of their investments but rather shift them to creditors, lawyers in an LLP will take on more risk than is optimal. Moreover, creditors may not be in a good position to assess the risks that the lawyers take on, which also leaves the creditors vulnerable to uncompensated risk.

Whether limited liability is optimal will depend on the relative costs of risk when borne by the lawyers as opposed to their creditors. Given the economic incentives for lawyers to make value-increasing choices of business structures, it is noteworthy that adoption of the LLP form has become popular in the Canadian landscape in recent years. This is suggestive of its efficiency relative to the general partnership.

⁶³ See, e.g., Hadfield, *The Cost of Law*, *supra*.

d) Professional Corporation

A professional corporation has the same strengths and weaknesses of the LLP, but for one difference: under the professional corporation in Ontario, the professionals who are also the shareholders remain jointly and severally liable for the damages caused by the firm's negligence. The professional corporation thus combines the joint and several unlimited liability attributes of a general partnership when it comes to liability for negligence with the limited liability attributes of an LLP when it comes to liability for other debts. As noted when discussing the general partnership, unlimited joint and several liability better assures clients of non-negligent service by encouraging partners to monitor one another, and also provides better assurance to clients of being made whole if negligence were to occur. But such liability causes each partner to bear risk over which she may have only limited control, and this is costly for risk-averse individuals. Limited liability for other debts, as discussed in the context of LLPs, also presents trade-offs. An advantage is that partners bear less risk from uncertain investments. A disadvantage is that creditors may not be as well placed to assess firm risks, and moreover by imposing downside risk on creditors, firms that borrow may be inclined to take on too much risk. The professional corporation is a hybrid of a general partnership and an LLP, and its economic merits and drawbacks reflect this combination.

e) Business Corporation (Limited Liability)

If a sole proprietor is at one end of the organizational spectrum, the business corporation is at the other. In this section, we consider the economic advantages and disadvantages of this form. As with previous discussions, we continue to assume that lawyers must be the equity investors in the firm; we consider below the prospect of non-lawyer, equity investors.

The key difference, and the one that we therefore focus on in this section, between a business corporation on the one hand, and the partnership, LLP and professional corporation on the other, is that the lawyer-shareholders in the corporation are not liable for any unpaid debts of the corporation, including debts to clients who have successfully sued for negligence. This has advantages and disadvantages from a capital structure perspective. An advantage is that the lawyer-shareholders are not exposed to risks over which they may have relatively little control, namely, the risks of fellow lawyers within the firm behaving negligently. Unlike other structures such as an LLP, the lawyer in a corporation is also potentially protected from personal liability for her own negligent actions, the possibility of which would also expose her to costly risk and uncertainty.

We say that the lawyer is “potentially” protected because the limited liability status of a corporation does not necessarily protect individual tortfeasors within the corporation from personal liability for their torts.⁶⁴ (We would also note that lawyers would presumably remain subject to professional discipline even if practicing within a corporation.) The difference with a corporation is that the lawyer cannot be held personally liable for the torts committed by the corporation generally. Lawyers’ personal assets are better protected in a corporate structure than in any of the other structures, which mitigates risk that they bear.

The disadvantage of fully limited liability is that clients can no longer rely on the bond that pledging personal assets effectively implies; lawyers with less risk of personal liability may be less inclined to take care. Moreover, lawyers not financially responsible for the misconduct of their colleagues will be less inclined to monitor their colleagues, which may also lead to less care for the client. The risk mitigation benefits must be weighed against the weaker incentives to take care in order to assess the net gains from incorporation.

⁶⁴ See *ADGA Systems International v. Valcom Ltd.* (1999), 43 O.R. (3d) 101 (C.A.).

Given the starkest limitation on personal liability that the corporation presents, this is a useful juncture at which to review the implications of insurance. While alluding to the possibility of liability insurance, we have generally treated the prospects of liability in, say, a general partnership as creating risk for lawyers. In reality, lawyers may take steps (and indeed by regulation may be obliged to do so) to mitigate this risk through insurance. This does not eliminate the conclusion that lawyers bear costs if there is potentially personal liability. For one thing, lawyers must pay for liability insurance, which is a cost resulting in part from personal liability. For another thing, insurers may risk rate the particular lawyer. This has other implications. First, the insurer may itself monitor the lawyer to some extent to minimize the chances that the lawyer behaves negligently; this substitutes to some extent for limited incentives to take care that the threat of personal liability would otherwise generate. Second, a lawyer that has an incident on her insurance record may have to pay greater premia in the future, which implies some personal risk associated with negligence. As a final point, insurance contracts will typically include both deductibles and maximum liability for the insurer. This also implies that the lawyer will bear residual risk. In short, liability insurance does not negate the conclusion that personal liability exposes the lawyer to risk that she would not face in a corporate setting.

