

**Submission of Addleshaw Goddard LLP**  
**to the Legal Services Board's Consultation Paper**  
**on Developing a Regulatory Regime for Alternative Business Structures**

**ADDLESHAW GODDARD**

### **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?**

We strongly agree that a mid 2011 start date for ABS licensing is desirable. Many firms and financiers are already considering potential structures pending licensing as part of their strategic business planning and in some cases have prioritised such options to allow for growth or survival under the current difficult market conditions. There is, however, an unacceptable level of uncertainty given the lack of guidelines from the approved regulators. A further delay in licensing until the statutory longstop date of mid-2012 will inhibit developments and recovery within the industry.

Achievability is, in our view, dependent on a number of factors. The legislation is inherently permissive and as such does not prescribe either one type of ABS model, nor restrict the commercial rationale for such structures. Broadly, ABSs will fall within two categories, first, those providing primarily legal services, but with an element of non-lawyer participation (such as an external financier), and secondly, a multi-disciplinary practice providing complementary or integrated services to consumers. These models will give rise to separate considerations which to our mind have not been sufficiently addressed to allow licensing authorities to be in a position to take a uniform approach to regulation. We are concerned to avoid conflicts between regulators and inconsistencies in standards across the industry.

Unless the LSB is to be the sole regulator in 2011 (as to the desirability of which see Qu.3 below), guidance to licensing authorities must be agreed well in advance of that date. We note that, according to the LSB's timeline draft guidance on the content of licensing rules will be published in September/October 2009, with the final rules issued Q4 2009/10. We regard this timeline as ambitious. We assume that an approved regulator's application to become a licensing authority will not be successful unless it agrees to follow the guidelines. We are aware that a number of approved regulators, such as the Solicitors Regulation Authority, are currently undergoing their own consultations and may not therefore be in a position themselves to comment on the draft guidelines within the LSB's timeline.

### **Question 2**

#### **How do we ensure momentum is maintained across the sector towards opening the market?**

We believe that this should be a priority for the LSB. As noted at Qu.1 above, the LSB's timeline does not take into account consultations and processes being undertaken by key approved regulators. A co-ordinated timeline for consultation and discussion should be agreed between the LSB and the key approved regulators (such as the SRA and the Bar Standards Board) with a view to producing mutually acceptable and agreed guidelines. We believe that this may reduce the need for the LSB to become a direct licensing authority and facilitate the LSB's decisions on applications to become licensing authorities within its stated timeline.

We would suggest that a consultative committee comprised of representatives from the key approved regulators be established and work closely with the LSB, ensuring that all relevant bodies move forward in unity and in a timely manner.

### **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?**

We strongly believe that the existing frontline regulators are most appropriately placed to license and regulate ABSs, with the LSB as a supervisory regulator. Were the LSB to position itself as a licensing authority, it would necessarily divert its focus from collaborating with other regulators and preparing

the sector for the mid-2011 start date. This would invariably cause a delay in issuing licenses to other regulators. We do not believe that the LSB, as the sole licensing authority, would be in a position to deal with the initial volume of ABS applications effectively. No time efficiencies would be achieved and the decision to license directly would be counterproductive.

#### **Question 4**

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

The LSB would need to establish an independent subsidiary to issue licences, regulated by the LSB on the same basis as any other approved regulator. To put in place this infrastructure would cause yet further unnecessary delay in the proposed timeline.

#### **Question 5**

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

We believe that ultimately there will be significant change within the legal profession and that the legal landscape and the way which consumers access legal services will fundamentally alter in the future. The question is how quickly this change will come about.

Whilst a number of legal providers will be considering opportunities (not least, in part due to be difficulty in obtaining conventional financing and the need to invest in human capital for growth), consumer demands will probably be the main driver for reform.

Commercial firms will be under pressure to reduce costs from key clients and may look to outsource or commoditise bulk or processing services to a special purpose vehicle which they own or control in a low cost jurisdiction. Such firms may be looking to external financiers for investment in such a structure, although global law firms may encounter overseas restrictions in those jurisdictions where lawyers are not permitted to practice through ABSs. Nevertheless, for firms seeking a competitive edge, the recent Rio Tinto deal serves to highlight how a commercial firm which is able to deliver such an offering effectively might benefit substantially.

