THE CITY OF LONDON LAW SOCIETY

4 College Hill
London EC4R 2RB

Telephone 020 7329 2173
Facsimile 020 7329 2190
DX 98936 – Cheapside 2
mail@citysolicitors.org.uk
www.citysolicitors.org.uk

18 February 2010

Mahtab Grant
Legal Services Board
7th Floor
Victoria House
Southampton Row
London
WC1B 4AD

By email: consultations@legalservicesboard.org.uk

Dear Mr Grant

Re: Alternative Business Structures: Approaches to Licensing

The City of London Law Society ("CLLS") represents approximately 13,000 City lawyers through individual and corporate membership including some of the largest international law firms in the world. These law firms advise a variety of clients from multinational companies and financial institutions to Government departments, often in relation to complex, multi jurisdictional legal issues.

The CLLS responds to a variety of consultations on issues of importance to its members through its 17 specialist committees. This response in respect of Alternative Business Structures: Approaches to Licensing has been prepared by the CLLS Professional Rules and Regulation Committee.

Question 1

We agree that the regulation of Alternative Business Structures ("ABSs") should be based on achieving outcomes and that the outcomes should apply to all Licensing Authorities ("LAs").

We believe that it is important for there to be a level playing field between ABSs and other legal service providers and therefore that a principles-based regime for ABSs should not be promulgated by an LA unless it can offer, at the same time, the same principles-based regime to the other legal service providers which it regulates. It is understood that the SRA is trying to move towards a principles-based regime for solicitors. It would be helpful if the LSB could obtain confirmation from the SRA that it intends to have principle-based regulation for all and that the introduction of the new regime will occur on the same date for all.

The proposed outcomes might include a specific reference to promoting competition. It could be argued that there has been regulatory failure in other sectors where consolidation has resulted in market domination by too small a number of businesses to ensure meaningful competition or where regulators find themselves in a position where they cannot allow a dominant player to fail. The competition

authorities have been unable to provide a solution to the latter problem and we are concerned that the LAs might seek to avoid responsibility for promoting competition by sheltering behind the competition authorities. The Legal Services Act requires the LSB to promote competition and sets out a framework for the relationship between the regulators and the OFT. We wonder whether further consideration might be given to this area in drawing up the licensing regime.

The division between entity and individual regulation will only have real meaning if responsibility for entity compliance rests with specific individuals in the ABS and not with all regulated individuals. The individual behaviour referred to in the last bullet point of paragraph 64 "ensuring the entity they work within meets the standards required" would suggest that if an entity breaches a regulation, then all those regulated individuals working within the entity would be treated as being responsible for failure and therefore would be subject to sanction. If the thinking is that only the head of legal practice will have to take the blame for entity failure, then that should be made explicit. In the interests of there being a level playing field, if sanctions for entity failure can only be applied to a specific individual charged with responsibility for entity behaviour in an ABS, then other legal service providers should be able to take advantage of a similar narrowing of responsibility, rather than have all the regulated persons in an entity be responsible for failures.

Question 2

We believe that the tests should be consistent across all LAs.

We consider that more work will have to be done in order to accommodate existing rules and practices for listed companies. For example, contracts for differences and other derivative instruments are often used as an alternative to investing in shares, so the rules on ownership would have to be flexible enough to pick up such matters.

As you know, the ability of UK registered companies to buy in or redeem their shares is narrowly circumscribed and therefore the Australian approach might not be feasible. For example, a company has to have distributable profits in order to buy in shares (stated briefly) and companies might not always be in that position. We believe that a regime for forced divestiture with the removal of voting and dividend rights pending divestiture is likely to prove a more fruitful avenue to explore than introducing a requirement that companies be obliged to buy in shares. We would also note that conflicting duties to the regulator and creditors may have to be considered.

In relation to your references to associates, including partners, you will be aware that private equity investors typically invest through a fund structured as a limited partnership. The commercial sensitivity of investors (pension funds and other institutional investors, fund of funds, etc.) dictates the market practice that the manager of the fund is not permitted to disclose the identity of the investors to the target investee company or others with the sole exception of taxing authorities. Current FSA practice in relation to 'controllers', where the investee company is a regulated entity, is not entirely satisfactory and may turn on whether the manager of the private equity fund is known to the FSA. We suggest that the better approach would be to have specific provisions dealing with funds where the manager of the fund is regulated. In such circumstances, reflecting the reality of the situation, the manager alone should be treated as the controller for the purposes of the ownership tests.

With regard to checking the background of owners, LAs should not assume that foreign regulators and other bodies with information pertinent to fitness to own will be willing (or able) to produce confirmatory evidence, and so the system for making declarations should take into account the practical difficulties.

We agree with your proposed test on fitness to own.

We agree that the ultimate owner should be identified, subject to some form of exception for funds (see above).

We support your approach on defining restricted interest.

We do not think that requiring covenants is an appropriate way forward.

Question 3

We would ask that the guiding principle of there being a level playing field as between ABSs and other regulated firms be followed in relation to financial assurance and stability. It is important that there be no barriers to entry, but equally important that no commercial advantage be given to providers of legal services by virtue of their providing such services through ABSs. In particular, detailed consideration should be given to the indemnity and compensation obligations of ABSs which provide legal services in combination with other services and structure their businesses to minimise turnover in those parts of their businesses which are subject to regulatory obligations.

Question 4

Our members carry on mainly unreserved legal activities. In the interests of there being a level playing field, if ABSs are allowed to segregate reserved and unreserved matters into separate legal entities, with only the former being regulated, then that option should likewise be available to other legal service providers.