f) Non-Lawyer Ownership

We have reviewed the basic structures that law firms may currently adopt, as well as a limited liability corporation, which lawyers in Ontario cannot form. We have restricted the analysis by assuming that only lawyers can own equity in the firm, an assumption that is much less apt in liberal jurisdictions like Australia and the UK. Ontario itself allows for multi-disciplinary partnerships, but imposes important restrictions such as a requirement that lawyers control the firm. In this section we consider the potential economic advantages and

disadvantages of liberalizing rules concerning non-lawyer equity ownership of a law firm. We begin by focusing on the theory of the firm, which discussion can be conducted without significant emphasis on the particular legal organizational form (e.g., partnership or corporation) that the firm with non-lawyer equity-holders adopts. We then turn to capital structure, which will include a more detailed discussion of form.

There are two kinds of non-lawyer ownership worth considering. Non-lawyers may themselves bring professional credentials to the firm, or they may be simply passive, financial investors. The theory of the firm advantages largely arise with the former kind of equity-holder. Allowing non-lawyers to own equity in a firm that includes lawyers has several possible economic advantages. From a Coasean perspective, there are potentially significant savings in transaction costs resulting from non-lawyer equity owners. Take the example of a client that requires both legal and accounting advice on a given matter. If a lawyer and an accountant are equity-owners in the firm, each realizes an economic benefit when the other is retained by a client. This creates economic incentives for one to refer business to the other without complicated referral contracts (even if permitted). Moreover, when working for the same client on a file, it is likely that the lawyer and accountant will be better able to coordinate their actions if they are both within the same firm than if they practice independently.⁶⁵ This creates productivity gains, as Coase pointed out, but also in all probability lowers the transaction costs of the client, who is able to engage in one-stop shopping.

Moreover, if the lawyer and accountant both have equity stakes in the firm, this encourages personal investments in general assets of the firm, including its reputation. For example, an ownership stake in the accountant's future billings would encourage the lawyer to

⁶⁵ See, e.g., Lilla Csorgo and Michael Trebilcock, "Multi-Disciplinary Professional Practices: A Consumer Welfare Perspective" (2001) 24 Dalhousie Law Journal 1.

be especially willing to take extra steps to enhance the reputation of the accountant, through referrals if nothing else. To the extent that multi-disciplinary firms tend to have a larger number of partners, having both the reputation of both accountants and lawyers at stake in the firm's work may also create stronger incentives to maintain a reputation for quality work: more professionals' reputation is in jeopardy when the firm performs its work.

It is worth noting an additional potential gain from adding non-lawyer professionals to a firm that practices law. Non-lawyers may not be themselves a member of a regulated profession, but may simply be professional business managers. There is no reason necessarily to conclude that lawyers will be the best managers of legal practices. An advantage, then, from allowing non-lawyer equity-holders is that it would allow non-lawyers to manage while owning equity stakes in the firm that incentivize them to a good job. This is another theory of the firm advantage of non-lawyer equity ownership: non-lawyer managers may have the ownership stakes that provide them with economic incentives to invest in firm value.

There are clearly potential economies from a theory of the firm perspective in allowing non-lawyer equity investment, but there are potential costs as well. The larger and broader is a firm's practice, the lower the costs of coordinating action outside the firm through contract, but the larger the costs of coordinating within the firm. There could be difficulties in coordinating behaviour across members of the firm as it grows in size and scope, especially if there are cultural differences between different professions. For example, professional managers may not have the same understanding of a lawyer's sense of ethical responsibilities, which could create intra-firm conflicts and consequential costs. Other costs may include a temptation for each member of the firm to refer clients to their own firm's professionals when in fact the client's

circumstances may call for a different provider. That is, some credibility of the referral may be lost if referrals are intra-firm.

It is therefore not necessarily the case that non-lawyer equity ownership leads to economic gains on net, though such ownership clearly allows some expected economic benefits from a theory of the firm perspective.

