

Tunbridge Wells, Tonbridge and District Law Society

Response to the Legal Services Board Consultation entitled 'Wider Access, Better Value, Strong Protection Discussion paper on developing a regulatory regime for alternative business structures'.

This response to the consultation has been prepared for and on behalf of the Council of the Tunbridge Wells, Tonbridge and District Law Society by its Regulatory Sub-Committee.

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?

Answer

As to whether a start date of mid-2011 is achievable, this is entirely a matter of for the LSB. It is clearly desirable that the regulatory framework is suitable and is fully considered before it is put in place and it will be harmful to the professions governed by the LSB if ABS licensing commences without a robust scheme being in place which has the consent of all stakeholders.

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

Answer

We are somewhat concerned that there may be an undue emphasis on opening the market for legal services which will attract individuals and organisations which are concerned principally with the creation of LDPs and MDPs. In our view, the professionalism of firms and individuals has always been assured by the quality of the individuals offering the services and running the firms. Where there is a substantial disconnection between the managers, owners and professional staff, we will see an erosion of professional conduct which will be detrimental to the community. It is imperative that there are open lines of communication between the LSB and all stakeholders.

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?

Answer

As we understand it, the objective of the Legal Services Act 2007 was to ensure that there was proper regulation of those firms providing legal services and that should be done through their separate professional bodies. The provisions in Schedule 12 of the Act, made pursuant to s.84, do provide a catch-all in the circumstances where there is no competent licensing authority and no potentially competent licensing authority.

We do not think it should be a principal objective of the LSB to seek to be the direct licensing authority save in exceptional circumstances. It is possible for all of the professional bodies to indicate whether they wish to be a licensing body and only in circumstances where there is a substantial gap where there is no potentially competent licensing authority, should the LSB go to the considerable expense and trouble of creating a licensing department and structure.

We anticipate that the SRA will be the appropriate licensing authority for Solicitors.

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

Answer

In accordance with the general principles adopted concerning regulation under the LSA, it seems to us appropriate that where there is no potentially competent licensing authority, the LSB should in each case create such a separate entity which will deal with licensing and regulatory issues.

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

Answer

There is considerable danger that those aspects of legal practice which can be "commoditised" will be removed from the vast majority of legal practices and will be dealt with by large corporations where outsourced labour in, for example, India, will be used to process personal injury claims. This will lead to a polarisation of the legal market in those areas which can be commoditised.

Legal advice from a commoditised environment will undoubtedly be less focused and of a diminished standard than bespoke advice.

A proliferation of MDPs will result in an increased number of conflict of interests arising and undoubtedly the volume of litigation concerning professional misconduct and disciplinary action will inevitably increase. After an initial price war between many High Street practices, there will be a considerable reduction in the number of firms offering legal services and the choice to the public will be diminished. There will be an increase in litigation in consequence of such conflicts of interests arising and the consequent increase in insurance premiums will undoubtedly lead to additional costs being passed on to the consumer.

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?

Answer

The objectives of the legislation were never clear on this point. The only objective that was understood was the government's desire to cheapen services and to gain popularity through making claims that legal services will be provided more cheaply and more efficiently. At no point has there been a proper assessment and statement of how services can be delivered to attain the objective. The unintended consequence of the introduction of ABSs will be a reduction of choice and quality of adviser and advice to the consumer.

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?

Answer

Considerable benefits may arise in enabling solicitors to bring in unqualified but capable fee-earners into their partnership structure. We welcome this evolution in the way in which solicitors practises are organised. However, we do think that there

ought to be strict regulation on the percentage of the profits of a law firm can be taken by individuals who are not members of the profession.

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

Answer

The introduction of ABSs will have no effect upon the diversity of the legal profession, or at least so far as Solicitors are concerned. The Solicitors' profession is very diverse, no matter what allegations are made to the contrary. More women than men join the profession and it continues to become more diverse over time.

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

Answer

We are clearly concerned that through the introduction of ABS, there may be people involved in the management of law firms who would not have the requisite skills to advise clients. In circumstances where a complaint, for example, is escalated to senior management, it is difficult to see how a senior manager who did not have the requisite educational qualifications, could adequately deal with such a matter. With a view to ensuring that consumers are protected from the depredations of rogues, it will be necessary to have a strict qualification requirement.

