

## COMPLIANCE AUDITING OF LAW FIRMS: A TECHNOLOGICAL JOURNEY TO PREVENTION

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The changing nature of the legal services marketplace in the 21<sup>st</sup> century has not only resulted in considerable challenges for practitioners but also challenges for those that are responsible for regulating the legal profession. The New South Wales Office of the Legal Services has responded to these changes by augmenting the traditional regulatory paradigm which focused on complaints with a new regulatory framework that utilises a technology focused compliance based paradigm of practice reviews and risk profiling. The ultimate aim of the new regime is to reduce the number of complaints against legal practitioners. As the saying goes – ‘prevention is better than cure’.

### I INTRODUCTION

Over the past few decades we as a society have witnessed considerable developments in trade, foreign direct investment, capital flows, migration, and technology to the extent that national boundaries have gradually diminished in importance. The fall of barriers has simulated free movement of capital and paved the way for companies to set up global businesses resulting in entities with profits as large as the gross domestic incomes of third world countries.<sup>1</sup> The incidence of global institutions is not however limited to transnational corporations alone. Globalisation has also led to significant growth in the legal services marketplace both in Australia and overseas.<sup>2</sup> In conjunction with the growth of law firms there has also been a strong growth in trade in transnational legal services.<sup>3</sup> The practice of law is today becoming big business. As a result major structural changes are

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<sup>1</sup> In 2001, General Electric for example had revenues of \$126 billion, more than the combined national incomes of sub-Saharan African countries, except the Republic of South Africa. See John Madeley, *Big Business, Poor People: The Impact of Transnational Corporations on the World's Poor* (1999).

<sup>2</sup> A consolidated list of global law firms published annually and based on research survey compiled by The America Lawyer in the US and Legal Week in the UK lists 100 law firms as achieving ‘global status’. The Global 100 is a list produced by the American Lawyer which ranks the world’s highest-grossing firms see ‘The Global 100’ list available at <www.law.com> at 6 December 2009.

<sup>3</sup> In Australia, legal services are today a significant component in the export of professional and technical services. Statistics reveal that Australian exports of legal services have grown from \$A74 million in 1987/88 to about \$A250 million in 2000/01. See Australian Bureau of Statistics, Legal Services Industry, *Australian Legal Services Export Development Strategy 2003 to 2006* (March 2003) ILSAC <www.law.gov.au/ilsac> at 6 December 2009.

now occurring within the legal marketplace. Whilst a number of law firms have expanded establishing offices in more than one jurisdiction to ensure greater global coverage, a number of other law firms have avidly taken advantage of recent legislation in jurisdictions that permits incorporation and public listing.<sup>4</sup>

In NSW for example, there are now more than 900 incorporated legal practices (ILPs). These ILPs are primarily located in the suburbs of Sydney and in the CBD<sup>5</sup> and comprise of three or less practitioners. In addition to the establishment of these ILPs, one law firm has franchised their practice<sup>6</sup> whilst another has adopted a limited partnership model and two law firms have already gone public and listed on the Australian Stock Exchange (ASX).<sup>7</sup> Anecdotal evidence suggests however that this is only the beginning with interest in pursuing alternate business structures growing by the minute. This wave of change is not without repercussions. As the legal world aligns itself more closely with the business world, some authors have expressed concern that these new practice arrangements raise ethical issues for the legal profession.<sup>8</sup>

Commercialization by its very nature increases the pressure on firms to consider the profit motive as a superior business objective.<sup>9</sup> This has profound

<sup>4</sup> On 1 July 2001, the Legal Profession (*Incorporated Legal Practices*) Act 2000 ('2000 Act') and the Legal Profession (*Incorporated Legal Practices*) Regulation 2001 came into force in New South Wales amending the *LPA 1987*. The 2000 Act and Regulations amended the 1987 Act to enable providers of legal services in NSW to incorporate by registering a company with the Australian Securities & Investment Commission (ASIC). At present Victoria (*Legal Profession Act 2004* (Vic) pt 2.7); Queensland (*Legal Profession Act 2007* (Qld) pt 2.7.); Western Australia (*Legal Practice Act 2003* (WA) §§ 45-74); the Northern Territory (*Legal Practitioners Act 2006* (NT) pt 2.6); and the Australian Capital Territory (*Legal Profession Act 2006* (ACT) pt 2.6). All of these jurisdictions have identical legislation to that in NSW permitting incorporation and have adopted the same self-assessment program designed and introduced in NSW. South Australia and Tasmania have not yet enacted legislation permitting the incorporation of law firms but have undertaken to do so.

<sup>5</sup> There are at present 344 ILPs practising in suburban Sydney, 259 ILPs practising in the CBD and 202 ILPs practising in rural NSW. Statistics from Law Society of NSW, *Profile of the Solicitors of NSW* (7 January 2009) <<http://www.lawsociety.com.au/idc/groups/public/documents/internetcontent/025941.pdf>> at 6 December 2009.

<sup>6</sup> This law firm operates through a group of independent branch offices throughout New South Wales, the ACT and Queensland. Each branch office is an ILP and is related to the law firm but not to each other, as is typically the nature of franchises. The law firm has to date entered into a franchise agreement with over 20 branch offices.

<sup>7</sup> On 21 May 2007, Slater & Gordon an ILP made legal and corporate history when it became the first law firm in the world to list its whole firm on the ASX. Following Slater & Gordon's listing, Integrated Legal Holdings (IHL), a Western Australian based law firm, listed on the ASX on 17 August 2007. Prior to Slater & Gordon's listing in March 2004, Noyce Legal, a Sydney based law firm, listed its banking and finance division of its practice on the ASX. Noyce Legal did not list the whole firm but incorporated the division which specialised in residential mortgage processing, into National Lending Services Ltd (NLS) and sold all of its shares to listed consumer finance website Infochoice.

<sup>8</sup> Bruce MacEwen, Milton Regan, Larry Ribstein, 'Law Firms, Ethics and Equity Capital: A Conversation' (2007) 21 *Georgetown Journal of Legal Ethics* 61; Milton Regan Jr, 'Commentary: Nonlawyer Ownership of Law Firms Might Not Cause the Sky to Fall' (2007) *The American Lawyer*; Paul Grout, 'The Clementi Report: Potential Risks of External Ownership and Regulatory Responses' (July 2005) available at <<http://www.dca.gov.uk/legalsys/grout.pdf>> at 6 December 2009; Bill Myers, 'Firms Gravitating to Corporate Model: Study' (2003) *Chicago Daily Law Bulletin*.

<sup>9</sup> William Reece Smith Jr, 'Teaching and Learning Professionalism' (1997) 32 *Wake*

implications for the legal profession whose duty to the court has always been paramount.<sup>10</sup> 'Professionalism' speaks of ethically minded conduct and duties to the court. Lawyers as professionals have been traditionally seen as the portal to the justice system, a bridge between society at large and its underpinning rules.<sup>11</sup> This public service claim of the profession of law embodied the ideal of the legal profession as one of faithful service. It also embodied ideals of wise and dispassionate advice by a group of learned and privileged representatives who applied their knowledge in the interests of others against the injustices of the State. However the very notion of justice and the ideal of the legal profession as one of faithful service beyond pure economic self-interest is being challenged by profit and money under the current climate of today's legal service marketplace.<sup>12</sup>

These competing obligations not only have implications for law firms themselves but also for legal regulators who are charged with regulating the legal profession. As the regulator of legal practices in NSW, the Office of the Legal Services Commissioner<sup>13</sup> (OLSC) has thus been forced to revise its role to ensure

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*Forest Law Review* 613, 613.

<sup>10</sup> The duty to the Court is the primary ethical duty and stands over and above any other ethical duties. The duty to the court stipulates that as officers of the Court, legal practitioners must act in a certain way. Legal practitioners must not only obey the law but must also ensure the efficient and proper administration of justice. These duties, which are enshrined in conduct rules and have been reinforced by the Court's provide that legal practitioners must not mislead the Court and must act with competence, honesty and courtesy towards other solicitors, parties and witnesses. The duty to the Court also provides that legal practitioners are independent (free from personal bias), frank in their responses and disclosures to the Court and diligent in their observance of undertakings given to the Court or their opponents, see: *Giannarelli v Wraith* (1988) 165 CLR 543, 555-6 (Mason CJ), 586-7 (Brennan J); *Myers v Elman* [1940] AC 282, 291 (Lord Maugham), 302 (Lord Atkin), 307 (Lord Russell of Killowen), 316-9 (Lord Wright), 334-5 (Lord Porter).

