

The Levy: funding legal services oversight regulation

Decision paper

1 November 2010

Contents

1	Executive Summary	Page 4
2	Summary of Responses	Page 9
3	Next Steps	Page 25
4	Annex 1 – List of respondents to the consultation paper	Page 26
5	Annex 2 – Statutory Instrument to be laid in Parliament	Page 27

1. Executive Summary

- 1.1 The Legal Services Board (“LSB”) and the Office for Legal Complaints (“Legal Ombudsman”)¹ have been established under the Legal Services Act 2007 (“the Act”) to ensure appropriate regulation of and complaints resolution within the legal services sector in line with the provisions of the Act and for the benefit of consumers and the profession alike.
- 1.2 The Legal Ombudsman has been set up by the Office for Legal Complaints under Part 6 of the Act and is impartial in its decision making and independent of the profession and the Approved Regulators, as well as the LSB and government.
- 1.3 We are required by the Act to be funded by a levy on the bodies that are determined by section 20 and Schedule 4 of Part 1 to the Act to be “Approved Regulators”². The mechanism under which those levies are calculated, raised and paid has to be determined through rules which are consulted on by the LSB and which are then implemented by way of a Statutory Instrument.
- 1.4 On 8 July 2010, we issued a consultation paper setting out our suggested approach that we proposed to include in the rules (to be made under sections 173-74 of the Act) for apportionment of all leviable operational expenditure of the LSB and the Legal Ombudsman. The consultation closed on 29 September 2010.
- 1.5 Eight responses were received to this consultation. Copies of these responses are available on the LSB’s website. A summary of the issues raised, and the LSB’s and the Legal Ombudsman’s response, is set out below:

Estimated expenditure and payment date

- Respondents generally agreed that the levy should be calculated on the estimated leviable expenditure and paid by 31 March of each financial year to which it relates.

LSB’s levy methodology

- Respondents generally agreed that the LSB’s share of the levy should be calculated by apportioning costs by the number of authorised persons per Approved Regulator. However, some respondents considered that different methodologies (such as, a risk based approach and allowing for entity regulation) should be considered in the future when there may be more data readily available.

¹ Section 115(3) of the Legal Services Act 2007 provides for the Office for Legal Complaints to operate its Ombudsman scheme under a different name. The Ombudsman scheme is referred to as “Legal Ombudsman”.

² The 10 Approved Regulators are: The Law Society, General Council of the Bar, Institute of Legal Executives, Chartered Institute of Patent Attorneys, Council for Licensed Conveyancers, Institute of Trademark Attorneys, Master of the Faculties, Association of Law Costs Draftsmen, Association of Chartered Certified Accountants, and the Institute of Chartered Accountants of Scotland.

Legal Ombudsman's levy methodology

- Respondents generally agreed that the Legal Ombudsman's share of the levy should be calculated using the average number of service complaints during the three-year period ending 31 December 2009. Many respondents raised concerns about the validity of this data, and suggested that we should use the actual complaints data for the period September 2010 to March 2011 (the period in which the Legal Ombudsman is in operation during the 2010-11 financial year).
- We accept that historical complaint data is not ideal and there is not complete consistency in the collection of this data. However, as we intend to calculate and send the levy invoices during the last quarter of 2010-11, in effect, if we were to adopt this suggestion, we would only be able to use three months of data. Our proposed approach is also consistent with HMT's fees and charges guidance.
- We do not feel that three months data would provide a robust method of calculating the levy and so we consider it more appropriate to use the historical complaints data as proposed. This will be reviewed once the Legal Ombudsman has appropriate and robust data over an extended period of operation to consider. The Legal Ombudsman will assess the distribution of costs if it was based on their data rather than historic complaints data. We have committed to review the methodology for the Levy in 2013-14 or sooner if we deem that the current method is not fair and proportionate.

"Business not as usual" costs

- Respondents were generally supportive of the proposal to require that those Approved Regulators that generated a disproportionate work to the LSB and/or Legal Ombudsman should be charged the associated costs, and that these costs should not be borne by the other Approved Regulators. However, respondents wanted clarification on several points.
- In particular, regardless of whether an Approved Regulator, who has taken the LSB and/or Legal Ombudsman to court, has won or lost its case, that Approved Regulator would be required to pay the LSB's and/or the Legal Ombudsman's legal costs. This approach is necessitated by the provisions of the Act, which requires all costs of the LSB's and Legal Ombudsman's operations to be recovered through the levy. It is also worth noting that this model is applied by other regulators.
- Also, should the LSB and/or the Legal Ombudsman decide to impose the additional costs onto the Approved Regulator, we will record the time spent by colleagues within the LSB and/or the Legal Ombudsman in dealing with this issue. Given that we intend to raise the possibility of charging an Approved Regulator at an early stage, and will only charge for time spent after notification, we consider that it would not be necessary to introduce a minimum threshold to be incurred by the LSB and/or the Legal Ombudsman.

- With regard to the concern whether a judicial review case is “unfounded”, the LSB and/or the Legal Ombudsman will have and will express a view on the merits of a potential case. However, the determination of whether a case is unfounded will be made by the judge either in procedural hearings leading up to the hearing of the case or in the hearing of the case itself.

Cancellation of an Approved Regulator’s designation

- The majority of respondents agreed that an Approved Regulator’s designation is cancelled in relation to all of its reserved activities then its unpaid levy share should be paid in full at the time when the cancellation order is made. The unpaid levy share would be based on the number of days that that Approved Regulator held its designation before it was cancelled.

Recovering 100% of the LSB’s and the Legal Ombudsman’s costs

- This proposal relates to, in particular, the situation whereby a leviable body has become bankrupt and that share of the levy being redistributed among the remaining Approved Regulators. As we are billing in the last quarter of the year we would have significant notice of an impending problem with an Approved Regulator.
- The majority of respondents did not agree with this proposal, with the main concern being that it did not seem fair to transfer the financial risk of the bankrupt Approved Regulator to the remaining Approved Regulators. In doing so, there were also concerns that it may result in the remaining Approved Regulators experiencing financial difficulties.
- It is our intention that we will exhaust all avenues, including absorbing as much (if not, all) of the costs to the extent practicable, before deciding to collect the bankrupt Approved Regulator’s share of the levy from the remaining Approved Regulators. If the outstanding amount is immaterial we may choose to absorb or write-off the amount. This might be achievable as the levy would be based on an estimate of costs.
- However, if the amount is material, we will seek to recover this amount from the remaining Approved Regulators. Should this occur, we are mindful that it may have significant impact on the financial stability of the remaining Approved Regulators. As such, we will consult with each of the remaining Approved Regulators on the timing in which that year’s levy would need to be paid by. This may include paying the levy in instalments over a period of time.
- In addition, the LSB is currently considering suitable contingency plans and intends to work with all Approved Regulators with the aspiration that, if an Approved Regulator were to become bankrupt (or experience a sudden and unforeseen incident that impacts on its operating and/or financial viability), it would be able to rectify the situation in a structured and responsible way. To ensure the continuity of regulation one option could be to allow an ordered transfer of authorised persons from the bankrupt

Approved Regulator to the remaining Approved Regulators, and an ordered transfer of associated entitlements and practising fee revenue.

New Approved Regulators

- The majority of respondents did not agree with this approach, whereby bodies that are designated as Approved Regulators after 1 January 2010 are not required to contribute to the levy in its first year.
- The LSB maintains that although a newly designated body is not required to contribute to the levy in its first year, that body will, in fact, have needed to address most of the regulatory issues that it would need to engage with the LSB in the first year as part of the application process for which it has paid its designation application fee (£22,000). Furthermore, it is unlikely that a new Approved Regulator will have many, if any, authorised persons at the time of designation.
- As the Legal Ombudsman's costs are largely comprised of fixed and semi-fixed costs, it is unlikely that the minimal (if any) impact of complaints from a new Approved Regulator would materially increase the Legal Ombudsman's costs in that Approved Regulator's first year.
- Consequently, it is unlikely to create a material cost of regulation and complaints handling in the balance of its first year that would make it proportionate and administratively cost effective to levy and collect a levy from them.

Draft Statutory Instrument

- The majority of respondents did not have any or only minor comments to the draft Statutory Instrument.

1.6 The purpose of this decision document is to:

- provide a summary of the range of responses that we received to the questions that we posed in the consultation document; and
- articulate the final position that the LSB and the Legal Ombudsman intends to follow with regard to apportioning our leviable operational expenditure.

1.7 Having considered these responses, the Board has decided not to amend the form of the statutory instrument it consulted upon. The final form of the statutory instrument submitted to the Ministry of Justice is therefore attached to this document (Annex 2). Once the Lord Chancellor has given his approval, the statutory instrument will go through the Parliamentary process with the intention that it will come into force on 1 January 2011.

