Response by Irwin Mitchell to the Legal Services Board's Consultation paper "Wider Access, Better Value, Strong Protection"

Introduction

1. As a major National firm providing a wide range of legal services to consumers of all kinds, Irwin Mitchell has taken an active interest in the post Legal Services Act (LSA) regulatory reforms and, as a supporter of the general thrust of the LSA reforms, has responded to all consultations since the first report by Sir David Clementi. Irwin Mitchell also has a substantial regulatory practice which provides insight and understanding of how the SRA (and other regulators) deal with the clients (individual solicitors and firms) we represent on regulatory matters.

2. We believe that regulators of the legal profession should behave in a manner that is proportionate, fair and reasonable, coupled with a clear understanding of the commercial drivers likely to influence practitioners as they face up to the most significant challenges and changes in the legal services market for generations. If regulators are to carry out their responsibilities in a flexible, professional and pragmatic manner, they should acquire a good understanding of the real issues facing the individuals, firms, and 'entities' subject to regulation. Indeed, the priority approach of legal regulators should be to convey to those whom it regulates that its principal aim is to assist them to 'get it right' in a manner that will encourage them to take advantage of the opportunities offered by the LSA rather than being restrained from development of their businesses by over-regulation that inhibits the provision of legal services to consumers.

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

The timetable set out in paragraph 3.4 is desirable and is (or should be) achievable. It is desirable because there is adequate evidence of external investment (a) being welcomed (even needed) by those lawyers/firms/entities who will wish to seek it and (b) being pursued by non lawyer potential investors who wish to participate in the provision of legal services in a more competitive marketplace that better serves the interests of the consumer. The timescale should also be achievable because (as far as solicitors are concerned) the SRA has already completed the major first step of introducing the regulatory framework to permit LDPs. This learning curve has given the SRA a body of knowledge and experience to enable it to move swiftly towards the implementation of ABS licensing within the two year timescale of mid 2011. In doing so it is important to ensure that a level playing field is maintained between now and mid 2011 in the regulation of traditional model law firms and non-lawyer commercial organisations conducting unreserved legal activities (see our response to Question 20).

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

The LSB needs to maintain pressure on the SRA to meet the timetable. It also needs to oversee resolution of the current differences between the Law Society and the SRA about regulatory oversight and independence. The tensions that exist need to be resolved so that both organisations can develop the positive co-operation that will be essential if they are jointly to fulfil their duty to implement the licensing regime for ABS within the LSB timescale.

We suggest that in order to understand the practical concerns and issues of those most likely to be affected by ABS the LSB should promote dialogue and consultation with law firms and investors who are known to be interested in applying for ABS licenses. On high level policy issues the College of Law Forum on External Ownership & Investment is an extremely useful think tank to assist a wide range of interested parties to gain a through understanding of the complex issues that will need to be covered by the ABS licensing regulations. The joint working party between the LSB and the SRA is also an important driving force in maintaining momentum to ensure that the regulators deliver within the timetable. Putting the clients first of course, the LSB might also usefully involve its Consumer Panel to advise on practical issues from the client point of view. Similarly, the LSB might consider forming a panel (or focus group) of practitioners and potential investors to address the issues they see as important to ensure that the new ABS model is introduced as a fully operational regime from the outset.

Question 3: What are your views on whether the LSB should be prepared to license ABS directly in 2011 if necessary to ensure that consumers have access to new ways of delivering legal services?

If the SRA does not move quickly enough to meet the timetable in paragraph 3.4 the LSB should certainly be prepared to become the direct licensing authority and should therefore take appropriate preparatory steps.

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

This is very much an internal matter for the LSB to resolve. Much will depend on resources. If necessary the LSB levy would have to be adjusted upwards to take this extra cost into account but avoiding duplication of levy raised by the SRA and LSB for the same purpose.

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

This question is potentially of the 'multiple choice' variety because the legal services market is comprised of many parts. We respond by highlighting five areas:

- Consumers will benefit from wider choice of providers and increased competition that will in some areas of legal service delivery have a downward pressure on the price of legal services and produce better value for money.

- Lawyers whose legal businesses are under capitalised (many are particularly because of the recession) will have the opportunity to stabilise their finances not only in their own interests but also in the interests of their clients.

- Lawyers whose legal businesses are **not** under capitalised but have clearly defined strategies for expansion to provide more and better services to a wider sector of the public/business community will be able to do so with the benefit of external investment.

- Commercial investors, whether non legal institutions or private equity, will bring greater financial stability and experienced management skills to the traditional model of legal businesses at the same time as realising a return on their investment.