<sup>11</sup> Anthony Kronman, 'The Law as a Profession', in Deborah Rhode (ed), *Ethics in Practice: Lawyers' Roles, Responsibilities and Regulation* (2000).

<sup>12</sup> There has been much discussion of the decline of the legal profession and professionalism in favour of business. This discussion dates back to the 1900s. See eg, Julius Henry Cohen, *The Law: Nusiness or Prefession* (1919). Most recently discussions of this nature have been led by Anthony T. Kronman, *The Law Lawyer* (1993). He stated, 'America's large firms have become explicitly, candidly, without shame in the last twenty years unembarrassedly commercialistic in their outlook and practice. The bottom line has become the only line for them, and the older ethos of craftsmanship which was nourished and reinforced in a very deliberate and careful way by lawyers in these firms in these firms a half century ago has disappeared, and has been replaced by an ethos of moneymaking with puts the exclusive stress mark on the number of billable hours that you put in and the number of dollars those billable hours produce'. Anthony Kronman, 'Transcript, The Second Driker Forum for Excellence in the Law' (1995) 42 *Wayne Law Review* 115. Similar sentiments have been expressed here in Australia. See eg, Bret Walker SC, 'Lawyers & Money' (Speech delivered at 2005 Lawyers' Lecture, St James Ethics Centre).

<sup>13</sup> The Office of the Legal Services Commissioner ('OLSC') receives complaints about solicitors and barristers in NSW. The OLSC works as part of a co-regulatory system, together with the Law Society of NSW (professional body for solicitors) and the NSW Bar Association (professional body for barristers) to resolve disputes and investigate complaints about professional conduct. The OLSC's main role is to ensure that legal practitioners abide by their ethical and other professional obligations when providing services to the public. The OLSC can take disciplinary action against legal practitioners and help resolve problems between practitioners and other members of the community. The OLSC is an independent statutory body and its decisions, can only be challenged through the normal process of administrative law, see: OLSC, *About Us* at

that its regulatory framework responds effectively to this change.

The OLSC has responded to this challenge by augmenting the traditional complaints-based paradigm with a new regulatory framework that utilises compliance-based mechanisms such as 'practice reviews'.<sup>14</sup> These practice reviews are, by and large, audits but unlike traditional audits, the OLSC's practice reviews are not focused solely on financial or practice issues, but include a consideration of ethical behaviour. The practice reviews are trigger-based and are not limited solely to a formal complaint. The OLSC is aiming to promote a high standard of ethical behaviour. The aim is also to encourage legal practitioners to put ethics before profit. In adopting this approach the OLSC hopes to foster a positive cultural change, which will in turn hopefully effect a corresponding positive behavioural change.

## II GLOBALIZATION AND STRUCTURAL CHANGES IN THE AUSTRALIAN LEGAL SERVICES MARKET

The effects of globalisation on the legal services marketplace have been widely documented.<sup>15</sup> We are now witnessing the emergence of the 'global lawyer'. The global lawyer is no longer confined to the jurisdiction in which he/she had been educated and qualified. This global lawyer works in many different jurisdictions throughout the world and must understand the cultural, political and social differences each legal system enjoys. This global lawyer can provide sophisticated and specialized legal services to individuals and corporate clients of all sizes anywhere in the world.

In conjunction with the emergence of the global lawyer we are also witnessing the emergence of the 'global client' and the growth of client power.<sup>16</sup> The global client is sophisticated, their expectations are immediate and they expect effective results. Global clients demand more from their lawyer, as their dealings are no longer confined to their home jurisdiction. The global client thus demands local access to legal solutions in multiple jurisdictions and practice areas. Today's global clients are drawn to providers who offer one-stop shopping and often a broad range of professional services.<sup>17</sup> State and Territory Governments in Australia have responded to this demand by enacting legislation to permit law firms to adopt alternate business structures to the traditional partnership model that had dominated legal practice for so long.<sup>18</sup>

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<[http://www.lawlink.nsw.gov.au/lawlink/olsc/ll\\_olsc.nsf/pages/OLSC\\_aboutus](http://www.lawlink.nsw.gov.au/lawlink/olsc/ll_olsc.nsf/pages/OLSC_aboutus)> at 6 December 2009.

<sup>14</sup> The power to conduct an audit (practice review) is proscribed in the *Legal Profession Act 2004*: see sections 140(3) and 670 LPA 2004.

<sup>15</sup> Carole Silver, 'Globalization and the U.S. Market in Legal Services: Shifting Identities' (2000) 31 *Law and Policy in International Business* 1093; John Flood, 'The Cultures of Globalization: Professional Restructuring for the International Market' (1995) *Professional Competition and Professional Power: Lawyers, Accountants and the Social Construction of Markets* 139.

<sup>16</sup> Bill Cobb, *Are you ready for the Revolution in Legal Services*, *The Complete Lawyer*, <<http://www.thecompletelawyer.com/volume3/issue6/>> at 26 June 2008.

<sup>17</sup> See Dr Martin Henssler and Laurel S. Terry, 'Lawyers Without Frontiers – a View from Germany' (2001) 19(2) *Dickinson Journal of International Law* 269.

<sup>18</sup> Since 1996 a scheme has existed in Australia through mutual recognition which has allowed lawyers certified in one jurisdiction to have their certification recognised in other jurisdictions. Such cross-border practice has however raised concerns about the existence of different regulatory rules and standards for admission in each jurisdiction. Noting these problems work commenced on harmonising the legislation to allow for consistency in procedures. The aim has been to create a true National Legal Services

In 2001 for example, New South Wales passed legislation permitting the creation of incorporated legal practices (ILPs), which could also include multidisciplinary practices (MDPs).<sup>19</sup> The legislation permitted legal service providers to register as a company with the Australian Securities and Investments Commission (ASIC), the agency responsible for ensuring compliance with the *Federal Corporations Act 2001* (Cth) (Corporations Act). Once so incorporated, the company was obliged to abide by its constitution, the Act and Regulations and the Corporations Act. In 2004 the *Legal Profession Act 1987* through which the 2001 amendments permitted incorporation was replaced by the *Legal Profession Act 2004* (LPA 2004). The 2004 provisions permitting incorporation remained largely unchanged. Identical legislation has also been adopted in a number of other jurisdictions across Australia.<sup>20</sup>

Pursuant to the LPA 2004 a legal service provider may incorporate and provide legal services either alone or alongside other service providers who may, or may not be 'legal practitioners'.<sup>21</sup> The legislation however provides that at least one legal practitioner director<sup>22</sup> (LPD) must be appointed.<sup>23</sup> The LPD is responsible for the management of the legal services provided in NSW by the ILP.<sup>24</sup> Such management, which is discussed later in the paper includes, inter alia, a requirement that the LPD implement and maintain 'appropriate management systems'.<sup>25</sup> According to the legislation it is an offence if an incorporated legal practice does not have any LPDs for a period exceeding seven days and the practice may be forced into administration.<sup>26</sup>

There has been a growing interest by law firms with the prospect of following the path to incorporation and beyond.<sup>27</sup> However the implications of the introduction

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Market in Australia. In March 2002 the Standing Committee of Attorneys-General in Australia (SCAG) commenced examining the regulation of laws through the National Profession Model Laws Project. Since 2002 the Project has seen the development of model provisions (National Model Bill) as a basis for consistent laws and rules that apply to lawyers in Australia. The National Model Bill provides the basis for a nationally uniform and consistent legislative framework for the regulation of the legal profession in Australia. All States and Territories have committed to pass legislation based on the provisions of the National Model Bill: For further information about the National Profession Model Laws Project see the website of the Law Council of Australia at <http://www.lawcouncil.asn.au/initiatives/national-practice.cfm>.

<sup>19</sup> The *Legal Profession (Incorporated Legal Practices) Act 2000* (the Act) and the *Legal Profession (Incorporated Legal Practices) Regulations 2001* (the Regulations) entered into force on 1 July 2001.

<sup>20</sup> See above n 4. All of the States and Territories in Australia agreed to adopt the same self-assessment program at the 2006 Conference of Regulatory Officers which was held in Sydney on 9-10 November 2006. The Conference of Regulatory Officers is the pre-eminent conference of statutory regulators, Law Societies, Bar Associations and admitting authorities involved in the regulation of the legal profession in Australia. See <<http://www.coro.com.au>>.

<sup>21</sup> Section 140(1) LPA 2004.

<sup>22</sup> A legal practitioner director is defined as a director of an incorporated legal practice who is an Australian legal practitioner holding an unrestricted practicing certificate.

<sup>23</sup> Section 140(1) LPA 2004.