1.8 The LSB and the Legal Ombudsman would like to thank all respondents for their constructive engagement in this consultation process and looks forward

to engaging again with all stakeholders when it begins its consultation on the review of the levy arrangements in 2013-14.

2. Responses to our Consultation

- 2.1 This section of the paper sets out a summary of the range of responses that we received to each question we posed in the consultation paper and sets out the final position the LSB and the Legal Ombudsman have reached as a result of these responses.
- 2.2 We received eight responses. A list of these respondents is set out at Annex 1. Full copies of the responses can be found on the LSB's website. During the consultation period, we met with two respondents.

Question 1 – Do respondents agree that the LSB's levy should be calculated on the estimated leviable expenditure and paid by 31 March 2011?

- 2.3 The majority of respondents supported the approach of the LSB basing its levy calculation on its estimated leviable expenditure. However, some respondents raised some concerns about the accuracy of the estimated leviable expenditure. Generally, most respondents agreed that they should be paid by 31 March 2011.
- 2.4 Responses received included:
- ILEX was concerned that the annual estimated leviable expenditure will also be susceptible to variables such as need for further investment, invocation of enforcement powers, and the extent to which the LSB may have to invoke direct regulatory or licensing activity.
 - ILEX also noted that *“given that the LSB is a relatively new organisation; there is an absence of track record of forecasting activity levels...In light of this, we expect there to be proper and transparent scrutiny of the budget and actual expenditure and arrangements for refund and/or credit of the underspend.”*
 - The Bar Council agreed with this approach but stated that the *“amounts to be raised by the LSB and the Legal Ombudsman in each year should be calculated on the basis of the estimated leviable expenditure provided that there has been sufficient time for each of the Approved Regulators to be consulted and for any dispute to be resolved about the proposed expenditure.”*

LSB's position

- 2.5 We note the concerns raised by respondents regarding the accuracy of the LSB's estimated leviable expenditure.
- 2.6 We will do our best provide an accurate estimate of our budget each year as part of the consultation of our business plan for the following year. This gives Approved Regulators an opportunity to scrutinise the proposed activities and the costs of undertaking them.

- 2.7 The majority of levy funded organisations are required by Her Majesty's Treasury ("HMT") to collect the annual levy at the beginning of the financial year. However, we have persuaded HMT that collecting these funds in arrears will provide levy papers with greater certainty as there will be nine months of actual costs and only one quarter of estimated costs.
- 2.8 The levy is calculated to recoup all of the LSB's costs and this will take account of any unused funds it has retained.

Question 2 – Do respondents agree that the Legal Ombudsman's levy should be calculated on the estimated leviable expenditure and paid by 31 March 2011?

- 2.9 The majority of respondents accepted the suggested approach.
- 2.10 However, some respondents were concerned about the following issues:
- The CLC was also concerned "*with the proposal to make adjustments to the levy arising from in-year increases in the Legal Ombudsman's costs without any indication of the level of increase in the volume of complaints which should necessitate an increase. It seems to us that a well run organisation which the Legal Ombudsman is set up to become should be able to absorb a certain level of increase in the volume of complaints without any corresponding adjustment in costs.*"
 - ILEX suggested that the Legal Ombudsman's element of the levy could be set in advance based on prior data, which would then be adjusted retrospectively.
 - ACCA stated that it anticipates that "*in the early years, there may be a greater variance between the estimated and actual costs of the Legal Ombudsman, compared with the variance in respect of the LSB.*"
 - ILEX noted that "*the [Legal Ombudsman's] leviable expenditure excludes any costs incurred that may be reasonably attributed to its functions under section 164 (power to establish a voluntary scheme for resolving complaints); section 165 (making of orders under section 164); and section 166 (operation of a voluntary scheme). It is unclear from the consultation document whether such a scheme is to be established and how the costs of such a scheme will be ring-fenced and not attributable to leviable expenditure.*"

LSB and the Legal Ombudsman's position

- 2.11 The LSB and the Legal Ombudsman share the concerns about the method of calculation and timing of payment of the levy but no better solutions were raised by respondents and so, in our view, the proposals made remain the most appropriate way to address these issues.
- 2.12 In the event of the Legal Ombudsman taking on voluntary jurisdictions, the associated costs would be ring-fenced and recovered directly from the

applicable bodies. This activity would have no additional impact on the levy payments for Approved Regulators.

- 2.13 In the consultation document, the Legal Ombudsman's costs are based on the assumption that it is operating at its full capacity. The Legal Ombudsman does not expect its estimated costs to change materially unless call and/or case volumes change materially and exceed its estimated operating capacity. The Legal Ombudsman will establish regular communication with Approved Regulators throughout the operating period to provide additional information to assist with understanding its levy component and so that any issues arising from increases in complaints are made visible as soon as possible.

Question 3 – Do respondents consider the risk-based approach is the most appropriate way of calculating the levy? If yes, can you suggest ways in which the risk for each Approved Regulator could be easily calculated and verified without adding additional cost burdens to the LSB, Approved Regulators and individual regulated entities?

- 2.14 Although about half of the respondents stated that they preferred a risk-based approach for calculating the LSB's share of the levy, they recognised the difficulties in identifying and obtaining the appropriate data to measure the risk posed by each Approved Regulator. Some suggested that the risk-based approach should be reconsidered as part of the 2013-14 review so that it can take into consideration the implications of an ABS environment.

- 2.15 Responses included:

- The Master of the Faculties raised a possible future concern regarding ABS and Licensing Authorities *“authorised persons who seek to gain from ABS should bear the burden of paying for their regulation. These monies should be recouped from Licensing Authorities through their licensing fees. The LSB should determine what areas of their work relate only to ABS and recoup those costs from the Licensing Authorities only.”*
- The SRA noted that it *“supports the LSB’s proposal (at paragraph 4.12 of the consultation paper) to consider a risk-based approach again in more detail once the mechanisms for establishing ABS in the legal services market are in place.”*
- ILEX *“believes that the risk-based approach is the most appropriate approach given the regulatory objectives but accepts that at present the LSB may not have enough data to consider this.”*
- The Law Society stated that *“we do not think there is a practical basis on which a risk based approach could be implemented at present. It is impossible to find an objective measure for the damage which would be done if particular Approved Regulators took actions which were inappropriate in terms of the Act.”*

LSB's position

- 2.16 As stated in the consultation document, given that there do not appear to be any suitable metrics to measure the risk posed by each Approved Regulator, we will reconsider this approach as part of our review in 2013-14 so that we can take into consideration any implications of an ABS environment.
- 2.17 This may include considering whether there should be a separate methodology for calculating the costs incurred by the LSB and the Legal Ombudsman with regard to Licensing Authorities and ABS entities. As part of this, we need to bear in mind that Licensing Authorities are required to pay an application fee of £16,000 to £22,000 for the LSB to consider their applications.

Question 4 – Do respondents consider the volume of activity generated by each Approved Regulator approach is the most appropriate way of calculating the levy? If yes, can you suggest ways in which we could easily and accurately apportion the current costs of our activities with the future benefits and/or work arising from our activities?

- 2.18 Most respondents considered that the volume of activity generated by each Approved Regulator is not the most appropriate way of calculating the levy. However, it was suggested by some respondents that this approach should be reconsidered in the next review of the levy arrangements.
- 2.19 Responses included:
- The CLC argued that “*one unintended consequence of such a policy may be to reduce interactions or particular interactions with the LSB if such interactions generate a charge*” and that “*a number of functions of the LSB relate either to matters of public policy or do not relate to a specific Approved Regulator.*”
 - SRA noted that this approach “*should be re-explored as part of future reviews carried out by the LSB.*”
 - The Law Society recognised that “*there is a strong case in principle for basing the levy on the volume of activity generated by each Approved Regulator. However, a large part of the LSB's work will be carried out in relation to the regulatory system as a whole, rather than to an individual Approved Regulator.*”

LSB's position

- 2.20 We agree with respondents' view that this approach may not be the most appropriate long term way of calculating the levy. However no clearly better approach has been identified that could be used at present. We will reconsider this approach in the next review of the levy arrangements when we have more operating experience and more experience of interacting with the Approved Regulators to see if, a fairer, longer-term alternative to apportion the levy charge emerges.

Question 5 – Do respondents consider the number of authorised persons per Approved Regulator approach is the most appropriate way of calculating the LSB’s levy?

2.21 The majority of respondents agreed that this was the most appropriate way of calculating the LSB’s part of the levy.

