

# **Entity Regulation**

## **Frequently Asked Questions**

### **What is Entity Regulation?**

“Entity regulation,” “entity-based regulation,” and “law firm regulation” are terms used to describe programs that regulate law firms as well as the lawyers and perhaps the non-lawyers who work at a law firm.

### **Are there various Forms of Entity Regulation?**

No. Entity regulation is all or nothing. You either regulate entities or you don’t. If you only regulate part of an entity then it is not entity regulation. However, entity regulation can be applied to a subset of entities. For example, in every State and Territory in Australia, entity regulation has so far applied only to incorporated legal practices.

### **Are there variations in the manner in which jurisdictions use Entity Regulation?**

There are, however, various ways in which entities may be regulated. Some jurisdictions that regulate law-practice entities may choose to use “proactive management based regulation” (defined below), as Australia has done; others may use frameworks that are neither particularly proactive nor focused on management. Some may require firms to evidence their compliance with entity regulation (discussed below); others may not. Others, such as New York and New Jersey, are simply authorized to discipline law firms as well as individual lawyers.

### **What is “proactive management based regulation”?**

The term “proactive management based regulation” (PMBR), coined by Professor Ted Schneyer, refers to programs designed to promote ethical law practice by assisting lawyers with practice management. These programs generally have three features. First, they emphasize proactive initiatives as a complement to traditional, professional discipline. Second, they tend to focus on the responsibility of law firm management to implement policies, programs, and systems – in short, an “ethical infrastructure” -- that is designed to prevent misconduct and unsatisfactory service. Third, they strive to improve legal services and reduce problems by establishing information-sharing and collaborative relationships between regulators and service providers.

According to Professor Schneyer, the framework pioneered in NSW, Australia, is a prototype for PMBR because it gives content to the term “ethical infrastructure.” It does so by “identifying ten types of recurring problems that infrastructure should be designed to prevent and mitigate.”<sup>1</sup>

PMBR departs from the traditional regulatory approach, which is chiefly reactive: conduct rules and standards are prescribed and lawyers are subject to discipline if their conduct fails to meet

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<sup>1</sup> Ted Schneyer, On Further Reflection: How “Professional Self-Regulation” Should Promote Compliance with Broad Ethical Duties of Law Firm Management, 53 Ariz. L. Rev. 577, 585 (2011).

those prescribed norms. PMBR, in contrast, emphasizes efforts to be more proactive, such as by requiring continuing legal education, or bridge-the-gap tutorials for new lawyers. (It is also consistent with the approach taken by malpractice carriers who have found it cost effective to focus on preventative efforts, rather than simply paying for mistakes after they happen.)

A law firm's ethical infrastructure can include a variety of measures. As Dr. Christine Parker explains, ethical infrastructure:

might include the appointment of an ethics partner and/or ethics committee; written policies on ethical conduct in general and conduct in specific areas such as conflicts of interest, billing, trust accounting, opinion letters, litigation tactics and so on; specified procedures for ensuring [that] ethical policies are not breached; [as well as] encourag[ing] the raising of ethical problems with colleagues and management; . . . monitoring . . . lawyer compliance with policies and procedures; and [providing] ethics education, training and discussion within the firm.

Many law firms *have some* elements of the ethical infrastructure Parker describes. For example, research indicates that most U.S law firms have formal procedures for identifying conflicts of interest and periodically monitoring for compliance with those procedures.

Rather than reacting only after a complaint is filed, regulators in a PMBR regime would likely encourage and help firm leaders to detect and avoid problems in advance by focusing on management systems and processes designed to ensure ethical conduct. Importantly, however, PMBR generally allows firms to develop *their own* processes and management systems and engage in internal planning to achieve regulatory goals.

The regulatory goals of PMBR are typically drafted at a broad level of generality so they can be applied flexibly, in a manner appropriate to each firm's size and practice. Goals are stated in qualitative rather than quantitative terms.

### **Which jurisdictions presently use some form of Entity Regulation?**

Australia, Canada, and England & Wales presently use some form of entity regulation. For example, British Columbia and Nova Scotia are now authorized to regulate law firms as well as individual lawyers. Other provinces are aware of these developments.<sup>2</sup>

Canada has also recently taken steps towards a PMBR-type of entity regulation with the development of a management tool to embed ethical practice within firms.<sup>3</sup> In 2012, the Canadian

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<sup>2</sup> See Nova Scotia Legal Profession Act SNS 2004, c 28, s 45(5). (authorizes findings of professional misconduct against law firms); Legal Profession Act of British Columbia, [SBC 1998] CHAPTER 9, Sec. 36 (authorizing discipline against law firms). See also Allan Fineblit, QC, "Regulating Firms" Communiqué (August 2012) at 3, online: The Law Society of Manitoba <<http://www.lawsociety.mb.ca/publications/communique> 2012/LSM%20-%20August%202012.pdf/view>, stating "You likely have never given it much thought, but those of us who do regulation for a living sometimes wonder why we regulate lawyers and not law firms."; Adam M Dodek, "Regulating Law Firms in Canada" (2012) 90:2 Canadian Bar Rev 383.