<sup>24</sup> Section 140(2) LPA 2004.

<sup>25</sup> Section 140(3)(a) LPA 2004.

<sup>26</sup> Section 142(1) LPA 2004.

<sup>27</sup> See: L MacIntyre, *What is old is new: PwC opts for MDP* (12 February 2008) Lawyers Weekly <[http://www.lawyersweekly.com.au/blogs/top\\_stories/archive/2008/02/12/what-is-old-is-new-pwc-opts-for-mdp.aspx](http://www.lawyersweekly.com.au/blogs/top_stories/archive/2008/02/12/what-is-old-is-new-pwc-opts-for-mdp.aspx)> at 6 December 2009; Ian Fraser, 'SNP Victory Ushers in New Look at Legal Services Market Reform', *The Herald* (Scotland), 28 June 2007; MacEwen et al, above n 8; Milton Regan Jr, above n 8.

of such legislation are considerable. Incorporation brings with it both benefits and challenges for law firms.<sup>28</sup> By contrast to partnerships, incorporation is seen to protect directors of a firm through the benefit of limited liability. Incorporation can also provide taxation benefits, grants the drafters of the company constitution flexibility regarding ownership, control and distribution of profits and can constitute a profitable investment for shareholders.<sup>29</sup> Share transferability gives owners and other shareholders, who may be non-lawyers, greater flexibility by comparison with partnerships in their financial relationship to the firm. Non-lawyer directors may make valuable contributions to the operations of a company, providing speciality expertise. Incorporated legal practices avoid the requirement of partnerships to reconstitute themselves on the death, retirement or withdrawal of a partner. In addition, whereas non-performing partners may have only been exorcised from a practice through litigation, in an ILP they need only be voted off the board. Incorporation provides for greater flexibility in how employees are rewarded for productivity and that may contribute to a greater corporate camaraderie.<sup>30</sup>

Law firms considering the shift to incorporation must however also consider the impact of a solicitor-director's professional obligations to the court and a solicitor-director's duties to a company's shareholders. Law firms considering the shift to incorporation must also consider the impact of the relatively rigorous reporting requirements of the Corporations Act and in the case of listing, the rules of the Australian Stock Exchange (ASX).<sup>31</sup> Law firms must also consider that through the process of incorporation – they may cede authority for the ownership and management of the practice.

These challenges may have a profound effect on the traditional role and function of legal practitioners. This is because in Australia a legal practitioner's primary duty is owed to the court.<sup>32</sup> The duty to the Court is the primary ethical duty of a legal practitioner and stands over and above any other ethical duties. Inherent in the lawyer's duty to the Court is a duty to the community through the lawyer's high ethical standards and duty to uphold the rule of law. This is a duty owed to society as a whole. In addition to the duty to the Court a legal practitioner in Australia also has a duty to the client. This duty to the client places the legal practitioner in a fiduciary relationship with his/her client. In this relationship the client places complete confidence and trust in his fiduciary, the legal practitioner.<sup>33</sup> All legal practitioners

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<sup>28</sup> Steve Mark, NSW Legal Commissioner, notes on the issue of listing of law firms in New South Wales and the incorporation of law firms, address at the Joint NOBC, APRL and ABA Centre for Professional Responsibility Program in 'Brave New World: The Changing Face of Law Firms and the Practice of Law from a Professional Responsibility Perspective', (Aug. 10, 2007) <[http://infolink/lawlink/olsc/ll\\_olsc.nsf/vwfiles/Notes\\_for\\_Joint\\_NOBC\\_APPL\\_ABA](http://infolink/lawlink/olsc/ll_olsc.nsf/vwfiles/Notes_for_Joint_NOBC_APPL_ABA)> at 6 December 2009.

<sup>29</sup> See: Ibid; Steve Mark, 'The Corporatisation of Law Firms – Conflicts of Interest for Publicly Listed Firms' (Address at the Australian Lawyers Alliance National Conference 2007, 11-13 October 2007).

<sup>30</sup> Ibid.

<sup>31</sup> See Australian Stock Exchange, *Rules, Guidance Notes and Waivers*, <[http://www.asx.com.au/supervision/rules\\_guidance/index.htm](http://www.asx.com.au/supervision/rules_guidance/index.htm)> at 5 March 2009.

<sup>32</sup> See, The Law Society of New South Wales, *Professional Conduct and Practice Rules*, (1995) <<http://www.lawsociety.com.au/idc/groups/public/documents/internetcostguidebook/026327.pdf>> at 6 December 2009, Rules 17-24.

<sup>33</sup> The generally accepted Australian definition of what constitutes a fiduciary is by Mason J in *Hospital Products Limited v United States Surgical Corp* (1984) 156 CLR 4: 'The critical feature of these relationships is that the fiduciary undertakes or agrees to act for or on behalf of or in the interests of another person in the exercise of a power or discretion which will affect the interests of the other person in a legal or practical sense. The

stand in a fiduciary relationship to their clients, as agents and as providers of legal advice. These being so all lawyers are subject to the range of duties arising out of that fiduciary relationship. The English Law Commission's report on fiduciary duties has conveniently summarised the scope of a fiduciary's duties as follows:

- (i) the 'no conflict' rule – A fiduciary must not place himself in a position where his own interests conflicts with that of his customer, the beneficiary. There must be a 'real sensible possibility of conflict';
- (ii) the 'no profit' rule – A fiduciary must not profit from his position at the expense of the customer, the beneficiary;
- (iii) the 'undivided loyalty' rule – A fiduciary owes undivided loyalty to his customer, the beneficiary, not to place himself in a position where his duty towards one customer conflicts with a duty that he owes to another customer. A consequence of this duty is that a fiduciary must make available to a customer all the information that is relevant to the customer's affairs;
- (iv) the 'duty of confidentiality' – A fiduciary must only use information obtained in confidence from his customer, the beneficiary, for the benefit of the customer and must not use it for his own advantage, or for the benefit of any other person.<sup>34</sup>

The ethical duty to the client and the ethical duty to the Court arise from the historical role of the lawyer as a servant of the public. This role is enshrined in the general sociological definition of a 'profession'. The Australian Council of Professions, for example, defines a 'profession' as:

A profession is a disciplined group of individuals who adhere to ethical standards and who hold themselves out as, and are accepted by the public as possessing special knowledge and skills in a widely recognised body of learning derived from research, education and training at a high level, and who are prepared to apply this knowledge and exercise these skills in the interest of others.

It is inherent in the definition of a profession that a code of ethics governs the activities of each profession. Such codes require behaviour and practice beyond the personal moral obligations of an individual. They define and demand high standards of behaviour in respect to the services provided to the public and in dealing with professional colleagues. Further, these codes are enforced by the profession and are acknowledged and accepted by the community.<sup>35</sup>

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relationship between the parties is therefore one which gives the fiduciary a special opportunity to exercise the power or discretion to the detriment of that other person who is accordingly vulnerable to abuse by the fiduciary of his position. The expressions 'for', 'on behalf of' and 'in the interests of' signify that the fiduciary acts in a 'representative' character in the exercise of his responsibility, to adopt an expression used by the Court of Appeal'.

<sup>34</sup> Law Commission for England and Wales, 'Fiduciary Duties and Regulatory Rules' (Report 236, 20 December 1995) 2.

<sup>35</sup> Rather than discussing in detail the definition of 'profession' which has been widely traversed by academia this paper relies on a general understanding of the definition of a 'profession' as espoused by the Australian Council of Professions which includes the following elements: adherence to codified ethical standards; specialized knowledge or skills; a socially acknowledged and accepted group; self-regulation and preparedness to apply knowledge or exercise skills in the interest of others.

This definition clearly embodies the characteristics of the legal profession: the law is a body of esoteric knowledge consisting of statutes, case law, doctrines, rules of evidence and procedures; it features institutionalized formal education requirements; it boasts elevated socio-economic and cultural status; it relies (at least in part) on self-regulation and has a monopoly over the provision of legal services; it has a set of codified ethical rules and a public service claim.

The public service claim of the profession of law embodies the ideal of the legal profession as one of faithful service beyond pure economic self-interest. The practice of law has always been seen as a privilege. The privilege was not only that of being fortunate enough to study the law but also the privilege of being able to use that study to profess and protect those that were not fortunate enough to be protected from the injustices of the state. The public service claim therefore embodied ideals of wise and dispassionate advice to clients. The public service claim also embodied the ideal of personal relationships and loyalty between practitioner and client that was of the utmost importance and highly respected. It is this public service claim that became essential to the purpose of the legal profession and the real justification for its existence.

