

Legal Services Board

Alternative Business Structures: Approaches to Licensing

Submission of the Association of Partnership Practitioners

ABS: Approaches to Licensing

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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 nine largest accountancy firms and seven 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 January 2010, 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 circulated to the APP Committee for their comments, which have been incorporated into this response.

Annex B: A list of questions raised in this document

1. What is your view of basing the regulation of ABS on outcomes?

We agree that the regulation of ABS should be based on outcomes or broad principles. However these outcomes should be consistent, clearly understood and no more or less onerous than those providing legal services in a non ABS vehicle.

a. Should all LAs have the same core outcomes?

We believe that all LAs should have the same core outcomes. If this is not the case there will be scope for regulatory arbitrage between LAs which we do not believe is desirable. It may be appropriate for specific LAs to supplement the core outcomes but any such additions should not be used to inhibit the use of the ABS or to make its operation unduly restrictive.

b. Are the proposed outcomes appropriate?

We agree that the proposed outcomes are broadly appropriate.

c. Is the division between entity and individual regulation appropriate?

We believe that a division between entity and individual regulation is appropriate. However, we believe that this approach needs to be used with caution. No lawyer should be able to abdicate responsibility for acting appropriately in the best interests of his or her clients. Accordingly there may be many circumstances in which both the entity and the individual may be sanctioned for non compliance (in relation to the entity because of inadequate systems or controls and in relation to the individual due to his or her personal activity or breaches). The extent to which those in leadership positions and particularly the HoLP should incur a personal responsibility for breaches by the entity should also be considered.

2. Do you think our approach set out to the tests for external ownership is appropriate?

We do believe that your general approach to the tests for external ownership is appropriate. It is important that the review regime is sufficient to cover those exercising control or influence through “nominees” but it should not be so burdensome as to require disclosure of de minimus or irrelevant connections which have no impact on the operation of the ABS. Accordingly it may be appropriate for shareholders to confirm that they are the beneficial holders of the interest in the ABS and that they are not subject to any instructions or influence from any third party. You may also wish to consider the position where there are individual groups of shareholders who are individually below the disclosure threshold (and prima facie unrelated to each other) but who nonetheless “act in concert” together.

a. Should the tests be consistent across all LAs?

Yes.

b. Is our suggested approach to fitness to own test the right one?

Yes.

c. If declarations about criminal convictions are required, should these include spent convictions?

This is difficult but on balance we think spent convictions for dishonesty or fraud should be included. A person’s business and financial probity is essential for public confidence in the ABS regime and therefore any spent conviction involving dishonesty or fraud should be disclosed to the LA.

d. What is your view of our suggested approach for considering associates? Is there an alternative approach that would work better in practice?

See our answer at 2. We believe your approach is broadly appropriate but it is essential that the beneficial owners of the interest are properly disclosed and that any special arrangements which may affect that interest (e.g. a charge in favour of a third party) are disclosed if a third party is able to influence the beneficial owners behaviour in relation to its holding.

- e. **Should there always be a requirement to declare the ultimate beneficial owner of an ABS?**

Yes.

- f. **Overall, are any modifications needed to ensure that our approach works in a listed company?**

There needs to be a credible threshold for disclosure but 10% should not unduly affect share liquidity. Disclosure must not just include shareholding but options and similar instruments entitling a party to acquire ultimate ownership or control over the shareholding.

- g. **Overall, are any modifications needed to ensure that our approach will work in very small companies?**

With very small companies it should be relatively easy to identify the real beneficial owners and the investor group with sufficient certainty. Accordingly, it should be possible to reduce or mitigate some of the “associates” tests applicable to such shareholders.

- h. **Do you think that the definition of restricted interest should change?**

Given that this is in the LSA we doubt that this is worth trying to do so provided that its implementation is as you propose.

- i. **Do you think that covenants should be required from those identified as having a significant influence over an ABS?**

In general yes in that an acknowledgement of the duties of the ABS to its clients and the role of the HoLP and HoFA would be useful as would an undertaking not to seek to influence the legal advice or service given to clients of the ABS.