- Consumers will also become used to being provided with improved channels of communication with their legal services provider including access to 24/7 legal helplines, on-line access to their individual matter and web enabled documentation that they can download themselves.

In combination the above (non exhaustive) list should mean that the post ABS market for legal services will be more transparent and vibrant in style with a greater variety of offering to the public as well as firms/entities that are more financially sound and better managed, reducing the number of complaints and the consequential burden on the regulator.

Question 6: In what ways might consumers of all types – including private individuals, small businesses and large companies – benefit from new providers and ways of delivering legal services?

In part the answer to this question is already dealt with in the answer to question 5. Without a crystal ball it is hard to be more precise. It must be hoped that the introduction of the ABS model will invigorate the lawyers who embrace that opportunity to develop ideas in an innovative way that will be to the benefit of their clients. It seems certain that the ABS model will encourage creativity by entrepreneurial lawyers and external investors working together in business to meet the diverse needs of all kinds of consumers who should have greater confidence in the financial stability of the ABS model.

Question 7: What opportunities and challenges might arise for law firms, individual lawyers, in-house lawyers and non-lawyer employees of law firms as a result of ABS?

The answer to this question has been partly dealt with in the answers to questions 5 & 6. Without a crystal ball it can safely be predicted that the

greater flexibility provided by the combination of lawyers and non lawyers offering legal services in conjunction with external investors is certain to produce opportunities (a) for developing new models of legal service for clients, (b) for improved internal management and better career development, (c) for business expansion (domestically and internationally) and the creation of incentives to share in return on investment for owners both internal and external and (d) for taking courageous and entrepreneurial business decisions. Equally, there will be many challenges, particularly to ensure that a newly licensed ABS is operated and managed according to the ethical and professional principles laid down by the licensing body to protect the consumer.

Question 8: What impact do you think ABS could have on the diversity of the legal profession?

There is considerable potential for the new ABS regime to promote diversity by making it easier for non lawyers to participate in legal businesses in a more meaningful way, bringing the important skills and experience they have to offer. The ABS model should send out the message that the legal profession (already diverse by comparison with other professions) has a new means of improving diversity, moving towards even greater openness and equality of opportunity.

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

Many of the educational and developmental implications of ABS have been usefully studied in the College of Law Forum (see above) and it is unnecessary to repeat them here. Undoubtedly there will be much for all participants to learn avoiding excessive caution about the implications of ABS because of misplaced fear that the subject is too complex. The issues that led to the introduction of the LDP and ABS models were extensively analysed by Sir David Clementi; in numerous consultations; by the MOJ; and by Parliament. The LSB now has a clear and important role to implement part 5 of the LSA by ensuring that all relevant participants are aware of the issues that will need to be understood to make the ABS model work. One important aspect is the new concept of the HOLP & HOFA whose responsibilities and qualifications will need to be clearly set out for licensing purposes and subsequent monitoring. The LSB may need to enlist help from educational bodies to ensure that standards are preserved (even enhanced) by the introduction of the ABS regime.

Question 10: Could fewer restrictions on the management, ownership and financing of legal firms change the impact upon the legal services sector of future economic downturns?

It is hard to imagine, even with hindsight, whether the impact of the economic downturn would have been lessened if the ABS regime had been in place in October 2008 or even earlier as the recession started to bite. However, given that the essence of an ABS is to permit external investment it seems very likely

that better financed ABS law firms would be able to weather future economic downturns better than the traditional model.

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

We note that chapter 5 of the consultation paper does not list all of the eight regulatory objectives, confining itself to four. In our response to Question 9 in the LSB consultation on 'Regulatory Independence' we agreed that the LSA mandatory "permitted purposes" for use of the practising certificate fee should be extended to include regulatory objective (g) "increasing public understanding of the citizen's legal rights and duties" (otherwise described as public legal education or "PLE"). We therefore believe that the discussion in chapter 5 should also include regulatory objective (g) on the basis that failure to pay proper attention to PLE will run the risk that the public will lack awareness and appreciation of the better choice that will be available in a more flexible legal services market that includes ABSs.