With the advent of incorporation and the move toward commercialised professionalism<sup>36</sup> it has become questionable as to whether the duty to the Court and the virtues of professionalism can continue to survive. This is because the very nature of true professionalism stands in direct contrast to the goals of running a business. Commercialised professionalism dictates that services should be tailored to meet the needs of the client or shareholder. Commercialised professionalism therefore emphasises the necessity of completing a task even if it violates traditional professional criteria stipulated in regulations.<sup>37</sup> As Deborah Rhode explains:

In the last quarter century, the American legal profession has been transformed by a series of sweeping changes that have compromised each of the four features of law practice that justify its claim to be a profession. In the first place, the commercialisation of law practice, especially in its upper reaches, at the country's largest and most prestigious firms, has introduced an element of competitiveness that has caused many lawyers in these firms to view their public responsibilities as a luxury they can no longer afford in the frantic scramble to attract business by appealing to the self-interest of clients. This tendency has been exacerbated, I am bound to say, by the official pronouncements on legal ethics made by the American Bar Association and other organized groups, which increasingly endorse the view that lawyers serve the public best by serving the public interests of their clients with maximum zeal, in effect treating lawyers like Adam Smith's tradesmen, who count on an invisible hand to transmute their pursuit of private advantage into a benefit for the community as a whole.<sup>38</sup>

With the rise of the global client, lawyers are experiencing this tension more frequently than ever before. Consequently, the OLSC, as the regulator of legal

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<sup>36</sup> The term 'commercialised professionalism' was first coined by Gerard Hanlon in 1988 in discussing the practices of the large global accounting firms. Hanlon argued that such firms placed more importance on managerialism than the practice of law and therefore placed undue pressure on their employees to satisfy clients at the expense of their professional values: See Gerard Hanlon, "'Casino Capitalism' and the Rise of the 'Commercialised' Services Class – An Examination of the Accountant' (1996) 7 *Critical Perspectives on Accounting* 339

<sup>37</sup> Andrew M. Francis, 'Legal ethics, the marketplace and the fragmentation of legal professionalism' (2005) 12(2) *International Journal of the Legal Profession* 173-200.

<sup>38</sup> Deborah Rhode, 'Ethics in Practice: Lawyers' Roles, Responsibilities and Regulation' (2000) 38.

practices in NSW, has thus been forced to reconsider and revise its role in the legal services marketplace and accordingly adjust its regulatory approach.

### III COMPLAINT BASED REGULATION

The Office of the Legal Services Commissioner ('OLSC') receives complaints about solicitors and barristers in NSW. The OLSC works as part of a co-regulatory system, together with the Law Society of NSW and the NSW Bar Association to resolve disputes and investigate complaints about professional conduct. The primary function of the OLSC is, inter alia, 'to regulate' the legal profession. The Oxford Dictionary defines the phrase 'to regulate' as follows:

1. Control, govern, or direct by rule or regulations; subject to guidance or restrictions; adapt to circumstances or surroundings
2. Bring or reduce (a person or group) to order
3. Alter or control with reference to some standard or purpose; adjust (a clock or other machine) so that the working may be accurate
4. Exhibit regulation<sup>39</sup>

Historically regulators of the legal profession have adopted the 'control and govern approach' and in fact this was the approach that was taken in NSW when the OLSC was first established in 1994.<sup>40</sup> This approach traditionally categorised as a 'complaints-based approach' focused on setting high ethical standards by holding practitioners against these standards and disciplining or removing those that failed.<sup>41</sup> The approach is thus by and large a pass/fail system: either the rules are found to have been broken or they are not. Consequently, in the approximately 95 per cent of cases where there was insufficient evidence that a genuine breach of the conduct rules had occurred, the complaint was dismissed without any real attempt at problem solving or systemic improvement. This was one of the greatest problems of this approach.<sup>42</sup>

Additionally this approach did not satisfy consumers of legal services. This is because the overwhelming majority of people who lodge complaints against legal practitioners in NSW are simply not interested in a result whereby most complaints are dismissed or the legal practitioner gets disciplined.<sup>43</sup> What consumers are really after is the outcome they originally went to their practitioner for and failed to get. They want, for example, the conveyance to go through, the personal injuries action

<sup>39</sup> *The New Shorter Oxford English Dictionary*, (1993) 2530.

<sup>40</sup> The regulation of the legal profession in NSW prior to 1994 was the responsibility of the Professional Councils (Law Society and Bar Association), which set standards against which practitioners' conduct was assessed when complaints were lodged against them. It was largely a pass/fail system: either the rules were found to have been broken or they were not. In the approximately 95 per cent of cases where there was insufficient evidence that a genuine breach of the conduct rules had occurred the complaint was dismissed. See Steve Mark, *Complaints Against Lawyers: What Are They About and How Are They Handled?* (May 1995) Office of the Legal Services Commissioner <[http://www.lawlink.nsw.gov.au/lawlink/olsc/ll\\_olsc.nsf/pages/OLSC\\_may\\_1995](http://www.lawlink.nsw.gov.au/lawlink/olsc/ll_olsc.nsf/pages/OLSC_may_1995)> at 6 December 2009; New South Wales Law Reform Commission, 'Scrutiny of the Legal Profession: Complaints Against Lawyer' (Report 17, 2003).

<sup>41</sup> Mark, *ibid*.

<sup>42</sup> *Ibid*; Steve Mark, 'Regulation: Putting the Profession in Good Order' (paper delivered at the Conference of Regulatory Officers, Canberra, 2001).

<sup>43</sup> NSW Law Reform Commission, above n 40, xii.

to finally get listed, the estimate for settlement to be in accordance with what they were originally told, they want the kids from the marriage, they want to get out of jail.<sup>44</sup> In short, they want 'justice' as they see it.

The second problem with this approach is that it was 'ad hoc and reactive', and thus triggered only in response to problems that have already occurred.<sup>45</sup> So a practitioner who had overcharged a complainant in a particular matter was only reprimanded in respect of that particular matter even though that practitioner may have engaged in a practice of overcharging in every matter he dealt with. Similarly, a practitioner who had failed to disclose his/her costs in relation to one matter would only be reprimanded in that particular matter even if that practitioner had continually failed to disclose his costs in other matters he had acted for that particular complainant.

The third problem with the approach is that it was narrow and secretive and is incapable of bringing about systematic change.<sup>46</sup> The limitations of the disciplinary process meant that the practitioner would be disciplined only and there would be no guidance or assistance to educate the practitioner about not making the same mistake again.

Fourth, the traditional complaint-based regulatory regime focuses solely on individual conduct, that is conduct by an individual practitioner in a firm, not conduct by the firm itself. Law firms could not therefore be held to be vicariously liable for the actions of their employees. Critics have argued that sanctions against a law firm are possible and necessary to 'encourage partners to invest in structural controls, such as conflicts checking procedures, to promote firm-wide compliance with professional regulation'.<sup>47</sup>

These limitations appeared to be in stark contrast with the objectives of the regulatory system, which is to redress consumer complaints by users of legal services; ensure that individual practitioners comply with professional standards, and maintain the standards of the profession as a whole. The limitations similarly appeared to be in stark contrast with the vision and mission statement of the OLSC to 'lead in the development of an ethical legal services market which is fairer, more accessible and responsive', and reduce complaints by:

- Developing and maintaining appropriate complaints handling processes
- Promoting compliance with high ethical standards
- Encouraging an improved consumer focus in the profession;

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<sup>44</sup> Mark, above n 40; OLSC Annual Report 1995-2006 at p 4.

<sup>45</sup> Mark, above n 42.

<sup>46</sup> Ibid.

<sup>47</sup> Quoted by Professor Ted Schneyer, 'Professional Discipline for Law Firms' (1991) 77 *Cornell Law Review* 2236, cited by E. Chambliss & D. E. Wilkins, 'A New Framework for Law Firm Discipline' (2003) 16 *Georgetown Journal of Legal Ethics* 335. The concept of law firm discipline was first proposed in 1991 by Professor Ted Schneyer of the University of Arizona as a response to the growth of large law firms and their team based approach to practice. It was intended to address the situation where supervision and responsibility for the actions of an employee is an issue. Professor Schneyer argued that law firm discipline is beneficial because it making everyone liable for the firm's actions it encourages partners to invest in structural controls, such as conflicts checking procedures to promote firm-wide compliance with professional regulation. See also, C. Parker, A. Evans, L. Haller, S. LeMire, R. Mortensen, 'The Ethical Infrastructure of Legal Practice in Larger Law Firms: Values, Policy and Behaviour' (2008) 31(1) *University of New South Wales Law Journal*.