The next set of issues to consider are the economic costs and benefits of non-lawyer equity ownership from a capital structure perspective. Given the analysis above, the most illuminating context in which to examine this question is one that departs most significantly from the contexts discussed already, which is one in which there are no restrictions on the form or ownership of firms that offer legal services, as in Australia. And the most useful scenario within this context to consider is passive, non-lawyer, financial investment in equity.

Passive investors by definition do not directly affect the nature of the activities within the firm, but may significantly alter the capital structure of the firm and thus affect the firm's performance in carrying on business. There are two prominent advantages of outside equity ownership. First, outside shareholders may provide capital to the firm that would be very difficult to raise from capital-constrained professionals within the firm, or from banks. As discussed above, many investments are not suitably financed with debt. An investment in technology such as the web-based application discussed above is not a good candidate for debt financing: its returns are highly variable and uncertain, and moreover bank lenders may not be in a good position to assess its worth (and there may not be any physical collateral to offer as security). But equity investment in technology start-ups is suitable, and indeed is common. There may be expert investors in the technology space, venture capitalists for example, that are

not only capable of valuing a prospective investment, but once having made the investment may be able to offer management advice, thus adding non-lawyer management skills to the mix.

Outside investors may also be in a position to finance risky investments in lawsuits by a firm that has entered a contingency fee arrangement. A firm may be willing to take on such a fee arrangement, but may not have the capital to finance the suit. Because of a highly variable outcome and uncertain cash flow, as well as a difficulty in valuing the suit, banks may be unwilling to lend. Equity investors may, in contrast, be willing to assume uncertainty in returns, and may either have or develop expertise in valuing such suits. Law firms that would otherwise not be able to finance contingency-fee based lawsuits may be able to do so in the presence of non-lawyer equity investors.

On a related point, even if lawyers or other active professionals within a firm could conceivably raise the capital to pursue a risky investment such as a technological investment in law, or an uncertain lawsuit on a contingency fee, doing so exposes equity-holders to risk. This is especially problematic for sole proprietors and small firms, but even for larger firms, partners may bear considerable risk. In contrast, at the limit, a law corporation could be publicly traded with literally thousands of investors, each with small stakes in the firm. Such investors are much better placed to diversify the firm's risk than the inevitably smaller number of equity-owners at a firm without outside passive investors. This is a feature of potentially great importance in facilitating risky investment by law firms.

Allowing passive non-lawyer investment opens up a range of capital structures that could alter radically the economics of law firm capital structures. We have discussed the theory of the firm benefits of having both lawyer and non-lawyer equity-owners. There may, however, be advantages on net if lawyers were not to own equity at all, and a firm instead is financed by non-

lawyer shareholders. For example, if lawyers have a comparative advantage in providing legal advice and not managing a business, it may be better to have a business owned and managed by non-lawyers, with lawyers serving as employees but not shareholders. Non-lawyer managers may provide the entrepreneurial skills that the firm requires to be successful, while lawyer employees provide the legal expertise.⁶⁶ Such a model would be probably most especially suitable for a firm that relied heavily on technological solutions to support the provision of legal advice: non-lawyer entrepreneurs may have the skill set, and finances, to manage and fund the firm, while lawyer employees provide the legal advice that may underpin the development and operation of the technology. To draw an analogy, it is not unusual for technological entrepreneurs to provide a vision and business skills at a tech start-up, while relying on engineer employees (perhaps motivated by stock options) to actually create the technology. This may also be an appropriate model for legal practice: lawyers bring their human capital to the firm, but leave financial capitalization to others who may be better placed to bear the risk of the firm's success, perhaps because they can diversify more easily, perhaps because bearing such risk allocates to them appropriate incentives to manage the business. We observe that such a model has in effect been adopted in Australia at Slater and Gordon, which has a very large complement of lawyer employees, but is publicly traded.

In the context of publicly listed firms, the limited liability associated with a corporation assumes stark advantages relative to other possibilities, such as joint and several liability among shareholders. In the absence of limited liability, the value of a share may depend in part on the identity, and more specifically, wealth, of fellow shareholders.⁶⁷ This makes valuing a share

⁶⁶ See also, Hadfield, *The Cost of Law*, *supra* (observing that non-lawyers will often have the technological insights necessary for innovation in the legal services market).