2.22 Responses included:

- The Master of the Faculties stated that “*we agree with the LSB that apportioning the levy on the basis of the number of authorised persons per Approved Regulator is the most appropriate approach because it provides greater certainty as to the amount each Approved Regulator has to pay in each year.*”
- The Bar Council stated that it “*supports [this approach] as the most appropriate way of calculating the LSB levy by reference to the number of authorised persons per Approved Regulator. The number of authorised persons should be agreed with the Approved Regulator within a reasonable and specific timeframe.*”
- ACCA stated that “*on the assumption that a more detailed basis of apportionment is administratively impractical, we believe that apportioning the levy on the basis of number of authorised persons per Approved Regulator is broadly fair.*”

LSB’s position

2.23 We agree with respondents in that this approach provides a fair, straightforward and proportionate way of calculating the levy and is the same approach that was adopted to recoup the set up costs of the LSB. However, we will not discount looking at other approaches in the next review as long as the benefits of a more sophisticated approach are not outweighed by disproportionate costs to Approved Regulators or the LSB of administering that approach.

Question 6 – Do respondents consider levying on the number of authorised persons per Approved Regulator is the most appropriate way of recovering the Legal Ombudsman’s leviable costs?

2.24 The majority of respondents did not support this proposal.

2.25 Responses included:

- The CLC believes that “*each Approved Regulator (and in the future each Licensing Authority) should make a contribution to the Legal Ombudsman’s costs.*”
- The Law Society stated that “*it would be attractive...in respect of the Legal Ombudsman [costs] to be apportioned on the basis of the number of authorised persons regulated by each Approved Regulator...Nevertheless,*

the Law Society accepts that that would not be the fairest basis for apportionment.”

LSB and the Legal Ombudsman’s position

- 2.26 The LSB and Legal Ombudsman agree that apportioning the Legal Ombudsman’s share of the levy based on the number of authorised persons is not the most appropriate way of recovering those costs.
- 2.27 Unlike with the arrangements for the establishment cost levy, all Approved Regulators with service complaints made against authorised persons will be required to make a contribution to the Legal Ombudsman’s costs (refer paragraphs 5.19-5.20 of the consultation document).
- 2.28 We will review the levy arrangements in 2013-14. As part of this, we will consider whether it remains appropriate and fair to calculate the Legal Ombudsman’s share of the levy based on the actual numbers of complaints.

Question 7 – Do respondents consider that there are more appropriate ways to estimate the likely number of service complaints and/or cases during the first few years of the Legal Ombudsman’s operation (that is, the period from the anticipated commencement in late 2010 to approximately 2013)?

- 2.29 Respondents generally agreed that the Legal Ombudsman’s share of the levy should be calculated using the average number of service complaints during the three-year period ending 31 December 2009.
- 2.30 Responses included:
- The Law Society also noted that *“the consultation paper does not discuss the relationship between case fees and apportionment of the levy...The principle is best achieved by apportioning the levy on the basis of the Legal Ombudsman’s gross costs, and then abating each Approved Regulator’s share to give credit for the case fees paid by those regulated by the Approved Regulator concerned.”*
 - The CLC has concerns about this approach and questioned the accuracy of using the 2007-09 service complaints data, and that *“seems more appropriate to base the levy on actual complaints received by the Legal Ombudsman which more directly [reflects] cost causation”*. The CLC suggested using a reference date of 30 September 2010, which is *“closely aligned to the ‘go-live’ date for the Ombudsman”*.
 - ILEX supports this approach but also suggested that *“another option is that at the end of the year, the actual cost could be apportioned by reference to actual complaints.”*
 - Although the Law Society supports this approach it *“does not consider it acceptable to base the apportionment on historical information for any longer than absolutely necessary. The information collected by Approved Regulators in the past has not been collected on a consistent basis.”*

- The Law Society “believes that the running costs for the period from October 2010 to March 2011 should be based on the number of complaints received in respect of the different Approved Regulators over that period.”
- ACCA noted that “the statutory instrument must make it clear that the service complaints that form the basis of this allocation method must be only those potentially chargeable complaints in respect of reserved legal activities...It is not clear whether a complaint meeting the conditions set out paragraph 6.3 of the Legal Ombudsman’s Scheme Rules would be included among the complaints forming the basis for the apportionment of the levy.”

LSB and the Legal Ombudsman’s position

- 2.31 The LSB and Legal Ombudsman welcome the suggestions provided by the respondents with regard to apportioning the Legal Ombudsman’s costs.
- 2.32 Many respondents raised concerns about the validity of using the data ending 31 December 2009, and suggested that we should use the actual complaints data for the period September 2010 to March 2011 (the period in which the Legal Ombudsman is in operation during the 2010-11 financial year).
- 2.33 We accept that historical complaint data is not ideal and there is not complete consistency in the collection of this data. However, as we intend to calculate and send the levy invoices during the last quarter of 2010-11, in effect, if we were to adopt this suggestion, we would only be able to use three months of data.
- 2.34 We do not feel that three months data would provide a robust method of calculating the levy and so we consider it more appropriate to use the historical complaints data as proposed. This will be reviewed once the Legal Ombudsman has appropriate and robust data over an extended period of operation to consider. The Legal Ombudsman will assess the distribution of costs if it was based on their data rather than historic complaints data. We have committed to review the methodology for the levy in 2013-14 or sooner if we consider that the current method may not be proving to be fair and proportionate in practice.
- 2.35 With regard to the Law Society’s suggestion that “*apportioning the levy on the basis of the Legal Ombudsman’s gross costs, and then abating each Approved Regulator’s share to give credit for the case fees paid by those regulated by the Approved Regulator concerned*”, we are concerned that such approach may encourage poor regulation.
- 2.36 In particular, if an Approved Regulator’s authorised persons are generating many complaints, it would indicate that that Approved Regulator’s regulatory performance may not be of an adequate standard. As such, it would seem unusual to reduce that Approved Regulator’s levy share by abating the Approved Regulator’s share of the levy with the case fees that were paid by their approved persons.

- 2.37 The service complaints that will be used will relate to any activity undertaken by Approved Regulators with regard to their regulatory activities under the Act. We acknowledge the concerns raised by respondents, but we will review this arrangement in 2013-14, as part of the overall review of the levy, to take into account the data the Legal Ombudsman would have collected by that point and how best to improve the levy methodology.
- 2.38 The Legal Ombudsman's case fee consultation set out its proposed approach to ensure that collecting the case fee would be done fairly. Complaints are both leviable and potentially chargeable for a case fee. The Legal Ombudsman will re-visit the case fee mechanics once they begin to have a material impact.
- 2.39 Existing costs are largely of a fixed and semi-fixed nature and based on volume estimates of complaints from 2007-2009. The costs are therefore reflective of what is expected to occur based on historical data and will only be marginally affected during the 2010-11 year by current activity. Therefore it seems fair that these costs are borne by the Approved Regulators whose complaint numbers in effect determined them.
- 2.40 It would be possible to conduct a retrospective exercise to demonstrate to Approved Regulators the impact of apportioning costs from October 2010 to March 2011 on actual complaints during the period. However should material differences exist, the Approved Regulators would have to agree to any subsequent re-alignment amongst themselves.

Question 8 – Do respondents consider that levying specific Approved Regulators for costs attributable to them above a given threshold is the most appropriate way of recovering costs that are beyond the “business as usual” costs? If yes, can you suggest how such a threshold should be calculated and/or what its level should be? If no, can you suggest ways in which these costs should be cost-recovered?

- 2.41 Although respondents generally supported this proposal they wanted further information on how this proposal would work in practise.
- 2.42 In particular, some respondents wanted clarification whether, in the scenario where an Approved Regulator successfully takes legal action against the LSB and/or the Legal Ombudsman, the Approved Regulator would be required to pay the LSB's and/or the Legal Ombudsman's legal costs.
- 2.43 In this scenario (as well as in the circumstances where the Approved Regulator had lost the case), the successful Approved Regulator would be required to pay the LSB's and/or the Legal Ombudsman's legal costs. This arrangement does not preclude the prosecuting Approved Regulator from seeking agreement beforehand from the other Approved Regulators that the costs would be shared among all of the Approved Regulators. This approach is necessitated by the provisions of the Act, which requires all costs of the LSB's and Legal Ombudsman's operations to be recovered through the levy. It is also worth noting that this model is also applied by other regulators.

