

**Review of the Regulatory Framework for Legal Services in
England and Wales**

**Submission of the Association of Partnership Practitioners
on developing a regulatory regime for alternative business structures**

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The APP Working Party Members

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1. The Association of Partnership Practitioners (“APP”)

The Association of Partnership Practitioners (APP) is a multi-disciplinary organisation that includes solicitors, barristers, accountants, bankers, business consultants, HR managers, academics and insurance brokers. Members include representatives of three international banks, the four largest accountancy firms and 7 of the 10 largest law firms. It offers a focal point for debate and discussion on the complex issues surrounding partnership and LLP law and practice in its broadest sense and provides its members with a comprehensive training in the developing areas of partnership. As at 1st June 2009, APP membership stood at approximately 400. In the context of the LSB discussion paper review the APP represents providers as well as consumers of legal services.

2. Summary – The APP Response

This response was prepared by a working party comprising the individuals listed above. A draft of this response was discussed with the APP Committee and made available to all members for their comments, which have been incorporated into this response.

Question 1 What are your views on whether the LSB's objectives of a mid 2011 start date for ABS licensing is both desirable and achievable?

APP A commencement date of the ABS regime is desirable and in our view necessary by mid 2011. This process commenced in the mid 1990s with the development by the major accounting firms of "associated" law firms and first achieved government attention with the Competition Commission report in 2001 which was followed by the Clementi Report, a White Paper, a draft bill and then the final legislation. If the LSB does not set a commencement date then the process will drift further. It may be difficult to achieve a date in mid 2011 but it is a credible target to aim for. Given the current recession and the restrictions on the availability of bank financing, many firms wish to consider an ABS and/or outside investment as a means of survival or development. Accordingly, any further delay may unnecessarily damage the choice of legal providers available to consumers.

Question 2 How do we ensure momentum is maintained across the sector towards opening the market?

APP The LSB needs to establish a clear timetable and regularly to report on progress, action needed and milestones. The LSB will need to work closely with and to instil a sense of urgency on the existing frontline regulators. It needs to be understood that any slippage of the timetable may compound the funding problems faced by certain small and medium sized law firms by the current recession.

Question 3 What are your views on whether the LSB should be prepared to license ABS directly in 2011 if necessary to ensure that consumers have access to new ways of delivering legal services?

APP We do not believe that this is a desirable outcome. However, in order to achieve momentum and meet the declared timetable, it may be necessary for the LSB to be prepared to licence ABSs directly.

Question 4 How should the LSB comply with the requirement for appropriate organisational and financial separation of its licensing activities from its other activities?

APP It will probably be appropriate for the licensing authority to be a subsidiary of the LSB with an independent board and transparent financial reporting. The LSB has an oversight role so if it has its own licensing body it must be, and be seen to be, subject to the same review and oversight of its regulatory functions as any other regulatory body.

Question 5 How do you expect the legal services market to respond and change as a result of opening the market to ABS?

APP It is difficult to tell at the moment. Some firms will not change, others will seek outside investment as a means of growing and developing their range of services and, new entrants will enter the market, especially at the retail level. However the pace and level of change is uncertain although we do envisage considerable consolidation in the market below the “top twenty” firms. One other factor will be the recruitment of talented individuals who may be attracted by the offer of a true “equity interest” or golden hello in the form of cash payment which outside investment may allow. The LSA is a piece of enabling legislation. So, some will take advantage of it and others will not. Those who take advantage will do so if they perceive that they can establish a profitable business with a sustainable range of relevant services to consumers. However, ultimately, it will be the attractiveness of any provider’s offering to the market that will decide the success or otherwise of any particular business model. There will we think also be a limited number of deals by outside investors in the market who will be initially looking for firms to increase in size to achieve operating efficiencies, hence the inevitable drive for consolidation.

Question 6 In what ways might consumers of all types – including private individuals, small businesses and large companies – benefit from new providers and ways of delivering legal services?