Consolidators will invariably enter the market looking to achieve economies of scale. This may reduce the number of small high street practices.

Demand for on-line and telephone access to legal services will undoubtedly increase and providers of such services are likely to be connected with new entrants into the legal market, such as retail groups, financial institutions, insurers and roadside recovery providers.

We also anticipate that a number of multi-disciplinary practices will emerge.

#### **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?**

We believe that there will be an initial period of consolidation within the industry and this may impact on availability of legal services to individuals living in remote areas, as legal service providers become centralised. Invariably, however, on-line or remote access legal service providers will be able to satisfy many of such consumers' day-to-day requirements, notably conveyancing, PI claims, matrimonial, wills and probate services. This is consistent with the way in which many consumers now prefer to access other services, including insurance, investment and banking.

For many businesses, particularly small businesses, the availability of legal services from a multi-service provider will invariably reduce duplicated work and hence costs, and such businesses can only benefit from developing a relationship with an MPD which has a much deeper understanding of its business.

Larger businesses will undoubtedly benefit from reduced fees, as large firms look at implementing or outsourcing to structures (possibly all or partly externally owned or funded) which provide processing or commoditised services at low costs, maximising recovery rates on premium work undertaken by such firms.

The introduction of ABSs will increase the expertise within certain areas of practice. Consumers will therefore benefit from improved standards and access to high quality legal services in specialist areas to which they may not have had access at a reasonable cost before.

#### **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?**

Law firms may choose to exploit a number of opportunities which will be available to them. An investor in a law firm may have a long-term growth investment strategy, and may therefore, be amenable to the provision of finance where conventional loans would be unavailable due to lack of short term funds for repayment. This will be particularly relevant where firms are looking to make an investment in human capital.

ABSs will open up a range of alternative career options for individual lawyers, particularly for those for whom partnership in a professional practice is either undesirable or inappropriate. Furthermore, there will be greater flexibility around equity structures as value can be accumulated within a corporate vehicle which can be realised on an exit, floatation or sale of the business.

Senior non-lawyer employees of law firms are able to enjoy the same status and rights as partners or members.

#### **Question 8**

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

Alternative and more flexible business structures may increase the appeal of the legal market to a wider section of the public, particularly those with family responsibilities. The entry into the market of organisations for whom diversity issues are not so acute, such as retail groups, may also have the effect of reducing the statistical diversity bias within the profession.

#### **Question 9**

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

Some ABSs will, by virtue of the fact that they operate in limited sectors, be unable to offer training contracts that comply with the SRA requirements. This is currently the case for many in-house legal departments. We believe that junior lawyers benefit from experiencing a range of legal disciplines and would suggest that it was premature to narrow the current qualification requirements or introduce specialist practicing certificates specifically to accommodate ABSs.

As the ABS market matures, we would suggest that the LSB, together with frontline regulators, continue to keep under review the appropriateness of the qualification process.

## **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?**

Firms are, in general, ill-equipped for the economic downturns, as many firms operate a full distribution policy for tax reasons and are largely reliant on bank financing (either to the firm itself or directly through loans to partners to make capital contributions) for capital reserves and working capital. In an economic downturn, particularly where the availability of conventional funding becomes more difficult to secure, firms will suffer.

The various ABS models will undoubtedly redress a number of these issues. ABSs which are part of or take the form of a corporate entity or group, particularly those which are publically owned, will be organised and managed by professional managers. Although ABSs owned by a corporate group will, to some extent be dependent on that group's success (or failure) in an economic downturn, the association risk can be properly addressed through the "fit to own" test.

Where an external financier is involved, it will be looking to develop the business, possibly in preparation for a secondary market buy-out and will focus on managing long-term strategy and investment in the business. This will inevitably result in the end of the full distribution policy.

It is therefore anticipated that in general the introduction of ABSs will lead to more robust commercial vehicles able to withstand future economic downturns.

