"WIDER ACCESS, BETTER VALUE, STRONG PROTECTION": DISCUSSION PAPER ON DEVELOPING A REGULATORY REGIME FOR ALTERNATIVE BUSINESS STRUCTURES

RESPONSE FROM THE BAR STANDARDS BOARD

INTRODUCTION

1. The Bar Standards Board ("BSB") welcomes the opportunity to respond to the LSB's discussion paper on ABSs. As the independent regulatory arm of the Bar Council, the BSB has worked closely with the LSB to date and will continue to do so.

2. The BSB is still at an early stage of considering its approach to ABSs. Its immediate priority is to reach decisions on Legal Disciplinary Practices (LDPs) on which it is currently commissioning some research and considering further legal advice. It is therefore not in a position to respond to all the issues raised in the LSB's paper. It would however like to make the following general points in relation to the discussion paper:

1. The BSB is committed to maintaining the availability to the public of a broad choice of expert advocates and of specialist advisory services including services available on a referral basis. We believe maintaining such a choice is in the public interest and promotes the regulatory objectives (notably in promoting access to justice, consumer choice, competition, and encouraging an independent, strong, diverse and effective legal profession).

2. The BSB must be satisfied that any changes in the business structures through which barristers provide advocacy and advisory services are such as to promote, and not undermine, the regulatory objectives (for example, that they do not pose risks to access to justice, cause distortions of competition, or threaten adherence to the professional principles). Subject to those overriding considerations, we agree that there should not be any unnecessary restrictions on structures.

3. We do not accept that because the Legal Services Act 2007 (LSA) potentially allows all forms of ABSs, all forms are necessarily compatible with the regulatory objectives. This needs consideration and testing. The consequences for consumers and the legal market as a whole need to be studied and the risks inherent in the various potential models identified (as the BSB is seeking to do in relation to allowing barristers to practise as managers of LDPs).

4. We recommend a step by step approach building on experience, rather than the big bang proposed by the LSB. More time is needed to learn lessons from LDPs before permitting other forms of ABSs.

5. We agree that entity regulation has a role to play, particularly in relation to larger organisations. More broadly, we agree that improving systems is an area for regulatory focus in relation to all organisations, including those that are not required by the LSA to be regulated as entities (such as barristers' chambers).

However, professional regulation of individuals remains crucial. High standards ultimately depend on the integrity and commitment of the individual and if that professional culture is lost, clients will suffer.

6. With the probable growth in the number of regulators covering similar services, there is a risk that standards will fall to the detriment of consumers as regulators seek to attract more business. The LSB must ensure that standards are maintained across the regulatory system. There must not be a race to the bottom in relation to regulatory standards.

7. The Bar Council and the BSB will consider whether the Bar Council should seek the powers necessary to enable it to regulate LDPs and whether to seek to become a licensing authority for ABSs, and if so what range of services to license, once the BSB has decided whether, having regard to the regulatory objectives, it will allow barristers to practise as managers of LDPs, and by implication ABSs.

8. There are risks and substantial costs involved if Approved Regulators seek to become licensing authorities for services which they have no experience of regulating. The BSB currently does not regulate litigation (except to a very limited degree in relation to employed barristers, who will in future, if providing services to the public, be subject primarily to the rules of their entity regulator). It would be a major undertaking to develop an appropriate rulebook and enforcement machinery, particularly if the licensed bodies were allowed to undertake a wide range of activities and to hold clients' money. The BSB does not currently have the staff or the experience to undertake such a role. Although they could be developed, the risks could be high (depending on the types of activity permitted) and, unless it was clear that the take up would be large, the costs might well be prohibitive. These are matters which the Bar Council and Bar Standards Board will have to take into account in reaching a decision, even if it is decided in principle that it would be desirable to become a licensing authority.