- j. **How should the LSB respond to the information it receives about information on action taken against people that falls short of disqualification?**

Given that a range of information may be received and some may come from credible sources and some may not it will be necessary to proceed with some caution. At first instance it would be for the LSA to share such information with the relevant LA. The LA may seek an explanation from the ABS or the relevant shareholder and subject to the response make the ABS approval

subject to certain conditions. Alternatively it may seek an undertaking from the relevant shareholder as to its activities as per (i) above.

3. Do you have views on how indemnity and compensation may work for ABS?

The key principle issue here is that the consumer should not be disadvantaged whether it seeks legal advice from an ABS or a traditional law firm.

a. How should an appropriate level of PII be set for ABS that are carrying out a variety of different activities, not all of which are currently regulated by the ARs?

We believe that a minimum level of insurance cover should apply to all providers of legal services including an ABS.

Given an ABS may be conducting a range of businesses the issue arises as to what level of protection is required for the consumer where legal and nonlegal services are provided. On balance we believe that the minimum insurance terms should apply to all activities of the ABS unless some activities are sufficiently distinct from the provision of legal services and the consumer is adequately made aware that the insurance regime does not cover such services. However, for many organisations seeking to provide legal services it is likely that these services will be provided by a separate legal entity and therefore as part of a group structure, only that entity will be subject to a minimum level of PII, but the rules should not encourage this as such a move would be self defeating to the ABS model.

b. Should there be minimum PII levels, which are the same for all LAs for different types of activity?

In general we would support common minimum PI levels. Most larger businesses will take out additional cover based on their own business needs. Given the information set out in paragraph 138, a minimum level of cover of £1m per claim may be sufficient for the vast majority of consumer claims. We see little benefit in a compulsory fixed renewal date provided that cover is always maintained. There should also be no disincentive, by means of requiring run off cover to a firm moving from a traditional law firm to an ABS provided that the ABS is defined as a successor practice.

c. Are Master policy arrangements appropriate for ABS?

We do not see that a master policy is necessary. The key issue is that coverage is obtained. Whether this is by a mutual, a master policy or separate bilateral insurance policies is to a large extent irrelevant.

d. What would be appropriate arrangements for runoff and successor practices to enable sufficient commercial freedom for ABS as well as protection for consumers after practice closure?

The current SRA regime produces a significant exit cost to closing a business and significant uncertainty as to whether any form of hiring of any of the staff will result in the hirer becoming a successor practice. This significantly impedes orderly law firm consolidation. However consumer protection is important and the six year run off cover is valuable in this context. One approach may be to require run off cover to be purchased by the closing firm unless the acquiring firm elects to become a successor practice. This would at least remove one level of uncertainty in mergers as to whether or not the firm acquiring part of the business was a successor practice. Reducing the minimum level of PII per claim to say £1m may also mitigate the cost of run off cover.

e. What should the requirements be for compensation funds in ABS?

We believe that a form of compensation fund is desirable in ABS. We would prefer to avoid taking this from interest on client accounts as much of this interest should, in any event, be passed onto the client. This may be particularly unfair as the client account interest would otherwise have gone to (and been the property of) the client and the protection underwritten by the compensation fund would presumably extend to all business and client matters. If any provision of bonds/guarantees as set out in paragraph 153 was to fall to the Banks, then it is likely that the banks would require cash cover and so any liquidity benefit could be illusory. A simple fund as mentioned in paragraph 152 may be preferable although we appreciate that it may face a liquidity gap in the event of claims in its early years of operation. However we do believe that, due to the cost and complexity of setting up and guaranteeing a compensation fund, alternative provisions such as through appropriate insurances are investigated.

f. How could a compensation fund work in an ABS environment, in particular when the services offered by the ABS may be much wider than legal advice where an AR may not currently have a compensation fund?

See our answer to 3(a). We believe that any compensation fund in an ABS environment should apply to all services provided by the ABS unless they are sufficiently distinct from legal services from the consumer's perspective and

the consumer is made adequately aware that the compensation fund does not apply to such other services.

4. Do you agree with our position on reserved and non-reserved legal activities?

In general yes. As you say the distinction between reserved and non-reserved legal activities is largely an historical accident and is unlikely to be understood by the consumer.

a. Do you agree that ABS should be treated in a consistent way to non-ABS?