<sup>3</sup> See The Canadian Bar Association, The Ethical Practices Self-evaluation Tool, <http://www.cba.org/CBA/activities/code/ethical.aspx> ; A. Salyzyn, Regulating Law Practice as Entities: Is the Whole Greater than the Sum of Its Parts?, November 29, 2013, <http://www.slaw.ca/2013/11/29/regulatinglaw->

Bar Association (CBA) began a project to develop a tool that encourages law firms to implement more effective ethical infrastructure.” After considerable research and evaluation of existing regulatory programs, the CBA developed “The Ethical Practices Self-evaluation Tool.”<sup>4</sup> The Tool is not mandatory and is therefore unenforceable, but it is suggested for adoption as best practice.

Although PMBR is currently optional in Canada, it might soon become mandatory in at least one province. In October 2013, Nova Scotia’s regulatory body approved an initiative to develop within 2.5 years a proactive, risk-focused, and principles-based regulatory regime. Nova Scotia is now in the midst of implementing that regime. In November 2014, the Nova Scotia Barristers’ Society distributed for comment a draft self-assessment tool that would be mandatory if adopted.<sup>5</sup>

In England and Wales, the *Legal Services Act of 2007* requires all “alternative business structures” (ABSs) to be regulated as entities. (ABSs are law-practice entities that may be owned in whole or in part by non-lawyers). In 2011, in response to calls for a level playing field, the Solicitors Regulation Authority (SRA) extended entity regulation to encompass traditional law firms as well. Under these rules, all lawyers holding practice certificates must work in regulated entities (i.e., either traditional law firms, referred to as “recognised bodies”<sup>6</sup>, or ABSs, referred to as “licensed bodies”). Practice entities are subject to initial approval, which includes approval of all of the owner/managers and the appointment of compliance officers for both legal practice and finance and administration. Entity approval is one-off but entities are required to report on rule breaches; maintain appropriate systems; provide indemnity insurance cover appropriate for the work they do; and, act as a mechanism of communication with individual solicitors. Entities can be subject to fines and other disciplinary measures, interventions and winding up orders. Individual solicitors remain subject to the traditional requirements of initial approval, ongoing regulation and disciplinary sanctions.<sup>7</sup>

Entity regulation was also introduced in England and Wales for barristers from March 2015.<sup>8</sup> Previously the Bar Standards Board (BSB) only regulated individual barristers, whether self-employed or in-house. As at 30 June 2015, around 20 BSB regulated entities had been approved. At this stage entity regulation for barristers in England & Wales is optional.<sup>9</sup> For the moment the BSB will limit itself to regulating entities owned and managed by barristers and other legal professionals. It will also focus primarily on entities specializing in advocacy, litigation, and specialist legal advice.

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[practices-as-entities-is-the-whole-greater-than-the-sum-of-its-parts/](#) ; A.Salyzyn, What if We Didn’t Wait? Promoting Ethical Infrastructure in Canadian Law Firms, July 25, 2013, <http://www.slaw.ca/2013/07/25/whatif-we-didnt-wait-promoting-ethical-infrastructure-in-canadian-law-firms/>

<sup>4</sup> The Canadian Bar Association, The Ethical Practices Self-evaluation Tool, <http://www.cba.org/CBA/activities/code/ethical.aspx>

<sup>5</sup> See Nova Scotia Barristers’ Society, A Management System for Ethical Legal Practice (Nov. 10, 2014), [http://nsbs.org/sites/default/files/ftp/InForumPDFs/NSBS\\_SelfAssessment.pdf](http://nsbs.org/sites/default/files/ftp/InForumPDFs/NSBS_SelfAssessment.pdf); see generally NSBS, Transform Regulation Page, <http://nsbs.org/transform-regulation..>

<sup>6</sup> Forms of recognized body include ‘recognised sole practitioners’.

<sup>7</sup> See Solicitors Regulation Authority, Firm Based Authorization <http://www.sra.org.uk/solicitors/firm-based-authorisation.page>.

<sup>8</sup> See Bar Standards Board, For prospective entities, <https://www.barstandardsboard.org.uk/regulatory-requirements/for-prospective-entities/>

<sup>9</sup> Ibid.

## **How do these jurisdictions use Entity Regulation?**

### **(a) Who oversees entity regulation?**

In NSW (Australia), entities are co-regulated by the Law Society of New South Wales and the Office of the Legal Services Commissioner (OLSC). The Law Society is responsible for “registering law firms as entities (incorporated legal practices)” and the OLSC is responsible for regulating their conduct. The OLSC was created by the NSW legislature. The Legal Services Commissioner reports to the State Attorney General.