9. We believe there is a role for regulators who are specialised in regulating particular sectors of the legal services market (such as advocacy services) or in regulating particular types of entity (such as low risk bodies). It is neither necessary nor desirable for all regulators to gear up to regulate all conceivable types of ABS and LDP. Encouraging "niche" regulators promotes choice and encourages a regulatory approach which is efficient and appropriately tailored to the needs of the given sector.

10. We share the concerns outlined in the SRA's consultation paper on ABSs about the regulation of non-reserved legal services.

LAYOUT OF THE RESPONSE

3. The BSB has not replied to all the individual questions set out within the consultation paper as it considers it more useful to concentrate on major points of interest and concern arising out of each of the chapters.

CHAPTER 3: TIMELINE (QUESTIONS 1-4)

4. In our response to the LSB's business plan we suggested that the LSB should look to learn from the experience of LDPs before deciding on its policy for ABSs. We still believe that it is essential for regulatory bodies to be given sufficient time to carefully consider the successes and issues following the introduction of LDPs. These are still very new and limited in number. If there is no opportunity to learn from this experience before much more radical changes are introduced, there is a serious risk that over-hasty and ill-thought through changes may expose consumers and the public interest to business-driven initiatives that are inconsistent with the regulatory controls necessary properly to protect consumers, the wider public and the interests of justice.

CHAPTER 4: THE BENEFITS OF OPENING THE MARKET (QUESTIONS 5-10)

5. Much of the evidence on which the LSA was based was undertaken many years ago in very different circumstances. Without more research, it is difficult to predict the likely effects on the market of introducing ABSs or to assess how best to introduce changes in ways which ensure that the benefits to consumers outweigh the potential disadvantages to them.

6. The consultation paper states at numerous points that the LSB would like to receive "hard, ideally quantified, evidence" on a number of issues related to the introduction of ABSs. These issues include:

- The risks to the regulatory objectives from different types of ABS (1.10)
- How the legal services market may develop in the years ahead as a result of regulatory restrictions (2.19)
- Views about how opening the market might change both the way that legal services are delivered to consumers, and the structure of the market itself (4.3)
- Maintaining a strong career structure for those who wish to specialise in advocacy (5.9)
- The risks to the regulatory objectives of the payment of referral fees by advocates to attract business from referring solicitors (5.8)
- Specific examples of ABS that give rise to particular concern (5.11)
- The impact on the proposed market changes to specific groups (e.g. the elderly) (7.4)
- Risk of consumer detriment which may arise in an ABS model and how it can be addressed (7.44)

7. The BSB is commissioning research focussing on the effects on the market and consumers of potentially allowing barristers to practise as managers of LDPs and other new business vehicles. The aim of the research is to assist the BSB in reaching decisions which best achieve the regulatory objectives. The research will model the

likely outcomes of the proposed reforms on the profession, on the provision of legal services and, most importantly, on the consumer's ability to readily obtain affordable access to high quality advocacy services. We will be happy to share the results of this work with the LSB when it is complete.

8. However, in order to obtain answers to the questions which the LSB has identified, the LSB itself has an important role to play in commissioning and sharing research across a broader range, focussing on the questions which are of common interest to all regulators in this field, in particular how the market might change as a result of removing current restrictions and what risks might be inherent in particular types of ABS. We would encourage the LSB to take this course.

CHAPTER 5: MANAGING THE RISKS OF OPENING THE MARKET (QUESTIONS 11-13)

9. In paragraph 5.3, the LSB sets out its starting point which is to the effect that "in the absence of a compelling case for further restriction" the Act determines what restrictions alone are appropriate.

10. We think that the Act places responsibility on the regulators to assess whether or not particular types of ABS (within the broad range now made available for their consideration) would promote or undermine the regulatory objectives and to make judgments as to what restrictions or conditions would be appropriate to minimise any risks associated with the potential gains from introducing ABSs. We do not agree that the risks are the same as those already present in the market. Indeed four out of five of the risks mentioned in paragraph 5.11 are new ones which do not arise in the business structures currently permitted. External ownership and the involvement of, for example, insurance companies which have an interest in the outcome of legal actions, will introduce and/or intensify risks which will need to be identified and effectively managed[1]

11. We therefore propose that a more appropriate starting point is to identify, by careful analysis of possible scenarios and by consulting stakeholders and consumer groups, what different or greater risks are likely to arise, and in relation to what types of ABS. Decisions can then be made as to what regulatory safeguards are necessary to manage them.