⁶⁷ See Jensen and Meckling, *supra*; Paul Halpern, Michael Trebilcock, and Stuart Turnbull, "An Economic Analysis of Limited Liability in Corporation Law" (1980) 30 *University of Toronto Law Journal* 117.

costly, and undermines the value of a public listing. Moreover, the separate legal personality of a corporation allows clear “asset partitioning”: the assets of the corporation are owned by the corporation as an independent legal entity, thus avoiding blurry lines between business assets and personal assets of investors.⁶⁸

There are, naturally, economic disadvantages associated with outside equity ownership. Most prominently, lawyers that do not own equity in the firm will not have the same incentives to work to increase the value of the firm as lawyers in a partnership. There is a cost to incentives from diversifying the risk of a firm across passive investors. Indeed, because of this, clients may be reluctant to engage lawyers that do not have a stake in their firm. One possibility to respond to this concern is for a controlling shareholder to emerge that, because of its stake in the firm, has a strong incentive to monitor management to ensure that the lawyers in the firm’s employ are providing service optimally.

Other possibilities include the emergence of hybrid ownership solutions, such as the franchising possibility discussed above.⁶⁹ In a franchise, the overall business model and firm reputation (brand) is promoted by a franchisor. The franchisor corporation engages franchisees that have territories in which they provide the franchise system’s product or service under the franchise system’s brand. This system allows a centralized entrepreneurial team to create a business model that they in effect rent to franchisees in exchange for payment, including, typically, a share of the franchise’s profits.⁷⁰ The primary advantage of the franchise system over a single entity model of a business with geographically distributed, but centrally owned

⁶⁸ See, e.g., Henry Hansmann and Reinier Kraakman, “The Essential Role of Organizational Law” (2000) 110 Yale Law Journal 387; Edward Iacobucci and George Triantis, “The Legal and Economic Boundaries of Firms” (2007) 93 Virginia Law Review 515.

⁶⁹ For discussion of franchise contracts, see, e.g., Gillian Hadfield, “Problematic Relations: Franchising and the Law of Incomplete Contracts” 42 Stanford Law Review 927.

⁷⁰ See QualitySolicitors as an example of a network of independent firms: <http://www.qualitysolicitors.com/>.

outlets, is that the franchisee owns the equity in the franchise, which provides her with incentives to build the value of the local business. The franchisee benefits from the brand created by the franchisor, and the franchisor works to maintain this reputation by monitoring franchises to ensure that they meet the system's standards.

Such a model could be successful in the legal context, just as it has in the tax context as outlined in the H&R Block example alluded to above, and is off to a promising start in the legal context with the QualitySolicitors example from the UK. Local lawyers could own a local franchise to provide legal services, but a franchise system with non-lawyer investors could build the brand and relevant business solutions, such as technology applications that would be available to franchisees and their clients. Moreover, it would be conceivable that the franchisor could help provide capital to fund risky, contingency-fee lawsuits led by a franchisee. Such a system could draw on entrepreneurial experts at the franchisor, who are incentivized through equity ownership to grow the profits of the franchise system as a whole, while allocating equity and profits to local franchisees to promote the local business.

As this discussion has demonstrated, liberalized ownership rules create the potential for the most gains from alternative business structures by creating a potential separation between the financiers of a legal business and the providers of legal advice within that business. While there are potential incentive problems that non-lawyer ownership might create, there are significant gains in raising equity capital to finance investment, and in allowing investors in law firms to diversify risk, that may offset these problems. Moreover, imaginative hybrid solutions, such as franchise systems, could attempt to exploit the benefits of non-lawyer entrepreneurship, while preserving lawyers' incentives to promote their personal practices.

There is no question that legal reform in the UK and Australia has led to interesting and significant innovations in legal structures. Publicly traded law firms, such as Slater and Gordon, and networks of firms, such as QualitySolicitors, are prominent examples of such innovation. Evidence of the impetus to innovate can also be found within the more traditional regulatory framework of the provision of legal services. In North America, LegalZoom offers an innovative combination of online and in-person legal advice, while conforming with the more restrictive sets of rules governing business structures found there.⁷¹ Removing the constraints that presently exist on alternative business structures would undoubtedly invite even further innovation.⁷²