Unlike the U.S., England and Wales have long had several legal professions. This complicates the allocation of authority to regulate law-practice entities. The oversight regulator for legal services in England and Wales, the Legal Services Board (LSB) approves regulatory regimes for alternative business structures proposed by the ‘front line regulators’ for different legal professions. The LSB has now authorized a number of regulators to regulate licensed bodies (ABS) operating in various legal areas, including the SRA, the Council for Licensed Conveyancers, the Chartered Institute of Legal Executives etc. It is important to note that there is an explicit difference between the entity authorization granted to a law firm by the SRA – which covers any area in which a solicitor may practice, and the authorization of an alternative business structure which is based on identified areas of practice set down in the licence application. Although there is therefore a choice of regulatory regime open to different types of entities operating in the legal sector, this choice will be dictated by their area of practice. A traditional law firm, wanting to practice all areas of law will remain under the regulatory oversight of the SRA.

The Bar Standards Board (BSB) regulates entities owned and managed by barristers and other lawyers. For the time being, the BSB will not be licensing bodies that have non-lawyer owners or managers (ABSs). But the BSB hopes to regulate ABSs in the future, after filing a separate application to the LSB.

### **(b) What specifically is regulated?**

In Australia the conduct of law-practice entities has been regulated for over a decade. Entities are required, inter alia, to implement and maintain “appropriate management systems” to meet ten management objectives).<sup>10</sup> The ten management objectives concern:

1. Negligence (providing for competent work practices).
2. Communication (providing for effective, timely and courteous communication).
3. Delay (providing for timely review, delivery, and follow up of legal services).
4. Liens/file transfers (providing for timely resolution of document/file transfers).
5. Cost disclosure/billing practices/termination of retainer (ensuring a shared

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<sup>10</sup> Office of the Legal Services Commissioner, Incorporated Legal Practices, [http://www.olsc.nsw.gov.au/olsc/lsc\\_incorp.html,c=y](http://www.olsc.nsw.gov.au/olsc/lsc_incorp.html,c=y)

understanding of retainer terms, appropriate documentation of the commencement and termination of retainers, and appropriate billing practices).

6. Conflict of interests (providing for timely identification and resolution of conflicts, including when acting for multiple parties in a matter or proceeding against previous clients; anticipating potential conflicts arising from relationships with third parties).

7. Records management (maintaining appropriate filing, archiving and document-retention policies to minimize the risk of loss or destruction of correspondence and documents; ensuring that legal requirements for protecting client files, property, and financial interests are met).

8. Undertakings (monitoring for timely compliance with notices, orders, rulings, directions, or other requirements of regulatory authorities such as the OLSC, courts, and cost assessors).

9. Supervision of practice and staff (providing for compliance with statutory conditions concerning licensing, practice certification, employment of persons; providing proper quality standards for work outputs and the job performance of legal, paralegal, and non-legal staff involved in the delivery of legal services).

10. Trust account requirements (providing for compliance with statutory trust account procedures and using proper accounting principles).<sup>11</sup>

The OLSC requires entity compliance with these objectives through a self-assessment process that is explained below.

In England and Wales, law firms are required to comply with a range of duties set out in the SRA's Handbook. The Handbook identifies duties that apply to firms as well as solicitors and other individuals regulated by the SRA. It establishes a comprehensive ethical framework for law practice, including rules governing authorization, practice, management of accounts, indemnity insurance, training, etc. It also contains SRA Principles and the SRA Code of Conduct.<sup>12</sup> Although the Code applies to all authorized individuals and entities, some chapters are more clearly relevant to entities. Chapters 7-9, for example, govern issues relating to management of the legal business, publicity, and referrals. Each chapter of the Code identifies "outcomes" that are mandatory, as well as "indicative behaviors," which are intended as guidance on how outcomes might be achieved, but are not mandatory.

Among the key required 'outcomes' for entities are the following:

**O(7.1):** you have a clear and effective governance structure and reporting lines;

**O(7.2)** you have effective systems and controls in place to achieve and comply with all the *Principles*, rules and outcomes and other requirements of the Handbook, where applicable;

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<sup>11</sup> Summary of the ten objectives. Office of the Legal Services Commissioner, Appropriate Management Systems to Achieve Compliance,

[http://www.olsc.nsw.gov.au/olsc/lsc\\_incorp/olsc\\_appropriate\\_management\\_systems.html](http://www.olsc.nsw.gov.au/olsc/lsc_incorp/olsc_appropriate_management_systems.html)

<sup>12</sup> Solicitors Regulation Authority, SRA Handbook Welcome,

<http://www.sra.org.uk/solicitors/handbook/welcome.page>

**O(7.3)** you identify, monitor and manage risks to compliance with all the *Principles*, rules, outcomes, and other Handbook requirements (if applicable to you) and you take steps to address issues identified;

**O(7.4)** you maintain systems and controls for monitoring the financial stability of your *firm* and risks to money and *assets* entrusted to you by *clients* and others, and you take steps to address issues identified;

**O(7.5)** you comply with legislation applicable to your business, including anti-money-laundering and data protection legislation;

**O(7.6)** you train individuals working in the *firm* to maintain a level of competence appropriate to their work and level of responsibility;

**O(7.7)** you comply with the statutory requirements for the direction and supervision of *reserved legal activities* and *immigration work*;

**O(7.8)** you have a system for supervising *clients'* matters, to include regular checking the quality of work by suitably competent and experienced people;

**O(7.9)** you do not outsource *reserved legal activities* to a *person* who is not authorised to conduct such activities.<sup>13</sup>

Entities are expected to have a risk management system in place but the rules do not prescribe what this should be. They are also required to report material breaches of any mandatory outcomes.