- 2.44 Respondents also wanted clarification on the definition of “business *not as usual*” and that this proposal should not be “*used as a device for concealing deficiencies in budgeting and financial management*”.
- 2.45 As stated in our response to Question 1, the LSB’s and the Legal Ombudsman’s business plans, including our respective budgets, annual report and accounts (which are independently audited by both the National Audit Office and private sector auditors), are published each year.
- 2.46 As the business plans set out our work programmes for the upcoming year, it would be relatively easy to determine whether we have been able to undertake our work programmes, or whether an Approved Regulator has generated a disproportionate level of work to the LSB and/or Legal Ombudsman.
- 2.47 Responses included:
- The Law Society questioned “*what is to happen if the LSB should be unsuccessful in litigation, whether in defending a judicial review brought by an Approved Regulator, or when the Board seeks unsuccessfully to enforce directions? It would be plainly wrong for the individual Approved Regulator concerned to bear the LSB’s costs in these circumstances...In the Society’s view...the Government will need to meet the costs since it is the Government which is responsible for establishing the regulatory structure. If a change to primary legislation is needed, then it should be dealt with promptly...*”
 - The CLC questioned “*on whose judgement will determine whether a legal action is ‘unfounded’? Does this approach make it almost impossible for smaller regulators to legitimately challenge the LSB and Legal Ombudsman in the courts?*”
 - Although the SRA stated that, from regulatory perspective, it does not have a particular view on this proposal, it “*wholly supports the proposal set out at paragraph 6.14 of the consultation paper, namely that ‘they (LSB or Legal Ombudsman) will discuss with the Approved Regulator and take their views into consideration before deciding what, if any, additional levy will be imposed.’*”
 - The Bar Council stated that “*the associated work and costs should be demonstrably ‘additional’ rather than ‘instead of’. Alternatively, if ‘instead of’, the LSB and OLC must identify what planned and budgeted activity did not take place because of the need to address ‘business not as usual’.*”
 - The CLC “*does not consider that a specific threshold is appropriate. It would be dependent on the circumstances of each case and a matter for the LSB to justify.*”
 - The Bar Council stated that “*there is a need for an auditable threshold of expenditure. Whether that should be £100,000 or £20,000 merits careful formulation and one size might not fit all. Consequently, the answer is*

probably a mid-range threshold figure and some accompanying early warning system that alerts the Approved Regulator to a potential liability.”

- The Law Society supported this approach and agreed that “*it would be sensible to have a minimum threshold for costs before that principle is invoked, so as to avoid a situation in which the process for calculating the levy significantly added to the overall costs involved. The Law Society thinks the threshold should be a little lower than the level floated in the consultation paper, at perhaps £50,000 rather than £100,000.*”
- ACCA considered that “*the threshold suggested by way of example of £100,000 would appear reasonable. For the avoidance of doubt, this threshold should apply to specific costs incurred in any financial year.*”

LSB and the Legal Ombudsman’s position

- 2.48 The LSB and the Legal Ombudsman note the concerns raised by respondents. Should we consider charging an Approved Regulator specifically, we will raise the possibility with the Approved Regulator at an early stage. We would discuss the implications of this approach and the alternatives available in order to resolve the issue at hand.
- 2.49 Should we decide to impose the additional costs onto the Approved Regulator, we will record the time spent by colleagues within the LSB and/or the Legal Ombudsman in dealing with this issue. We will use the same costs methodology for working out staff cost based on this time as has been used (with HMT’s approval) to calculate the fee charges for new Approved Regulator application fees. This is to ensure that there is transparency and accountability for the additional costs incurred by the LSB and/or the Legal Ombudsman.
- 2.50 Given that we intend to raise the possibility of charging an Approved Regulator at an early stage, we consider that it would not be necessary to introduce a minimum threshold to be incurred by the LSB and/or the Legal Ombudsman. It would be likely that by the time the LSB and/or the Legal Ombudsman consider that there is a possibility of imposing an additional levy on the Approved Regulator that a disproportionate amount of time and resources that have been spent to resolve the issue.
- 2.51 However we would only charge for time spent after the early notification as we will need to make a determination on when to start recording time against the matter specifically. This means that an Approved Regulator will always be aware of its activity and the LSB and/or the Legal Ombudsman’s resulting activity that is likely to or will give rise to charges.
- 2.52 With regard to the concern whether a case is “unfounded”, the LSB and/or the Legal Ombudsman will have and will express a view on the merits of a potential case. However, the determination of whether a case is unfounded will be made by the judge either in procedural hearings leading up to the hearing of the case or in the hearing of the case itself.

- 2.53 It may also be determined if the Approved Regulator withdraws its case as a result of identifying legal and/or procedural and/or evidential flaws in its case following commencement of proceedings (for example during mediation) that could reasonably have been discovered before proceedings were commenced.
- 2.54 It is important to divorce the concept of challenging the LSB and the Legal Ombudsman in court—which any Approved Regulator can do subject to having a valid case and complying with procedural rules—with the constraints imposed on the LSB and/or Legal Ombudsman that mean, effectively that that Approved Regulator will have to pay the costs of that review.

Question 9 – What are your views on the proposed approach for cancellation of designation of an Approved Regulator?

- 2.55 Respondents generally supported this approach.
- 2.56 Responses included:
- The CLC stated that “*we assume that the cancellation of the designation of an Approved Regulator is likely to result in reduced workload for the LSB with a corresponding reduction to its running costs.*”
 - ILEX suggested that “*there should be the option for the other Approved Regulators to make representations to pay the share of the levy for the Approved Regulator in difficulty or where the cancellation of designation is inevitable. This would allow another Approved Regulator to consider regulating their members if appropriate.*”

LSB and the Legal Ombudsman’s position

- 2.57 As respondents generally supported this proposal, the approach will remain as proposed. However, we note that it is likely that the cancellation of designation (in particular, in relation to all of an Approved Regulator’s reserved legal activities) and the transitional arrangements will create a short term increase in the LSB and the Legal Ombudsman’s workload.
- 2.58 Although ILEX’s suggestion that “*there should be the option for the other Approved Regulators to make representations to pay the share of the levy for the Approved Regulator in difficulty or where the cancellation of designation is inevitable*”, it is our view that would fall outside the definition of section 51 of the Act (regarding the permitted purposes of funds raised from practising certificate fees).
- 2.59 However, it may be possible for another Approved Regulator to use funds that have not been raised from practising certificate fees to consider paying the share of the de-designated Approved Regulator’s levy share.
- 2.60 Furthermore, if an Approved Regulator’s designation is cancelled under sudden and unexpected circumstances, the LSB would want to examine all options for the discharge of that Approved Regulator’s functions. This may

include some or all of its authorised persons being taken over by another Approved Regulator. However, we do not consider that express provision for payment of any outstanding levy is needed to facilitate such discussions.

Question 10 – What are your views on the proposed approach with regard to ensuring that 100 per cent of the levy is collected from all the remaining Approved Regulators?

2.61 This question relates to, in particular, the situation whereby a leviable body has become bankrupt and that share of the levy being redistributed among the remaining Approved Regulators. The majority of respondents did not agree with this proposal, with the main concern being that it did not seem fair to transfer the financial risk of the bankrupt Approved Regulator to the remaining Approved Regulators. In doing so, there were also concerns that it may result in the remaining Approved Regulators experiencing financial difficulties.

2.62 Responses included:

- The CLC believed that *“on the insolvency of an Approved Regulator the likelihood is that its regulated community will be transferred to one or more of the remaining Approved Regulators or in default to the LSB acting as an Approved Regulator...In those circumstances the outstanding levy contributions of the failed Approved Regulator should be transferred to that regulated community’s new Approved Regulator(s) in proportion to the transferred regulated community.”*
- The CLC suggested that *“the LSB should also consider the extent to which it should absorb a degree of the lost revenue through its efficiency program. As most other business organisations have to deal with this situation from time to time, it seems sensible that the LSB’s automatic response should not be to always collect 100 per cent of the levy.”*
- Irwin Mitchell agreed with this approach but noted that *“recovering the levy share owing by a bankrupt Approved Regulator from the remaining Approved Regulators must be a last resort only to be taken when the LSB has taken all other reasonable steps to recover those monies.”*
- ILEX does not agree with this approach especially if a larger-sized Approved Regulator became bankrupt that this *“could have a severe financial impact on some Approved Regulators but also disregards the issue of responsibility.”*
- The Law Society considered that the unpaid levy of a bankrupt Approved Regulator *“should be met by the government”*.
- The Master of the Faculties suggested that *“the LSB should make arrangements with the Ministry of Justice to borrow the necessary shortfall in the event of an Approved Regulator suddenly being made bankrupt, and, if necessary, recoup this money from the Approved Regulators in the subsequent financial years.”*

- The Bar Council did not agree with this proposal “*unless the LSB has pursued all appropriate legal avenues to recover costs due to LSB from a failed Approved Regulator. It might be that the LSB would wish to consider requiring the Approved Regulators to keep funds collected on behalf of the LSB and the Legal Ombudsman in special ring-fenced accounts.*”

