

For discussion
on 27 May 2002

LegCo Panel on Administration of Justice and Legal Services

Solicitor Corporations Rules

Background

In 1995, the then Attorney General's Chambers published a Consultation Paper on Legal Services which made a number of proposals regarding Hong Kong legal services. One was a proposal to allow solicitors to incorporate their practices as companies. An incorporated company is in law a separate legal entity, distinct from its members. Shareholders of a company with limited liability are only liable to the extent of the unpaid nominal capital of the shares which they own. The advantages for conducting business are that an incorporated company can raise capital, borrow money and enter into contracts in its own capacity as a legal person. The view expressed in the Consultation Paper was that, subject to proper safeguards, solicitors should be permitted to incorporate their practices with either limited or unlimited liability.

2. The Report on the Consultation Exercise and Proposals for the way forward, subsequently published by the Attorney General's Chambers, revealed that the majority of the submissions supported the recommendation on the incorporation of solicitors' practices. The Law Society agreed with the recommendation and proposed to prepare detailed regulations regarding the conditions under which solicitors may elect to practise through a company.

3. The Administration introduced amendments to the Legal Practitioners Ordinance ("the Ordinance") through the Legal Services (Miscellaneous Amendments) Bill which was enacted at the end of June 1997. The amendments provide that the Law Society may "in accordance with the [Law Society] Council's rules" approve or refuse to approve an application for the approval of a company as a solicitor corporation.

The Draft Solicitor Corporations Rules (“the draft Rules”)

4. The Law Society undertook the drafting of the relevant rules. In June 2001, the Law Society released the draft Rules for comments by its members.

5. The Administration studied the draft Rules and provided its comments to the Law Society from the public interest angle. The Law Society answered our queries on a number of issues. The major outstanding issue relates to the insurance of solicitor corporations for the protection of consumers.

6. The Administration’s main comments on the draft Rules from the public interest point of view are set out below.

(1) Grounds of Refusal

7. Rule 2(5) and (7) of the draft Rules (at **Annex A**) provide that the Council of the Law Society should be of the opinion that its approval of a company or proposed company as a solicitor corporation is not contrary to the interests of the solicitors’ profession or the public. We considered that the Law Society seemed to suggest that the interests of the profession may differ from those of the public. We sought the Law Society’s justification for the reference to the interests of the solicitors’ profession in the draft Rules.

8. The Law Society replied that should such a conflict occur between the interests of the profession and the public, the Law Society would acknowledge its duty as a regulator of the profession on behalf of the public and act on the basis that the public interest was paramount. The Law Society agreed to amend the relevant draft provision to give effect to this intention.

(2) Qualification for approval

9. Rule 3(2) and (3) of the draft Rules (at **Annex B**) provide that a person who is not a solicitor may also be a member or director of a solicitor corporation. This would enable a sole practitioner to comply with the requirements of the Companies Ordinance (Cap.32) that a company formed under it must have two members and two directors. The rule provides that the

second member or director would need to execute a declaration of trust in favour of the sole practitioner in respect of the one share that he holds, and the management and control should remain with the sole practitioner.

10. The Administration commented to the Law Society that, if such a situation were to arise, the public may not be aware that the second member (who may be a well known/respected member of society), though being held out as director, is only a trustee of the share and that he is not involved in the operation and management of the company. We asked for the Law Society's clarification of the role of the non-legally qualified director and of the measures that should be taken for the adequate protection of the public.

11. The Law Society suggested that the problem be resolved by amending the new section 9AA of the Ordinance (at **Annex C**) to include an "officer" in the list of persons or entities which, in relation to misconduct, could be investigated, inquired into and dealt with under the Ordinance. A definition of "officer" would be added to section 2(1) of the Ordinance to include directors, managers, etc. This would effectively bring those appointed as directors under Rule 3(2)(b) of the draft Rules within the parameters of the new section 9AA of the Ordinance.

(3) Right of Appeal

12. A right of appeal against a decision of the Law Society is provided under Rule 8 of the draft Rules (at **Annex D**). The Administration suggested that, for the purpose of fairness to potential appellants, it should be specified in Rule 8 that, where the Council refuses an application, it must notify the applicant of the refusal and the grounds for such refusal within a specified period of time.

13. The Law Society agreed to amend Rule 8 to provide that the Law Society would give written grounds for refusal within 28 days of the decision to refuse an application made under the rules.

