European Commission Conference - “A Single Market for Lawyers: valuing achievements, tackling remaining challenges”

Presentation by Chris Kenny, Chief Executive, Legal Services Board, appearing on the discussion panel *New organisation of the profession and of law firms: cross-border issues*

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I am grateful for the opportunity to explain recent developments in England and Wales and to reflect on the challenges they pose in thinking about the effectiveness and future direction of the Services and Establishment Directive. I want firstly to highlight the need for greater flexibility within the European legal market, to explain why England and Wales has attached such importance to the regulation of entities as well as individuals, and to consider the continued relevance of the Directives in their current form in the light of that, before turning to some specific points about alternative business structures.

The need for greater flexibility seems to me clear. The entire EU is rightly giving great priority to the growth agenda. There is no reason why the legal sector should be immune from that: professional services expertise is a strength of the United Kingdom and many other Member States as well. Perhaps even more importantly, an effective legal services market is essential for growth in the wider economy. Bank finance is perhaps the number one requirement, but good legal advice at the point when a small business hires staff for the first time, rents premises or seeks to register intellectual property is almost as important. But extensive survey evidence commissioned by my organisation shows that this need is not recognised by many small businesses – and many of those that do recognise it feel that the services they receive are so inaccessible and so expensive that they choose to rely on informal networks instead. Only 12% of UK businesses regard legal services as a good value.

The growth agenda is, of course, intimately linked with the single market agenda. Recovery will not be sustained in the absence of a greater intra-member state activity and greater global trade as well. We know that both of these have been intensifying for many years and can be expected to continue to do so. We have already been reminded today that current legal students are growing up with expectations of working within a globalised legal market place in a way that would not have been the case previously. How odd therefore that legal services themselves seem to be less mobile and less liberalised than the markets which they seek to facilitate.

The other reason to stress the need for flexibility is the increasing inter-penetration of law with other professional services. Is advice on taxation legal advice – or is it purely accounting? What about intellectual property – is that a matter for lawyers or for patent agents? The Clementi report in the England and Wales received a great deal of comment, not least in its reference to “one-stop shops” for both businesses and consumers in which a variety of services could be accessed. Without greater flexibility, there is a real danger that lawyers might miss out on these developments, leaving the ground to other providers – and consumers with less choice.

Why does that relate to entity regulation? I believe that, in this complex world, the risks to the wider public interest and the risks to individual consumers - which legal regulators have traditionally tried to ascribe only to individuals - are much more likely to arise from the activities of the firms which employ them or the organisations within which they work. It is increasingly rare for an individual consumer to simply buy a legal service from one individual. They are far more likely to buy the services of the firm in which the matter they are progressing is handled by a number of people. Or they will be buying access to a managed value chain in which many aspects of the service will not be under the direct control of the person they approach initially at all. In this kind of world, it is rather unfair to the individual lawyer for them to be held to account for what may be a systemic failing within their organisation – but it is equally wrong for consumers to have no redress and for regulators to only be able to address major issues if blame can be pinned entirely on one individual who can claim, probably legitimately, that his part in the failing is a relatively small one.

So there is not a choice between entity and individual regulation. They are necessarily complementary, with oversight of the entity particularly important in order to ensure orderly exit from the market when financial or other circumstances force this to happen and in ensuring a systemic grip on questions of ethical practice. The Legal Services Commissioner in New South Wales, Steve Mark, created the phrase “ethical infrastructure” – a neat description of what regulators need to oversee within legal practices at the organisational level.

The recent reforms in England and Wales recognised this in the creation of two new statutory posts within alternative business structures: the Head of Legal Practice and the Head of Finance and Administration, responsible for regulatory and ethical compliance on the one hand and sound business practice on the other. The Solicitors Regulation Authority recognised the strength of this model and has therefore rolled it out across all firms. This was a very important step forward – and actually a fine case study on how liberalisation of ownership has led to improved monitoring and targeting of ethical standards across the entire sector.

I dwell on the importance of entity regulation, as the existing Directives are not drafted for that world. A number of speakers have emphasised that they have stood the test of time really rather well. I do not dissent from that, but that does not of itself mean that they are “future-proof”. We should be looking now for a new approach that

will prove equally resilient for the next forty years, not relying on potentially tenuous legal interpretations as the basis for practice by entities in other Member States.