LSB and the Legal Ombudsman’s position

- 2.63 We note the concerns raised by respondents regarding this proposal. It is our intention that we will exhaust all avenues, including absorbing as much (if not, all) of the costs to the extent practicable, before deciding to collect the bankrupt Approved Regulator’s share of the levy from the remaining Approved Regulators. What money that is available from the bankrupt Approved Regulator and how it can be deployed will be affected by applicable insolvency legislation and the precise circumstances of the Approved Regulator in question.
- 2.64 As we intend to bill in the last quarter of the year we would have significant notice of an impending problem with an Approved Regulator. As with all organisations, if the outstanding amount is immaterial we may choose to absorb or write-off the amount.
- 2.65 However, if the amount is material, we will seek to recover this amount from the remaining Approved Regulators. Should this occur, we are mindful that it may have significant impact on the financial stability of the remaining Approved Regulators. As such, we will consult with each of the remaining Approved Regulators on the timing in which that year’s levy would need to be paid by. This may include paying the levy in instalments over a period of time.
- 2.66 It would not be possible for us to collect the bankrupt Approved Regulator’s share from the government, as this is not consistent with legislation. Furthermore, the intention of the Act is that all of the costs of oversight regulation would be financed by the profession rather than government.
- 2.67 The comment from the Bar Council that “*the LSB might wish to consider requiring the Approved Regulators to keep funds collected on behalf of the LSB and the Legal Ombudsman in special ring-fenced accounts*” has some merit although we do not have any specific powers to require this. The Act in section 174 (5) states ‘Any amount which is owed to the Board in accordance with the levy rules may be recovered as a debt due to the Board’, which makes clear that funds collected are not anticipated by the Act to be held on trust for us.
- 2.68 So, while the Board is happy to invite Approved Regulators to consider this proposal, it is sceptical about whether it has the vires to insist upon it and whether, even if it did under its wider regulatory powers, that it would be justifiable and proportionate to specify such a detailed rule.
- 2.69 Furthermore, the LSB is currently considering suitable contingency plans and intends to work with all Approved Regulators with the aspiration that, if an

Approved Regulator were to become bankrupt (or experience a sudden and unforeseen incident that impacts on its operating and/or financial viability), it would be able to rectify the situation in a structured and responsible way. To ensure the continuity of regulation one option could be to allow an ordered transfer of authorised persons from the bankrupt Approved Regulator to the remaining Approved Regulators, and an ordered transfer of associated entitlements and practising fee revenue.

Question 11 – What are your views on the proposed approach with regard to the levy arrangements for new Approved Regulators?

2.70 The majority of respondents did not agree with this approach and considered that a newly designated body should be required to pay an amount towards the levy.

2.71 Responses included:

- The CLC said *“it seems to us that the LSB’s oversight responsibilities commences from the date than an Approved Regulator is designated and as such a contribution to the levy appears appropriate...Theoretically, firms overseen by a new Approved Regulator could be responsible for service complaints in the first year of their operation resulting in cost causation to the Legal Ombudsman and yet make no contribution to the levy.”*
- Irwin Mitchell stated that new Approved Regulators should be asked to make a minimum contribution towards regulator costs in their first year of operation.
- ILEX stated that *“new Approved Regulators should pay a levy in the first year but on a pro rata basis. ILEX is of the view that the new designated Approved Regulator should pay immediately upon becoming an Approved Regulator...The other option is for the Lord Chancellor to hold designation until the following year.”*

LSB and the Legal Ombudsman’s position

2.72 Having considered this concern regarding the bodies that are designated as Approved Regulators after 1 January 2010, the LSB maintains that although a newly designated body is not required to contribute to the levy in its first year, that body will, in fact, have needed to address most of the regulatory issues that it would need to engage with LSB and the Legal Ombudsman in the first year as part of the application process for which it has paid its designation application fee (£22,000). Furthermore, it is unlikely that a brand new Approved Regulator will have many, if any, members at the time of designation who would then become authorised persons.

2.73 Consequently, it is unlikely to create a material cost of regulation and complaints handling in the balance of its first year that would make it proportionate and administratively cost effective to levy and collect a levy from them.

- 2.74 While the suggestion that the Lord Chancellor should not approve a designation application until the following year would eliminate the need for this proposal, proceeding with this approach may artificially stifle the market and hence be in breach of the Regulatory Objectives.
- 2.75 We would also like to clarify that, should a group of authorised persons that are regulated by an existing Approved Regulator decide that they want to set up a new Approved Regulator to regulate themselves, then as part of the LSB's process for considering applications to designate a new body, that any regulatory conflicts between the existing Approved Regulator and the new Approved Regulator are resolved and detailed in its application. This is consistent with the requirements of section 52 of the Act.
- 2.76 For these reasons, the proposal regarding the newly designated Approved Regulators will remain unchanged.

Question 12 – Is the proposed payment date (by 31 March) workable for Approved Regulators?

- 2.77 Respondents either agreed or had no specific views for the proposed payment date of 31 March of each year. Only one respondent (Bar Council) disagreed with this date and suggested that the payment date should be 30 April of each year.

LSB and the Legal Ombudsman's position

- 2.78 HMT requires that levies should be payable at the start of the levy year. Although we have managed to get a concession on the timing of payments they must be made prior to the end of the financial year for both the LSB and the Legal Ombudsman, so 31 March is the latest that amounts must be paid by. The original consultation for the set up fees for both the LSB and the Legal Ombudsman proposed a payment date of 28 February. As such, the payment date will be 31 March of the financial year to which it relates.

Question 13 – Do the draft rules accurately reflect the preferred approach (as set out in the consultation paper)?

- 2.79 The majority of respondents did not have any comments with regard to the draft rules.
- 2.80 However, one respondent (ACCA) asked the following questions:
- *“Rule 3(2)(b) states that a new leviable body will only be required to pay a levy in respect of LSB expenditure, and implies that it will never be required to contribute to the costs of the Legal Ombudsman. We do not believe that this is the intention of the LSB.”*
 - *“Rules 2(3)(b) and 2(4)(b) serve to enable recovery of any shortfall between the amount levied on the Approved Regulators and the amount actually received from those Approved Regulators. However, the draft Rules do not provide for the recovery of any shortfall between the*

estimated expenditure for a particular 12 month period (levied on the Approved Regulators) and the actual expenditure of the LSB and the Legal Ombudsman during that period.”

- *“Rule 6(4) states that, generally, each Approved Regulator must state the number of its authorised persons as a 1 April by the following 1 May (i.e. within one month). This may be difficult for some Approved Regulators. Why does the information have to be provided so early, given that the LSB will not calculate the levy of each Approved Regulator until the fourth quarter of the year?”*
- *“There is an error in the explanatory note in that it refers to the basis period for service complaints as ending on 31 March 2009 rather than 31 December 2009.”*

- 2.81 The intent of rule 3(2)(b) is to require a new leviable body to only pay a levy with regard to the LSB’s expenditure and not the Legal Ombudsman. This is to reflect the proposal dealing with newly designated bodies (refer paragraphs 6.25-6.26 of the consultation document). It is intended that this arrangement will stay in place until the review in 2013-14, which will consider whether changes will need to be made to the levy arrangements.
- 2.82 It is our view that rules 2(3)(b) and 2(4)(b) do provide for the recovery of any shortfall between the estimated expenditure for a particular 12-month period and the actual expenditure of the LSB and the Legal Ombudsman during that period.
- 2.83 Rule 6(4) requires Approved Regulators to provide information on the number of authorised persons they regulate as at 1 April by the following 1 May. The timings for this requirement came as a result of the consultation on the levy for the establishment costs. The 1 April/May dates allow for Approved Regulators to calculate an indicative cost of their levy share at the start of the year to enable them to set their practising certificate fees to ensure that practising certificates are paid for and issued before the renewal date (in late Autumn).
- 2.84 We thank ACCA for identifying the error in the Explanatory Note. The reporting period for service complaints is ending on 31 December 2009.

LSB and the Legal Ombudsman’s position

- 2.85 After considering the comments raised by respondents, and our responses to those comments, the Statutory Instrument will remain as it is currently drafted—except for the typographical error in the Explanatory Note.

3. Next steps

- 3.1 It is anticipated that the final draft of the Statutory Instrument will be presented to the Lord Chancellor in November 2010, as the Lord Chancellor needs to consent to the form of the rules providing for the imposition of the levy.
- 3.2 Once the Lord Chancellor has given his approval, the Statutory Instrument will go through the Parliamentary process with the intention that it will come into force on 1 January 2011.
- 3.3 The levy will be collected in full by 31 March of the financial year to which it relates.
- 3.4 We acknowledge that these proposals may need to be refined in the light of experience but have concluded that they represent the fairest and most proportionate methodology to recoup the costs of both the LSB and the Legal Ombudsman in the short term.
- 3.5 We are committed to reviewing the arrangement for the payment of the levy in 2013-14 but may bring this date forward if comparisons of the distribution of costs are wholly out of line with the complaints data that the Legal Ombudsman will collect during this period.

Annex 1 – List of respondents to the consultation paper

- Association of Chartered Certified Accountants
- Council for Licensed Conveyancers
- General Council of the Bar
- Institute of Legal Executives
- Irwin Mitchell LLP
- Master of the Faculties
- Solicitors Regulation Authority
- The Law Society

Annex 2 – Statutory Instrument to be laid in Parliament

STATUTORY INSTRUMENTS

2010 No.

LEGAL SERVICES, ENGLAND AND WALES

The Legal Services Act 2007 (Levy) (No.2) Rules 2010

<i>Made</i> - - - -	***
<i>Laid before Parliament</i>	***
<i>Coming into force</i> - -	***

The Legal Services Board with the consent of the Lord Chancellor makes the following Rules in exercise of the powers conferred by sections 173, 174 and 204(2), (3) and (4)(b) of the Legal Services Act 2007⁽³⁾.