In Nova Scotia the proposed framework for entity regulation envisages that all law firms will be required to implement and maintain an ethical infrastructure called “A Management System for Ethical Legal Practice.” That infrastructure includes the following “elements”:

1. Developing competent practices;
2. Communicating in a manner which is effective, timely and civil;
3. Ensuring that confidentiality requirements are met;
4. Avoiding conflicts of interest;
5. Maintaining appropriate file and records management systems;
6. Managing the law firm/legal entity and staff appropriately;
7. Charging appropriate fees and making appropriate disbursements;
8. Ensuring that reliable trust account practices are in use;
9. Sustaining effective and respectful relationships with clients, colleagues, courts, regulators and the community; and
10. Working to improve the administration of justice and access to legal services.<sup>14</sup>

Like the NSW and England & Wales’ entity regulation models, Nova Scotia’s model envisages firms appointing a lawyer-manager to be personally responsible for compliance with their management systems.

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<sup>13</sup> Summary of the outcomes. Solicitors Regulation Authority, SRA Code of Conduct 2011, <http://www.sra.org.uk/solicitors/handbook/code/content.page>

<sup>14</sup> Nova Scotia Barristers’ Society, Draft NSBS Self-Assessment Tool, [http://nsbs.org/sites/default/files/ftp/InForumPDFs/NSBS\\_SelfAssessment.pdf](http://nsbs.org/sites/default/files/ftp/InForumPDFs/NSBS_SelfAssessment.pdf)

## **Who is responsible for implementing entity regulation?**

In Australia the responsibility for establishing and implementing “appropriate management systems” rests with a person nominated by each firm to serve as a “legal-practitioner director” (LPD).<sup>15</sup> An LPD’s failure to establish and maintain “appropriate management systems” may constitute professional misconduct.<sup>16</sup>

In England & Wales, the *Legal Services Act of 2007* requires that a Head of Legal Practice (HOLP) and Head of Finance and Administration (HOFA) be appointed in each ABS. The SRA decided that all practices, including those that are not ABSs, must appoint someone to these positions. The SRA calls these appointees Compliance Officers for Legal Practice (COLP) and Compliance Officers for Finance and Administration (COFA), respectively. The SRA’s Authorization Rules for Legal Services Bodies and Licensable Bodies identifies the eligibility requirements for these roles.<sup>17</sup> A designated COLP or COFA must be an individual and a firm manager (e.g, a partner) or employee must consent to their designation; must have sufficient seniority and responsibility to fulfil their role; and must not be disqualified from being a Head of Legal Practice or Head of Finance and Administration.

COLPs are responsible for identifying and limiting ethical risks and fostering compliance at their firm, and also serve as the SRA’s point of contact at the firm. More specifically, a COLP is responsible for ensuring that the firm complies with statutory duties set out in the SRA’s Handbook, for recording any failure(s) to comply, and for informing the SRA of such noncompliance. A COLP must also report material failures to the SRA as soon as reasonably practical.<sup>18</sup>

COFAs are responsible for their firm’s overall financial management. They must take steps to ensure that the firm, including its employees and managers, complies with duties imposed under the SRA Accounts Rules. They must keep a record of any failure to comply and make the record available to the SRA.<sup>19</sup> Like COLPs they must report material failures to the SRA as soon as reasonably practical.

COLPs and COFAs must be “fit and proper” to undertake their role/s.<sup>20</sup> Fitness is assessed by criteria identified in the SRA Suitability Test (2011) and in light of any relevant information. The assessment is made upon initial SRA approval. If a COLP or COFA is assessed as unfit, the SRA may withdraw the initial approval. Although the COLP is the SRA’s principal point of contact in a firm, he or she is not intended to have *sole* responsibility for firm compliance. The entire management, and to some extent all regulated individuals, may be held responsible for a firm’s misconduct.

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<sup>15</sup> Office of the Legal Services Commissioner, Obligations Of A Legal Practitioner Director, [http://www.olsc.nsw.gov.au/olsc/lsc\\_incorp/olsc\\_obligations\\_legal\\_practitioner\\_director.html](http://www.olsc.nsw.gov.au/olsc/lsc_incorp/olsc_obligations_legal_practitioner_director.html)

<sup>16</sup> Section 140(3) *Legal Profession Act 2004 (NSW)*.