Yes.

b. Should all legal activities undertaken by an ABS be regulated or just reserved legal services?

All legal activities undertaken by an ABS should be regulated. However if the ABS has a separate business e.g. an employment benefits consultancy we do not see that this should be regulated provided it is clearly a separate business and probably has a differentiated branding from the ABS. The task of trying to define legal services is very difficult. In the US, the ABA has been trying to draft such a definition for many years but without success. Accordingly, care needs to be taken in relation to ancillary services conducted in a different vehicle. Once again the regime for an ABS should not be more restrictive than those applying to traditional law firms and we consider that the regime should be as permissive as is possible within the proper regulatory context.

c. What role do you see consumer education playing?

Consumer education has a key role to play. For example, the level of qualification and PII of a lawyer preparing a will as opposed to an unqualified will writer needs to be explained clearly so that the consumer is able to make an informed choice of provider.

d. How should ABS which are part of a wider group of companies be treated?

This demonstrates the concern that we have about related services. We believe that the ABS should be subject to regulation but the other group companies should not. However rules may be necessary as to the relationships with their other group companies and in particular the level of

disclosure necessary when a consumer is referred from an ABS to another group company.

5. Are the enforcement powers for LAs suitable?

In general yes, we agree that a risk-based proportionate and targeted approach to enforcement is appropriate. This may, in certain circumstances, require the regulators to be more proactive and to be better trained and informed than they have appeared to be in the past.

a. What is your view on the proposed maximum level of financial penalty that a LA can impose on an ABS?

We are content with the potentially unlimited fines provided that it is clear that the LA has to act proportionally to the circumstances and that there is an appropriate independent appeals mechanism. It is very important that the financial penalties are consistent between providers of legal services so as not to provide a disincentive to the use of ABS.

b. If you do not consider the proposed maximum to be appropriate what amount or formula would you propose?

N/A.

c. Will LAs have sufficient enforcement powers?

We believe so. However we do believe that formal intervention powers should only be taken as a last resort and to a large extent should be seen as a failure by the LA to identify issues at an earlier stage and to address this by licence conditions or other restrictions or enforcement action.

d. Will ABS have sufficient clarity as to how the enforcement powers may be used?

It is clear what powers can be used. The “how” will develop based on the activities of the relevant LA so inevitably, initially, this will be to some extent unclear. However it should be clear that they will be used in a manner which is risk based, proportionate and targeted and understood by those who adopt ABS structures.

e. In what circumstances should a LA be able to modify the terms of a licence?

If it receives information that, if received when considering the initial licence application would have resulted in it imposing licence conditions, it should be able to modify the terms of the licence. It will be appropriate for it to discuss the information received with the ABS before acting to ensure that any such conditions are risk based, proportionate and targeted.

f. Are there appropriate enforcement options for use against non-lawyer owners?

It is possible to determine that they are no longer fit and proper and therefore require them to divest their holding. In most circumstances this should be sufficient. If they are interfering with the operation of the ABS to the detriment of consumers this will almost certainly result in other breaches which would allow the licences to be revoked or conditions applied. On balance we believe that the enforcement options are appropriate.

6. What do you think of our approach to access to justice?

The Legal Services Act was passed partly with a view to encouraging the creation of more dynamic consumer focused provision of legal services. Accordingly we agree with your approach. The issue of cross subsidisation of legal services should be avoided where possible. All providers of legal services should be encouraged to have regard to the needs of the wider community whether by the provision of pro bono assistance or otherwise.

a. Do you think the wide definition to access to justice that we have taken is appropriate?

Yes we do. It is difficult to define exactly what constitutes access to justice. It is certainly not limited to face to face contact. Indeed call centre and internet based services could, for some sections of the community, widen access to justice and in particular be more readily approachable and understandable by certain consumers.

b. Is asking an ABS on application how they anticipate that they will improve access to justice a suitable approach?

Yes, every provider of legal services (not just an ABS) should consider how they can improve access to justice. However we agree that the access to

justice argument should not be used to restrict new entrants who otherwise satisfy the licence criteria.