In accordance with section 173(3) of that Act, the Legal Services Board has satisfied itself that the apportionment of the levy as between different leviable bodies is in accordance with fair principles.

The Legal Services Board has complied with the consultation requirements in section 205 of that Act.

General

Citation, commencement and interpretation

1.—(1) These Rules may be cited as the Legal Services Act 2007 (Levy) (No.2) Rules 2010.

(2) These Rules come into force on [date].

(3) In these Rules “the 2007 Act” means the Legal Services Act 2007⁽⁴⁾.

(4) In these Rules any reference, in relation to the imposition of a levy, to—

- (a) the leviable Board expenditure; or
- (b) the leviable OLC expenditure,

is a reference to such expenditure in relation to the 12 month period in respect of which the levy is imposed.

⁽³⁾ 2007 c. 29.

⁽⁴⁾ “Leviable body”, “leviable Board expenditure” and “leviable OLC expenditure” are defined in section 173 of the Legal Services Act 2007. “The Board” and “the OLC” are respectively defined in sections 2 and 114 of that Act.

Levy imposed under these Rules

2.—(1) A levy is to be imposed on leviable bodies in respect of the 12 month period ending with 31st March 2011 and in respect of each successive 12 month period.

(2) The levy is for the purpose of raising an amount corresponding to the aggregate of—

- (a) the leviable Board expenditure; and
- (b) the leviable OLC expenditure.

(3) The expenditure referred to in paragraph (2)(a) or (b) may include—

- (a) estimated expenditure; and
- (b) such amount as is necessary to make good any shortfall in respect of a levy previously imposed.

(4) For the purposes of paragraph (3)(b)—

- (a) the reference to a levy previously imposed is to a levy imposed under these Rules or under the Legal Services Act 2007 (Levy) Rules 2010⁽⁵⁾; and
- (b) the reference to shortfall, in respect of any such levy, is to the difference between the amount to be raised by way of that levy and the amount actually received by the Board.

(5) The Board must obtain the Lord Chancellor's agreement to the amount to be raised by way of the levy in respect of each 12 month period.

Amount payable by each leviable body

Determining the amount of the levy for each leviable body

3.—(1) The amount that each leviable body must pay to the Board in respect of the levy imposed in respect of any 12 month period is to be determined by adding together the amounts determined for that body under rules 4 and 5 (subject to paragraphs (2) and (3)).

(2) Where a body becomes a leviable body in the course of any 12 month period ("the initial period")—

- (a) no amount is payable by the leviable body under paragraph (1) in respect of the initial period; and
- (b) the amount that the leviable body must pay to the Board in respect of each subsequent 12 month period is the amount determined for that body under rule 4 only; but
- (c) if the leviable body is the subject of a determination under rule 4(3) or 5(3) in respect of any 12 month period, the amount that the body must pay to the Board under paragraph (1) is—
 - (i) where the determination is in respect of the initial period, any amount determined for that body under rule 4(4)(a) or 5(4)(a) (or the aggregate of such amounts); and
 - (ii) where the determination is made in respect of any subsequent 12 month period, the amount determined for that body under rule 4, together with the amount (if any) determined for that body under rule 5(4)(a).

(3) The amount that a body would otherwise be required to pay under paragraph (1) is to be proportionately reduced where—

- (a) before the end of any 12 month period, the body ceases to be a leviable body because its designation as an approved regulator is cancelled by an order under section 45 (cancellation of designation as approved regulator) of the 2007 Act; and
- (b) the order is made in relation to all the reserved legal activities in relation to which the body was an approved regulator.

(4) The Board must notify each leviable body of the imposition of the levy, stating—

- (a) the amount determined for that body; and
- (b) the deadline for payment determined in accordance with rule 7.

⁽⁵⁾ S.I. 2010/213.

(5) The liable body must pay to the Board the amount stated in the notice.

Apportionment of liable Board expenditure

4.—(1) Subject to paragraphs (3) to (5), the amount payable by a liable body under this rule is an amount equal to the relevant proportion of liable Board expenditure.

(2) For these purposes—

- (a) the relevant proportion is the number at the specified date of persons authorised by the liable body to carry on one or more reserved legal activities, as a proportion of the total number at that date of persons authorised by all liable bodies to carry on one or more such activities; and
- (b) the specified date is 1st April of the 12 month period in respect of which the levy is imposed.

(3) Paragraphs (4) and (5) apply where the Board determines on reasonable grounds that—

- (a) anything done, or not done, by a liable body has given rise to an additional amount of liable Board expenditure; and
- (b) as a result, the amount of liable Board expenditure attributable to that body is materially disproportionate to the amount attributable to any other liable body (apart from one in respect of whom a determination under this paragraph has also been made).

(4) The total amount of liable Board expenditure to be used in applying the calculation described in paragraph (1) is to be reduced as follows—

- (a) in relation to each liable body which is the subject of a determination under paragraph (3), the Board must determine the additional amount of liable Board expenditure referred to in paragraph (3)(a); and
- (b) the amount so determined (or the aggregate of such amounts) is to be deducted from the total amount of the liable Board expenditure which would otherwise be used for the purposes of the calculation described in paragraph (1).

(5) The amount payable by each liable body which is the subject of a determination under paragraph (3) is the aggregate of the amounts determined for that body under paragraphs (1) and (4)(a).

Apportionment of liable OLC expenditure

5.—(1) Subject to paragraphs (3) to (5), the amount payable by a liable body under this rule is an amount equal to the relevant proportion of liable OLC expenditure.

(2) For these purposes—

- (a) the relevant proportion is the number of service complaints received in the course of the reference period by the liable body in its former regulatory capacity, as a proportion of the total number of service complaints received in the course of that period by all liable bodies in their former regulatory capacities; and
- (b) the reference period is the three year period ending on 31st December 2009.

(3) Paragraphs (4) and (5) apply where the Board determines on reasonable grounds that—

- (a) anything done, or not done, by a liable body has given rise to an additional amount of liable OLC expenditure; and
- (b) as a result, the amount of liable OLC expenditure attributable to that body is materially disproportionate to the amount attributable to any other liable body (apart from one in respect of whom a determination under this paragraph has also been made).

(4) The total amount of liable OLC expenditure to be used in applying the calculation described in paragraph (1) is to be reduced as follows—

- (a) in relation to each liable body which is the subject of a determination under paragraph (3), the Board must determine the additional amount of liable OLC expenditure referred to in paragraph (3)(a); and

(b) the amount so determined (or the aggregate of such amounts) is to be deducted from the total amount of leviable OLC expenditure which would otherwise be used for the purposes of the calculation described in paragraph (1).

(5) The amount payable by each leviable body which is the subject of a determination under paragraph (3) is the aggregate of the amounts determined for that body under paragraphs (1) and (4)(a).

(6) In this rule—

“the 1990 Act” means the Courts and Legal Services Act 1990 Act⁽⁶⁾;

“former regulatory capacity”, in relation to a leviable body, means the capacity in which before 1st January 2010 the body in question regulated persons who, before that date, fell within one or more of paragraphs (a) to (f)—

(a) any person with any right of audience before a court in relation to any proceedings which was granted, or is deemed to have been granted, by the body in question under sections 27(2) (rights of audience) or 31 (barristers or solicitors) of the 1990 Act⁽⁷⁾;

(b) any person with any right to conduct litigation in relation to any proceedings which was granted, or is deemed to have been granted, by the body in question under sections 28(2)(a) (rights to conduct litigation) or 31 of the 1990 Act⁽⁸⁾;

(c) any person providing probate services by virtue of an exemption under section 55 (preparation of probate papers etc: exemption from section 23(1) of the Solicitors Act 1974⁽⁹⁾) of the 1990 Act⁽¹⁰⁾ which was granted by the body in question;

(d) any person practising as a duly certificated notary in accordance with rules made by the body in question under section 57 (notaries) of the 1990 Act⁽¹¹⁾ (and for these purposes, “duly certificated notary” has the meaning given in paragraph 12 of Schedule 5 to the 2007 Act);

(e) any person who is authorised by, or registered with, the body in question and who is an authorised person within the meaning of section 113 (administration of oaths and taking of affidavits) of the 1990 Act⁽¹²⁾; or

(f) any person licensed or otherwise authorised by the body in question to carry on conveyancing services within the meaning of section 119 of the 1990 Act; and

“service complaint” means a complaint received before 1st January 2010 by a leviable body in its former regulatory capacity, being a complaint—

(a) that was made by, or on behalf of, a consumer;

(b) that relates to an act or omission of any person at a time when that person—

(i) was regulated by the body in question, or

(ii) was not so regulated but was a manager or employee of a person who was so regulated; and

(c) that was eligible to be dealt with under arrangements made by the body in question for the determination of consumer complaints.