However, before concluding this section on the promise of alternative business structures for legal practice, a note of caution is appropriate. As Noel Semple has pointed out, the rules on alternative structures have been very liberal for over a decade in Australia, yet the legal profession has not undergone a radical transformation.⁷³ There have clearly been innovations, such as the emergence of publicly traded law firms, but many traditional structures remain in place. For example, Semple observes that in New South Wales, where liberal rules have been in place the longest, the number of sole practitioners and small firms has *grown* in the last ten years.⁷⁴ In light of this evidence, it would be inappropriate to predict a sweeping revolution from liberalization in Ontario, but the analysis has shown that the potential for economic gains is nevertheless real. Even if only some firms attempt to adopt new models, this could nevertheless be of economic advantage to lawyers, their investors, and ultimately, clients.

⁷¹ See <http://www.legalzoom.ca/>.

⁷² Hadfield, *The Cost of Law*, *supra* argues that the economics of reducing the cost of legal services for ordinary individuals makes clear that the scale of legal services delivery needs to expand dramatically to justify the fixed costs of investments in marketing, document production, consumer and legal research, information technology and firm management. In turn these functions require an expanded role for non-legal expertise as well as greater scope for diversifying the risks associated with such investments. In her view the limited liability corporation with non-lawyer shareholders is an essential mechanism for realizing economies of scale and specialization in servicing the needs of ordinary individuals.

⁷³ Semple, *supra*.

⁷⁴ Semple, *supra* at 46.

V. CONCLUSION

One conclusion should be abundantly apparent from this review of the economics of alternative business structures: there is no single structure that is optimal across all contexts.⁷⁵ Rather, there are trade-offs with respect to every choice of form and capital structure, and the best resolution of each trade-off depends on the circumstances. The nature of a firm's clients in some cases may best call for a general partnership; in others, a limited liability partnership. The nature of the service provided may in some cases call for a sole proprietorship; in others, a publicly traded corporation. It is overly simplistic, therefore, to favour one form over others from an economic perspective.

The importance of context, however, does not imply that it is impossible to draw any meaningful policy conclusions from the analysis. It is clear that from an economic perspective, there are potential gains from opening up options for business structures and associated capital structures. This itself makes an economic argument in favour of liberalization: even if most legal practices maintain traditional structures, if some firms benefit from innovative models, choice creates economic benefits. It is also fair to conclude that the gains from liberalization are most likely to materialize where a large capital investment is necessary for a firm to realize certain gains. An investment in a client's lawsuit through a contingency fee, for example, may generally be more efficiently financed with outside, financial investors than the handful of lawyers who may prosecute the suit. An investment in technology will also more probably be efficiently achieved by a firm with outside investors than a general partnership.

Liberalization predictably generates economic gains, but the size of these gains cannot be predicted with any certainty. Experience in the UK and Australia suggests that liberalization

⁷⁵ See, e.g., Iacobucci and Triantis, *supra*.

does invite change, although the pace of change appears to be much more evolutionary than revolutionary, at least to date.

We conclude by making observations about the impact of reform on key stakeholders: lawyers themselves, and clients. These effects would presumably have a significant influence on the politics of reform. As noted in the discussion of competition, changing the rules on alternative business structures does not itself affect the number of lawyers in practice in a given jurisdiction. It may, however, affect considerably the nature of the firms in which the lawyers practice. Individuals with significant economic stakes in existing firms may be threatened by reform. But such a threat to current firm structures should not be elided with a threat to the kinds of lawyers that practice at these firms. For example, consider a small-town sole proprietor with a general practice. Such a lawyer may predict that liberalization would result in a large corporation, perhaps a franchise system, encroaching on her business. Such a development would undermine the value of the equity of an existing lawyer in her sole proprietorship, but would not imply that the lawyer (and others of her type) will be out of business. Rather, the corporation will itself need lawyers, and the sole proprietor may shift from being an owner of her practice to an employee in a larger firm. While there may be short run dislocations in some instances, in the longer run new business models will generally emerge if they are more economically efficient than existing models. Greater efficiency means greater potential gains for lawyers, clients and investors alike. For example, lawyers may prefer simply to practice law rather than run a business; for them, status as an employee may be preferable to status as a sole proprietor. When considering the politics of liberalization, then, it is important not to confuse challenges to existing law firm structures with challenges to existing lawyers. Reform, while it may threaten existing structures, may be welcome both for many clients and for many lawyers.

