Response to: Alternative Business structures: approaches to licensing.

I am the managing partner of Scott Moncrieff Harbour & Sinclair, a two partner "virtual" firm with an office in Kentish Town, London and about 60 fee earners working at different locations in England and Wales. The firm has legal aid contracts in mental health, prison, family and public law and to undertake CCRC applications and criminal appeals. We also have solicitors specialising in personal injury, clinical negligence, military claims and employment law.

Our business model includes paying our fee-earners 70% of the profits they generate (so as to attract and retain excellent and experienced staff) and focusing on quality assurance (so as to ensure our staff provide an excellent service to clients). Money is tight, and we prefer to spend it on paying and supporting our staff, rather than on unnecessary bureaucracy. We assume our professional regulators, whether front-line or oversight, share our goals, and we expect them to ensure that regulation helps us in our endeavours.

In this response I have answered some of the questions put in the consultation document, but have not answered those where I don't feel I have enough knowledge or information to give a view.

Q1. What is your view of basing the regulation of ABS on outcomes?

The SRA has already indicated that it is intending to move from prescriptive rules based regulation to (mainly) non-prescriptive outcome based regulation. If it does so, it is clearly right that ABS should be subject to the same regulatory regime. If, therefore, you were suggesting that authorised regulators to apply the same regulatory regime to ABS as to existing entities, this would be unexceptionable. Unfortunately, this is not the approach that you have proposed.

Paragraph 37 (pp 11/13 of the consultation document) sets out the outcomes that you propose for all licensing authorities in their regulation of ABS. The first proposed outcome is that: "*Regulation of ABS is based primarily on clear outcomes supplemented by guidance, with rules where there is only one appropriate way to ensure consumer protection and broader public interest*".

In effect, you intend to prescribe that authorised regulators which wish to become licensing authorities must make regulatory arrangements in the form of outcome focused regulation rather than rules based regulation. As authorised regulators are required to comply with the principles of good regulation, including consistency and proportionality, it must follow that if an authorised regulator brings in outcome focused regulation for ABS, it must also do so for the non-ABS it regulates.

Your timetable (para. 38 on p.14) envisages that ABS will be licensed from July 2011. This means that if you continue to insist that the regulatory arrangements for ABS follow the principles of outcome based regulation, necessarily all entities regulated by an authorised regulator which is also an licensing authority will have to be regulated in accordance with the principles of outcome based regulation by July 2011.

There are serious problems both of principle and practice with this approach.

Firstly, it is not at all clear that the LSA allows you to prescribe in this way.

Part 5 of the LSA sets out your duties in relation to the licensing of ABS, with s.83 and schedule 11 providing the details concerning the licensing rules that licensing authorities must put in place. S. 83(5) describes what the licensing rules "*must contain*", and s.83(7) refers to schedule 11 making "*further provision as to the content of licensing rules.*"

In para. 37 (pp 11-13), you set out the outcomes that you propose for all licensing authorities in their regulation of ABS.

All of these, other than the one quoted above, can legitimately be seen as defining the content of the licensing rules that will apply to ABS, and, as such, are clearly legitimate in accordance with s.83 and schedule 11.

However, the first proposed outcome in para. 37, quoted above, does not deal with the content of the rules but with their form – with the "how" rather than the "what".

Part 4 of the LSA sets out how you should regulate approved regulators, and gives you the power to set targets, monitor, make directions, fine, intervene, cancel designation as approved regulator or cancel designation as licensing authority. S.49(4) in part 4 reminds you that you must have regard to the principle that you "*should not exercise any of those functions by reason of an act or omission of an approved regulator unless the act or omission was unreasonable*".

Although part 4 does not cover the granting of a designation as licensing authority, it is difficult to see why the principle would not apply equally in such circumstances, particularly as, for the reasons given above, the same regulatory scheme will have to apply to non-ABS. If it does apply, you have no authority to prescribe the form of regulatory arrangements that an authorised regulator may propose for ABS, unless you are satisfied that the form proposed by the authorised regulator is unreasonable.

Furthermore, s.82 requires each licensing authority to issue a statement of policy as to how it will comply with s.28, including how it will act in a way which is compatible with the regulatory objectives and which the approved regulator considers most appropriate for the purpose of meeting those objectives. Clearly it is intended that the authorised regulator will decide how

it is to carry out its regulatory functions in relation to ABS, and so it cannot be for the LSB to prescribe this.

Secondly, even if the letter of the Act allows you to prescribe the form of regulation that licensing authorities must apply in relation to ABS, it cannot be in the spirit of the Act that you are prescriptive in this way.

For the reasons given above, your proposed prescription in relation to the regulatory arrangements for ABS will, because of the need to adhere to the principles of good regulation, necessarily result in all entities regulated by that authorised regulator being regulated in accordance with outcome focused regulation. In accordance with the principle articulated in s.49(4) it would be against the spirit of the Act for you, in effect, to prescribe the form and content of regulation where there are other forms that would be reasonable to use.