We find it difficult to understand why the LSB should be proposing a diminution in professional standards required to organise and manage a law firm at the same time as the Financial Services Authority is imposing ever stricter obligations upon firms and individuals to ensure that they are technically competent. A considerable amount of comment in the discussion paper appears to be trite and politically motivated rather than an objective proposal concerning the protection of consumers, the maintenance of the quality and professionalism of the providers of legal services and making access to legal services easier.

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?

Answer

The maintenance of professional standards and the protection of consumers are two aspects of practice that must be jointly paramount and compatible. We are of the opinion that very strict regulation should be imposed to ensure that the manner in which law firms are financed does not impact upon the independence and professionalism of those firms.

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

Answer

We are clearly concerned that the high standards of professionalism which are displayed by the vast majority of firms of solicitors will be undermined by an increasing number of firms dominated by non-lawyers primarily motivated by profit. We view the principal risks to which regulation should be directed are as follows:

1. International terrorism or organised crime;

2. The introduction of ABS will undoubtedly lead to a considerable number of undesirable people wishing to clothe themselves in the respectability of being part of a law firm. Many activities which are currently regulated by the FSA may be directed by such individuals through more firms with a view to cloaking dubious activities. Unless there are very firm regulations concerning the ownership of ABSs a flood of claims concerning malpractice be unavoidable;
3. There will be a disconnection between the management of the firm and those individuals who are providing legal services;
4. Many firms will see the objective of profitability eclipse the delivery of legal services at an economic rate;
5. Law firms will become brands which will be tradable and where short term profitability or capital growth will eclipse the needs of clients and the long term stability of the legal profession.

We feel that the foregoing risks are best mitigated by ensuring that there are strict limits placed on the amount of profit that can be shared with a non-solicitor who has invested in a firm.

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

Answer

Organisations which have outsourced considerable parts of their back office and client servicing to parts of the world where corruption is endemic are largely to be viewed with considerable suspicion. Furthermore, where there is overseas involvement with law firms, the possibility of enforcing penalties against those overseas is diminished and the reach of the Regulator must, therefore, be diminished also. It is our view that all ABSs should be owned and controlled from within the jurisdiction to avoid international terrorists and criminals taking over law firms.

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

Answer

It is manifest that there will be a considerable number of conflicts of interests arising which have not been seen in the past. For example, where an ABS is partly owned by an individual who owns an estate agency, there would be a reluctance on the part of the firm of solicitors in bringing an action against that estate agency where a conveyancing solicitor noticed that the particulars issued by the estate agency were defective and had resulted in a succession of failed or abortive transactions. There must be stringent regulation to ensure that professional integrity is maintained and conflicts of interest are not allowed to arise in consequences of the structure of ABSs.

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

Answer

It seems evident to us that the FSA model is being adopted by the LSB and the FSA has not had any difficulty in dealing not only with firms but also authorised individuals. It will clearly be important to ensure that the firms regulated are given appropriate guidance to ensure that there is no inadvertent breach of the regulations

and this may result in an FSA-style relationship between the Regulator and the authorised firm through nominated individuals.

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?

Answer

It seems odd that the LSB should continue with the risk-based approach to regulation rather than outcomes based regulation which is now being proposed by the FSA. We have no doubt that ABSs will be significantly riskier than traditional law firms because they may have a "get rich quick" attitude towards the provision of legal services which has not been experienced within the profession.

It is important to ensure that all firms are regulated equably but prudently. In this regard we view the risks posed by an ABS to be greater than that posed by a traditional law firm due to the profit and capital growth incentives to a non-solicitor investor in such an ABS. It would be wholly inappropriate to saddle the entirety of the profession with additional costs arising out of this higher degree of surveillance and monitoring resulting from the introduction of ABSs. We would propose that ABSs pay a considerably higher practice fee in order that the additional costs incurred by the SRA in monitoring such ABSs might be recouped.

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

Answer

It is necessary to have a set of principles to which all firms can adhere. This will assist in determining whether actions are ethical in addition to whether they fall within the ambit of the regulatory architecture. To adopt the FSA model with exceptionally complex regulation would, in our view, be counter-productive. Equally, simply to express a number of principles is counter-intuitive for common lawyers and applicable only to those with a civil law background. We would, therefore, suggest that the regulation of ABSs be left to the professional bodies to which they are licensed and that the LSB adopts the model which is appropriate to whichever organisation is licensed directly by the LSB. We do not see there is any reason to have a protracted debate about the regulatory framework, examples which already exist in some numbers.