We recommend that you review the distinction between reserved and non-reserved legal matters and the underlying principles to determine whether the distinction remains of relevance today.

As a general point, we believe that all legal services (that is, where someone is held out as a legal adviser or held out in a manner which may lead the consumer to consider the person to be an adviser on law) be regulated, as the distinction between reserved and unreserved matter and, indeed, between solicitors and other "lawyers" is something that the consumer may not be interested in, nor would necessarily be, even if educated on the point. Reference on a firm's literature to being regulated may have varying degrees of relevance to sophisticated and unsophisticated users and, equally importantly, the absence of regulation may not be a barrier to consumers going to a particular brand for legal advice. If the policy of government is to regulate the provision of legal advice for the protection of consumers, then we believe that all provision should be regulated.

You will be aware that the insurance market does not offer unlimited cover and that firms are involved in transactions which may carry risk in excess of their cover; that disclosure of insurance cover is not a standard practice in the market place, although some clients demand a set minimum well in excess of SRA rules; that solicitors may seek to cap their liabilities on a contractual basis with their clients and will often do so where jointly advising with accountants or others; and that there is a de facto limit on liability where firms (and in the future ABSs) choose structures which afford limited liability (LLPs, limited companies, etc.).

Our main concern is to ensure that rules provide a level playing field as between ABSs and other legal service providers, do not require financial assurance beyond the current rules (which allow the above-mentioned practices) and give the necessary flexibility to allow ABSs/other firms to work with clients and the insurance market to develop products and approaches that can meet changing market conditions.

Our view is that ABSs which are part of a wider group should be treated in the same way as any other ABS.

Question 5

At present, the current approach of the SRA to breaches of the Code does not sit comfortably with all the principles of good regulation, nor does it generally engender a relationship of trust and co-operation between the SRA and many of those it regulates. The new approach set out in the recent SRA paper on OFR is a step in the right direction, provided that the enforcement regime reflects the new approach. (It

is understood that the SRA is shortly to publish a paper on enforcement which may throw some light on how the current regime might change).

We agree that unlimited fines, with an obligation on an LA to act proportionately in the circumstances of a particular case, is the most appropriate approach.

With regard to enforcement powers, we would reiterate our concern to ensure a level playing field between ABSs and other providers, subject to three principal points.

The main thrust of the proposed enforcement regime is to ensure that financial penalties are significant enough to act as a deterrent for ABSs. We are concerned that where an ABS is part of a larger group, the enforcement regime should take the financial position of the ultimate owner and the part that the ABS plays in that group (e.g. cross-subsidising services, using the legal services as a marketing tool for other services, etc.) fully into account.

The second point we would make is that where the owners of a business are regulated as individuals, the main deterrent they face is being disqualified as a solicitor. This deterrent will not apply to the owners of an ABS.

Third, we believe that LAs should have an obligation to ensure that they do not allow regulated entities to become too big to fail and that the LA has as an optional sanction the disqualification of unregulated individuals or entities from being beneficial owner of more than, say, 10% of an ABS in the future.

Question 6

It is not clear what your wide definition of 'access to justice' is, but we understand the difficulty of defining the expression. We agree generally with the thrust of your propositions in this chapter. The firms we represent provide world-class legal services in an extremely competitive market where competition on price, quality and accessibility ensure that almost all commercial clients can obtain advice at a price that suits them. We would not wish to see any obligation being passed on to ABSs or other providers to offer services which they do not want to provide or at a cost which makes no commercial sense for the provider.

We believe that LAs should be obliged to take competition issues into account in formulating their licensing rules.

Question 7

We would prefer a single appeals body.

Question 8

We have no comment, save that we believe special bodies should be making an appropriate contribution to the costs of regulation where they are competing with ABSs and other legal service providers in any particular market. It would be unfair, for example, for a charity to offer legal advice on criminal law where legal aid was available and not have to pay the same contribution to the regulator as an ABS which was competing for that work.

Question 9

We consider your approach to be suitable. We would agree that HoLPs and HoFAs undergo fit and proper tests, perhaps with some 'grandfathering' provisions, but query the need for mandatory training. We consider that in the interests of the consumer and for the reputation of regulated entities, it would be important that the HoLP and HoFA are not one and the same person.

Question 10

We agree with your approach.

Question 11

As we have said on a number of occasions, we believe that a key to increasing diversity within the profession is to encourage those from non-traditional backgrounds to target a legal career (and corresponding academic attainment) whilst in secondary education. The focus of the LSB and the LAs should therefore be to assist with such encouragement.

Question 12

We are concerned to ensure that our members' money is not wasted on expensive campaigns or otherwise to educate foreign jurisdictions on ABSs.

Question 13

We have no comments.

Question 14

We agree with your approach.

Question 15

We have no reason to disagree with your approach to managing regulatory overlaps.

Yours faithfully

David McIntosh
Chair
City of London Law Society

THE CITY OF LONDON LAW SOCIETY
PROFESSIONAL RULES AND REGULATION COMMITTEE

Individuals and firms represented on this Committee are as follows:

Chris Perrin (Clifford Chance LLP) (Chair)
chris.perrin@cliffordchance.com

Raymond Cohen (Linklaters LLP)

Sarah deGay (Slaughter and May)

Alasdair Douglas (Travers Smith LLP)

Antoinette Jucker (Pinsent Masons)

Jonathan Kembery (Freshfields Bruckhaus Deringer LLP)

Heather McCallum (Allen and Overy LLP)

Julia Palca (Olswang)

Mike Pretty (DLA Piper UK LLP)

John Trotter (Lovells)

Clare Wilson (Herbert Smith LLP)