

To:	Board
Date of Meeting:	28 October 2010
Item:	Paper (10) 71

Title:	The Legal Services Act 2007 (Levy) (No. 2) Rules 2010
Workstream(s):	The Levy
Introduced by:	Edwin Josephs, Director of Finance and Services edwin.josephs@legalservicesboard.org.uk / 020 7271 0084
Author:	Anna Cheung, Regulatory Associate anna.cheung@legalservicesboard.org.uk / 020 7271 0072
Status:	Restricted

Summary:
<p>This paper summarises the main responses that we received to our consultation on the operational expenditure levy arrangements; our proposed final policy position to them (see draft decision paper at Annex A); and the finalised Statutory Instrument (i.e. the rules that the Board must make) to give effect to these proposals.</p>

Risks and mitigations	
Financial:	If the Statutory Instrument is not laid in Parliament by November 2010 (for commencement on 1 January 2011), the LSB will not be able to collect its operational expenditure from the Approved Regulators (AR) within the current financial year and will have to seek grant-in-aid from Ministry of Justice (MoJ).
FoIA:	Annex A – s22 (intended for future publication).
Legal:	N/A.
Reputational:	The LSB may attract criticism from the ARs, legal practitioners and firms, and MoJ if it is unable to make suitable levy rules which the Lord Chancellor will consent to.
Resource:	N/A.

Consultation	Yes	No	Who / why?
Board Members:		✓	Consultation document previously considered by the Board.
Consumer Panel:		✓	
Others:	We have sought clearance of the documents from Legal Ombudsman (LeO). We are currently seeking final clearance of our proposals from HM Treasury and MoJ. Both HM Treasury (HMT) and MoJ were content with the initial consultation proposals and the proposed Statutory Instrument.		

Recommendation(s):

The Board is invited to agree:

- (1) the publication of the decision paper (**Annex A**);
- (2) the submission of the levy rules (Legal Services Act 2007 (Levy) (No. 2) Rules 2010) at Annex 2 of the decision paper for the consent of the Lord Chancellor;
and
- (3) to delegate authority to approve any amendments to the decision paper (proposed, for example, by MoJ) to the Chairman and the Chief Executive (it being understood that the Board will need to approve any amendments to the text of the draft Statutory Instrument).

LEGAL SERVICES BOARD

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

Recommendation(s)

The Board is invited to agree:

- (1) the publication of the decision paper (**Annex A**);
- (2) the submission of the levy rules (Legal Services Act 2007 (Levy) (No. 2) Rules 2010) at Annex 2 of the decision paper for the consent of the Lord Chancellor; and
- (3) to delegate authority to approve any amendments to the decision paper (proposed, for example, by MoJ) to the Chairman and the Chief Executive (it being understood that the Board will need to approve any amendments to the text of the draft Statutory Instrument).

Background/context

1. Sections 173-75 of the Legal Services Act 2007 (**'the Act'**) require the LSB to meet all its leviable expenditure through a levy on the ARs.
2. On 8 July 2010, we published a consultation paper that sought stakeholder comment on the proposed methodologies to apportion the LSB and LeO's operational leviable expenditure.
3. The consultation period was 12 weeks, and eight responses were received. At their request, two ARs met LSB colleagues during the consultation period to discuss the proposals. In addition, all outstanding issues with HM Treasury have been resolved.

Summary of proposals

4. Overall, respondents were generally supportive of the levy proposals.

Estimated expenditure and payment date

5. 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

6. Respondents generally agreed that the LSB's share of the levy should be calculated by apportioning costs by the number of authorised persons per AR.
7. 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. This will be taken into account when the levy rules are reviewed in 2013/14, once LeO is in a position

to provide robust complaints data and Alternative Business Structures (**ABS**) have had a chance to enter the legal services market.

LeO's methodology

8. Respondents generally agreed that LeO's share of the levy should be calculated using the average number of service complaints during the three-year period ending 31 December 2009.
9. 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 LeO is in operation during the 2010-11 financial year).
10. We accept that historical complaints 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. 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.
11. LeO will also separately calculate how much each AR would have paid if its costs were based purely on new data from 6 October 2010, for comparison purposes only. If this demonstrates that that method of using historical data is not fair or proportionate, we will consider bringing the review planned for 2013/14 forward.

"Business not as usual" costs

12. Respondents were generally supportive of the proposal to require those ARs that generated a disproportionate work to the LSB and/or LeO should be charged the associated costs, and that these costs should not be borne by the other ARs. In the decision document we will note that:
 - Regardless of whether an AR, who has taken the LSB and/or LeO to court, has won or lost its case, that AR would be required to pay the LSB's and/or LeO's legal costs. This approach is dictated by legislation and ensures that all aspects of the LSB's and LeO's operations and costs are recouped via the levy.
 - As we intend to raise the possibility of charging an AR 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 LeO.
 - With regard to the concern whether a judicial review case is "unfounded", the LSB and/or LeO 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 AR's designation

13. The majority of respondents agreed that if an AR'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 the AR held its designation before it was cancelled.

Recovering 100% of the LSB's and LeO's costs

14. This proposal relates to, in particular, the situation whereby an AR has become bankrupt and that share of the levy being redistributed among the remaining ARs. As we are billing in the last quarter of the year, we would have significant notice of an impending problem with an AR.
15. 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 AR to the remaining ARs. In doing so, there were also concerns that it may result in the remaining ARs experiencing financial difficulties.
16. 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 AR's share of the levy from the remaining ARs.
17. However, if the amount is material, we will seek to recover this amount from the remaining ARs. Should this occur, we are mindful that it may have significant impact on the financial stability of the remaining ARs. As such, we will consult with each of the remaining ARs 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.

New ARs

18. The majority of respondents did not agree with this approach, whereby bodies that are designated as ARs after 1 January 2010 are not required to contribute to the levy in their first year.
19. We maintain that although a newly designated body is not required to contribute to the levy in its first year (as it is unlikely to have many, if any, members who would become authorised persons immediately), 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).
20. In addition, as LeO'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 AR would materially increase LeO's costs in that AR's first year.
21. As the new AR 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. In the application process we would ensure that a new regulator which took on regulatory functions for a specific group of authorised persons, for example city lawyers currently covered by an existing regulator, would not be approved unless there were suitable arrangements in place to meet the previous liability for levy payment between the two regulators.

Draft Statutory Instrument

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

Next steps

23. If the Board agrees, the decision paper will be published on our website and we will ask MoJ to commence the process to have the signed Legal Services Act 2007 (Levy) (No. 2) Rules 2010 laid before Parliament at the start of November 2010.
24. Once we have received the Lord Chancellor's consent, the Board will be required to sign the Statutory Instrument before it can be laid.
25. It is anticipated that the Legal Services Act 2007 (Levy) (No. 2) Rules 2010 will take effect from 1 January 2011 to enable us to request the necessary information from the ARs in order for us to issue their levy invoices. ARs will have until 31 March 2011 to pay their 2010/11 levy amounts.
26. The levy arrangements will be reviewed in 2013/14. This review will allow us to take account of any lessons learned, complaints and case data from LeO, and implications of ABS and entity regulation.
27. We have made a commitment to bring forward this review if there is clear evidence, particularly from LeO, that the distribution of costs is not fair or proportionate.

19.10.10