Moreover, the threat to existing structures should not be exaggerated. Experience elsewhere has demonstrated that liberalization may be entirely consistent with one-person and other small practices. For example, as Semple notes, the number of small firms has increased in the last ten years in New South Wales.⁷⁶ Neither theory nor experience suggests that lawyers will necessarily suffer economically under a more liberal regime.

Finally, to return to a point that we raised in the Introduction, our focus has been on the economics of alternative business structures, but economic gains are entirely consistent with the promotion of at least some non-economic values. Access to justice is a matter of concern in Ontario and elsewhere,⁷⁷ and high prices for legal services are clearly a major contributor to this concern.⁷⁸ If alternative business structures emerge in a liberalized regime, this is likely to reflect the economic gains that they generate. Moreover, given that the legal services market is highly competitive, it is probable that economic efficiencies realized as a result of liberalization would be passed onto clients and prospective clients.⁷⁹ It is possible, therefore, that the economic gains that liberalization tends to promote would in turn tend to promote access to justice.⁸⁰ In this respect, at least, economic and non-economic social goals are aligned.

⁷⁶ Semple, *supra* at 46.

⁷⁷ See, e.g., Michael Trebilcock, Anthony Duggan and Lorne Sossin, *Middle Income Access to Justice* (Toronto: University of Toronto Press, 2012).

⁷⁸ See Hadfield, *The Cost of Law*, *supra*.

⁷⁹ Again, the market would not become more competitive as a consequence of liberalization; rather, competition would simply tend to push any savings down to clients.

⁸⁰ See Semple, *supra*.

Business Structures for the Practice of Law and the Delivery of Legal Services in Ontario

The following provisions in the *Law Society Act*, other Ontario legislation, *Rules of Professional Conduct* (version currently in force until October 1, 2014), *Paralegal Rules of Conduct*, and Law Society By-Laws are relevant to business structures.

Rules of Professional Conduct - Division of Fees, Fee-Sharing, and Fee-Splitting

1. Described below, the provisions relating to division of fees, fee-sharing and fee-splitting have the effect that:
 - (i) fees may not be shared except within permitted participants in a permitted business structure; and
 - (ii) referral fees are only permitted to be paid to licensed Ontario lawyers and paralegals.
2. Rule 2.08(6) of the *Rules of Professional Conduct* provides that where a client consents, fees for a matter may be divided between licensees (or members of the Law Society of Upper Canada) who are members of the same firm, provided that the fees are divided in proportion to the work done and the responsibilities assumed.
3. Rule 2.08(7) imposes the following restrictions with respect to referral fees:
 - (a) The fee must be reasonable, and cannot increase the total amount of the fee charged to the client; and
 - (b) The client must be informed of the fee, and must consent to it.
4. Rule 2.08(8) of the *Rules of Professional Conduct*, which applies to lawyers, provides that lawyers may not share fees with a non-licensee. It provides as follows:

2.08(8) A lawyer shall not

 - (a) directly or indirectly share, split, or divide his or her 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.

5. Rule 2.08(9) limits this broad prohibition to permit fee sharing in certain circumstances:
 - (a) within a multi-disciplinary practice (an “MDP”);
 - (b) between partners of an inter-provincial law firm; and
 - (c) between partners of an international law partnership.
6. Rule 5.01(10), (11) and (12) of the *Paralegal Code of Conduct* (the “Paralegal Rules”) imposes similar restrictions on paralegals with respect to the division of fees, fee-splitting, and referral fees. Paralegal Rule 5.01(12) permits fees sharing between partners in a Multi-Disciplinary Partnership (MDP).

Ownership Restrictions

Professional Corporations

7. The ownership and permissible scope of practice of professional corporations is limited by the current regulatory structure. Section 62(0.1)14(iv) of the *Law Society Act* provides that Convocation may make by-laws regarding professional corporations. Section 62(28.1) provides that Convocation may make by-laws governing the practice of law and provision of legal services through professional corporations.
8. Section 3.1(2)(a) of the *Business Corporations Act* (OBCA) provides for the practice of a profession by a professional corporation if an Act so permits.¹ Section 3.2(2) of the Act provides for conditions which a professional corporation must satisfy, including the identity of shareholders. Section 61.0.1(4) of the *Law Society Act* limits ownership of professional corporations practicing law and providing legal services to lawyers and paralegals.²

¹ *Business Corporations Act*, R.S.O. 1990, c. B16, online at http://www.e-laws.gov.on.ca/html/statutes/english/elaws_statutes_90b16_e.htm.