- Developing realistic expectations by the community of the legal system.<sup>48</sup>

Noting these difficulties the OLSC in 1994 began a process of enhancing its complaint handling approach by strengthening its consumer focus and by strengthening its educational focus. It was able to do so because of an amendment to the legislation in 1994 concerning the regulation of legal practitioners.<sup>49</sup> The approach taken was that embodied in the second part of the definition of ‘to regulate’ – being ‘to bring to order’.<sup>50</sup>

The ‘bring to order’ approach recognises that there are multiple aims to an effective regulatory system. These aims include a consumer dimension, with the consequent need to redress the complaints of dissatisfied users of legal services, a practitioner dimension, ensuring the diligence and competence of individual practitioners and a profession dimension, maintaining high standards of ethics and practice for the profession generally.

The ‘bring to order’ approach to regulation is by contrast to the ‘control and govern approach’ proactive, public and positive. It involves continually building, evaluating and improving our activities. The philosophy behind this approach is formulated on ensuring that the OLSC will make a lasting and significant contribution to raising standards in the legal services industry – to put the profession in better order so to speak – and ultimately to improve the satisfaction with the services delivered by legal practitioners to the community. The OLSC has sought over the years to invoke this approach in three ways; the capture and publication of knowledge, the education of practitioners and would-be practitioners, and the education of consumers and their representatives/agencies.<sup>51</sup>

The ‘bring to order’ approach has proven to be an undeniable success in reducing the number of complaints against legal practitioners.<sup>52</sup> This success is clearly reflected in the OLSC complaint statistics. During the first year of operation in 1994 the OLSC received 2,801 written complaints and 6,700 inquiry calls.<sup>53</sup> In 2007-2008 the OLSC received 2653 written complaints and 9694 inquiry calls.<sup>54</sup> Notwithstanding the increase in the number of inquiries received, the number of written complaints has remained virtually static. This is particularly impressive when one considers the increase in the number of members of the legal profession from about 12,000 to about 25,000 for that period. Despite this success recent structural changes to the legal marketplace have once again forced the OLSC to reassess the dynamics of the ‘bring to order’ approach.

<sup>48</sup> OLSC Vision and Mission Statement, Annual Reports 1994 to present.

<sup>49</sup> The *Legal Profession Reform Act* 1993 (NSW) amended the *Legal Professional Act 1987* by (*inter alia*) inserting a new Part 10 into that Act. Part 10 deals with the handling of complaints against, and the discipline of legal practitioners in NSW. It defines professional misconduct and the more recent concept of unsatisfactory professional conduct, establishes my position and my office, discusses how complaints are to be handled by the various bodies involved in discipline against legal practitioners and various other incidental matters. The new Part 10 was proclaimed on 1 July 1994.

<sup>50</sup> Mark, above n 42.

<sup>51</sup> *Ibid.*

<sup>52</sup> The ultimate purpose of the OLSC is to reduce complaints against practitioners. The Legal Services Commissioner has relayed this purpose on numerous occasions and has stated: ‘it is my view that the only long term valid performance indicator for this Office should be a reduction in complaints against legal practitioners’. See for example, Mark, above n 40; OLSC Annual Report 1994-1995, 4; OLSC Annual Report 1997-1998.

<sup>53</sup> OLSC Annual Report 1994-1995, 4.

<sup>54</sup> OLSC Annual Report 2007-2008, 7.

## IV COMPLIANCE BASED REGULATION

With the enactment of the 1987 and ensuing 2004 legislation permitting ILPs came a new range of additional responsibilities for legal practitioners who sought to incorporate. The usual professional obligations that complement the privileges enjoyed by Australian legal practitioners bound those practitioner employees and officers delivering legal services on behalf of an ILP.<sup>55</sup> However these responsibilities were extended in the case of legal practitioner directors of an ILP to include obligations under the Corporations Act as well as:

- (i) A general responsibility on the solicitor director for management of the legal services provided by the incorporated legal practice – this responsibility probably does not extend beyond those general responsibilities that partners have to the general management of their partnership.
- (ii) The implementation and maintenance of ‘appropriate management systems’ to enable the provision of legal services in accordance with the professional obligations of solicitors and the other obligations imposed by or under section 140(2) and (3) of the LPA 2004. Failure to implement and maintain ‘appropriate management systems’ is declared to be professional misconduct.
- (iii) A responsibility to report to the Law Society any conduct of another director of the practice that has resulted in or is likely to result in a contravention of that person’s professional obligations or other obligations imposed by or under the Act.<sup>56</sup>
- (iv) Report to the Law Society any professional misconduct of a solicitor employed by the practice.
- (v) An obligation to take all action reasonably available to deal with any professional misconduct or unsatisfactory professional conduct of a solicitor employed by the practice.<sup>57</sup>

In order to effectively comply with these additional responsibilities the OLSC together with Law Society, LawCover (the provider of professional indemnity insurance in New South Wales), and the College of Law, the largest provider of continuing legal education in New South Wales developed an educational program which by and large puts in place a quasi ‘ethical infrastructure’ – that is, formal and informal management policies, procedures and controls, work team cultures, and habits of interaction and practice that support and encourage ethical behaviour<sup>58</sup> – for ILPs.

The ethical infrastructure is put in place by the requirement under section 140(3) of the LPA 2004 that a legal practitioner director must ensure that ‘appropriate management systems’ are implemented and maintained by the ILP.

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<sup>55</sup> Section 143 LPA 2004.

<sup>56</sup> Section 140(4) LPA 2004.

<sup>57</sup> Section 141 LPA 2004.

<sup>58</sup> The term ‘ethical infrastructures’ was developed by Professor Ted Schneyer. See Ted Schneyer, ‘A tale of Four Systems: Reflections on How Law Influences the ‘Ethical Infrastructure of Law Firms’ (1998) 39 *South Texas Law Review* 245. It was developed further by Elizabeth Chambliss and David Wilkins in ‘Promoting Effective Ethical Infrastructure in Large Law Firms: A Call for Research and Reporting’ (2002) 30 *Hofstra Law Review* 691 and Ted Schneyer, ‘A New Framework for Law Firm Discipline’ (2003) 16 *Georgetown Journal of Legal Ethics* 335

Failure to implement an appropriate management system pursuant to the LPA 2004 may pursuant to the 2004 Act constitute professional misconduct.<sup>59</sup> 'Appropriate management systems' are not defined in the LPA 2004. The OLSC has however in collaboration with the Law Society of NSW, the College of Law and LawCover developed key criteria to ascertain whether an ILP has 'appropriate management systems' in place. The majority of these objectives relate to a practitioner's duty toward his/her client. Inherent in this duty is however the practitioner's duty to the court. These key criteria set out below are what the OLSC considers to be the ten objectives of a sound legal practice.

1. Competent work practices to avoid negligence.
2. Effective, timely and courteous communication.
3. Timely delivery, review and follow up of legal services to avoid instances of delay
4. Acceptable processes for liens and file transfers.
5. Shared understanding and appropriate documentation from commencement through to termination of retainer covering costs disclosure, billing practices and termination of retainer.
6. Timely identification and resolution of the many different incarnations of conflicts of interest including when acting for both parties to a transaction or acting against previous clients as well as potential conflicts which may arise in relationships with debt collectors and mercantile agencies or conducting another business, referral fees and commissions etc.
7. Records management which includes minimizing the likelihood of loss or destruction of correspondence and documents through appropriate document retention, filing, archiving etc and providing for compliance with requirements as regards registers of files, safe custody, financial interests.
8. Undertakings to be given with authority, monitoring of compliance and timely compliance with notices, orders, rulings, directions or other requirements of regulatory authorities such as the OLSC, Law Society, courts or costs assessors.
9. Supervision of the practice and staff.
10. Avoiding failure to account and breaches of s61 of the Act in relation to trust accounts.<sup>60</sup>

It is important to note that these objectives are not set in stone. The objectives require constant revision in light of the changing legal marketplace.

A standard 'self-assessment document' has been developed to enable legal practitioner directors to assess their management systems.<sup>61</sup> This self-assessment document is sent to ILPs once the OLSC has received notification from the Law Society of NSW that a practice has incorporated. The self-assessment document takes into account the varying size, work practices and nature of operations of different ILPs, eschewing an inappropriate 'one size fits all' approach requiring the

<sup>59</sup> Section 140(5) LPA 2004.

<sup>60</sup> See OLSC, <[http://infolink/lawlink/olsc/ll\\_olsc.nsf/pages/OLSC\\_ilp](http://infolink/lawlink/olsc/ll_olsc.nsf/pages/OLSC_ilp)> at 6 December 2009.