12. One risk involved in the growth of firms which provide advocacy as well as other legal services is that the firms will wish to keep as much business in house as possible, or will refer the work to an advocate prepared to pay a referral fee, irrespective of the best interests of the client. We therefore attach great importance to re-enforcing the duty of the solicitor to act in the best interests of the client. Clients should be made aware that they have a choice of advocate and should be told if those advising them have any financial or other relationship with the person to whom they are referred. We welcome the LSB's intention to consider referral fee arrangements which can operate to the detriment of clients.

13. At present the self-employed bar provides expert advocacy and specialist advisory services primarily on a referral basis (i.e. solicitors refer consumers' cases to the bar), and now in a growing range of circumstances also on a direct access basis (where consumers come directly to the Bar). There are real consumer benefits at present in

[1] The paper draws attention to the experience in New South Wales. It should be noted that barristers are not allowed to practice in multidisciplinary practices in that State.

the ability to choose from a broad range of advocates and specialist advisory services, not limited to those available within the firm which happens to be conducting litigation on the consumer's behalf. It is important that these benefits are not lost.

14. Another important consideration is whether allowing barristers to practise in ABSs would make it more difficult to obtain the services of a suitably qualified barrister in smaller towns or specialist areas of the law. If barristers work together in larger businesses, they will not be able to appear against each other. Depending on how the market develops, this may reduce the choice of barrister. This is one of the concerns which the BSB is considering.

15. A further concern is the potential disapplication of the "cab rank rule" for ABSs. It may not be possible to apply the cab-rank rule to ABSs as the rule could be used to conflict out all senior barristers in a firm by securing the services of a junior barrister to deal with one minor element of a case. This could again make it more difficult to obtain suitable representation. If and to the extent that the development of ABSs meant that access to justice for a wide range of people deteriorated, that would be clearly contrary to the regulatory objectives.

CHAPTER 6: RISK-BASED REGULATION OF ENTITIES

Entity based regulation (question 14)

16. The LSA 2007 requires LDPs and ABSs to be regulated as entities. This is of particular importance in relation to ABSs, as their managers will include lay people who are not subject to individual regulation by a professional regulator. Such entity regulation will be concerned particularly with ensuring that the entity has proper systems and controls in place, including suitable governance arrangements. However, it does not follow that there should be a wholesale shift away from a focus on regulation of professional conduct of the individuals. Reserved legal services will continue to be delivered by individuals who must themselves be individually authorised. The quality of service to clients ultimately depends on the skills, commitment and integrity of those individuals. High standards depend on the acceptance of personal responsibility and continuing to hold individuals personally to account as well as regulating the entity as a whole. The approved regulators have a responsibility for maintaining the professional principles. Other regulators, such as the FSA, which regulate both entities and firms, have found that focusing on individuals is the more effective method of deterrence[2].

17. In a world where a barrister (or any other lawyer) could move, without barriers, between different entities and between entities regulated by different regulators, it would become, if anything, even more important to identify and keep track of "problem" individuals (not just entities), whose individual track record shows them to pose a regulatory risk. The regulators will need to cooperate, in this respect, to collect and share information.

18. Authorised persons working in ABSs will be subject to the rules both of the ABS regulator and of their professional regulator. The LSA gives pre-eminence to the entity's rules if there are any clashes and puts an onus on Approved Regulators to resolve any

[2] See, for example, Margaret Cole's speech in June 2008 in which she described the FSA as having taken a strategic decision to focus enforcement more on individuals, on the basis this was the most effective form of deterrence

conflicts. It will be important to ensure that this does not result in the lowest common denominator being accepted where this may not be adequate to protect the public interest. The LSB will have a role in ensuring standards are maintained. The BSB is currently reviewing the rules which will apply to barristers if they are permitted to practise as managers of SRA regulated LDPs.