² *Law Society Act*, R.S.O. 1990, c. L.8, online at http://www.e-laws.gov.on.ca/html/statutes/english/elaws_statutes_90l08_e.htm.

9. The *Law Society Act* limits all forms of share ownership. Unlike the case of some regulated health professionals,³ family members of lawyers and paralegals are not permitted to own shares in a professional corporation. Further, lawyers from other jurisdictions may not be shareholders in Ontario professional corporations.
10. As well as limiting ownership of professional corporations, the activities of professional corporations are limited by section 61.0.1(1)(5) (paragraph 3) of the Act which requires that

The articles of incorporation of a professional corporation ... shall provide that the corporation may not carry on a business other than [the practice of law or the provision of legal services], but this paragraph shall not be construed to prevent the corporation from carrying on activities related to or ancillary to [the practice of law of law or legal services], including the investment of surplus funds earned by the corporation.

11. A professional corporation is limited to providing services “related to” or “ancillary to” legal or paralegal practice.

Limited Liability Partnerships

12. Section 44.2(a) of the *Partnerships Act* provides that a limited liability partnership may carry on business in Ontario for the purpose of practicing a profession if a statute so permits.⁴ Section 61.1(1) of the *Law Society Act* provides that subject to the by-laws, lawyers and paralegals may form a limited liability partnership for the purpose of practicing law or providing legal services in Ontario. Section 61.1(1) (d) provides that two or more professional corporations may form a limited liability partnership for the purpose of practicing law in Ontario, providing legal services, or both.
13. Part III of Law Society By-Law 7 (“Business Entities”) regulates the following:

³ Members of the College of Physicians and Surgeons of Ontario and members of the Royal College of Dental Surgeons of Ontario may form professional corporations in which their family members own shares.

⁴ *Partnerships Act*, R.S.O. 1990, c. P.5, online at http://www.e-laws.gov.on.ca/html/statutes/english/elaws_statutes_90p05_e.htm#BK49.

- (i) limited liability partnerships (the By-Law imposes insurance requirements on a limited liability partnership and imposes disclosure requirements);
- (ii) professional corporations; (corporate names, certificates of authorization, and information that must be contained in the register of professional corporations required under section 61.0.2 of the Act);
- (iii) multi-disciplinary practices, which will be discussed in greater detail below; and
- (iv) affiliations with non-licensees.

Multi-Disciplinary Partnerships

14. Section 62(0.1)32 of the Law Society Act provides that Convocation may make by-laws regarding multi-disciplinary partnerships. By-Law 7 permit a business structure in which non-licensees can be partners with licensees, but only where the licensees are in control and where the services provided by non-licensees are supportive or supplementary to the practice of law or to the provision of legal services. The non-licensee must agree to comply with Law Society rules, policies and guidelines, but the licensee is responsible to the Law Society for any non-compliance with Law Society rules.
15. Currently, there are 13 Multi-Disciplinary Partnerships (MDP) in Ontario.⁵ The types of services which are provided by the non-licensee partners in an MDP are as follows:
- i) human resources consulting;
 - ii) advice and assistance with patents and trademarks;
 - iii) public policy advice;
 - iv) translation;
 - v) economic, tax and accounting advice;
 - vi) financial services advice;

⁵ This information is current to November 2013.

- vii) mortgage broker services;
- viii) chartered accounting services;
- ix) immigration consulting;
- x) U.S.-licensed attorneys with expertise in class action litigation and civil trials; and
- xi) marketing and advertising services.⁶

16. Section 16 of By-Law 7 provides that:

A licensee shall not, in connection with the licensee's licensed activity, provide to a client the services of a person who is not a licensee except in accordance with this Part.

17. Section 17 provides a limited exception to this broad prohibition:

A licensee may, in connection with the licensee's licensed activity, provide to a client the services of a person who is not a licensee who practises a profession, trade or occupation that supports or supplements the licensed activity.

18. The language of "supporting or supplementing" the licensed activity in the MDP By-Law is similar to the language of "relating to or ancillary to" the licensed activity in section 6.0.1(1)(5) of the *Law Society Act* in respect of permitted activities of professional corporations.