APP **Some consumers may benefit whilst others may be disadvantaged. Consumers may have access to legal advice of a credible standard via call centres or the internet or via in store or similar outlets. Some traditional smaller firms which manage to survive the recession may be forced out of business. Other firms may use outside capital as an opportunity to expand their geographic and practice breadth and depth and to attract new teams and individuals. SMEs may gain access to legal advice that they cannot currently afford using traditional business models. As large brands develop there may be a greater focus on client service, client satisfaction and customer feedback as a means of protecting and developing the new supplier's investment in its brand. There will be intense competition on the "retail" end of the market which will drive consistency, efficiency as well as competition on pricing. Ultimately the consumers will decide which model works for them. However, older, less mobile and less internet savvy consumers may find their already limited access to legal services even more restricted.**

Question 7 What opportunities and challenges might arise for law firms, individual lawyers, in-house lawyers and non-lawyer employees of law firms as a result of ABS?

APP A range of opportunities may arise:

- A Law firms could merge with accountants, property consultants, estate agents, tax advisers and IFAs to provide a comprehensive service to SMEs and mid net worth individuals. (Many law firms already have associated estate agency and IFA businesses).**
- B Law firms may seek long-term investment to grow by merger or otherwise, to expand their geographic or practice coverage, to manage a generational transition and to invest in IT and new operating systems.**
- C Individual lawyers may have a wider choice of career options which meet their financial and workload aspirations at different stages in their working lives. Lawyers who do not aspire to traditional partnership may enjoy clear and alternative career paths with the possibility of long-term incentives such as share option plans.**
- D In house lawyers may have an opportunity to run businesses delivering direct, paid for, services to consumers rather than merely to their employer organisation.**

However challenges may arise in providing appropriate training models for young lawyers, managing potential conflicts of interest and as the number of law firms may reduce this may reduce the availability of traditional legal service models and opportunities for appropriate legal training in essential disciplines.

Question 8 What impact do you think ABS could have on the diversity of the legal profession?

APP A range of business models may provide different working models especially for those with family responsibilities (i.e. young children or aged parents). The ability to work remotely and from home and access to know how and retraining may help to bring back to the legal profession many that leave because the existing models are insufficiently flexible.

However the ABS will not be a panacea for addressing the range of diversity issues in the profession, whether by reference to sex, social background or ethnic origin. This being said, a wide range of career options and working practices may give a greater and more flexible range of career options, which should assist in addressing some existing diversity issues and outside investors may require degrees of diversity which firms have not yet achieved.

Question 9 What are the educational and developmental implications of ABS and what actions need to be taken to address them?

APP **Some providers may be providing a very limited range of services e.g. probate or conveyancing. This will raise issues as to how new entrants will achieve the wide range of experience necessary to develop as an all round professional. This is not an entirely new issue as some existing law firms only provide a very limited range of services. This may be addressed by more limited qualifications or practising certificates restricted to the lawyer acting in a defined area of law e.g. conveyancing. As the shape and nature of the profession and the ABS regime develop the educational and development implications of new models will need to be kept under constant review if the range and diversity of skills in the profession is not to be unreasonably restricted.**

Question 10 Could fewer restrictions on the management, ownership and financing of legal firms change the impact upon the legal services sector of future economic downturns?

APP At the moment law firms are owned and managed by the partners with the limited use (except in the larger firms) of professional management. Firms are financed by bank debt, deferred profit distributions and partner capital (often funded by a bank). Generally it is tax disadvantageous to leave retained earnings in the business. Indeed the model under which a partner joins a firm and pays nothing except his capital, takes his or her income on an annual basis and leaves with nothing (other than the return of the original capital) encourages a focus on immediate income and annual profit distributions rather than investing in the firm for longer term capital gain. Accordingly many firms are undercapitalised and this is becoming particularly apparent in the recession as more cash is tied up in work in progress and debtors and less cash is retained in the firm as a reserve against partners future tax liabilities. At the same time, the banks are less amenable to increase working capital facilities.

New models may provide access to larger, better capitalised and professionally run organisations. In a corporate vehicle profits can be retained in a relatively tax efficient manner to fund future growth and to provide a cash cushion in the event of a downturn. Corporates may, of course, take more “decisive” action in a downturn by reducing lawyer headcount or closing an underperforming business.