With specific reference to key risks to the regulatory objectives referred to in Chapter 5 we comment as follows:

- **Paragraph 5.5. Improving access to justice:** We do not believe that the ABS model will intrinsically pose a threat or risk to access to justice. Provided that ABS licensing and monitoring is carried out correctly, the new and flexible models should improve rather than inhibit access to justice for the public. We agree with the first two sentences of paragraph 5.5. The fear that consumers in rural locations will find it difficult to obtain access to legal advice and representation is in our view misplaced. Many people today whatever their geographical location can have access to a legal helpline provided through their legal expense insurance policy or bank card providing access to legal advice and, if necessary, legal representation. ABS businesses that are likely to adopt more flexible and innovative methods will be unlikely to ignore the commercial advantages of offering legal services to the large number of consumers who comprise the rural community. Where face to face legal advice is preferred by the consumer this should still be possible using the traditional model law firm with its local and loyal client base. In today's world where the use of technology to purchase all manner of services (not just legal) has seen exponential growth in the use of the telephone and the internet the purchase of legal services will be no exception. Indeed, as these methods of accessing legal and other services become further ingrained in society, the rural community will use them routinely to gain access to the legal advice and representation they need to obtain justice.

- **Paragraph 5.6. Protecting and promoting the interests of consumers:** The ABS model should not pose a risk to this regulatory objective provided that the licensing regime that governs the ABS model is applied consistently, ensuring a level playing field by adopting the

same standards as applied to traditional model firms. The risk of closure of an ABS business should be no greater than the risk of closure of the traditional model firm which does occasionally happen, not just by SRA intervention. The roles of the HOLP and the HOFA will clearly be crucial, ensuring that accountability for practice standards, regulatory matters and financial requirements are firmly placed on the shoulders of suitable individuals who may be more focussed on risk than their equivalents responsible for similar tasks in the traditional model firm. Chapter 5 rightly refers to the Australian example of a stock exchange listed law firm where it seems that the positive approach of the regulator together with the requirements of Australian company law and stock exchange regulations combine to ensure protection for the consumer that is as good, if not better, than the traditional model law firm.

- **Paragraphs 5.7 to 5.10. Encouraging an independent, strong, diverse and effective legal profession:** We do not share the concerns about the independent Bar in paragraph 5.7. As a large national law firm with a heavy litigation base we have for many years instructed many barristers at all levels of experience in numerous sets of chambers on a very substantial basis. Without commenting on the controversy of whether the cab rank rule is rigorously adhered to by the Bar or 'honoured in the breach', we believe that on the whole the current split profession model serves well the interests of the consumer who can access the specialist advice and representation of a barrister. However, applying the 'permissive' Clementi approach, there is every reason why barristers and solicitors should be allowed to join together in business in LDP or ABS models if they so wish to offer a 'one stop' greater choice to consumers. We believe that publicly funded work will continue to be carried out by all branches of the legal profession whatever model of service delivery is utilised and that any risk of failing the needs of the consumer in this area has more to do with the eligibility, scope and levels of remuneration for legal aid work than any perceived threat of the ABS model. We also believe that (paragraph 5.9) there will continue to be a strong need for specialist advocates, both at the Bar and in entities that comprise solicitors (many of whom are specialist advocates, not just those with higher rights of audience) and/or solicitors in business with others in an ABS. Market forces have always supported the role of the specialist advocate whose service (solicitor and barrister) continued to play an essential part in the justice system despite frequent reforms (e.g. Woolf) that have been perceived as threats, particularly to the junior bar.

  Referral fees (paragraph 5.8) are an increasingly controversial subject. If payment of a referral fee to an introducer of business by a lawyer in any kind of practice (not just ABS) has the result of pushing up prices this is clearly contrary to the interests of the consumer. And although referral fees may promote competition between lawyers for new business, it is unsatisfactory if the measure of competitive strength is more likely to relate to the amount of the referral fee than the standard of service provided by the lawyer to the client. Further, it is essential to

ensure a level playing field in the regulation of referral fees to ensure that there is no competitive disadvantage to law firms in having to compete with the greater financial muscle of non-lawyer commercial organisations. (See also our response to Question 20). The SRA's rule on referral fees (formerly the Law Society's Introduction and Referral Code, relaxed in 2004 largely due to pressure from the Office of Fair Trading), deserves to be reviewed, as anticipated in the LSB Business Plan.

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

We agree with the reasoning in paragraph 5.10 about the risk of collapse of an ABS. We cannot envisage any particular type of business structure or model that presents a particular risk to the regulatory objectives. Experience in the licensing of ABS applications is likely to illustrate where particular risk might have to be considered.

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

Clearly conflict of interest issues will need to be considered carefully in an application for licensing of an ABS. However, we agree with the points made in paragraph 5.13 to 5.16 and have already commented on the useful example from Australia.

Dealing with the areas of potential conflicts listed in paragraph 5.11 in the same sequence we would comment that:

- The recently proposed revised rules on conflict by the SRA, paying particular regard to the business model of large corporate firms, have addressed the problem of lawyers within the same firm acting for clients on different sides of a dispute/case.