19. Section 18 of By-Law 7 regulates partnerships or associations with persons who are not licensees of the Law Society of Upper Canada and who practice a profession, trade or occupation that "supports or supplements" the licensed activity. A licensee may enter into a partnership or association with a professional to permit the licensee to provide the services of the professional to clients. A "professional" is "an individual or a professional corporation established under an Act of the Legislature, other than the *Law Society Act*, the services of whom or which a licensee may provide to a client in connection with the licensee's licensed activity."

⁶ Lawyers who are partners in an MDP reported the following areas of practice: employment and labour law, workplace safety and insurance law, intellectual property law, litigation, corporate/commercial, administrative law, civil litigation, real estate law, wills/estates/trusts, criminal law, citizenship and immigration, consumer legal services, and tax law.

20. Section 18(2) requires that a licensee who wishes to enter into a multi-disciplinary partnership or association must ensure that the following conditions are satisfied:
 1. the professional must be qualified to practise a profession, trade or occupation that supports or supplements the licensee's licensed activity;
 - 1.1.1 the professional must be of good character;
 2. the professional must agree that the licensee has "effective control" over the practice of the other profession, trade or occupation (the professional must practice the profession, trade or occupation to provide services to clients of the partnership or association);
 3. the professional must agree with the licensee in writing that when acting in partnership or in association, the professional will not practice his or her profession, trade or occupation outside of the provision of services to the clients of the MDP or association;
 4. if the professional provides services other than to clients of the firm/association, the non-lawyer/non-paralegal can only do so from other premises;
 5. the non-lawyer/non-paralegal must agree with the licensee to comply with Law Society rules, by-laws, policies and guidelines;
 6. in the case of partnerships (as opposed to associations), the non-lawyer/non-paralegal must agree with the licensee to comply with the Law Society rules, policies and guidelines on conflicts of interest in relation to clients of the partnership who are also clients of the professional practicing independently of the partnership.
21. According to section 19 of the By-law, while the non-licensee must agree to comply with Law Society rules, policies and guidelines, it is the licensee who is responsible to the regulator for the non-licensee's compliance with Law Society rules.

22. Section 20(1) of the By-Law requires that Law Society approval must be obtained before a licensee enters into partnership with a professional.
23. Rule 6.10 of the *Rules of Professional Conduct* provide that a lawyer in an MDP shall ensure that non-licensee partners and associates comply with these Rules and all ethical principles that govern a lawyer. Rule 3.04(15) of the Paralegal Rules similarly provides that a paralegal in a multi-discipline practice shall ensure that non-licensee partners and associates observe the conflict of interest rule for the provision of legal services and for any other business or professional undertaking carried on by them outside the professional business.

Affiliations

24. The essence of affiliation is joint service delivery by licensees and non-licensees. Currently there are 49 affiliations in Ontario.⁷
25. Section 62(0.1)31 of the Law Society Act permits Convocation to make by-laws regarding affiliations. Section 31(2) of By-Law 7 provides that
 - a licensee affiliates with an affiliated entity when the licensee on a regular basis joins with the affiliated entity in the delivery or promotion and delivery of the services of the licensee and the services of the affiliated entity.
26. With respect to the professional business through which licensed services are provided, section 32 of By-Law 7 requires that the licensee
 - (a) own the professional business or comply with the MDP By-Law;
 - (b) maintain control over the professional business; and that
 - (c) the joint business not be carried on from premises from which the non-licensee carries on other business.

⁷ Information as of November 22, 2013.

27. Section 33(1) of By-Law 7 requires a licensee who agrees to affiliate to immediately notify the Law Society of the affiliation. Further, section 33(2) requires that the notice contain the following information:
1. the financial arrangements between the licensee and the non-licensee; and
 2. arrangements for compliance with Law Society rules, policies and guidelines on conflicts of interest and confidentiality of information with respect of the joint clients.

Supervision

28. Rule 5.01(2)(b) of the *Rules of Professional Conduct* requires that a lawyer directly supervise non-lawyers to whom particular tasks and functions are assigned. Rule 8.01(3) of the *Paralegal Rules of Conduct* provides that “a paralegal shall, in accordance with the By-Laws, directly supervise staff and assistants to whom particular tasks and functions are delegated”. By-Law 7.1 governs the circumstances in which a licensee may assign certain tasks and functions to a non-licensee within a law practice.