<sup>61</sup> A copy of the self-assessment document can be found at OLSC, *Incorporated Legal Practices* (2007) <[http://www.lawlink.nsw.gov.au/lawlink/olsc/ll\\_olsc.nsf/pages/OLSC\\_ilp](http://www.lawlink.nsw.gov.au/lawlink/olsc/ll_olsc.nsf/pages/OLSC_ilp)> at 6 December 2009.

fulfillment of uniform criteria. The self-assessment document instead suggests indicative criteria to assist legal practitioner directors to address each of the ten objectives along with examples of what an ILP *may* do that would provide evidence of compliance. For example, regarding ‘competent work practices to avoid negligence,’ the self-assessment document suggests as a criterion that ‘fee earners practice only in areas where they have appropriate competence and expertise’. A ‘written statement setting out the types of matters in which the practice will accept instructions and that instructions will not be accepted in any other types of matters’ would provide evidence that this criterion had been met. Legal practitioner directors then rate the ILP’s compliance with each of the ten objectives as either ‘Fully Compliant’, ‘Compliant’, ‘Non-Compliant’ or ‘Partially Compliant’.

The OLSC has, in practice, by agreement with the Law Society, assumed the role of ‘auditing’ ILPs for compliance with the LPA and Regulations pursuant to sections 140(3) of the LPA. The OLSC’s power to audit ILPs is found in section 670 of the LPA 2004, which provides as follows:

670 Compliance audit of law practice

- (1) The Law Society Council or the Commissioner may cause an audit to be conducted of the compliance of a law practice (and of its officers and employees) with the requirements of this Act, the regulations or the legal profession rules.
- (2) Without limiting subsection (1), an audit conducted in relation to an incorporated legal practice may include an audit of:
  - (a) The compliance of the incorporated legal practice with the requirements of Part 2.6, and
  - (b) The management of the provision of legal services by the incorporated legal practice (including the supervision of officers and employees providing the services).

Note Section 140 (3) (Incorporated legal practice must have legal practitioner director) requires legal practitioner directors to ensure that appropriate management systems are implemented and maintained.

The OLSC’s audit powers are reasonably new. In 2001 the LPA 1987 was amended to allow the OLSC and the Law Society Council to ‘conduct a review of the compliance of an incorporated legal practice (and of its officers and employees) with the requirements of or made under this Act in connection with the provision of legal services by the practice’.<sup>62</sup> The test for compliance was found in section 47E(3)(a) of the Act which stipulated that it was professional misconduct if a solicitor director did not ensure that appropriate management systems were implemented and maintained by the ILP.

The term ‘review’ was not defined in the 1987 Act.<sup>63</sup> However it appears that it was defined to connote something similar to that of a compliance audit in so far as the regulations gave the OLSC power to examine persons, inspect books and

<sup>62</sup> Section 47P LPA 2007.

<sup>63</sup> ‘Review’ is defined in the New Shorter Oxford English Dictionary as follows: ‘The action of looking over a book etc. for the purpose of correction or improvement; revision; an instance of this...An inspection, an examination...A general survey or reconsideration of some subject or thing...Consideration of a judgment, sentence...An account or criticism of a (new or recent) book, play, film, product’.

hold hearings on the same terms as those powers have been conferred on the ASIC. The extent of the review power under the 1987 Act was thus very specific.

Five formal reviews were conducted under the 1987 Act as well as a number of informal reviews. The five reviews entailed a visit from the OLSC and review of the firm's ILP client files systems and accounting procedures. During each review, the solicitor-director was interviewed about the self-assessment document and asked a list of standard questions. After the interview the ILPs client files and accounting procedures were reviewed to determine the extent of compliance with the ten objectives. Once the visit was complete the OLSC drafted a review report for the ILP in respect of its management systems.<sup>64</sup>

In 2004 the provisions of the LPA 1987 relating to ILPs and audits was greatly amended. Section 670, which replaced section 47P conferred a broad general power on the OLSC to audit all legal practices not just ILPs. Accordingly the LPA 2004 created two types of 'audits'. The first is a general power to 'audit' any law practice regardless of entity status pursuant to section 670(1) of the LPA 2004. The OLSC has characterised this type of an 'audit' as a 'compliance audit' in line with the wording of the provision. The second is an audit of an ILP which is broken into two components – Part 2.6 compliance and management of the provision of legal services (section 670(2)(a) & (b)) – an ILP audit.

#### *A The Compliance Audit: Section 670 of the LPA 2004*

Section 670 does not define the term 'compliance audit' nor does it provide a test for compliance. This being so the OLSC has had to consider the concepts of 'audit' and 'compliance' and interpret them in accordance with the objects and purpose of the provisions.

Black's Law Dictionary defines the term 'audit' to mean:

A formal examination of an individual's or organisation's accounting records, financial situation, or compliance with some other set of standards.<sup>65</sup>

Similarly, the New Shorter Oxford English Dictionary defines the term 'audit' as follows:

1. An official examination and verification of (orig. orally presented) financial accounts, esp. by an independent body
2. A statement of account; a balance sheet
3. A hearing, an inquiry, a methodological and detailed review
4. A periodical settlement of accounts between landlord and tenants
5. A searching examination; a reckoning, a settlement.<sup>66</sup>

Each of these definitions are problematic for the OLSC because they appear to focus on financial records as a key activity of an audit. A similar notion is also expressed in the legal definition of an 'audit':

Bring into question, certify, check, check on, conduct an inquiry, examine, examine financial accounts, examine the accounts officially, go through the books, hold an inquiry, inspect, inspect accounts officially, investigate, monitor, probe, pursue an

<sup>64</sup> Steven Mark and Georgina Cowdroy, 'Incorporated Legal Practices – A New Era in the Provision of Legal Services in the State of New South Wales' (2004) 22(4) *Penn State International Law Review* 671.

<sup>65</sup> Black's Law Dictionary < <http://www.blackslawdictionary.com/> > at 6 December 2009.

<sup>66</sup> L Brown, *The New Shorter Oxford English Dictionary on Historical Principles* (1993) 146-147.

inquiry, rationes dispungere, re-examine, research, review, scrutinize, search, study, subject to examination.<sup>67</sup>

In light of the difficulties the OLSC was of the view that the power to conduct a compliance audit of a legal practice pursuant to section 670 of the LPA 2004 should *not* involve the OLSC conducting an audit of a practice's accounting and financial records. This is because the power to conduct a financial audit is already dealt with under the LPA 2004.<sup>68</sup> and the Corporations Act 2001.<sup>69</sup> The OLSC is clearly of the view that section 670 audits under the LPA should not override provisions of the LPA 2004 with respect to the trust account inspectors whom the OLSC works closely with. This being so, the OLSC has recently adopted the term 'practice review' rather than audit when discussing the power under section 670 of the LPA 2004 because a 'practice review' has no implied financial connotations.

The OLSC is of the view that there are several objectives of a practice review under section 670 of the LPA 2004. Such objectives include as follows:

- a) Support the provision of high quality, ethical legal services by practices;
- b) Improve the process for regulating and improving ethical behaviour by practices;
- c) Reduce complaints against practices;
- d) Encourage levels of consistency and certainty to ensure higher levels of consumer protection;
- e) Provide greater visibility of the compliance of practices;
- f) Provide information on compliance to the OLSC aiding in the execution of responsibilities;
- g) Monitor compliance of practices with their professional and ethical responsibilities;
- h) Improve reporting and accountability by practices to the OLSC;
- i) Validate information provided by practices;
- j) Information dissemination;
- k) Provide analysis of how practices are being run;
- l) Assist practices in customisation of and alternate paths through self assessment and regulation;
- m) Provide regulatory and educational information practitioners; and
- n) Facilitate the adoption of good business practices and appropriate management systems in practices.

The ultimate objective with respect to conducting a practice review is improved practice management and compliance with the LPA 2004. As stated above the ILP audit refers to section 140(3), which stipulates that a legal practitioner director must ensure that appropriate management systems are implemented and maintained. A practice review is not so specific but is generic in that it refers to compliance with the LPA 2004, the Legal Profession Regulation 2005 and the Professional Conduct and Practice Rules of the Law Society of NSW and is not limited to management

<sup>67</sup> See William V. Burton, *Legal Thesaurus* (2<sup>nd</sup> ed).

<sup>68</sup> The power to conduct a financial audit of a law firm is entrusted to the Law Society's Trust Account Inspectors. This involves trust account investigators visiting law practices throughout New South Wales on a regular basis in order to detect and prevent fraudulent practices.