⁽⁶⁾ 1990 c. 41.

⁽⁷⁾ Section 27(2)(a) was amended by paragraph 6(2) of Schedule 6 to the Access to Justice Act 1999 (c. 22). The section was repealed by paragraph 84(g) of Schedule 21 to the Legal Services Act 2007. Section 31 was substituted by section 36 of the Access to Justice Act 1999. The section was repealed by paragraph 84(g) of Schedule 21 to the Legal Services Act 2007.

⁽⁸⁾ Section 28(2)(a) was amended by paragraph 7(2) of Schedule 6 to the Access to Justice Act 1999. The section was repealed by paragraph 84(e) of Schedule 21 to the Legal Services Act 2007.

⁽⁹⁾ 1974 c. 47. Section 23 was repealed by paragraph 26 of Schedule 16 to the Legal Services Act 2007.

⁽¹⁰⁾ Section 55 was amended by S.I. 2003/1887. The section was repealed by paragraph 88 of Schedule 21 to the Legal Services Act 2007.

⁽¹¹⁾ Section 57 was amended by Part 2 of Schedule 15 to the Access to Justice Act 1999.

⁽¹²⁾ Section 113 was amended by Part 2 of Schedule 15 to the Access to Justice Act 1999 and S.I. 2003/1887. The section was repealed by paragraph 96 of Schedule 21 to the Legal Services Act 2007.

Duty to provide information

Duty to provide information required to calculate the levy

6.—(1) For the purpose of enabling the Board to determine the amount payable by a leviable body in respect of any 12 month period, each leviable body must provide the Board with the information required by paragraphs (2) and (3).

(2) The information to be provided is—

- (a) for the purposes of rule 4, a statement of the number of persons who were authorised by the leviable body at 1st April of the 12 month period in question; and
- (b) for the purposes of rule 5, a statement of the number of service complaints received in the course of the reference period by the leviable body in question in its former regulatory capacity (and for this purpose “reference period” and “former regulatory capacity” have the meaning given in rule 5).

(3) Any statement provided under paragraph (2) must contain or be accompanied by such information as will enable the Board, or such person as the Board may appoint, to be satisfied that the numbers stated are correct.

(4) The information must be provided—

- (a) before the end of the period of one month starting with 1st April of the 12 month period in respect of which the levy is to be imposed; or
- (b) on or before such later date as may be agreed in writing between the Board and the leviable body.

(5) The information referred to in paragraph (2)(b) does not have to be provided more than once.

Arrangements for payment

Making payment

7.—(1) Subject to paragraph (2), the amount of levy that a leviable body is required to pay to the Board under rule 3 must be paid in full by the leviable body no later than—

- (a) 31st March of the 12 month period to which the levy relates; or
- (b) if later, the end of the period of 28 days starting with the date of the notice given to the leviable body under rule 3(4).

(2) Where a cancellation order in relation to any body has been made as described in rule 3(3), the reduced amount determined for that body under rule 3(3) is immediately payable with effect from the date of the cancellation order.

Interest payable on late payment

8. If payment is not made by a leviable body in accordance with the requirements of rule 7, the Board is entitled to charge interest on any amount unpaid at the rate which is for the time being specified in section 17(1) of the Judgments Act 1838(13) in relation to a judgment debt.

Made by the Legal Services Board at its meeting on [date]

I consent

Signed by authority of the Lord Chancellor

⁽¹³⁾ 1838 c. 110. A relevant amendment was made by S.I. 1993/564.

Date

Name
[Minister]
Ministry of Justice

EXPLANATORY NOTE

(This note is not part of the Rules)

These Rules impose a levy under sections 173 and 174 of the Legal Services Act 2007 (c. 29).

Rule 2 provides that a levy is to be imposed in relation to the 12 month period ending with 31st March 2011 and in relation to each successive 12 month period. Each levy is to cover the leviable expenditure of the Legal Services Board (“the Board”), and leviable expenditure of the Office for Legal Complaints (“the OLC”), in respect of the period in respect of which the levy is imposed.

Rules 3 to 5 specify the procedure for determining the amount of levy that each leviable body must pay in respect of each 12 month period and the procedure for notifying each body of the amount due. Rule 3 provides that that amount is to be determined for a leviable body by adding together the amounts determined under rules 4 and 5. Rules 3(2) and (3) provide for adjustments to be made in certain circumstances to the amount payable by a leviable body.

Under rule 4, each leviable body is required to pay a proportion of leviable Board expenditure which is based on the number at the specified date of the persons authorised by it to carry on reserved legal activities. The proportion of leviable OLC expenditure which a leviable body is required to pay under rule 5 is based on the number of service complaints made to the body in the period starting on 1st January 2007 and ending on 31st December 2009. Rules 4 and 5 also provide for adjustments of the amounts payable in order to take account of materially disproportionate levels of expenditure that are attributable to any particular leviable body.

Rule 6 requires leviable bodies to provide the Board with the information necessary for it to calculate the proportions described in rules 4 and 5. Rule 7 requires that, except in certain specified cases, the levy must be paid in full no later than 31st March of the 12 month period to which it relates. Interest is payable under rule 8 in the event of any late payment.

An impact assessment in relation to the levy is available from the Legal Services Board, Victoria House, Southampton Row, London WC1B 4AD or at www.legalservicesboard.org.uk.

EXPLANATORY MEMORANDUM TO

LEGAL SERVICES ACT 2007 (LEVY) (No. 2) RULES 2010

2010 No. [XXXX]

1. This explanatory memorandum has been prepared by the Legal Services Board and is laid before Parliament by Command of Her Majesty.
2. **Purpose of the instrument**
 - 2.1 The purpose of this instrument is to make rules governing the imposition of a levy by the Legal Services Board (“LSB”) on leviable bodies. When this instrument comes into force, the leviable bodies will be the approved regulators set out in Schedule 4 to the Legal Services Act 2007 (“the 2007 Act”) as amended by the Legal Services Act 2007 (Approved Regulators) Order 2009. The Association of Chartered Certified Accountants and the Institute of Chartered Accountants of Scotland have been added by Order under 173(5)(c). Other bodies may become leviable bodies subsequent to this instrument coming into force. The instrument makes provision with regard to how and when those bodies will become subject to the provisions of the instrument. .
 - 2.2 The rules are required by section 173 of the 2007 Act and provide for a levy to meet (a) the ongoing costs incurred by the LSB, the Office for Legal Complaints (“OLC”) and the Lord Chancellor associated with the carrying on of the LSB’s regulatory functions and the OLC’s complaints resolution functions.
 - 2.3. As the levy will meet the ongoing costs of the LSB and the OLC it is important that the rules come into force by [1 January 2011] to enable the LSB to issue invoices and collect payment from the leviable bodies by the end of the current financial year. It is therefore intended that this instrument will come into force on [1 January 2011].
 - 2.4 In summary, this instrument:
 - 2.3.1 provides for the recovery of costs relating to the ongoing operational costs of the LSB and the OLC;
 - 2.3.2 establishes a principle under which the costs are to be apportioned amongst the leviable bodies;
 - 2.3.3 provides further detail as to the payment of the levy, in particular for situations where: a leviable body’s behaviour generates disproportionate work for the LSB and/or the OLC; a leviable body’s

designation is cancelled with regard to one or more, or all, of its reserved legal activities; a leviable body becomes bankrupt; and where the Lord Chancellor designates a new body to become an approved regulator.

3. Matters of special interest to the Joint Committee on Statutory Instruments

3.1 None

4. Legislative Context

4.1 The *Legal Services Act 2007 (Commencement No 1 and Transitory Provisions) Order 2008* commenced provisions in the 2007 Act which established the LSB and the OLC and provided for the appointment of board members and staff. The *Legal Services Act 2007 (Commencement No 3 and Transitory Provisions) Order 2008* commenced further powers under the 2007 Act allowing the LSB to set up and maintain a Consumer Panel and make rules about the exercise of the representative and regulatory functions of approved regulators and the exercise of its own regulatory powers. That order also commenced the majority of sections 173, 174 and 175, which establish the regime under which a levy is to be imposed on leviable bodies to cover the cost of the new regulatory regime.

4.2 This instrument is made under sections 173(1), 174, 204(2) and 204(3) of the 2007 Act. Section 173(1) requires the LSB, by order, to make rules providing for the imposition of a levy on leviable bodies corresponding to the leviable expenditure of the LSB, OLC and Lord Chancellor. Section 173(3) requires the LSB, before making the levy rules, to be satisfied that the apportionment of the levy as between the leviable bodies will be in accordance with fair principles, and 173(4) ensures that the rules can only be made with the consent of the Lord Chancellor. The LSB adhered to Cabinet Office guidance on consultation in making its rules and a full consultation was carried out for these levy rules.