<sup>17</sup> See Solicitors Regulation Authority, COLPs and COFAs, <http://www.sra.org.uk/solicitors/colp-cofa.page>

<sup>18</sup> See Solicitors Regulation Authority, Responsibilities of COLPs and COFAs, <http://www.sra.org.uk/solicitors/colp-cofa/responsibilities-record-report.page>

<sup>19</sup> *Ibid.*

<sup>20</sup> See Solicitors Regulation Authority, What is a COLP and a COFA, <http://www.sra.org.uk/solicitors/colp-cofa/ethos-roles.page>

This regime is supplemented by a risk framework that has identified the firms which are likely to pose the greatest risk to the SRA's regulatory objectives. These firms are subject to "regulatory management" which involves the designation of an SRA staff member to monitor them, provide advice, supervise, and if necessary oversee interventions and closure of law firms. Law firms that are not regarded as 'risky' are subject to 'thematic supervision', which allows the regulator to alert them through regular risk bulletins to issues of concern (e.g. new money laundering risks).

The forthcoming regime for entity regulation of barristers in England & Wales will be similar to the regime for solicitors. That is, every entity regulated by the BSB must also have a Head of Legal Practice (HOLP) and Head of Finance & Administration (HOFA). In a single-person practice, of course, the same individual can fill both roles

### **Exclusive? Or parallel to individual license regulation?**

In Australia and England and Wales, entity regulation supplements but does not replace the traditional model of individual lawyer regulation. Both lawyers and entities must adhere to the code of conduct and are subject to discipline.

Entity discipline in Nova Scotia and British Columbia also runs parallel to lawyer discipline – both law firms and lawyers can be disciplined. In Canada, the CBA's Self-Assessment Tool, which as stated above is not mandatory or enforceable, is designed to parallel individual lawyer regulation.

### **Is there annual registration?**

There is no annual registration in Australia. However, upon becoming an incorporated legal practice and therefore subject to entity regulation, a firm must submit to the regulator (OLSC) a self-assessment form demonstrating that it has "implemented and maintained appropriate management systems."

In England and Wales, lawyers must renew their licenses annually. Entities are only required to have initial authorization but they must nonetheless submit certain details on an annual or more frequent basis (e.g. insurance details, diversity statistics etc.). New entities established under the SRA's regulatory umbrella must become either recognized bodies (traditional law firms) or licensed bodies (ABSs) through an "authorization" process. Authorization is necessary before commencing a practice and any changes in the composition of a recognized body's management or in the nature of a licensed body's business are also subject to prior approval.<sup>21</sup>

### **Funding sources, fiscal impact?**

Information about funding sources and the fiscal impact of entity regulation can be obtained by contacting individual regulators.

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<sup>21</sup> The Law Society of England and Wales, Setting up a Practice: Regulatory Requirements, <https://www.lawsociety.org.uk/support-services/advice/practice-notes/setting-up-a-practice-regulatory-requirements/>

**Which jurisdictions are in the process of establishing entity regulation (i.e. more than just considering it as a regulatory option)?**

Singapore: On October 7, 2014 the Ministry of Law submitted the *Legal Profession (Amendment) Bill 2014* for its First Reading in Parliament.<sup>22</sup> The Bill establishes a new regulator, the Legal Services Regulatory Authority, and a framework for entity regulation. It also permits ABSs. The Minister's Second Reading Speech on the Bill briefly describes the framework for entity regulation.<sup>23</sup> On November 4, 2014 the Bill was adopted as law in Parliament but it is not clear whether entity regulation will be implemented as it has been in Australia and England and Wales.

British Columbia: When the Legal Profession Act was amended in 2012, the Law Society was authorized to regulate "law firms" in addition to its authority to regulate lawyers. "Law firm" is defined as "a legal entity or combination of legal entities carrying on the practice of law." The Law Firm Regulation Task Force has been created and ordered to recommend a framework for the regulation of law firms. In addition to determining how to implement entity regulation, the Law Society is considering other changes. In December 2014, a Law Society paper discussed the potential development of a regulatory system similar to the state of Washington's Limited Legal License Technician (LLLT) system.<sup>24</sup>

Ontario: The Law Society of Upper Canada (Ontario) has some authority to regulate firms but has not exercised this authority and does not actively regulate firms. Additional legislative authority would be required to implement full entity and outcomes-based regulation. The Law Society is developing regulatory options for consultation before further steps are taken. The options will address questions such as the role of the legal director, the degree to which firm compliance with ethical standards would be mandatory, and the degree to which firms would be subject to regulatory monitoring and discipline. A report on the options will be ready for circulation during the summer of 2015.

