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Dear James

## **RESPONSE TO LSB DISCUSSION PAPER: "WIDER ACCESS, BETTER VALUE, STRONG PROTECTION"**

The City of London Law Society (CLLS) represents over 13,000 City lawyers, through individual and corporate membership including some of the largest international law firms in the world. These law firms advise a variety of clients from multinational companies and financial institutions to Government departments, often in relation to complex, multi-jurisdictional legal issues.

The CLLS responds to a variety of consultations on issues of importance to its members through its 17 specialist committees. This response to the LSB's consultation on developing a regulatory regime for alternative business structures has been prepared by the CLLS's Professional Rules and Regulation Committee. The Committee is made up of a number of solicitors from twelve City of London firms who have specialist experience in the area of regulation of the profession.

The questions raised in the paper are very wide-ranging, and many are outwith our areas of expertise and experience. We have, though, commented where we think it useful to do so.

**Question 1 – What are your views on whether the LSB's objective of a mid-2011 start date for ABS licensing is both desirable and achievable.**

Clearly, setting a target for commencement focuses efforts and to that extent is helpful. It risks being seen as arbitrary though. It is quite possible that developing licensing rules by the proposed licensing bodies may be a time-consuming and difficult task. We comment below on how this might be addressed.

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

By drawing in those with an interest. For example, we would very much like to be represented on the "cross-stakeholder ABS Implementation Group" referred to in **paragraph 3.6**. Additionally, you may wish to consider establishing timelines for the relevant actions which need to be taken under Part 5 of the Legal Services Act (the **Act**) if a regulator wishes to be in a position to grant licences to ABSs by mid-2011.

**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?**

There are significant issues in relation to who would bear the no doubt significant costs the LSB would incur, particularly in staffing terms, in setting itself up as a front-line regulator. While the LSB is required by the Act to take on the role of licensing authority, the Act would appear to envisage that this is a "fail-safe" role. We would therefore expect that the establishment required, and the consequent running costs, would be scaled accordingly and would be considerably less than those required by "front-line" licensing authorities. We are concerned that by positioning itself as a front-line licensing authority in 2011, rather than following the guideline timetable in the Act, the LSB will (1) incur excessive cost (because its licensing establishment will have to be designed to meet up to 100% of the early market demand) and (2) inhibit the promotion of other licensing authorities and the development of its relationships with those authorities, by appearing in the guise of a direct competitor.

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

There are a number of models for the separation of such activities as is required by section 73 of the Act, from both the commercial and regulatory arena. Such models generally include an operationally separate unit.

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

From the perspective of the firms represented by the CLLS, it is not presently anticipated that the advent of the ABS structure will significantly change that particular sector of the legal services market. That said, it may facilitate the "unbundling" of matters presently handled in their entirety by such firms, with elements of work such as due diligence, and disclosure exercises, being handled by other service providers alongside the firm with overall responsibility for conduct of the matter.

In addition to the unbundling of certain elements of work, there may be other opportunities which could, as the market develops, also cause our own firms to rethink the way services are delivered. For example, there may be services where quality and delivery could be enhanced by separation out from the main practice and injections of external capital and expertise. ABSs may also allow firms to diversify into areas which they would otherwise not consider, or which require levels of

investment to build competence and critical mass which the firm alone would not have the resources or confidence to invest in.

It may also encourage the recruitment of professional managers to share in the success of the firm. It should be noted, however, that bar and professional rules in other jurisdictions in which such firms operate may inhibit such an expansion given the continuing constraint on lawyers' sharing profits with non-lawyers, as is the case in numerous jurisdictions.

**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?**

In relation to sophisticated commercial clients, possibly by increased efficiencies in service delivery. To the extent that multi-disciplinary practices evolve, the possibility of acquiring a multiplicity of professional services "under one roof" may benefit clients in terms of ease of access to services and, possibly, procurement arrangements.

**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?**

This question is too wide-ranging to be answered meaningfully.

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

Diversity is receiving high priority within the firms which are members of CLLS. The advent of ABS itself will have little impact and although some of the visions of the future that ABSs may enable (for example, an increased emphasis on process, telephone advice, etc.) may result in a more diverse workforce (e.g. by facilitating part-time work), the real diversity issues in the legal profession lie elsewhere: primarily in access to the highest standards of education.

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

We agree that it would not be appropriate to impose any mandatory training requirements for ABSs over and above those which will be required of individual practitioners.

**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?**

We don't think that the level of restrictions on management, ownership or financing of legal firms will change the impact on the sector of future economic downturns for CLLS members. We think that the reason why there has not to date been a significant number of applications for LDP status is not necessarily to do with the economic climate, but to do with the lack of any perceived advantage.

Further, while many firms have suffered a significant financial impact in the current recession, we are not aware of any significant failures. This is in large part because the financiers and principal employees are the same people (the partners). The introduction of external capital broadens the capital base but also breaks the identity of interest between financiers and principal employees. If "salaries" are put under

pressure, the principal employees may move elsewhere. This may result in future economic downturns having a more damaging effect upon the legal services sector than they have had to date.