<sup>69</sup> Section 301 *Corporations Act 2001* (Cth) provides, inter alia, that a company must have their financial report audited in accordance with Division 3 of the Act and must obtain an auditor's report.

systems. The OLSC has thus interpreted to mean that a practice review is ‘event driven’ – that is the review is appropriate due to an event. The event may be a complaint, as is the case in the traditional complaints paradigm, but it can also be something other than a complaint such as a breaches that amount to either unsatisfactory professional conduct or professional misconduct. Such breaches can for example include, a breach pursuant to section 84(2) of the LPA 2004 regarding advertising<sup>70</sup> or breaches of the costs disclosure provisions pursuant to sections 309-318 of the LPA 2004.

The initiation of a practice review can also occur as a result of the following events:

- a) Adverse media publicity;
- b) A practitioner who has appeared on OLSC’s Complaint Tracking System more than once in 12 months (or the disciplinary register);
- c) Referral from a Law Society trust account inspector;
- d) A follow up compliance audit which is due as a result of a previous audits;
- e) The practitioner has been listed in the Professional Conduct Committee reports of the Law Society of NSW ;
- f) information provided by OLSC, Law Society, ASIC or
- g) Any other source that is of concern or any other reason deemed appropriate by the Commissioner.

The OLSC’s concept of a practice review as set out above is similar to the way in which the NSW Auditor General conceptualises a practice audit:

A practice audit evaluates whether an organisation is effectively meeting its objectives, and using its resources economically and efficiently. It can cover all, or part of, the activities of an agency or agencies. These audits are undertaken in accordance with the provisions of section 15 of the Audit Act 1994 and are funded from parliament’s appropriation and, therefore, are not paid for by the agency audited.

Performance audit reports provide an independent assessment of an area of public sector activity and seek to improve resource management and add value to an agency through recommendations on improving operations and procedures. While recommendations from an audit can address improvements to operational methods, the Auditor-General cannot, and does not, question the merits of government policy.<sup>71</sup>

<sup>70</sup> Section 84(2) provides that a barrister or solicitor must not advertise in a way that might reasonably be regarded as (a) false, misleading or deceptive, or (b) in contravention of the *Trade Practices Act 1974* (Cth) and the *Fair Trading Act 1987* (Cth) or any similar legislation. A contravention of section 84(2) is capable of being professional misconduct or unsatisfactory professional conduct whether or not the barrister or solicitor is convicted an offence in relation to the contravention (s 84(3)).

<sup>71</sup> The power to conduct a performance audit is found in section 38B, Division 2A *Public Finance and Audit Act 1983* (NSW). Pursuant to section 38B(1) the Auditor General of NSW may ‘conduct an audit of all or any particular activities of an authority to determine whether the authority is carrying out those activities effectively and doing so economically and efficiently and in compliance with all relevant laws’. ‘Audit’ is defined in this section to mean ‘examination and inspection’ at <[http://www.audit.nsw.gov.au/info/about\\_us/role.htm](http://www.audit.nsw.gov.au/info/about_us/role.htm)> at 6 December 2009

The OLSC is also looking at developing and using other methods of conducting practice reviews such as surveys such as those used by the Queensland Legal Services Commission and similar external methods. To this end the OLSC has thus been working closely with the other regulators to ensure harmonisation across all practices and procedures.

#### *B* The ILP Audit: Section 140(3) of the LPA 2004

In addition to a general practice review under section 670 an ILP can also be subject to an ILP practice review. Like the general practice review, the ultimate objective of reviewing an ILP pursuant to section 140(3) is better practice management and compliance with the LPA. The objectives of an ILP practice review will allow the OLSC to evaluate the following factors in relation to the ILPs management systems:

- a) Confirmation that appropriate management systems has been implemented and maintained by the ILP in accordance with section 140(3) of the LPA;
- b) Ascertain whether any significant changes in management, organisation, policies, procedures, techniques or technologies are adversely affecting the management systems or welfare of the ILP in general;
- c) Provide relevant guidance, explanations and examples of how similar matters and concerns have been dealt with by other ILPs;
- d) Provide information on suitable and necessary training for staff or the LPD;
- e) Track and analyse ILPs in the self assessment process;
- f) Improve monitoring of the self assessment process for ILPs
- g) Provide further information on relevant elements;
- h) Determine the need for a follow up audit;
- i) Confirm compliance with obligations under Part 2.6 of the LPA.
- j) Align practice management with concerns following from a complaint history.

The same triggers that prompt the OLSC to conduct a practice review of a legal practice will also prompt the OLSC to conduct a practice review of an ILP. However in the case of an ILP practice review there are additional triggers and once again unlike the traditional complaints-based paradigm are not only limited to actual complaints. Such triggers may for example include if ILP fails to return a completed self-assessment form or if the LPD fails to warrant that the practice complies with the requirement to establish and maintain appropriate management systems or the LPD reports ratings less than compliant.

Other triggers may also include where there is evidence to suggest that the LPD has misled the Commissioner with respect to appropriate management systems or where the objectives remain rated less than compliant or an LPD or non LPD or a solicitor employee is listed in a cost warning or conflict of interest database or the most recent monthly Law Society or NSW Professional Conduct Committee Reports or the latest Law Society of NSW Inspection Itinerary. Similarly, a listing of the ILP in the OLSC's top '30' repeat offenders list which is maintained by the OLSC; or an ILPs certification which has expired will also be a trigger.

Since 1 January 2008, the OLSC has conducted 4 practice reviews on ILPs as well as a number of less formal reviews. The four formal reviews were conducted on the ILPs for numerous reasons including a returned self assessment form with 7 of

the 10 objectives rated as partially compliant,<sup>72</sup> a returned self-assessment form with all of the 10 objectives rated as non-compliant, a trust account inspection report which raised major issues with respect to supervision of employees and the veracity of the legal practitioner director's certification that appropriate management systems had been established and maintained,<sup>73</sup> and an ILP which has been the subject of 65 complaints with 49 complaints being made since incorporation in 2003.<sup>74</sup> The OLSC is also in the process of reviewing another ILP sole practitioner who has been the subject of over 100 complaints since that practitioner commenced practice.

All of the ILPs have responded reasonably positively to the reviews. Several were very nervous about the process but were still very accommodating. The OLSC decided that it would be beneficial for all concerned if a copy of the OLSC practice review workbook was sent to the ILPs. The practice book contains questions that the OLSC asks before the review occurred. This gives the ILP time to prepare, formulate the answers to the questions and also obtain copies of any documents that the OLSC might request. The positive reaction to the OLSC review process is largely because the OLSC takes an affirmative, non-adversarial approach to the review and at all times. In taking this approach the firms become aware that the OLSC is assisting and working together with them to achieve a better outcome.

The OLSC has characterised the general practice review and the ILP practice review process as a systematisation of ethical conduct. This approach sits well within the OLSC's general philosophy of regulation that a regulator should:

- (i) Ensure compliance with the relevant laws, rules and regulations;
- (ii) Consistently questions those laws, rules and regulations both for relevance, and in assessing their impact upon both the profession and the community at large, and to make appropriate recommendations for change or improvement;
- (iii) Educate the profession and consumers of legal services with the goal of creating a culture within the profession whereby compliance itself becomes cultural. Once such a culture is achieved, it follows that there will be a reduction in the number of complaints received by my Office. In fact, it has been a long standing stated aim of my Office to reduce the number of complaints about lawyers.<sup>75</sup>

In effect, what the OLSC is aiming to achieve, in New South Wales, is the creation of a new measure of 'success' for legal practices. Thus, those practices that have effectively implemented appropriate management systems and rate themselves compliant in all ten objectives can claim 'success'. It is a measure that does not,

<sup>72</sup> The ILP had previously completed a self-assessment form and was deemed compliant in around 2004. The OLSC asked the legal practitioner director to complete another form, as there had been a couple complaints about him that had given the OLSC cause for concern. As the ILP, which had been established for sometime, was only compliant with some of the objectives, an audit was appropriate.

<sup>73</sup> Following the Trust Account inspection both the Law Society of NSW and the OLSC initiated complaints about the legal practitioner director (we subsequently took over the Law Society complaints). Around 9 complaints had been made about the legal practitioner director in the past and coupled with the findings of the inspection report an audit was conducted.

<sup>74</sup> This does not reflect our position that complaints about practitioners fall after a practice has incorporated. The OLSC asked the legal practitioner director to complete another self-assessment form. It was returned with all 10 objectives rated as compliant or fully compliant. Given the nature and number of complaints made, an audit was appropriate.