- c. **Do you agree that restrictions on specific types of commercial activity should not be put in place unless there is clear strong evidence of that commercial practice causing significant harm?**

Yes.

- d. **Do you agree that LAs should consider how ABS in general impact access to justice rather than trying to estimate the impact of each application singularly?**

Yes.

- e. **Do you agree that LAs should monitor access to justice?**

Yes, but it should have a monitoring role and not any form of "enforcement" criteria.

7. What is your view of our preference for a single appeals body?

We agree that there should be a single appeals body. As the ABS is a new structure there is a material risk that different LA s will consider different factors when reviewing an ABS application. A single appeals body will provide a degree of consistency and best practice.

- a. **Should, in the future, a single body hear all legal services appeals?**

Ultimately that may be a preferable option although in the medium term it is probably appropriate to see how the LAs perform this role (and the ABS appeals body operates) before taking this additional step.

- b. **If you don't think there should be a single body, who should hear appeals from LSB decision should it become a LA?**

If there is not a unified single body then appeals from the LSB could go to the appeals body also handling the ABS appeals. However we would hope that it will not prove necessary for the LSB to become an LA.

c. Is the FTT, GRC an appropriate body to hear appeals?

We have insufficient experience of this body to comment in detail but provided it can provide the appropriate expertise it may be appropriate.

d. What other options for the location of the body?

It could be possible for the LSB to establish its own appeals body similar to that operated by the FSA.

8. Do you agree with our approach to special bodies?

Yes. The Legal Services Act was designed to enhance the choice to the consumer. These special bodies provide a crucial role in widening access to justice. However these bodies should be appropriately regulated even if, in the not for profit cases, this is very light touch regulation. It is also important that any material differences in the level of consumer protection available to the users of such services are adequately explained to the consumer.

a. Do you think that special bodies transitional arrangements should come to an end?

Yes.

b. Do you think 12 months after the start of mainstream ABS is sufficient time for them to gain a full licence?

We are doubtful that 12 months will be sufficient and would suggest 24 months.

c. Do you think LAs should adapt their regulation for each special body?

We would encourage the LA s to identify certain regulations that may need to be waived or varied for certain types of special bodies rather than a bespoke tailoring for each special body. This should also provide a degree of certainty for and reduce the application cost to such special bodies.

- d. Do you agree there are some core requirements that all special bodies should meet? If so, what do you think these are?**

Yes. The duty to act in the best interests of the client must be clear. Also if they are dealing with client money this needs to be protected. Depending on the nature of the special body, a level of professional indemnity cover may be appropriate or its absence adequately explained.

- e. What are your views on the suggestion that the OLC should make voluntary arrangements with special bodies?**

Whilst this may be an appropriate short-term solution, we would prefer all such special bodies to come within the ambit of the regulatory regime and hence the jurisdiction of the OLC.

- 9. Do you think that our approach to HoLP and HoFA is suitable?**

Yes.

- a. Do you think that our approach on focussing on compliance systems across the organisation is suitable?**

Yes it is essential that an ABS, as it will by definition include professionals without a legal background, has appropriate organisation wide compliance systems.

- b. Do you think that HoLP and HoFA should undergo a fit and proper test?**

Yes.

- c. Should there be training requirements for the HoLP and HoFA?**

An ABS may be a very small, medium or large business. A one size fits all approach to training requirements may not be appropriate. The LA s however should be encouraged to develop training programmes for these roles although we do not believe they should be compulsory at this stage and could be tailored to the nature of the business.

- d. **Do you agree that the HoLP and HoFA could be the same individual (especially in small ABS)?**

Yes but primarily only in a small ABS. In a larger ABS it should be expected that these roles will be performed by two separate people.

It may be appropriate to consider deputy HoLP or HoFA roles so that such a person could be approved by the LA and able to step into the HoLP or HoFA role if the incumbent is unable to act.

10. **Do you think that our approach to complaints handling is suitable?**

Yes.

- a. **Do you think that ABS complaints should be handled in the same way as non-ABS complaints?**

Yes.