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

Answer

We see only benefits in having the balance of management and control at all levels being held by lawyers. This is not a question of which to try to maintain a closed shop but reflects the natural concerns of all lawyers that professional standards will be adversely affected in the event that non-lawyers are allowed to control firms which deliver linked services.

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?

Answer

We are aware of the significant guidance which is given in relation to who is a "fit and proper person" for the purposes of the FSA Handbook and it occurs to us that the

same approach could, with modifications, be adopted here. We are aware, of course, that there is presently consultation regarding the regulation of persons exercising a significant influence function and following recommendations in that regard, we suggest that this matter is then reviewed once again.

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

Answer

There is no doubt that there will be significant risk of ABSs failing or carrying out their activities in a manner which is incompatible with the provision of legal services pursuant to the regulatory control of the Law Society. In these circumstances we feel that it is necessary to mitigate the risk to consumers of ABSs failing or acting contrary to the rules of professional conduct by ensuring that those individuals who exercise a significant management function or a significant influence function in relation to the business, should be properly qualified and subject to direct interview in the event that any change in status is requested.

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

Answer

By ensuring that licensed bodies are subject to the same degree of inspection and control as are regulated legal practises but are subject to heightened inspection and control in any circumstances where the Regulator is aware that there is an unstable market or where concerns have been expressed by clients or other professionals about that firm. To this end, we would be keen to ensure that foreign companies having rights to provide legal services through passporting should be subject to the full requirements of the British regulation in addition to the regulation of their home state.

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?

Answer

Poor quality advice actually denies access to justice. The regulator should reject applications for licences where:

there is an enhanced possibility that the applicant might give inadequate advice; or

if the grant of a licence may have other adverse effects on the access to justice, in the widest sense.

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

Answer

There should be a level playing field and all ABSs must be required to have the appropriate levels of insurance indemnity and compensation arrangements as established legal firms.

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

Answer

Complaint handling in relation to legal services provided by ABSs should be regulated in the same way as those for law firms. If the liaison between the Regulator and the ABS is as envisaged above, with deputed representatives of the Regulator and the regulated firm being in regular contact, no doubt there will be a requirement that all complaints should be logged and monitored and be subject to reporting to the Regulator.

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?

Answer

We are of the view that the fit to own test is absolutely crucial in relation to the ownership of ABSs and this should be approached by the Regulator on the same basis as the fit and proper test to authorised individuals. It is of paramount importance to ensure that ABSs do not become playthings of individuals of dubious antecedents or whose intentions are incompatible with the delivery of quality legal services at an affordable price. The LSB has been put into an almost impossible situation by trying to reconcile the Government’s desire to drive down the cost of the provision of legal services whilst maintaining its professional quality. We are of the view that a robust regulatory environment for ABSs will be essential to avoid a catalogue of claims for professional misconduct.

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

Answer

Most sophisticated legal advice is in relation to non-reserved legal services and it is our concern that the way in which the legislation has been framed and the very considerable costs of implementing the LSB regime will cause many solicitors to consider offering non-reserved legal services through alternative entities. These will not then be regulated and this can only be to the detriment of the consumer. It was clearly a consequence which should have been foreseen at the time the legislation was passed through Parliament but if it was, it appears to have been insouciantly dismissed.

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?

Answer

In view of the fact that many of the organisations referred to within s.23 of the Act seek legal advice from law firms, we find it very difficult to understand how, without more, special bodies can give advice concerning reserved legal matters without being incorporated within the regulatory regime. It would be wholly inappropriate, for example, for a Trades Union to provide conveyancing for its members using unqualified fee-earners. Indeed, it may result in the Trades Union leaders using such an organisation as a platform for trading and as a profit centre. We would be concerned that these special bodies would be offering legal services in competition with law firms without being properly regulated.

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?

Answer

A special body should be licensed in the same way as ABSs.

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?

Answer

We are concerned that there should be considerable regulatory control over the nationality and residence status of individuals who own or manage ABSs that they should be within the ambit of the Regulator's control at all times.

**Martin Varley, Chairman Regulatory Sub-Committee,
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