<sup>75</sup> Mark and Cowdroy, above n 65, 693.

indeed cannot, compete with a quarterly statement, but complements it. In so doing, it shifts the statistical analysis of legal business practice towards a greater balance between profit and ethics. Measuring such success is a vital step to rewarding it and vital also to ensuring that the consumers of legal services can be confident that legal ethics have not been compromised by the shift to corporate business structures.

## V TECHNOLOGY AND RISK PROFILING

In order to manage the self-assessment process more effectively and efficiently, the OLSC is building an online Portal to automate the management and regulation of legal practices in NSW. The original scope of the project was to build a browser-based system specifically for ILPs in NSW to automate and replace much of the manual processing. The original system focused only on the regulation of ILPs through the self-assessment process. It has however become abundantly clear that it is necessary to amend the scope so that the OLSC has the potential and ability to include all practices in NSW in the system, not just ILPs. It was recognised that a more comprehensive system is required so that future requirements can be addressed. Accordingly, the OLSC are now building the Portal for all legal practices. The Portal's features include:

- A database of legal practices' and legal practitioners' data and functions to maintain that data;
- A function to aid in information exchange between OLSC and external parties such as the legal practices and Law Society;
- A legal practices information and educational repository to assist legal practices improve their management systems;
- A function to automate the review, assessment and management of the self-assessment process; and
- A comprehensive set of operational and management reporting.

The Portal will improve the process for regulating and improving ethical behaviour by all legal practices and support the provision of high quality, ethical legal services. The OLSC envisage that this will in turn reduce the number of consumer complaints about the legal profession. The Portal will also enhance the application and technical capacity to address the OLSC's need for complete, timely and accurate information to support decision making, whilst providing the most effective utilisation of OLSC resources. The Portal will further provide an information and educational repository to aid legal practices in improving their management systems, which will support the provision of high quality, ethical legal services by legal practices and the OLSC's vision of education towards compliance.

### A Using the Portal – a Step-by-Step Guide

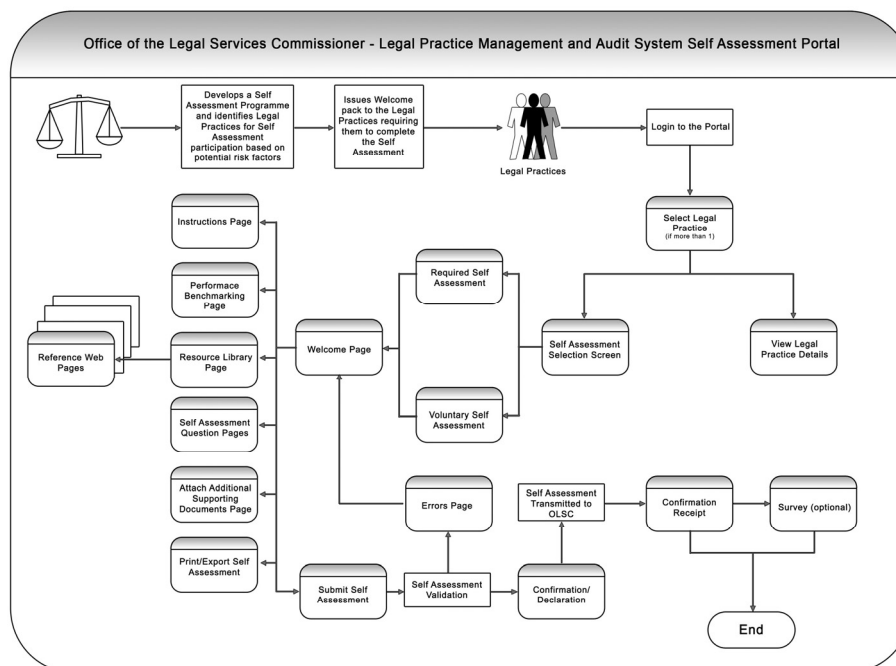
The diagram below shows how the portal will operate when a legal practitioner user (user) logs in. Once the user has logged in s/he will be presented with a screen where s/he can select which legal practice they wish to deal with (if the Legal Practitioner only has access to one legal practice, this screen is by-passed). Once the user has selected the practice s/he will then be presented with a selection screen. The selection screen gives the user three options - the user can either complete a Self Assessment, perform a Voluntary Self Assessment or display the Legal Practice details.

If the user selects the Self Assessment option a welcome screen will appear. If the user selects the Voluntary Self Assessment option the system will request a voluntary self-assessment welcome pack be mailed to the user. In either case the user will see a series of options to select from (in any order). The user may select to view the Instructions Page, the Performance Benchmarking Page, the Resource Library Page and its links to other pages, the Self Assessment Questions pages, the page to attach additional supporting documentation, the page to Print or Export the Self Assessment or the Submission page.

Selecting the Self Assessment questions pages allows any question or case study to be responded to in any order. In answering the questions the user may attach documentation supporting their response to a question.

When the user is ready to submit their Self Assessment to the OLSC the user will select the Submit button. In the background the system will perform a validation of the Self Assessment and if valid will allow the user to continue with the Submission otherwise the Error Page will appear.

If all responses indicate Compliance a popup will appear requesting the user to Print the Certification form, and when printed successfully requesting to press the Confirm Submission button. If any response indicates Non or Partial Compliance a popup will appear displaying the Declaration text and requesting to press the Confirm Submission button. The data will be transmitted to the OLSC and saved in the system. If everything was successfully received – another Page will appear displaying a Confirmation Receipt notification with buttons to Print and Close the popup. Following Receipt of the self assessment, the user may have the option to perform a voluntary Survey.



One of the most important functions of the Portal will be its risk-profiling element. The use of risk profiling will assist the OLSC in focusing its resources on reducing complaints against practitioners by identifying those, which are most at risk of non-compliance or unprofessional conduct. The key outputs of the risk-profiling framework will include priority practice review recommendations as well as targeted education programs to assist firms that are not doing well to help them improve and assist firms that are doing well to do better.

The use of risk-profiling to better regulate the legal profession is an innovative but necessary move. The OLSC have engaged a specialist business strategy and management company to assist with the risk-profiling component of the project. The company that has been contracted has developed a number of targeted strategies based on risk profiling and will assist us establish a risk-profiling framework. This framework will prioritise education programs and target practice reviews based on their risk of non-compliance or unprofessional conduct. The methodology used will support the effective conduct of practice reviews, maximise the opportunity to review operating practices and so minimise the opportunity for non-compliant practices to be missed. The Portal will draw upon both data from the Law Society database and the Complaints Tracking System currently used at the OLSC. Accordingly, the Portal will provide up-to-date information, which, inter alia, will enable risk profiling to be conducted on all NSW legal practices and legal practitioners. The risk-profiling element of the Portal will also allow the OLSC to rapidly acquire the data and the analytical capacity required to make evidence based risk assessments and accordingly review which legal practices require regulation and attention. Risk profiling will further allow the OLSC to identify systemic risk factors for practice reviews; and further investigation and provide a framework to continue ongoing refinement and monitoring for non-compliant behaviours from legal practitioners.

## VI CONCLUSION

The effect of globalisation on the legal services market has prompted legal practices to realise that in order for them to maintain their relevance that they must be versatile, innovative, and forward-thinking. Law firms in New South Wales have responded to this challenge in a number of ways. Many law firms have for example, adopted new management structures to ensure certainty in billing and greater efficiency in service. Law firms have also overcome their Luddite fear of technology and have welcomed its introduction in many facts of practice. In the courtroom, for example, technology has become a permanent fixture with the introduction of video-conferencing, electronic filing and real-time transcripts.<sup>76</sup> Similarly, in practice, the use of technology is today more normal than not - most lawyers now Google regularly and have adopted Blackberry's to ensure effective management control.

In order for a regulatory regime to maintain its relevance it must also be versatile, innovative, and forward thinking. The OLSC has thus been forced to review its traditional regulatory framework as a result of the structural changes in the legal marketplace to ensure that its methods and processes remain effective and relevant. As a result of the review the OLSC has now implemented new regulatory methods, which augments the traditional complaints-based regulatory system. This new system consists of performance reviews, 'quasi' audits whereby the OLSC conducts a compliance review of a legal practice pursuant to section 670 and 140 of

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<sup>76</sup> See Arthur Hoyle, 'The Court of the Future and its Lessons' (2004) 12(4) *Australian Law Librarian* 45.

the LPA 2004. In effect the OLSC is using the structural changes to promote cultural change which it hopes will in turn lead to better behavioural change.