(4) Top-up insurance

14. The qualification for approval as a solicitor corporation is provided

under Rule 3 of the draft Rules. However, there is no provision requiring a corporation to have insurance coverage before it can be approved as a solicitor corporation. The Administration considers it to be essential for the protection of consumers that there be adequate indemnity insurance taken out by solicitor corporations to cover civil claims made by their clients. We advised the Law Society that, under the English Solicitors Incorporated Practice Rules 1988 (the “English Rules”), there is a requirement for a top-up insurance over and above the minimum requirement of indemnity insurance to be taken out by a solicitor’s firm. We asked the Law Society to consider a similar approach for Hong Kong.

15. The Law Society initially replied that the cover provided by the existing Hong Kong Solicitors Professional Indemnity Scheme (“PIS”) is sufficient protection for the public. It considered that whilst there might also be a claim against the solicitor corporation in contract, it would be subsumed in any action in tort brought against the solicitor or member of his staff in the solicitor corporation who would be covered under the PIS in respect of such action. In its view, it was difficult to conceive of any situation where the solicitor corporation might be liable but not the solicitor directors/members other than in actions in contract to which the usual commercial rules would apply. It considered that it might be prudent for directors to take out directors’ and officers’ cover but it did not believe that this should be mandatory.

16. The Administration considered that this would be insufficient from the public interest angle. In determining whether solicitor corporations ought to take out top-up insurance, we therefore asked the Law Society for information on other common law jurisdictions where solicitor corporations exist – i.e. whether or not they require top-up insurance and, if so, according to what formula.

17. The Law Society replied that it was contacting other jurisdictions where solicitor corporations are permitted and would revert to the Administration as soon as possible.

18. To enable us to consider whether top-up insurance is required of a solicitor corporation over and above the minimum requirement of indemnity

insurance to be taken out by a solicitor firm, we sought information from the Law Society of England and Wales regarding the rationale of top-up insurance required under the English Rules.

19. The Law Society of England and Wales replied that –

“The requirement for a “recognised body” to take out top-up insurance over and above the minimum required by the Indemnity Rules applies only to recognised bodies which have limited liability – i.e. limited companies or limited liability partnerships.

It was initially introduced in response to a concern expressed by the Master of the Rolls in 1988, at the time the rules were first made. Solicitors could then practise only in unincorporated partnerships without limitation of liability. A litigant awarded a sum in excess of the minimum indemnity cover (then one million pounds, as now) could pursue the personal assets of the partners to make up the difference between the award and the amount paid under the firm’s insurance. The Master of the Rolls was concerned at the possibility of a “gap” and the requirement for top-up insurance was introduced to meet this concern.”

20. The Administration’s view regarding the issue of insurance is that, in the interests of consumers, adequate insurance coverage should be taken out by solicitor corporations. The concern identified in England in respect of the “gap” in the compensation that may be obtainable in respect of a negligent solicitor in a solicitor corporation, as opposed to a negligent solicitor in a firm, appears to apply equally in Hong Kong. It is recommended that the Law Society consider whether the existing minimum coverage taken out by a solicitors’ firm is sufficient for solicitor corporations and whether top-up insurance should be required.

Department of Justice

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2. Application for approval under section 7C(1) of the Ordinance

(1) Any person who wishes to have a company or a proposed company approved as a solicitor corporation under section 7C(1) of the Ordinance shall apply to the Society.

(2) An application made under subrule (1) shall be in Form 1 in the Schedule.

(3) When an application is made under subrule (1), there shall at the same time be paid to the Society such fee as is prescribed by the [Solicitor Corporations (Fees)] Rules.

(4) On receiving an application made under subrule (1), the Society may, in accordance with these rules, approve or refuse to approve the company or proposed company as a solicitor corporation.

(5) Before approving a company or proposed company as a solicitor corporation, the Council shall be satisfied that the company or proposed company satisfies or will satisfy the qualifications for approval as a solicitor corporation and that such approval is not, in the opinion of the Council, contrary to the interests of the solicitors' profession or the public.

(6) If the Society gives approval for a proposed company to be a solicitor corporation, the approval does not take effect until the company is formed and registered under the Companies Ordinance (Cap.32).

(7). Any approval given by the Society pursuant to subrule (4) may be withdrawn by the Society at any time if the continuance of such approval is, in the opinion of the Council, contrary to the interests of the solicitors' profession or the public or if the relevant solicitor corporation ceases for any reason to be qualified for approval under rule 3 or otherwise.

(8) Any approval given by the Society with respect to a solicitor corporation pursuant to subrule (4) shall expire where

- (a) a winding-up order under the Companies Ordinance (Cap 32) is made by the High Court with respect to such solicitor corporation;
- (b) a resolution for voluntary winding-up is passed with respect to such solicitor corporation; or
- (c) a person is appointed receiver or manager of the property of such solicitor corporation.