- The cross-selling of non legal services by lawyers in an MDP should not necessarily be regarded as a particular area of risk. It is hard to see how pressure to cross-sell (a normal business activity) could be regarded as undue. Already the small number of **reserved** legal activities (section 12 LSA) means that there are many **unreserved** legal activities that can be offered by non lawyers as has happened for a long time. It is therefore hard to see how it could be a particular risk for lawyers to cross-sell in an MDP non legal services than can already be sold by non lawyers pre ABS licensing in 2011.

- The protection of legal professional privilege is very important and will need to be as strongly adhered to by lawyers in an ABS as in the traditional model. The crucial need for lawyers to avoid the risk of being compromised because of additional risk in ABSs

will need to be clearly set out in the ABS licensing rules and regulatory framework.

- Similar care will need to be taken to avoid undue pressure from non lawyers with material interest in an ABS. A useful comparative example is the role of the third party litigation funder whose participation in financing litigation has been approved by the Courts, and is becoming established in the civil justice system. External investment in a piece of litigation with a view to profit from the proceeds at the outcome can be compared with investment in a legal business as a whole particularly if it has a litigation bias. In a piece of litigation that has third party funding the litigation funder does not seek to influence or control the progress of the litigation invested in and leaves the decision making to the solicitor and client subject to a reporting procedure on the continuing prospects of success. The proposed Code of Conduct for third party funders being promulgated via the Civil Justice Council may be instructive for those considering what rules/regulations may be necessary to minimise any risk of pressure on lawyers by non lawyers who have a material interest in an ABS.

- The Slater & Gordon example cited at paragraph 5.16 appears to have dealt successfully with the risk of conflict between the company's duties to shareholders and clients. We would urge the LSB to adopt the same approach.

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

AND

Question 15: Do you agree with our view that licensing authorities should take a risk-based approach to regulation of ABS, and if so, how might this work in practice?

In answering these questions together we agree with the analysis (paragraphs 6.1 to 6.10) of the issues relating to risk based regulation of entities rather than individuals. This shift in emphasis would be welcome anyway even if the LSA had not permitted the introduction of LDPs and ABS. The modern methods of delivering legal services, particularly in large firms (not just those that would qualify as 'corporate' according to the definition in the Smedley report), are more appropriate for entity based regulation. Indeed, the regulator who adopts the positive approach of helping the entity to 'get it right' is much more likely to have a systemic effect on the entire business operation than on the practice or conduct of particular individuals. Of course this does not mean that individual lawyers should overlook their professional duties under the Code of Conduct any more than the regulatory duties placed on the HOLP and HOFA should absolve other individuals from observing their

professional responsibilities. Indeed, the statutory provisions that require the HOLP and HOFA to shoulder responsibility in an ABS would appear to strike the right balance between the compliance requirements placed on individuals and on the entity itself. We therefore agree that the SRA is already on the right lines in developing entity based regulation which should be developed further, and in the case of large firms (not restricted to the Smedley definition of 'corporate') should adopt particular skills to regulate the entity in a proportionate manner. It is difficult to envisage precisely how licensing authorities will adopt the risk based approach but we agree with the general proposition that it is the right approach for the ABS entity.

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

We agree with the analysis in paragraphs 6.12 to 6.16 that the balance should be in favour of high level principles and outcomes along the lines of the FSA and the OLSC in New South Wales, rather than the more prescriptive approach.

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

We agree with the analysis in paragraphs 6.18 to 6.21 and support the conclusions in paragraph 6.22. We cannot see any advantage in a requirement that an ABS should have a majority of lawyer managers. The duties placed on the HOLP and HOFA (even if the same person) should be adequate for the regulator to be confident that the ABS entity will comply with the requirements of its license.

Question 18: What are your views about how licensing authorities should determine whether a person is a "fit and proper person" to carry out their duties as a HOLP or a HOFA?

We agree with the view in paragraph 6.26 that more stringent fit and proper requirements should not be placed on non lawyer managers. We believe that the SRA was about right in the criteria it adopted for the suitability test for non lawyers to be admitted into a partnership resulting in its LDP status.

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

We agree with paragraph 6.31 which neatly sums up the answer to this question. If the consumer focussed reforms of the LSA are to achieve the more competitive market for legal services and modernisation of methods of delivering it would be undesirable for the licensing body to be cautious from the outset. The statutory framework for ABS supported by the roles of the HOLP and HOFA and by the fit and proper test, should be sufficient to permit the licensing of ABS entities perceived to be at the high risk end of the spectrum of applications. Clearly post license monitoring will be important

although it will be difficult to determine the "right balance" other than in the light of experience. We simply repeat our initial proposition that proportionality should be at the core of all areas of regulation.