Nova Scotia: Nova Scotia is now developing a framework for a PMBR program and entity regulation that it has already approved in principle. Nova Scotia has not yet passed legislation permitting PMBR and entity regulation but a framework already exists for disciplining law firms.<sup>25</sup>

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<sup>22</sup> See *Legal Profession Amendment Bill 2014*,

[http://www.parliament.gov.sg/sites/default/files/Legal%20Profession%20\(Amendment\)%20Bill%2036-2014.pdf](http://www.parliament.gov.sg/sites/default/files/Legal%20Profession%20(Amendment)%20Bill%2036-2014.pdf)

<sup>23</sup> See Ministry of Law, Second Reading Speech by Minister for Law, K Shanmugam, on the Legal Profession (Amendment) Bill, <https://www.mlaw.gov.sg/content/minlaw/en/news/parliamentary-speeches-and-responses/2R-speech-Min-LPA-bill-2014.html>

<sup>24</sup> See The Law Society of British Columbia, Report of the Legal Services Regulatory Framework Task Force (Dec. 5, 2014), <http://www.lawsociety.bc.ca/docs/publications/reports/LegalServicesRegulatoryFraeworkTF.pdf>.

<sup>25</sup> The Society's authority to regulate law firms is found in Part III of the Act. Section 27 of the Legal Profession Act 2004 ("the Act") provides that in Part III and Part IV unless otherwise indicated, "member of the Society" includes a law firm. Pursuant to section 28 of the Act, Council has broad powers to make Regulations that include, inter alia, establishing or adopting ethical standards for members of the Society and establishing or adopting professional standards for the practice of an area of law.

## **Which U.S. jurisdictions could at present implement entity regulation?**

Currently, no jurisdiction engages in the PMBR form of entity regulation, but two states have already laid the groundwork for PMBR entity regulation by requiring law firms to make “reasonable efforts” to ensure that their lawyers conform to the disciplinary rules. In 1982, the New Jersey Supreme Court appointed a committee on the Model Rules of Professional Conduct chaired by Dickinson R. Debevoise, U.S. District Judge for the District of New Jersey. The court charged the committee to review the ABA’s recent amendments to its Model Rules and recommend whether New Jersey should adopt them. The committee ultimately recommended adoption but with some modifications. One recommendation was to amend Model Rule 5.1(a), which at that time only imposed on law firm *partners* a duty to make reasonable efforts to ensure that the partnership has measures in place to assure compliance with the Rules of Professional Conduct. The court approved this recommendation but revised it slightly to make it clear that New Jersey’s Rule 5.1(a) applies to all entities (and lawyers) authorized to practice law in the state.<sup>26</sup> The Supreme Court of New Jersey adopted the Debevoise Committee recommendation but revised it slightly to clarify that the rule applies to “all lawyers and entities engaged in the practice of law.”<sup>27</sup>

Although the New Jersey Supreme Court asserted its authority to discipline law firms since 1984, it was not until 1997 that the court exercised that authority. See In re Jacoby & Meyers, 147 N.J. 374 (1997), where the Supreme Court reprimanded a law firm for failing to use an approved New Jersey trust account for settlements received in connection with New Jersey legal matters. Then, in 1998, the court reprimanded another law firm for improperly soliciting clients by parking a rented recreational vehicle, covered with law firm ads, at the site of an apartment building gas line explosion. See In re Ravich, Koster, Tobin, Gleckna, Reitman & Greenstein, 155 N.J. 357, 715 A.2d 216 (1998). See also In re Bolden & Coker, P.C., 178 N.J. 324 (2004), reprimanding a Pennsylvania law firm for unauthorized practice of law in New Jersey. More recently, the Supreme Court reprimanded a law firm for violating Rule 5.1(a) by not ensuring that an attorney employed by the firm, but not admitted in New Jersey, took the bar exam before practicing there. In re Sills Cummis Zuckerman Radin Tischman Epstein & Gross, 192 N.J. 222, 927 A.2d 1249 (2007).

New York has also extended to law firms the duty to ensure their lawyers’ compliance with the disciplinary rules. In 1996, in response to a recommendation by the Association of the Bar of the City of New York, the state courts widened their disciplinary jurisdiction to include law firms. The four Appellate Divisions of the New York Supreme Court, which regulate law practice in the state, amended their disciplinary rules to provide that “[a] law firm shall make reasonable efforts to ensure that all lawyers in the firm conform to the disciplinary rules.”<sup>28</sup>

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<sup>26</sup> Similarly, the Debevoise Committee recommended that Rule 5.3(a), concerning duties regarding non-lawyer assistants, be amended to make clear its applicability not just to partnerships to other forms of practice besides partnerships.

<sup>27</sup> More specifically, New Jersey’s Rule 5.1(a) now applies to “[e]very law firm and organization authorized by the Court Rules to practice law” in New Jersey. New Jersey’s authorization to regulate law firms is found in N.J. CT. R. 1:20-1(a) (“Every attorney and business entity authorized to practice law in the State of New Jersey, including those attorneys specially authorized for a limited purpose or in connection with a particular proceeding, shall be subject to the disciplinary jurisdiction of the Supreme Court as set forth in the Constitution of 1947, Article 6, Section 2, Paragraph 3.”).

<sup>28</sup> In 2009, the New York courts changed their ethics code to a Model Rules format. New York’s Rule 5.1(a) now provides that “A law firm shall make reasonable efforts to ensure that all lawyers in the firm conform to these rules.”