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

We do not think that opening the market to ABSs of itself carries risks to the attainment of the regulatory objectives - assuming that the individual legal professional continues to be regulated on an individual basis.

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

No.

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

We anticipate that the conflicts of interest referred to in **paragraph 5.11** would be dealt with by the regulation to which the individual professionals will be subject. For example, the Solicitors' Code of Conduct already addresses the question of conflicts of interest. As to a quoted company, we cannot see that there is an inevitable conflict between the Board's duties to its shareholders and the professional obligations to the company's clients. We take it that, in any event, the shareholders will be made aware of the company's duties to clients. We cannot see that this is any different from any other business operating in a regulated sector, such as pharmaceuticals or financial services.

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

A number of these issues have already been addressed by the Solicitors Regulation Authority in the move to permit LDPs which came into effect on 31 March 2009.

**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?**

Yes we do. See our response to question 16 below.

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

Our preferred balance favours high-level principles and outcomes over a prescriptive approach. The latter risks encouraging a "box ticking" mentality.

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

Maintaining a requirement on ABSs to have a majority of lawyer managers would (at risk of stating the obvious) represent only a half-way house in the reforms introduced by the Act. The key point is that managers should be "fit and proper". The Act requires only that there be one Head of Legal Practice, who has to be legally qualified. That role will be extremely important within the organisation.

**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?**

While the Act may be silent on whether these roles are to be filled by different people, we think that may be inferred from the different requirements of them which are specified in the Act. In relation to the Head of Legal Practice, given that that individual must be an "authorised person" in relation to one or more of the licensed activities of the ABS (paragraph 11(3) of Schedule 11), we cannot see that a further stringent requirement should be introduced. Given the key role, however, of the Head of Legal Practice, it may be that a certain level of post-qualification experience should be a requirement. As to the Head of Finance and Administration, given that a similar issue was addressed by the SRA in relation to the introduction of non-lawyer managers, in relation to LDPs, a similar approach to that adopted by the SRA could apply here.

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

Monitoring compliance by higher-risk licensed bodies is likely to be proportionately time-consuming and expensive. It is not appropriate for that expense to be borne by the majority of lower-risk firms. Therefore either high risk firms should not be granted licences, or they should be required to bear the cost of increased monitoring.

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

By ensuring that the authorised persons are required to adhere to the same professional standards and codes.

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

As you suggest, a response on this from consumer and other not-for-profit bodies may be beneficial.

**Question 22 – How should licensing authorities give effect to indemnification and compensation arrangements of ABS?**

We see no reason why ABSs providing legal services should not be subject to the same requirements for insurance and indemnification cover as other regulated firms.

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

We agree with the views contained in your paragraphs 7.22 to 7.24, namely that there should be no material difference between the requirements for complaints-handling procedures in either ABSs or non-ABSs.

**Question 24 - How should licensing authorities approach the "fit to own" test and how critical is it in mitigating the risk to the regulatory objective of promoting lawyers' adherence to their professional principles?**

It may be appropriate to draw a distinction between non-authorised persons with an interest in an ABS, *qua* investor, as opposed to an employee or manager.

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

Chiefly the risk of confusion, particularly if the non-reserved activities predominate. Indeed, we can envisage the development of business models in which reserved (and therefore regulated) activities and "non reserved" (unregulated) legal services are offered under the same brand, while being technically structured to comply with regulatory requirements. In this context, further debate as to the scope of reserved activities may be necessary.

**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?**

Given the nature of our membership, we are unable to comment usefully on this question.

**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?**

Given the nature of our membership, we are unable to comment usefully on this question.

**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?**

In **paragraph 1.11** we note the shift towards entity-based regulation. We think it would be regrettable if that shift were to result in the erosion of individual professional responsibility, which can be a very powerful compliance tool.

In **paragraph 2.21**, we note that the Legal Services Consumer Panel will be an "important voice in the debates and decisions ahead". We trust that it is intended that the Consumer Panel should include members representative of sophisticated consumers of legal services, as well as individual consumers.

In **paragraph 3.17**, the LSB seems to acknowledge that its licensing operation should be self-financing. Would this include merely staffing costs, or will there be an apportionment in respect of rent, technology and other shared business expenses?

In relation to **paragraphs 4.10 to 4.12**, it may be optimistic to think that high street firms will be able to survive by "upskilling". If they lose work which can easily be commoditised, there may not be enough profitable work left for them to survive. This could conceivably hit BME firms harder. Further, consumers who do not have access to or cannot use technology, may face particular access to justice issues if they lose the possibility of obtaining face-to-face advice.

Finally, we are disappointed that the SRA is not trying to find a way to allow investment by third parties in solicitors' firms under the current rules, as a transitional measure which could be adopted while the ABS framework is being worked out. Non solicitors are actively building legal services brands, e.g. the Co-op, and the SRA's restrictive approach (see the guidelines "Preparing for Alternative Business Structures" published

in July 2009 by the SRA) to suggestions on structures which could be accommodated under current rules is putting the profession at a competitive disadvantage. We would wish you to engage with the SRA to explore whether some form of transitional arrangements could be allowed.

Yours faithfully

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