## **Question 11**

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

#### **(i) Improving access to justice**

Consolidation may have the effect of reducing the number of small high street practices. In their place, however, will be the emergence of high quality specialist services provided through both law firms and on-line or telephone legal service providers. We also believe that many legal services, particularly bulk or commoditised services, will become more affordable and therefore accessible to the public.

Some areas of practice, such as criminal law and other publically funded work may not, however, be attractive to consolidators or new entrants into the legal market. Whilst we recognise that there is a risk that firms operating in these areas could suffer we do not believe that at this stage the LSB should look to introduce protectionist measures (such as requiring consolidated firms to provide these services). However, the position should clearly be kept under review as the ABS market matures.

#### **(ii) Protecting and promoting the interests of consumers**

The consultation paper has specifically invited responses on the protection of client monies. Client monies are held on trust by law firms and as such outside the estate of an insolvent professional practice. We see no need for this to change as a result of the introduction of ABSs. The SRA has detailed rules dealing with client monies and we would suggest that these should apply equally to ABSs.

#### **(iii) Encouraging an independent, strong, diverse and effective legal profession**

We are aware of concerns raised by the BSB as to the continuing independence within the field of advocacy.

(iv) Promoting and maintaining adherence to the professional principles

We see the main risk to this objective as the potential for conflicts of interest. This risk is considered in more detail at Qu.12 below.

**Question 12**

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

In addition to those ABSs identified as high risk in para. 5.11 of the Consultation Paper (with which we agree), we would suggest that other conflicts and confidentiality issues could arise between the interests of the clients of an ABS and those of the investor member of an ABS or other ABSs in which it holds an investment.

We agree that some conflicts issues can be resolved by the existing processes in place with frontline regulators. However, we believe that some ABSs give rise to a particular set of concerns which have not been addressed and so the LSB will need to issue guidance on resolving such conflicts issues.

Cross-selling of goods and services within an MDP or an ABS established by a retail or insurer entrant into the market has been identified as one area of particular concern, although it should perhaps be noted that cross-selling is not of itself necessarily adverse to the interests of the consumer, unless there is an abuse of power or restriction of choice for the consumer.

In our view, it would not be desirable to prohibit a particular structure on the basis that it is identified as high risk. The legislation is permissive and provided that risks are managed by appropriate regulations, such as restrictions on participation in management decisions on issues of conflict and/or a limitation on the financial benefit which a conflicted participant may receive, together with a full disclosure and consent obligation, we believe that risks can be mitigated both operationally and optically.

**Question 13**

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

See Qu.12.

**Question 14**

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

Entity-based regulation is in our view an appropriate approach to regulation of ABSs, given that the participants may not all be individuals participating in the delivery of frontline services to clients, unlike in a traditional professional practice.

Nevertheless, we believe that it is important that individuals remain accountable, and such accountability should not just be restricted to the HoLP and HoFA. Individuals should still be bound by a set of core principles and be required to undertake appropriate training. Without this level of accountability, there could become a split level in standards within the industry which could adversely affect the interests of consumers.

**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?**

We agree that a risk-based approach to regulation is consistent with the statutory objectives. We agree that a system of objectives and training similar to that adopted by the Office of Legal Services Commissioner in New South Wales (identified in the Consultation Paper) offers a practical approach to regulation and supervision.

**Question 16**

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

We would advise against an overly prescriptive route. It is not yet clear as to the form ABSs will take. Furthermore, we believe that a prescriptive route would be inconsistent with the legislation, which is drafted on a principles basis.

We do, however, see some merit in the LSB producing a list of "safe harbour" structures. Not only would this give firms and investors some clear guidance as to the kind of schemes which are acceptable, it would also enable simple applications, which fall within the safe harbour categories to be fast-tracked through the licensing system, and we see a great deal of merit in this. It should be clear, however, that any such list is non-exhaustive.

**Question 17**

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

We see no particular merit in having an ABS with a majority of lawyer managers. In fact, the reverse may from a business perspective be preferable. Clearly the ABS will be bound by a set of ethical principles and regulation but there is no reason why lawyers are best placed to ensure compliance with those duties.