19. The BSB will continue to regulate self-employed barristers as individuals. Although barristers often work in chambers with other barristers, the chambers are not entities and are not collectively responsible for the conduct or competence of the individual barristers. The BSB will nevertheless be considering whether some of the concepts of entity regulation, particularly the emphasis on having proper systems and controls, should be extended to chambers (building on the existing responsibilities of Heads of Chambers).

Risk based approach (question 15)

20. Although in principle we support a risk based approach to regulation, such an approach depends on having experience of regulating similar businesses and an understanding of the risks involved. ABSs will introduce new risks which will need to be managed cautiously while experienced is gained of how they operate in practice.

High level principles or a more prescriptive approach (question 16)

21. The rules of conduct for lawyers articulate fundamental and well-established duties that are common to lawyers of different denominations (and, indeed, largely shared with lawyers in other jurisdictions), such as independence and honesty, competence in exercising a professional skill, the duty owed to the court, putting the client's interests first and keeping their affairs confidential. Rules of conduct for lawyers should, therefore, by and large be high level principles of a sort that an individual could sensibly be expected to internalize, rather than such that can only be discovered by extensive consultation of many complex interlocking rules and definitions This approach also minimizes conflicts between regulatory regimes (but is arguably more demanding on the competencies of the regulator). The BSB intends to move further in this direction in the work it is doing on revising its own Code of Conduct but it recognizes that high level principles will need to be supplemented by more detailed rules and guidance.

22. Likewise, in general, it is not for a regulator to prescribe particular business systems and processes relating to the delivery of legal services: as opposed to prescribing the outcomes which those systems and processes are to deliver (for example, timely communications) and the means by which whether they succeed in that goal will be assessed. .

23. It is less obvious that a high level and non-prescriptive approach is appropriate for aspects of ABS regulation other than conduct rules for the lawyers involved and business systems directly related to their delivery of legal services (i.e. systems of a sort which traditional law firms will already have experience of). Here, we are moving out of familiar territory, without the advantages of shared culture and education, past experience, and common understanding as to (for example) what a lawyer's duty to the court requires of him or her in a given situation and new risks may need to be managed by more detailed rules. For example, risks relating to particular types of shareholder with potentially conflicting interests might be regarded as justifying prohibition, or strict limits on the extent of any such holding and compliance with other specified safeguards, at least until there is more of a track record from which to judge the risks of adopting a more liberal approach in future.

Majority of lawyer managers (question 17)

24. For similar reasons, we favour an approach which, initially at least, requires (as a minimum) a majority of lawyer managers, whilst the impact of non-lawyer managers on regulatory risk is assessed in the light of developing experience (c.f. paragraph 6.22). We note that the current regime in New South Wales was developed only after experience had been built up with fee-sharing arrangements, which permitted up to 49% of fees to be shared with non-lawyers. It should at least be open to licensing authorities to impose such restrictions.

"Higher risk applications" (question 19)

25. Further relevant considerations are the expertise and resources of the regulator: it is neither necessary nor practicable for all ABS regulators to be geared up to regulate every conceivable type of ABS. A given regulator might offer itself as a "specialist" ABS regulator only to those entities whose structures and services fit that regulator's expertise and resource and may tailor its entry requirements accordingly. (Examples might include ABSs for referral advocacy and advisory services which do not hold client money; or ABSs for corporate legal work, of the sort for which Smedley has proposed a separate regulatory unit within the SRA.) Unless no other regulator is available, such an approach promotes rather than restricts choice and may allow for a style of regulation which is more closely tailored to the constituency being regulated and hence more effective than a "one size fits all" approach. Other considerations might, for example, relate to preventing the use of a "nominal" ABS to evade rules of conduct that would otherwise apply, such as the cab rank rule.

