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Your reference

This document sets out Taylor Wessing LLP's response to the Legal Services Board's (LSB) recent consultation papers on:

- Regulatory independence;
- Funding legal services regulation; and
- Alternative business structures.

We reserve the right to make further submissions in relation to the consultation paper on alternative business structures.

1. The relationship between The Law Society, the SRA and the LSB

1.1 The Legal Services Act ("the Act") established an unwieldy tripartite regulatory structure involving the Law Society, the SRA and the LSB. At this stage, there is probably little to be gained in debating whether this is an optimal structure. Instead the focus should be directed at making it work in an efficient, transparent and cost effective manner and with a minimum of duplication. A tension between the Law Society, the SRA and the LSB is probably inevitable and quite possibly healthy. Nevertheless, we perceive that the current tensions between The Law Society and the SRA to go beyond what can reasonably be described as healthy tension. This is undesirable and steps urgently need to be taken to reduce, and preferably remove, what appears to be a climate of mutual antipathy and suspicion. As the LSB points out in its consultation document on regulatory independence, constructive, but not cosy, relationships are a must for effective regulation at proportionate cost.

1.2 We are concerned that the current arrangements for funding the SRA and especially for the SRA to share services with The Law Society is a potential source of ongoing and potentially destructive conflict.

It appears to be taken for granted that the SRA will use certain shared services with The Law Society. We question whether, in other than the short term, this is either desirable or necessary. In view of the overriding need for the SRA to be, and to be seen to be, independent of The Law Society, we consider that there should only be shared services if there is clear, economic, evidence of benefit to the SRA in using shared services. There should be a presumption against the sharing of services in order to enhance the appearance of independence and reduce the necessity for ongoing negotiations between The Law Society and the SRA.

1.3 We question whether the current arrangements for agreeing the funding of the SRA are appropriate. Annual discussions between The Law Society and the SRA can be expected to encourage short termism and create tension between the two bodies. We would favour a regime under which the funding requirements of the SRA are agreed for, say, a three year period, rather than the current annual negotiation. It is essential that The Law Society, in its capacity as a representative of the profession, plays a significant role in influencing the mandatory element of the practising certificate that will be used to finance the SRA. We have considerable reservations whether it continues to be appropriate for The Law Society to determine that sum. There appears to be a fundamental conflict of interest between The Law Society acting as a representative of the profession and in its capacity as determining the funding requirements for the profession's regulator when it must act in the public interest.

1.4 Consideration should be given to establishing a new mechanism for determining the mandatory element of the practising certificate. This should involve approval by the LSB of the SRA budget and funding needs after having regard to clearly specified matters in order to ensure not only an effective regulatory function but also one which is efficient and complies with best regulatory practice. Under such a regime, both the SRA and the LSB would be required to consult with The Law Society and have due regard to representations made by it. This mechanism will ensure greater independence and separation between the representation and regulatory functions of the Law Society.

2. The funding of legal services regulation

2.1 We question whether the current arrangements for agreeing the funding of the SRA are appropriate. Annual discussions between The Law Society and the SRA can be expected to encourage short termism and create tension between the two bodies. We would favour a regime under which the funding requirements of the SRA are agreed for, say, a three year period, rather than the current annual negotiation. It is essential that The Law Society, in its capacity as a representative of the profession, plays a significant role in influencing the mandatory element of the practising certificate that will be used to finance the SRA. We have considerable reservations whether it continues to be appropriate for The Law Society to determine that sum. There appears to be a fundamental conflict of interest between The Law Society acting as a representative of the profession and in its capacity as determining the funding requirements for the profession's regulator when it must act in the public interest.

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2.3 If it is accepted that there should be a genuine risk based regime governing the permissible behaviour of solicitors then this will inform decisions on the behaviours of regulators that will be required to implement and enforce that regime.

2.4 An outcomes based, or principles based, regime founded on risk management principles will necessarily involve a regulator that is much better informed about the diverse needs of the profession and its clients and which has an informed understanding of the risks arising out of specific behaviours. That will necessarily require the recruitment by the SRA of staff capable of, and willing to, exercise judgment within appropriate, targeted and proportionate parameters. That in turn can be expected to increase the cost of regulation of the profession. In our opinion that is an inevitable consequence of a risk based regulatory regime. So that the regulatory burden is maintained at an appropriate level, the LSB should ensure value for money and that appropriate cost/benefit assessments are regularly performed.