Two New York law firms have been publicly disciplined since amendments to the state’s disciplinary rules took effect. In 2004, a law firm was publicly censured for engaging in “conduct that adversely reflected on the fitness of the firm’s lawyers to practice” as well as “conduct prejudicial to the administration of justice.” The conduct in question was pressuring immigration clients and their family members who came to the firm’s office to pay additional fees on the spot and yelling at those who could not or would not pay. See In re Law Firm of Wilens & Baker, 9 AD3d 213 (N.Y. App. Div. 2004). And in 2014, another firm was publicly censured for repeatedly pursuing collection matters without verifying the identity of the debtor and the validity of the debts. See In re Cohen & Slamowitz, LLP, 116 AD3d 13 (2014)

The Illinois ARDC is studying the concept of entity regulation as well as the experience with PMBR models of entity regulation in the U.K. and New South Wales as well as early developments along the same lines in Nova Scotia. The ARDC is looking particularly at aspects of entity regulation concerning the designation of an attorney (or attorneys) in each law firm or practice entity who would be administratively responsible for its ethical infrastructure. It is also considering how to engage designated attorneys in entity assessments and educational efforts both to improve the delivery of services to clients and reduce client grievances. To inform their study the ARDC is also analyzing data on Illinois lawyers and firms to. Apparently, the experience in New South Wales has met with interest among Illinois bar leaders.

The Colorado Supreme Court Advisory Committee has also formed a subcommittee to study regulatory objectives, entity regulation and PMBR. That subcommittee has begun its work and will continue to meet on a monthly basis until its work is completed.

Most U.S. jurisdictions have adopted ABA Model Rule 5.1 with little change.<sup>29</sup> As a result, most U.S. regulators have the power to achieve a measure of PMBR-like regulation without changing existing rules. For example, a regulator might inquire on a lawyer’s annual bar dues statement whether the lawyer has responsibilities under Rule 5.1. If the answer is yes, the regulator could ask whether the lawyer is in compliance with the rule. The regulator could also provide a link to online resources that would include educational materials and a self-assessment tool.<sup>30</sup>

### **What are the advantages of entity regulation?**

First, entity regulation encourages regulators to devote resources to (1) improving the management and culture of the firm as a whole and (2) preventing client and public harm, rather than focusing on individual conduct and discipline after-the-fact. Putting more emphasis on entity regulation,

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More broadly, New York Rule of Professional Conduct 8.4 provides, inter alia, “RULE 8.4 that “A lawyer or law firm shall not: (a) violate or attempt to violate the Rules of Professional Conduct, knowingly assist or induce another to do so, or do so through the acts of another...”

<sup>29</sup> See ABA CPR Policy Implementation Committee, *Variations of the ABA Model Rules of Professional Conduct: Rule 5.1: Responsibilities Of Partners, Managers, And Supervisory Lawyers* (Updated Oct. 21, 2014), [http://www.americanbar.org/content/dam/aba/administrative/professional\\_responsibility/mrpc\\_5\\_1.authcheckdam.pdf](http://www.americanbar.org/content/dam/aba/administrative/professional_responsibility/mrpc_5_1.authcheckdam.pdf)

<sup>30</sup> Colorado is considering adding these questions to its bar dues statement. See also Laurel S. Terry, *Globalization and the ABA Commission on Ethics 20/20: Reflections on Missed Opportunities and the Road Not Taken*, 43 Hofstra L. Rev. 95, 128, n. 142 (2014)(suggesting this idea).

might well encourage those who control a legal practice to develop management training, supervision, and quality control systems.

Second, entity regulation, especially when combined with PMBR, can improve the relationship between the regulator and the regulated because the regulator focuses on helping to improve the practice as a whole and reduce complaints, while shifting the regulatory focus away from discipline alone.

Third, entity regulation could remove the potential unfairness of holding one lawyer in a firm responsible for system failures where others in the firm, or the firm itself could just as well be made accountable.

Fourth, entity regulation overcomes a common problem in processing complaints, namely, identifying the lawyer(s) to whom the alleged misconduct is (and is not) attributable. Entity regulation will allow a complaint to be made against the firm as a whole and clients would be relieved of the obligation naming specific individual(s).

Fifth, entity regulation means that everyone in the law firm (whether they are lawyers or non-lawyers) have a stake in whether the firm is in compliance since law firm discipline directly or indirectly affects all firm lawyers.

Finally, entity regulation reduces the number of complaints made against law-practice entities and improves practice management. In 2008, a research study by Dr. Christine Parker of the University of Melbourne Law School in conjunction with the NSW regulator assessed the impact of ethical infrastructure and the self-assessment process in NSW to assess whether the process is effective and whether the process is leading to “better conduct” by firms required to self-assess.<sup>31</sup> The research focused on the number of complaints relating to incorporated legal practices after incorporation and comparing this with prior to incorporation. The research found that complaints rates for incorporated legal practices were two-thirds lower than non-incorporated legal practices after the incorporated legal practice completed their initial self-assessment. The research also revealed that the complaints rate for incorporated legal practices that self-assessed was one-third of the number of complaints registered against similar non-incorporated legal practices.