My real concern is that, given the great diversity of regulatory starting points at the moment, for example in terms of differing limits on external ownership and differing combinations of professionals allowed to practice in multi-disciplinary practices, it becomes ever-more easy for the host state model to become a route forward. This seems increasingly untenable as the internal market continues.

And it is already posing some practical problems. The Solicitors Regulation Authority are aware of German and Dutch firms who quite legitimately involve tax advisors within their corporate structure - and Italian firms, who similarly embrace dottores commerzialistes, wishing to serve their own clients' activity in London - having to consider becoming alternative business structures in order to do so, when their overall commercial strategy does not dictate this.

The SRA are seeking to find pragmatic solutions to this, but it strikes me as potentially a very serious problem. Regulation which forces specific structural decisions on entities always strike me as poor regulation, unless the structure adopted can clearly derive from the risks which the particular organisation poses. This is manifestly not the situation in these cases.

Any ABS firms in England and Wales would face similar difficulty were they to seek to expand into some other member states. Let me explain why I think those restrictions are based on myths – and why the resulting difference in treatment has the potential to produce positively perverse results.

First, let me deal with numbers. There are some 250 ABS firms out of a total of around 8,000 law firms, with perhaps a further 100 or so in line. Those are not insignificant numbers. There is also emerging evidence from LSB research that those firms are better at deploying, have a sharper customer focus than at least some of their competitors and, very interestingly, are significantly better at handling customer complaints: only 1 in 11 complaints to ABS firms turn into complaints to the Legal Ombudsman, whereas the equivalent figure for mainstream firms is 1 in 4.

The range of services they cover is increasing. I will deliberately not talk about supermarkets or personal injury firms where people expected there to be activity. But let me quote the example of the firm owned by the former president of the England and Wales Law Society, Lucy Scott-Moncrieff – a firm operating very innovatively and specialising in precisely those areas of public interest law, such as human rights and mental incapacity, which sceptics said ABS would never be interested in. Or the example of Riverview Law, focusing very sharply on the growth agenda by offering integrated services across the solicitor and barrister divide for medium-sized enterprises on a subscription basis. Or Everyman Legal, the first firm with individual external investors in England and Wales, which focuses on the entrepreneurial market and is itself a product of entrepreneurial activity.

So the range of ABS continues to grow – and perhaps even more importantly, to prompt equally innovative responses from mainstream firms, some of which have no desire at all to change their status. Nor should they feel any such pressure. ABS firms have had no formal or informal sponsorship. Their regulation is identical to that of mainstream firms and, in fact, they have tighter controls, in terms of the suitability test which their owners must pass. This includes very clear obligations about upholding the rule of law and proper administration of justice, acting with integrity, acting in the best interest of the client, providing a proper standard of service, running businesses effectively, encouraging equality of opportunity and respect for diversity, and protecting client money and assets. All values that would be recognised without any difficulty across the EU.

What I should also stress is the independence of their regulation. I often hear it said that my organisation is a part of Government. Not true. Government can give me only one instruction – on the form of my accounts. It cannot tell me who to employ, what to do, what organisations to agree with, what organisations to take action against, and it has never tried to do so directly or indirectly. (I suspect it has a shrewd idea of the response it would get were it to make that attempt). Likewise the licensing authorities who oversee ABS and the regulators who oversee the mainstream market are similarly independent both of Government, and also of their regulated community.

I am sure that there is complete agreement here today about the importance of independence in regulation and I am quite clear that both the fundamental regulatory structure in England and Wales meets that requirement in relation to ABS and other forms of practice. If therefore the regulatory framework at European level fails to allow firms properly authorised within such a framework to operate across the EU, then I would suggest that it is ripe for overhaul – as indeed it is when it fails firms properly established in other jurisdictions operating in London.

So I welcome the opportunity to take part in today's discussions and, in particular, welcome the Commission's communication on professional regulation generally, which seems to me a very helpful starting point for a wider debate and ultimately for action that will help the legal sector achieve greater growth in its own right and contribute to the growth agenda far more generally.