4.3 The *Legal Services Act 2007 (Commencement No 6, Transitory, Transitional and Saving Provisions) Order 2009* came into force on 1 January 2010.

4.4 The Order commenced many of the remaining powers of the LSB, including designation of new regulators, approval of regulatory arrangements and enforcement powers. As such, the LSB has assumed regulatory functions, including the recovery of the expenditure associated with the carrying on of its regulatory functions and those of the OLC, both in respect of the establishment of those bodies, and in respect of the ongoing operational expenditure of the LSB and the OLC.

5. Territorial Extent and Application

5.1 This instrument applies to England and Wales only.

6. European Convention on Human Rights

6.1 As the instrument is subject to negative resolution procedure and does not amend primary legislation, no statement is required.

7. Policy background

- ***What is being done and why***

7.1 The 2007 Act reforms the way in which legal services are regulated in England and Wales. The aims of the Act are to simplify the existing regulatory framework by establishing an oversight regulator, the LSB, and to improve consumer confidence and the way in which complaints are dealt with by establishing an independent complaints handling body, the OLC.

7.2 The Act also prescribes the principle that the costs of oversight regulation and complaints handling will be met by the profession itself, with the expenditure of the LSB and OLC being met by a levy on the approved regulators. Section 173(1) of the Act therefore requires the LSB to make rules providing for the imposition of a levy on leviable bodies to raise an amount to cover the expenditure of the LSB and the OLC incurred in with the ongoing functions of those bodies under the Act (the costs incurred in relation to the establishment of these bodies being recovered via a transitional levy on the leviable bodies that has been created under the Legal Services Act 2007 (Levy) Rules 2010. The levy will not cover certain amounts set out in section 175 such as application fees and sums received from penalties as these will be collected separately.

7.3 Rule 2 provides that a levy is to be imposed in relation to the 12-month period ending with 31st March 2011 and in relation to each successive 12-month period. Each levy is to cover the leviable expenditure of the LSB and the leviable expenditure of the OLC in respect of the period in respect of which the levy is imposed.

7.4 Rule 3 determines the amount of levy for each leviable body. Rule 3(2) prescribes that, where a body becomes a leviable body during a 12-month period, it is not required to contribute to the levy during the remainder of that 12-month period. Where a leviable body has had some or all of its designations cancelled, then rule 3(3) prescribes that the levy amount is to be proportionally reduced. Rule 3(4) prescribes

that the LSB must notify each liable body of the amount that it is required to pay and the date by which the payment must be made.

Costs in connection with the ongoing expenditure of the LSB

7.5 Rule 4 prescribes that each liable body is required to pay a proportion of the LSB's liable expenditure which is based on the number at the specified date (1 April of that 12-month period) of the persons authorised by it to carry on reserved legal activities. Rule 4(3) prescribes that where the LSB has determined, on reasonable grounds, that actions or non-action of a liable body, have given rise to additional expenditure by the LSB, then the LSB can impose that additional expenditure on that liable body's liable amount.

Costs in connection with the ongoing expenditure of the OLC

7.6 Rule 5 prescribes that each liable body is required to pay a proportion of the OLC's liable expenditure which is based on the number of service complaints made to the body in the period starting on 1st January 2007 and ending on 31st December 2009. The instrument effectively excludes the two approved regulators and any body designated as an Approved Regulator after 1 January 2010, which were brought into the regulatory framework of the Act by the Legal Services Act 2007 (Approved Regulators) Order 2009 because those approved regulators had no relevant service complaints during the assessment period upon which to base a calculation for liability to the levy. Rule 5(3) prescribes that where the LSB has determined, on reasonable grounds, that the actions or non-action of a liable body, which has given rise to additional expenditure by the OLC, then the LSB can impose those additional expenditure on that liable body's liable amount.

7.7 Rule 6 requires liable bodies to provide the LSB with the information necessary for it to calculate the proportions described in rules 4 and 5.

7.8 Rule 7 requires that, except in certain specified cases, the levy must be paid in full no later than 31st March of the 12-month period to which it relates. Rule 8 prescribes that interest is payable in the event of any late payment. The rule provides that the interest rate should be that specified in section 17(1) of the Judgement Acts 1838. A late payment by a liable body could impact on the LSB's ability to meet its own liabilities. Any interest charge will be paid into the Consolidated Fund.

- **Consolidation**

7.9 This instrument makes rules as required under the 2007 Act. There are no issues relating to consolidation.

8. Consultation outcome

- 8.1 The LSB has carried out a full consultation on the levy rules. It published a consultation document on 8th July 2010, which ran for 12 weeks and consulted a range of bodies including regulators and other interested parties. During the consultation process, the LSB met with two of the respondents. This document consulted on the policy surrounding the Rules and the Rules themselves.
- 8.2 Eight responses were received. These included responses from some of the approved regulators and a law firm. The proposals in the consultation document were generally supported by the majority of respondents. The main concerns raised were in relation to the proposal for the LSB and OLC to collect 100 per cent of their leviable expenditure from the leviable bodies in all circumstances and that bodies that are designated as approved regulators will not be required to contribute to the payment of the levy in their first 12 months of operation.
- 8.3 The first concern relates, in particular, to the situation whereby a leviable body has become bankrupt and that share of the levy is redistributed among the remaining leviable bodies. Having considered this concern, the LSB maintains that if the outstanding amount is immaterial it may choose to absorb or write-off the amount.
- 8.4 However, if the amount is material, the LSB will need to seek to recover this amount from the remaining leviable bodies. Should this occur, the LSB is mindful that it may have significant impact on the financial stability of the remaining leviable bodies. Consequently if this situation arose the LSB would consult with each of the remaining leviable bodies on the timing in which that year's levy would need to be paid by. This might, for example, result in agreement being reached to allow the payment of the levy in instalments over a period of time.
- 8.5 The second concern relates to the situation whereby the Lord Chancellor has designated a new body to become an approved regulator. Having considered this concern, the LSB maintains that although a newly designated body is not required to contribute to the levy in its first year, that body will, in fact, have needed to address most of the regulatory issues that it would need to engage with LSB in the first year as part of the application process for which it has paid its designation application fee (£22,000). Consequently it is unlikely to create a material cost of regulation in the balance of its first year that would make it proportionate and administratively cost effective to levy and collect a levy from them. As the Legal Ombudsman's costs are

largely comprised of fixed and semi-fixed costs, it is unlikely that the minimal (if any) impact of complaints from a new Approved Regulator would materially increase the Legal Ombudsman's costs in that Approved Regulator's first year.

- 8.6 The third concern related to liability for payments related to the issue of legal proceedings by a leviable body against the LSB or OLC. The 2007 Act and government policy constrain LSB and OLC to recovering their operating costs from the leviable bodies. In a closed system of this kind the LSB and OLC have no option but to seek to recover all costs incurred from the leviable bodies. If litigation against LSB or OLC is effective in establishing a point only in respect of the leviable body giving rise to the action then it is not proportionate to allocate the costs of the action across the other leviable bodies.

9. Guidance

- 9.1 The LSB has not issued any general guidance in connection with the levy rules. However, the LSB will be entering into detailed memoranda of understanding with each of the leviable bodies which will deal with the practical payment mechanics and the procedure for interaction between the LSB and the leviable body.

10. Impact

- 10.1 An impact assessment was prepared in respect of the imposition of a levy, which was included as part of the consultation. A copy of the Impact Assessment is attached to this memorandum.

11. Regulating small business

- 11.1 This instrument prescribes the mechanism under which the levy is to be apportioned among the leviable bodies. Under section 51 of the 2007 Act, a permitted purpose for which a practising fee may be payable by a person includes the payment of a levy imposed on an approved regulator. The effect of this is that the levy imposed under 173 may be met by practising fees charged on individuals and bodies.
- 11.2 However, the principle behind this was established and considered under the 2007 Act, and in developing those wider, the regulation of small businesses was considered in detail. Section 7 of the full RIA sets out the Small Firms Impact Test, in particular relating to the Board and ABS. In developing the Impact Test, the Small Business Service and Federation of Small Businesses were consulted and were content with the approach.

12. Monitoring and review

12.1 The levy rules relate to the apportionment of leviable expenditure for the ongoing costs of the LSB and OLC. The levy arrangements will be reviewed in 2013-14 and will take into consideration any lessons learnt to date. In addition, by then the OLC would have fuller data about the nature and origin of its casework and the revenue derived from case fees. Both are likely to assist in calculating and apportioning the leviable costs in the future. The LSB will also be able to reflect the implications of the licensing of Alternative Business Structures and the moves by a number of leviable bodies to levy an element of their charges on an entity basis, as well as on an individual basis, for the future design of the levy.

13. Contact

13.1 Edwin Josephs at the Legal Services Board (telephone: 020 7271 0084 or email: edwin.josephs@legalservicesboard.org.uk) can answer any queries regarding this instrument.