Conversely highly leveraged models may be more exposed to an economic downturn. Also, a business which is part of a much larger organisation may encounter difficulties if the parent’s other businesses suffer in another downturn. There may also be less bonds of loyalty where firms move from a partnership to a corporate model, with individuals in a corporate more ready to see the business fail in the event of economic pressures.

Question 11 What are the key risks to the regulatory objectives associated with opening the market to ABS and how are they best mitigated?

APP The key risk is maintaining the supremacy of the lawyer's duty to his or her client. Accordingly any actual or perceived issues as to the independence of the adviser and the absence of conflicts of interest between either the client and the service provider or other clients will need to be carefully preserved. However these are not new issues and have been managed by service providers and their regulators (with varying degrees of success e.g. the Miners' Compensation cases where it appears firms were not acting in their clients best interests) in the past. Accordingly it is important that any rules to ensure independence and the absence of conflicts are proportionate and do not discriminate between the various business models (whether an ABS, standard solicitors' firm or barristers' chambers) so as to provide an unfair or inappropriate competitive advantage.

Consolidation of the legal market, whilst opening the market up to a range of delivery models, may in certain locations reduce consumer choice (by way of analogy Tesco v the corner shop).

If consolidation reduces the price to the consumer then the consumer will benefit. The potential downside is that a consumer's first point of contact may be a partially trained paralegal rather than qualified lawyer and as a result the full impact of the consumer's problem may not be appreciated although in some existing law firm models this is already the case. However the consumer will have access to cost effective, timely advice in understandable terms thereby helping to demystify a range of legal issues.

The key regulatory concern must be transparency, so that the consumer can be informed as to the ownership and hence potentially competing interests of his "service provider" of choice. Firms should

be willing to work with the regulators to allow for open disclosure. These issues will also be of concern to those larger firms with international practices where, in some locations, local regulation or taxation issues might not allow third party investment.

Question 12 Are there particular types of business structure or model, which you consider to present a particular risk to the regulatory objectives?

APP **If, for example an ABS is owned by a major bank it will be inappropriate for that ABS to advise on products (e.g. mortgages) provided by its owner. However, other than obvious issues of this sort we do not believe that it is the role of the LSB to define which business structure or model is acceptable to it. If the LSB adopts a principles based approach to regulation, specific guidance may be required if a particular business structure, in practice, creates specific risks and the LSB and the front line regulators will need to be alert to any real risks. The key to successful regulation will be consistency openness and transparency.**

A further issue arises where an ABS is subject to the jurisdiction of more than one regulator (or jurisdiction) e.g. if accountants and IFAs are involved. The inter-relation of the regulatory requirements may be a challenging issue but once again we would urge that whatever the structure there should not be a regulatory competitive advantage or disadvantage of any particular structure in the absence of specific and real risks to the consumer.

Question 13 What conflicts of interest do you think might arise in relation to ABSs and how should they be managed?

APP See answer to 12.

The main issue is a potential conflict of interest between the interests of the consumer and the interests of the owner of the business.

Certain work in which the owner of the ABS has an interest may not be undertaken for clients of the ABS or only undertaken if strict compliance steps are taken and the client is in a position to make an informed decision.

It is unlikely that other entirely new issues will arise. For example concerns have been expressed about a lawyer referring work to an IFA or accountant within an ABS. However, in principle this issue already arises when a lawyer refers a client to one of his or her colleagues or to another office of the firm (at home or abroad or to an associated financial services or estate agency business). In such circumstances a lawyer making any such recommendation should act in the best interest of the client rather than the firm. Accordingly, provided the client is aware that the various professionals operate within one ABS it is unlikely that other, entirely novel, conflicts will arise.

Potential conflict issues may arise if an investor owns or controls more than one provider of legal services.

Question 14 How should licensing authorities approach entity-based regulation and what are the main differences from the traditional focus on regulating individuals?