2.5 The Smedley Report recommended that there would be a separate regime notionally under the umbrella of the SRA for the regulation of about 30 corporate law firms. We are firmly of the view that it is wrong in principle for a relatively small number of firms to fund the regulatory regime to which they are subject where that regime is fundamentally different from that governing the rest of the profession. We consider that the SRA should be adequately funded so that it can undertake an effective and efficient system of regulation of the profession as a whole. That may lead to a significant increase in the SRA element of the practising certificate. That, of itself, is not a sufficient reason not to take the steps necessary to ensure that there is a properly funded regime in place for the regulation of the whole profession. Rather, it points to the need to review whether a per capita levy through the practising certificate remains the optimal means to fund the regulatory regime that the profession now requires and the public demands.

3. Alternative business structures

3.1 It is the role of the regulator to ensure that appropriate frameworks and structures are in place that enable those law firms, and others, who wish to do so to enter into alternative business structures. Firms must then be free to decide, in accordance with their own business plans and commercial interests, whether or not to adopt those structures. There must be a level playing field between "conventional" law firms and alternative business structures. This was clearly the intention of Parliament when its legislated for alternative business structures. It would be quite wrong for any regulatory authority to tilt the regulatory or commercial balance between "conventional" law firms and alternative business structures.

3.2 We believe that it inappropriate, and quite possibly unlawful, that there should be an additional regulatory levy for those wishing to establish alternative business structures. Such a levy would seem to amount to little more than covert protectionism.

3.3 We do not see the need for the entirety of an alternative business structure to be regulated provided that the part of it engaged in legal activity is satisfactorily ringfenced and appropriately regulated.

3.4 The LSB is pushing for alternative business structures to be introduced by June 2011. Given the current inability of the SRA to introduce an effective regulatory regime for firms undertaking corporate legal work, it seems little more than wishful thinking that the SRA is going to be in a position in two years time not only to have an effective regime for regulating conventional corporate law firms but also those wishing to establish alternative business structures. If the SRA is not going to be in a position effectively to regulate alternative business structures then those structures are unlikely to happen as, despite the failings of the SRA, there appears to be no other body capable of undertaking the role. Even if the LSB considers itself lawfully able to make rules to permit alternative business structures, it will not be in a position to ensure compliance with those rules without a radical change in the nature and scope of its activities. In our opinion if alternative business structures are to come into existence anytime soon, the LSB needs to ensure that the SRA is not only capable of effectively regulating "conventional" corporate law firms in accordance with our proposals in section 3 above but also that steps are put in place by the SRA to understand what the consequences of alternative business structures may be across the profession. Only then will it be in a position to consider what regulatory regime is appropriate for them. This is a significant exercise.

In our view, the diversity and complexities associated with alternative business structures are such that it is not sufficient simply to state that they must be subject to the same rigorous standards of governance and regulation as proposed for other law firms.

3.5 We agree that no regulation should, or should be required to regulate alternative business structures unless and until it feels genuinely confident about its ability to do so.

3.6 The regulation of alternative business structures raises fundamental regulatory issues including:

- What risks should a legal regulator be regulating;
- Where the boundary should be between regulated risk, ethical standards and quality standards;
- Entity based regulation v regulation of individuals.

There are complex issues that demand proper analysis and consultation. Only once that has been done can any real progress be made on rewriting the Code and establishing an appropriate regulatory regime for alternative business structures. It is simply not sufficient for the LSB to wish away these complex issues in pursuit of achieving a self-imposed timetable.

3.7 Those individuals who are engaged in the management or control of alternative business structures should be regulated in order to ensure that the public interest is protected. In corporate terms this would mean the directors or shadow directors of the alternative business structure. At present, we are not convinced of the need to

regulate the ownership interest, (using corporate terms, shareholders and their beneficial owners) or financiers in order to protect the public interest.

3.8 It is important that any regulator fully understands the diverse risks associated with a particular alternative business structure. It is clear that a one size fits all approach will not be appropriate.

While we agree with the LSB that there should be no delay in introducing a regulatory regime for alternative business structures, the reality is that, at least at the present time, it appears unlikely that there will be anyone sufficiently informed to be capable of undertaking the complex risk analysis required in order to ensure an appropriate regulatory regime for alternative business structures and the proper implementation of that regime with the timescale currently envisaged by the LSB.

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