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

The plea for a level playing field was frequently heard during the passage of the legislation, embodying the fear of law firms that competing against non lawyer owned ABSs will place them at a competitive disadvantage because of unequal, less stringent or non existent regulation. This fear must be resolved otherwise the ABS reforms planned for mid 2011 will disrupt and distort the legal services market contrary to consumer interests. A possible key to ensuring a level playing field between the traditional model firms/lawyer dominated ABS/non lawyer dominated ABS will be the level and nature of responsibilities placed on the HOLP and the HOFA. The aim should be to ensure that the ABS (whatever its lawyer/non lawyer balance) is neither more tightly nor more loosely regulated than the other models that are part of the competition for legal services.

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

We agree with the analysis in paragraphs 7.2 to 7.8 and specifically agree with the expectation in paragraph 7.3 that the access to justice objective should be a positive reason for granting a license rather than a reason for turning it down. Indeed, the licensing authority should encourage applicants for ABS approval to include in their business plan the provision of services that will promote access to justice for the consumer clients that they will seek to attract. They should also be encouraged to include evidence of a commitment to social responsibility to the community particularly a contribution to pro bono activity.

Question 22: How should licensing authorities give effect to indemnification and compensation arrangements for ABS?

We think it unlikely that the Assigned Risk Pool (ARP) would be a relevant consideration at the time of application for licensing by an ABS. Moreover if the design of the ABS model achieves the intention of entities with improved capital adequacy rather than current non ABS models (where there is no capital adequacy requirement) the possibility of an ABS needing to seek protection of the ARP should be remote.

Insurers are very skilled at assessing the risk and pricing of insurance risks and opportunities particularly in the well understood market of underwriting professional negligence cover. It is therefore likely that in the answer to this question the key players will be the professional indemnity insurers. In the same vein, an ABS should be subject to the same requirements to contribute to the compensation fund as a non ABS entity. This requirement should be achieved via the combined responsibilities placed on the HOLP an HOFA and by

the licensing provisions that regulate an ABS. Licensing authorities should therefore aim for a level playing field when drawing up regulations in relation to indemnification and compensation arrangements.

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

As dealt with in our answer to Q22, it is also essential to achieve a level playing field in complaints handing, compliance and sanctions for non compliance as between ABSs and non ABSs.

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

This is an important area where, as stated above, the SRA has already made good progress in the 'fit and proper test'. We are unsure whether there is (or should be) any difference or distinction between the 'fit to own' test and the 'fit and proper' test. We agree with the proportionality requirement advocated in paragraph 7.34 and the importance of the roles of the HOLP and HOFA analysed in paragraph 7.35. With regard to any special considerations that may apply to initial public offerings we would urge the LSB to adopt the procedural approach of the OLSC in New South Wales.

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

This question raises a potentially very large area of debate about the LSA reforms and the market for legal services. The small number of reserved legal activities set out in section 12 of the LSA illustrates the scope of the market for unreserved legal activities in which many non lawyers are already active. The overarching regulatory objectives in section 1(i) of the LSA apply to the reserved legal activities set out in section 12. However, unreserved legal activities are not subject to the regulatory objectives or the professional principles in S(1)(iii). There is a clear gap in the regulation of those who operate reserved and unreserved legal activities. However, the task facing the LSB and approved regulators to oversee those who provide reserved legal activities is already substantial and it is unreasonable to expect them to extend their duties also to include regulation of those who provide unreserved legal activities. It is hard to assess whether this should change with the advent of ABSs. Already many traditional model firms deliver reserved **and** unreserved legal activities, provided by solicitors who are required to abide by the Code of Conduct in whatever they do. The only practical solution in our view seems to be to ensure a level playing field of regulation of an ABS if they are carrying out reserved/unreserved/both reserved and unreserved legal activities.

Question 26: What are the risks to the consumer associated with the delivery of legal services by special bodies and which more general risks are less relevant to these bodies?

It is difficult to respond to this question without greater knowledge of how the special bodies operate. We would certainly not wish to see any form of regulation that inhibited the contribution to the justice system and consumers by the Citizens Advice Bureaux, the Law Centres or the Trade Unions. We urge that the LSB and other regulators should first concentrate on the task of licensing ABSs before turning their attention towards the special bodies.

Question 27: Is it in the consumer interest to require special bodies to seek a licence, and if so, what broad approach should licensing authorities take to their regulation?

This is hard to assess but if licensing of special bodies is to be considered the example of the regulation adopted by the FSA and OFT appears to be a sensible model to follow.

Question 28: Are there any other issues that you would like to raise in respect of ABS that has not been covered by previous questions?

Not at this stage.