APP We would suggest that for entity based regulation it will be appropriate to ensure that the ABS has an appropriately qualified Head of Legal Practice and that the ABS has appropriate systems and procedures in place which are rigorous and cover issues such as staff selection, staff training, client acceptance procedures, allocation of client matters to those with the appropriate experience, client care and client complaints. If there is a system failure than the entity itself (and its H of LP) may be held accountable.

It is important that entity based regulation does not reduce the sense of responsibility of individuals to act ethically and responsibly so it should be clear that individual failings by lawyers (including failure to supervise) may result in action being taken against the individual personally whether or not action is also taken against the ABS.

Many large firms, in reality, will not notice any difference. They know that their firm's reputation and goodwill is their major asset and that any disciplinary action taken against an individual in the firm reflects badly upon and potentially damages the firm.

Question 15 Do you agree with our view that licensing authorities should take a risk-based approach to regulation of ABS, and if so, how might this work in practice?

APP Yes, it is very important that any regulation is designed to address real risks rather than fanciful hypotheticals, and that resource is focused on the high risk areas.

We would envisage the establishment of a number of core principles. Detailed regulation may be necessary in specific areas but these should clearly relate back to the relevant risk and be proportionate and relevant and clearly designed to mitigate the perceived risk rather than to prefer one means of operating a legal services business over another. The use of no-action letters and similar approaches (provided the process is transparent) may help to reduce the need for very detailed and prescriptive regulations but allow the regulator to be responsive as and when the need arises. What will also be important is consistency in advising on different ABS models which will allow investors to have confidence in the structures which they adopt.

A risk-based approach allows the front line regulators to focus on the areas which create the greatest risk to the consumer whereas the current blanket approach does not appear to focus resources upon areas of the greatest real concern.

Question 16 What is your preferred balance in regulating ABS between a focus on high-level principles and outcomes and a more prescriptive approach?

APP See answer to 15. We would prefer a clear balance on high level principles and outcomes. We acknowledge that more detailed and prescriptive rules may occasionally be necessary but when proposing these the question should always be put “do these rules help to advance the high level principle, are they addressing a real issue and are they proportionate to the mischief and its prevalence which has been identified?”. The regulatory regime should encourage and not discourage the development of ABS structures. The regime should also encourage a level of open discussion between the regulators and those they regulate to ensure that any regulatory intervention is necessary and proportionate.

Question 17 What are the advantages and disadvantages of a requirement on ABS to have a majority of lawyer managers?

APP The advantage of a majority lawyer managers is that the ABS will clearly be seen as a provider of legal services under the control of individuals who will be personally accountable to their regulators for their actions.

The disadvantage of such an approach is that it potentially reduces significantly the range of business models available. For example a law firm may wish to link with accountants and IFAs in a three way merger to provide a complete service to SMEs and medium net worth individuals. Why should such a business have a majority of lawyer managers? Why do the other members (who are also regulated professionals) have to assume a minority position?

It also needs to be appreciated that ownership and management are two different things. An owner will still retain the power to remove the management so could replace the management with more “compliant” individuals. It should also be appreciated that sheer numerical advantage is not necessary to exercise control. A strong strategic leader will often get his or her way irrespective of the voting balance.

Question 18 What are your views about how licensing authorities should determine whether a person is a “fit and proper person” to carry out their duties as a HoLP or a HoFA?

APP **These are very important roles and these individuals will carry out key functions both in terms of the internal controls and in establishing the credibility and sustainability of new business models.**

Accordingly the licensing bodies should be looking for individuals with a depth of experience and a level of personal probity which reasonably satisfies the licensing authorities that they will satisfactorily perform their roles and effectively and constructively engage with the licensing authority. It may be that such people should initially be so authorised for an initial “probationary” period of, say, two to three years before such status is made permanent. Although, even then, the regulator would have power to decide that the person was no longer “fit and proper”.

The HoLP should clearly be a lawyer with relevant experience (probably at least five years’ post call or admission) in the area of operation of the ABS. Preferably the person should also have a level of leadership experience and credible management skills. The SRA already has a requirement that at least one member of a recognised body should be “qualified to supervise” and it may be appropriate to develop this concept further.