Frontline services to consumers should clearly be delivered by appropriately qualified legal personnel but the operation of the business will not of itself affect the quality of those services.

**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?**

We agree that it would be appropriate to review the approach of other regulators, such as the FSA, that operate "fit and proper" tests. We would also suggest that the HoLP and HoFA should hold an appropriate qualification, such as a qualified legal practitioner or accountant.

**Question 19**

**What is the right balance between rejecting "higher-risk" licensing applications and developing systems to monitor compliance by higher-risk licensed bodies?**

See Qu.12.

**Question 20**

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

As noted at Qu.14 above, all practicing individuals, in either a legal practice or licenses body, should be bound by the same standards of ethical conduct, even if the individual regulation is more prescriptive in the case of a legal practice.

These minimum standards of ethical conduct also need to apply and be applied consistently across all licensing authorities to ensure that there is risk of regulator "shopping" and that MDPs which may be regulated by more than one licensing authority deliver a consistent standard of service to consumers across all disciplines.

#### **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?**

See Qu.11(i) above. We believe that in general the introduction of ABSs will improve access to justice. We are aware of the concerns surrounding publically-funded work and would caution against introducing protectionist measures unless they prove necessary. We would suggest that the LSB keeps this area under review as the ABS market matures.

The culture of pro-bono services is well-established in the UK, and many corporates run a CSR programme. We anticipate that this will continue and that there will be no need for intervention by the LSB.

#### **Question 22**

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

We would suggest that the arrangements in place for legal practices apply equally to licensed bodies regulated by the same regulatory authority. This will ensure the same level of protection for consumers.

We do not believe that the introduction of a capital adequacy requirement would be appropriate. Provided consistent PI and compensation fund arrangements are in place, and that client monies are protected through segregated accounts and regulation, consumers will be in no worse position than dealing with a legal practice. To introduce a capital adequacy requirement would place ABSs at a competitive disadvantage, contrary to the spirit of the legislation.

#### **Question 23**

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

Complaints handling will undoubtedly be complicated in the case of an entity regulated by several licensing authorities. We would suggest that complaints be addressed by consumers to either the HoLP or the HoFA, and that the onus be placed on those individuals to resolve matters in accordance with internal procedures or, if not resolved to the complainant's satisfaction, to ensure that the complaint is forwarded within a prescribed time period to the most appropriate body. This will remove any uncertainty for consumers as to whom to address their complaints.

As suggested at Qu.2 above, we would also suggest that the LSB works in conjunction with the multi-regulator consultation committee to determine an appropriate complaints handling procedure in MDPs and, in particular, which PI cover or compensation fund should be used to meet any liabilities. We believe that it is the responsibility of the LSB to ensure that all regulators are in agreement as to this procedure so as to ensure that complaints do not fall within gaps or inconsistencies within the regulations.

**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?**

The FSA and OFT have operated "fit to own" tests and these may provide useful guidance for the LSB.

Whilst it is clearly appropriate that certain standards of probity are maintained, and that involvement be monitored and regulated, we are extremely concerned that undue restriction would deter otherwise suitable businesses from entering into the market. We believe that in some instances there could be 100% non-lawyer ownership or management of the vehicle, such as a licensed body established by a retail group, financial institution or insurer, and in these circumstances, such organisations should be free to operate the ABS in line with its other group activities. The consumer safeguards stem from compliance with ethical standards and training at entity and individual level.

**Question 25**

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

We see no difference between an ABS and a traditional legal practice offering reserved and non-reserved services. The consumer protection regulations dealing with PI, compensation, ethical standards, complaints and client monies should apply to all services offered by an ABS.

**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?**

Whilst we agree that unduly burdensome regulation would be adverse to the interests of special bodies which provide a valuable service in vulnerable parts of the community, we nevertheless believe that they should be subject to the same minimum level of consumer protection as any other ABS.

**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?**

The minimum level of consumer protection should apply where the special body is provided legal services, albeit on a low cost or not for profit basis. It may however, be appropriate to reduce the level of cover where the legal advice given is less specific, and the consumer is fully informed as to the level of service he or she is receiving.

**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?**

No

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