- b. **Do you think that ABS should be allowed to adapt their complaints handling systems if they already have one for their non-legal services consumers?**

Yes, provided it meets the reasonable requirements of the LA.

- c. **Do you think it is appropriate for the OLC to take complaints from multi disciplinary practice consumers and refer where necessary?**

Yes, otherwise the consumer is left not knowing where to refer a complaint. The ABS structure is partly about assuring consumer confidence.

11. **What are your views on our proposed course of action to conduct research and, depending on the results, either compel transparency of data or encourage it?**

We consider it appropriate for research to be conducted and regular data published. However an ABS should not be subject to different requirements from other providers of legal services.

- a. **Do you agree with our position on diversity and ABS?**

Yes.

- b. Do you agree that the overall impact is unlikely to be adverse to the diversity of the profession?**

Yes, different business models and different roles within them should enhance the range of employment opportunities and hopefully increase the diversity of those involved in the provision of legal services.

- c. Do you agree that non-lawyer managers may open new career paths to lawyers and these may have a positive impact on career progression?**

Yes.

- d. Do you agree that the demand for diverse legal professionals will, largely, offset the potential impact due to the closure of small firms?**

Probably. However it is not the role of the LSB or LA to favour or protect one business model over another. Currently many small firms are closing and the competitive environment will cause many more to close whether or not ABS are introduced. The LSA was designed to enhance competition in the provision of legal services (indeed this process started with the publication of the Competition Commission report in 2001). The inevitable impact of effective competition is that consumers have a choice and this results in providers who win and others who lose. For the LSB or LAs to unduly interfere in this area would be contrary to one of the key objectives of the Act.

- e. Should the LSB require information about the diversity of the workforce in ABS? If so, when and should this be a requirement for other legal service providers?**

The LSB should require such information either from all legal service providers or from none.

- 12. Do you agree with our approach to international issues?**

In general yes. Many foreign bars, which have been against the MDP for over 20 years, will look for any excuse to block the operation of an ABS internationally. If this continues this is likely to be a significant impediment to the use of an ABS structure for larger law firms with an existing or anticipated international footprint. It is accordingly important that the LSB seeks to engage in a constructive debate with the relevant bars and governments to mitigate such opposition. This may become somewhat easier if over the next few years other European governments further liberalise the provision of legal services in their markets. To some extent many countries will be looking at the operation of the ABS regime in England, so from an international

perspective it is essential that the English regime works in the best interests of the consumer.

13. Should LDPs, Recognised Bodies and other similar firms have transitional arrangements into the wider ABS framework in the way we propose?

Yes.

a. Is 12 months after the start of mainstream ABS sufficient time to allow this to happen?

It should be given that LDPs have only been available for a year and only a small number are authorised. The number of other bodies appears sufficiently small to be managed within a 12 month window.

14. Should ABS licences be issued for indefinite periods?

We have no objection to the licenses being issued for an indefinite period. However as part of the annual charging process it may be appropriate for the ABS to certify that there have been no changes to its management or ownership or to identify such changes and to provide certain other information to the LA.

a. Should the annual charging process be broadly cost reflective or a fixed fee?

Broadly cost reflection but fixed annually based on the relevant budget of the LA.

b. How should LAs ensure ABS are continuing to comply with their licence requirements?

The LAs should make clear that the ABS needs to notify any changes in its management or ownership in a timely manner and, as mentioned above, may as part of the annual charging process require an appropriate certificate of no change from the ABS. The LA should also reserve the right to require certain information from an ABS at any time.

15. Do you agree with our approach to managing regulatory overlaps?

Yes, this is a pragmatic and flexible approach which hopefully assists co-ordination and information sharing between regulators whilst mitigating the potential cost and confusion from the activities of multiple regulators.

a. Is it desirable to have a framework approach to a MoU?

Yes, a reasonably standard approach is desirable for certainty.

b. Do you think we have identified the right bodies to develop a MoU with?

Yes. These are the immediate areas although, in due course it may be appropriate to include other professional bodies such as actuaries.

c. Do you think we have identified the right issues to include?

Yes but they should also include information exchange in relation to specific ABS and more generally.