The HoFA may often be a qualified accountant but will need to show a credible track record of financial experience and administration experience appropriate to the size and scope of the organisation.

In both cases formal qualification may be less relevant than experience, personal probity and a clear understanding of the role and responsibility that they are undertaking and the consequences for the consumer of contracting for services from an ABS

Question 19 What is the right balance between rejecting “higher-risk” licensing applications and developing systems to monitor compliance by higher-risk licensed bodies?

APP **The LSA is a piece of enabling legislation so as a general principle it should not stifle new business models. However the regulator has a duty to act in the interests of consumers. We believe that any applications to practise (whatever business model is used) should be subject to rigorous assessment that the owners and managers of the business are “fit and proper”, that they will act in the best interests of their clients and that they have or will have appropriate complaints systems in place.**

If an applicant meets these tests then they should be licensed although the licences could be limited to certain types of work, at least for an initial period.

If higher risk models are identified the regulator will need to be more vigilant as to the effective monitoring of the organisation and be prepared to take timely remedial action when appropriate. There has been a concern for some time that the SRA has insufficient experienced staff, and is too reactive and slow to currently perform this role effectively. It is essential that any new structures are subject to effective, timely and relevant regulation and have a consistency of approach. If this is not achieved from the start the whole credibility of the reforms will be in jeopardy. However regard has to be given to a regulatory level playing field and so additional regulatory requirements should only be imposed to address real and serious consumer protection issues.

Question 20 How should regulators ensure a level playing-field between regulated legal practices and licensed bodies?

APP **If high level regulation is adopted these should apply across all providers of legal services. Front line regulators should be discouraged from “gold plating” their own rules and from making it difficult or indeed impossible for their regulated persons to operate in an ABS or LDP. Indeed to do so would run counter to the intent of the LSA.**

We believe it may be necessary for the LSB to take a clear line and to be prepared to intervene by refusing to approve rules that are inappropriate or, as a draconian option, to threaten to remove the front line regulators status as such.

If certain key criteria are agreed, for example, over client money or professional indemnity coverage, there should be no advantage as to which regulator is used in terms of the minimum acceptable criteria.

Question 21 How should licensing authorities approach the access to justice condition, and do you agree that it is unlikely that many licenses should be rejected on the basis of the condition?

APP **The whole issue of what constitutes “access to justice” is problematic. Is access via the telephone or via the internet sufficient or does it require face to face contact with a qualified lawyer? This has already changed in recent years, especially in relation to publicly funded work, and will develop further as consumer expectations and needs develop. Many commercial organisations now have sophisticated complaints handling and Ombudsman schemes with a view to settling disputes early and avoiding recourse to the courts. Surely, in general, such free and relatively quick schemes help the consumer achieve redress and hence “access to justice”.**

“Access to justice” is a broad concept and needs to be delivered with care. It would be completely inappropriate, for example, for a probate business to allocate lawyers to work on criminal matters. They would not have the right skills and it would be dangerous for them to dabble in disciplines in which they do not have appropriate experience. Indeed there must be a concern that, especially in a recession, lawyers are currently tempted to operate outside their sphere of expertise to maintain their fee income.

It would also be difficult to impose restrictions requiring a firm to maintain offices in certain locations or to maintain a specified range of retail services.

The whole purpose of the LSA was to permit new service models to develop according to market demands for the efficient provision of legal services. Inevitably this will mean that some businesses based on existing models will fail (although many are already failing due to the recession). Some new models will almost certainly take advantage of call centres and internet technology. Accordingly for “access to

justice’ purposes it is not clear that a physical lawyers’ office will be appropriate or economic in every high street across the country.

We would encourage, however, all providers of legal services to have and to develop a commitment to pro bono services in its various forms. We doubt however that this should be a necessary pre condition of a licence.

On balance we fear that access to justice conditions to licences will impede the level of change needed in the provision of legal services and paradoxically could, by leaving lawyers to operate in undercapitalised and failing business models, indeed reduce access to justice still further.

Question 22 How should licensing authorities give effect to indemnification and compensation arrangements for ABS?