26. The discussion paper states that regulators should not adopt a "zero-failure approach". However, nor can regulators treat the public as guinea pigs in an ABS experiment, designed to permit the widest possible permutations on the ABS theme in order thereby to reveal where the additional, and unacceptable, risks may later turn out to lie (as paragraph 6.30 seems to come close to suggesting). We question whether regulators can be sure enough, at this stage, as to whether they can accurately identify those ABSs which are higher risk at the point of licensing, so as to apply more intensive monitoring (paragraph 6.32), and whether such monitoring will be adequate to manage those risks (as opposed to treating them as grounds for refusing a licence, at least at this stage).

27. It is the fact there is a track record of hands-on experience in regulating traditional firms which enables the SRA to identify the fact that only 5% of complaints relate to firms with 26 or more partners,[3] and consider what a risk-based approach to regulation might require in the light of that evidence. That track record and that evidence will only be built up with experience. In the meantime, a regulator has no choice but to make judgments about which structures involve more theoretical risk than others, based on criteria such as numbers of lawyers versus non-lawyers and presence of owners with potentially conflicting interests.

[3] Smedley report, para 1.7.

CHAPTER 7: SPECIFIC REGULATORY ISSUES

Access to justice condition (question 21)

28. The BSB considers that in the absence of further research and analysis, there is no basis for saying that it is unlikely that many licences should be rejected on the basis of the access to justice condition. Licensing bodies will need to analyse the market both when drawing up their rules and when considering individual licensing applications, looking at the structure of the relevant market and the impact of the proposed licences, particularly in relation to access to legal advice in the geographical area and in specialist areas of the law.

Complaints (question 23)

29. We agree that ABSs should be subject to the same complaints handling requirements as other regulated bodies.

Non-reserved legal services (question 25)

30. ABSs will need to be able to provide non-reserved legal services such as the provision of legal advice. Both solicitors and barristers (and no doubt other lawyers) provide such services, often closely linked with reserved services. The provision of such services should be subject to the same rules as apply to the provision of reserved services, and ABSs should be under a duty to ensure that they are provided only by people who are competent to provide them and that the status of the person providing the service is made clear.

31. The BSB shares the concerns expressed by the SRA in its recent consultative document about the potential detriment to consumers if ABSs are allowed to provide non-reserved legal services through a related but unregulated body.

CHAPTER 8: SPECIAL BODIES

32. A licensing authority should have the ability to choose to regulate only low risk bodies, and set its licensing rules accordingly. The Act assumes that licensing authorities will design their rules to cater for "normal" ABSs and disapply some of those rules for low risk bodies. This is indeed an option some licensing authorities may choose to follow. But there should also be an option for a licensing authority to decide only to license low risk bodies, such as LDPs with minority external lay involvement, and to design their rules and procedures proportionately to the lower risks involved. In the interests of diversity of regulation, it makes sense that not all regulators should have to regulate all types of ABS.

CONCLUSION

33. We have expressed above a number of concerns, some of which are of a serious nature, about some of the proposals contained in the LSB's discussion paper. We would urge the LSB to consider and research whether permitting the full range of possible ABSs will promote the regulatory objectives in the Act, rather than assuming that ABSs will necessarily achieve the regulatory objectives in the Act and bring benefits to consumers, if the responses to the discussion paper lack the quantified evidence requested.

34. We suggest that the LSB should look to learn from the experience of LDPs before deciding on its policy for ABSs. It is important for regulatory bodies to be given sufficient time to carefully consider the successes and issues following the introduction of LDPs. Following this regulatory bodies also need sufficient time to consider if they wish to be authorised to license ABSs, decide how new schemes of regulation could mitigate risks associated with new structure and to introduce changes necessary to regulatory structures in order to achieve the regulatory objectives set out in the Act. Regulators should be permitted, and indeed encouraged, to introduce ABSs gradually, starting with lower risk arrangements and only allowing higher risk models when experience has shown that additional risks can be managed effectively.

35. The BSB would welcome the opportunity to contribute to the further development of thinking on this important subject.