3. Qualification for approval as a solicitor corporation

(1) Subject to the discretion of the Council pursuant to rule 2(5), a company is qualified to be approved as a solicitor corporation if—

- (a) it is a company limited by shares and formed and registered under the Companies Ordinance (Cap 32);
- (b) all the members of the company are directors or employees of the company;
- (c) all the directors of the company are members or employees of the company;
- (d) subject to subrule (2), every member and every director of the company is an individual:
 - (i) who is a solicitor holding a current practising certificate which is not subject to any condition other than the condition that he shall comply with the Continuing Professional Development Rules and any other continuing legal education rules made under section 73 of the Ordinance; and
 - (ii) who is employed in the practice of a solicitor or a solicitor corporation in Hong Kong or who is practising as a solicitor on his own account or in partnership in Hong Kong or who is a member or director of a solicitor corporation or has been in any such employment or practice or has been a member or director of a solicitor corporation not more than 12 months prior to his becoming a member or director of the company;
- (e) subject to subrules (2) and (3), every member of the company beneficially owns the share or shares he holds in the company;
- (f) the name of the company is in compliance with rules 6(1), (2), (4) and (5) and the company does not conduct its Practice under any other name; and
- (g) the memorandum and articles of association of the company are in compliance with the requirements of the Companies Ordinance (Cap.32) and these rules.

(2) To enable a sole practitioner to establish a solicitor corporation under section 7C(1) of the Ordinance and to comply with the requirements of the Companies Ordinance (Cap.32) that a company formed thereunder must have two members and two directors, a company may have—

- (a) as the second member any other individual person, whether a solicitor or not, who is eligible under the Companies Ordinance (Cap.32) and who is not a member director or employee of another solicitor corporation, or a corporation approved for the purpose by the Council; and
- (b) as the second director any other individual person, whether a solicitor or not, who is eligible under the Companies Ordinance (Cap. 32) and who is not a member director or employee of another solicitor corporation

provided that—

- (i) the company shall at all times be managed and controlled by the sole practitioner;
- (ii) not more than one share of the company may be registered in the name of such second member who shall hold such share in trust for the sole practitioner; and
- (iii) such second member shall have executed a declaration of trust in favour of the sole practitioner in respect of the one share in the company which he or it holds in trust for the sole practitioner and the person who lodges an application under rule 2 shall furnish a copy of such declaration of trust to the Society.

(3) If the second member mentioned in subrule (2) ceases to hold the one share in the company in trust for the sole practitioner mentioned in subrule (2), such sole practitioner and the company shall procure that:

- (a) another individual person, whether a solicitor or not, who is eligible under the Companies Ordinance (Cap.32) and who is not a member director or employee of another solicitor corporation, or a corporation approved for the purpose by the Council, shall become a member of the company holding one share in the company within 6 months from the date on which such second member ceases to hold the one share in the company; and
- (b) an individual person or a corporation as aforesaid who or which shall become a holder of that one share in the company pursuant to subrule (3)(a)

shall execute a declaration of trust in favour of such sole practitioner in respect of such share which he or it holds in trust for the sole practitioner and such sole practitioner shall furnish a copy of such declaration of trust to the Society within 6 months from the date on which such second member ceases to hold such share; and

- (c) the provisions in subrules (2)(i) and (ii) shall continue to apply to the company.

(4) If the second director of the company mentioned in subrule (2) ceases to act as such, the company shall procure that another individual person, whether a solicitor or not, who is eligible under the Companies Ordinance (Cap.32) shall become a second director of the company within 2 months from the date on which such second director ceases to act as a director of the company.

(5) The Council may waive any of the requirements of subrule (1) where it considers it appropriate in the particular case.

**9AA. Misconduct of member or employee of
solicitor corporation or foreign
lawyer corporation**

Conduct of a person who is a member of, or is employed by, a solicitor corporation or a foreign lawyer corporation may be the subject of a complaint, and may be investigated, inquired into and dealt with under this Part in the same way as the conduct of a solicitor or employee of a solicitor or foreign lawyer may be investigated, inquired into and dealt with, but only in so far as the conduct relates to the practice carried on by the corporation.

8. Right of appeal against decisions of Society under these rules

(1) An appeal against a decision of the Society under these rules shall lie to the Court and the provisions of Order 55 of the Rules of the High Court (Cap. 4 sub. leg.) shall apply to each such appeal save that the time for serving notice of motion of appeal shall be 21 days from the date of the decision and not 28 days as provided in Order 55 and the decision of the Court on any such appeal shall be final.

(2) In any appeal under subrule (1) the Society shall be the respondent.

(3) The hearing of every appeal under this rule shall be in open court unless, and to the extent to which, the Court otherwise directs.