APP **The LSB should identify certain core standards, for professional indemnity cover and malfeasance compensation schemes. If the licensing authorities significantly depart from these standards the playing field will cease to be level, so gold plating may need to be avoided. For PI cover the position is reasonably straightforward as firms with poor internal systems or an unsatisfactory claims record will pay more or be unable to obtain cover and will be forced out of the market. A compensation fund may be more problematic as it penalises well run firms for the wrongs of other firms. This may cause tensions with licensing bodies. For example if small solicitors firms result in many such claims (and they seem to be rising alarmingly at the moment) this may encourage the larger law firms (say the top 50) to promote a new regulatory body which will then impose a higher burden on the remaining firms. Conversely however this may encourage the consolidation and change in the profession.**

Question 23 How should complaints-handling in relation to legal services provided by ABS be regulated?

APP **The ABS will inevitably be a complex animal as it may include businesses regulated by a range of regulators. It is essential that there are no gaps in the regulatory regime so that consumers are always able to pursue complaints against an ABS in a coherent and understandable manner.**

It may be that an ABS will need to make clear in relation to its legal services role that the first contact should be the H o LP and then if necessary the OLC. It will need to be considered how using the “polluter pays”, model an ABS will be assessed for its contribution to such a scheme.

Question 24 How should licensing authorities approach the “fit to own” test and how critical is it in mitigating the risk of the regulatory objectives of promoting lawyers’ adherence to their professional principles?

APP **The fit to own test has been used in banking and other regulated businesses for some time. It will be appropriate to have a credible threshold for the test say 5%, 10%, 15% or 20% ownership being equity ownership, voting rights or other similar business influence. The probity of the owners and their understanding and acceptance of the professional principles to which the business will be subject is essential. Also their other business interests which may cause real conflicts of interest will need to be identified and addressed. However these procedures should not be too cumbersome and should not deter credible listed companies from developing into legal services or from private equity, “angel” or other investors participating in the market. If the approval process is too restrictive the legislative intent of the LSA will be defeated.**

Special consideration may be required in relation to overseas owners as to the level of transparency of their business activities and ownership structure, and the quality of their financial reports.

It is the H of LP who will have primary responsibility for institutional regulatory compliance and it will be important to understand the different roles and responsibilities of managers and owners of businesses.

Question 25 Are there any particular risks to the regulatory objectives that arise from could arise from ABS offering non-reserved legal services?

APP **Given that the range of reserved legal services and non reserved legal services is somewhat arbitrary it is inevitable that many ABSs will offer non reserved services. Indeed, these may constitute the vast majority of their legal services offering. There is no consumer protection rationale for the distinction between reserved and non reserved legal services and many countries have fundamentally different definitions of reserved legal services.**

Provided that the non reserved legal services are regulated (as in the case of traditional law firms) and subject to the same conflicts, PI complaints and other protections there is fundamentally no difference with the traditional law firm model.

Question 26 What are the risks to the consumer associated with the delivery of legal services by special bodies and which more general risks are less relevant to these bodies?

APP **Special bodies have a key role to play in access to justice especially to vulnerable parts of the community. However the regulatory regime should not confer an unfair advantage for such special bodies. As many may operate on a not for profit basis it may be inappropriate to subject them to extensive regulatory requirements. However if they are purporting to provide legal advice they should be subject to rules as to PI, a compensation fund and lawyer competence/complaints. If they are not handling client money it may be possible to reduce or exclude compensation fund requirements. However if these providers are charging for advice a higher level of service may be expected. The key here is that the consumer knows what level of advice he or she is getting, the qualification of the person providing it and the consumers level of redress if the advice is wrong or incomplete.**

Question 27 Is it in the consumer interest to require special bodies to seek a licence, and if so, what broad approach should licensing authorities take to their regulation?

APP See answer to 26. On balance we believe that licensing is appropriate but depending upon the scope of operation of the special bodies a lighter touch may be applied provided the consumer is made aware of the different level of service and responsibility it can expect from such a special body.

Question 28 Are there any other issues that you would like to raise in respect of ABS that has not been covered by previous questions?

APP No