Moreover, in another recent research study conducted on incorporated legal practices in NSW, by Professor Susan Saab Fortney of Hofstra University, New York, in conjunction with the NSW regulator, revealed that a majority of law firms (71%) who completed the self-assessment process had revised their firm systems, policies, and procedures and 47% had actually adopted new systems, policies, and procedures.<sup>32</sup> Forty-two percent (42%) of firms indicated that they “strengthened firm management” following the completion of the first self-assessment.

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<sup>31</sup> C.E. Parker, T. Gordon, S. Mark, 2010, Regulating law firms ethics management: an empirical assessment of an innovation in regulation of the legal profession in New South Wales, *Journal of Law and Society [P]*, vol. 37, issue 3, Blackwell Publishing, UK, pp. 466-500.

<sup>32</sup> Susan Fortney & Tahlia Gordon, Adopting Law Firm Management Systems to Survive and Thrive: A Study of the Australian Approach to Management-Based Regulation, 10 *ST. THOMAS L. J.* 152 (2012).

### **What are the disadvantages of entity regulation?**

The greatest challenge for entity regulation is that the concept is not well understood within the bar. A change in mindset from the lawyer's traditional view of professional self-regulation is probably needed. Judging by the experience in Australia, the traditional view can be overcome with an effective education program that explains the purpose, and benefits of entity regulation.

Entity regulation requires firms to focus on ethical issues at the entity level, not just the individual lawyer level. Changing the focus is not easy, but it can benefit firms with multiple practice groups by enabling them to streamline their educational programs and ensure uniformity across practice groups.

Entity regulation requires planning and takes time from busy regulators and firms alike. Effective planning for entity regulation requires regulators to consult with the profession. But this may produce surprising benefits as discussions between regulators and the firms they regulate can create closer relationships and mutual understanding.

## **PART 2**

### **How have jurisdictions actively studying Entity Regulation gone about it? By creating a task force or other body?**

In considering entity regulation, jurisdictions have chiefly relied on consultation with the profession. For example, the Costs Lawyers Standards Board<sup>33</sup> (CLSB) in Manchester, England, last year sought the views of costs lawyers about how it might regulate costs-lawyer-led entities, in addition to its current system of regulating individual practitioners. After consultation, CLSB is seeking seeks to confine itself to the regulation of costs law *entities*, with sole practitioners and in-house Costs Lawyers continuing to be regulated through their individual practicing certificates.<sup>34</sup>

The Law Society of Scotland has also been considering entity regulation. In 2014 the Society released two consultation papers – one on entity regulation and the other on principles and outcomes-focused regulation. In 2015, they will be exploring what entity regulation might mean for the profession, what issues entity regulation may raise, and what models should be considered before further discussion and consultation with solicitors and other stakeholders. They will not be considering principles and outcomes focused regulation at this stage.<sup>35</sup>

### **What U.S. organizations are studying/considering Entity Regulation?**

The U.S. organizations studying entity regulation include the ABA Center for Professional Responsibility, the ABA Commission on the Future of Legal Services, the Conference of Chief Justices, the International Regulators Conference, the Illinois ARDC and the Colorado Supreme Court Advisory Committee. A number of these organizations are in communication with, or gathering information about, the entities mentioned in this FAQ.

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<sup>33</sup> The Costs Lawyers Standards Board is the Approved Regulator of Costs Lawyers. Costs Lawyers are legal costs experts who, inter alia, advises on the charging and recovery of legal fees and disbursements and undertakes costs budgeting.

<sup>34</sup> CLSB, Entity Regulation & Revised Principle 3.6, <http://clsb.info/policy-outcomes/consultations/entity-regulation/>

<sup>35</sup> The Law Society of Scotland, Regulation in the 21<sup>st</sup> Century, <http://www.lawscot.org.uk/members/regulation-and-standards/regulation-consultations/>

## **PART 3**

### **Resources**

#### **ABA Center for Professional Responsibility resources:**

#### **Law review articles:**

Susan Saab Fortney, *The Role of Ethics Audits in Improving Management Systems and Practices: An Empirical examination of Management-Based Regulation of Law*, 4 St. Mary's J. Legal Mal. & Ethics 112 (2014).

Ted Schneyer, *The Case for Proactive Management-Based Regulation to Improve Professional Self-Regulation for U.S. Lawyers*, 42 Hofstra L. REV. 233 (2013).

Ted Schneyer, *On Further Reflection: How “Professional Self-Regulation” Should Promote Compliance with Broad Ethical Duties of Law Firm Management*, 53 ARIZ. L. REV. 577, 585 (2011).

Laurel S. Terry, *Globalization and the ABA Commission on Ethics 20/20: Reflections on Missed Opportunities and the Road Not Taken*, 43 Hofstra L. Rev. 95, 128, n. 142 (2014)(suggesting the idea of using Rule 5.1 to achieve PMBR even in the absence of entity regulation).