To put it another way, if the principle quoted above were to be expressed in the form of an outcome, the outcome would be that you would only seek to alter or influence the acts and omissions of an approved regulator if those acts and omissions were unreasonable. It is obvious that any attempt by you to prescribe the form of regulatory arrangements, as opposed to their content, would not achieve the desired outcome.

In terms of principle, therefore, the issue is not whether outcomes focused regulation is a good idea or not, the issue is whether you can or should insist that approved regulators who wish to regulate ABS must, by July 2011, have set up a workable system of outcome focused regulation.

However this is not just a matter of principle, as the consequences of your proposed first outcome may do more harm than good.

It is well known that the SRA wishes to become a licensing authority, and it is right that it should do so, as there are many more solicitors in practice than all the other legal professionals put together. However, if the SRA, in its wish to become a licensing authority, has to try and create and implement outcome focused regulation in the 15 months between March 2010 (when you publish your final guidance on licensing rules) and July 2011(when the first ABS licences are granted), there must be serious risks that something will go badly wrong.

Rules based regulation has been around for as long as any solicitor has been in practice, and far longer than anyone has been working as a regulator in the Law Society or the SRA. Necessarily, any new system of outcome focused regulation will be experimental and imperfect and require refinement and adjustment while it is being bedded in. This is not a criticism, simply a fact. The new system will also require a new way of thinking about regulation, not just from the profession, but also from the SRA.

If the new arrangements are to have the confidence of the profession, it is essential to ensure that sorting out teething problems and resolving

unintended consequences is not done at the expense of members of the profession.

Solicitors, in my experience, have integrity and want to comply with their professional obligations. An allegation that they have committed a regulatory breach, which carries with it an implication that their clients' interests have been put at risk, can have a devastating effect, regardless of the eventual result of the investigation.

The SRA is currently seeking to amend its rules so that, in most cases of alleged regulatory breach, the standard of proof will be the balance of probabilities rather than beyond reasonable doubt. If the SRA is successful in this, the combination of new and experimental regulatory arrangements; a tight deadline; the need for a new mindset by SRA investigators and adjudicators; and a much lower standard of proof than previously, makes it entirely possible that competent and experienced practitioners and the entities in which they work will fall foul of the new arrangements.

They will be able to protect themselves to a certain extent by sticking slavishly to the examples of good practice that will accompany the outcomes to be achieved, but these examples will not cover every situation, and as soon as a decision has to be made about a matter where there is not precise guidance, they will run the risk of the SRA finding that their way of attempting to achieve the outcome amounts to a breach.

If the SRA wants outcome focused regulation to work properly, and not just be new wine in old bottles, it will need to show the profession that it has embraced an outcome focused mindset, and it must show the profession what this means. It should also provide a period of grace during which alleged breaches will not lead to penalties or publicity unless obviously deliberate and egregious, but instead will be used as learning opportunities for the whole profession, through discussion and debate. The SRA would need to accept that it will be learning alongside the profession, and be willing to adjust its methods if there is good evidence that it has got something wrong.

All this seems entirely do-able, but not in 15 months. It is so important to get this right, that the timetable for ABS must not be allowed to increase the risk of it going wrong.

We have been told that outcome focused regulation needs to be ready for the first ABS to be licensed, because the prospect of having to get to grips with the current system and then have to switch to a new system shortly thereafter might discourage some ABS for seeking early licences.

Well, maybe, but there is another way of looking at this. The introduction of ABS is going to be an opportunity for non-lawyers to take control or manage entities offering legal services. These people may come from professions or businesses that have different ethical codes.

The current Code of Conduct for solicitors, although it consists of rules, is based on an ethical code. Although many of the existing rules are tediously

and unhelpfully over-prescriptive, there seems to be little doubt that compliance with the code does give a solicitor a very strong sense of the way in which the ethical code is interpreted by the profession. It may be doing the members of an ABS a considerable disservice to get rid of all the detailed rules before the ABS comes into existence, as the guidance may not be sufficient to ensure that an entity that complied with it would therefore necessarily be working in accordance with the ethical code underlying the regulations.

It would be better if you decided that authorised regulators could not introduce outcome focused regulation until you are satisfied that it can be implemented without putting the profession and its clients at unnecessary risk. If this means ABS have to comply with the current rules, suitably amended to take account of their special circumstances, this does not seem a bad thing.

Q3. Do you have views on how indemnity and compensation may work for ABS?

It is important to bear in mind how easy it will be to become an ABS. S.72(1)(b) says that a body is a licensable body (entitled to become an ABS) if a non-authorised person (someone who is not entitled to carry out reserved activities) has an interest in the licensable body. Section 72(3) says that a person has an interest in a body if the person holds shares in the body and section 6 provides that, in relation to a body without capital, "shares" means interests conferring any right to share in the profits of the body. If I have understood this correctly, this means that if a friend of mine who is not a lawyer agrees to give me £10,000 in exchange for a 1% share of the profits of the firm, I will be entitled to apply for a licence to become an ABS.

It follows that, unless you want all provides of legal services to become ABS, you need to ensure that the insurance and compensation fund arrangements for ABS do not give them a financial advantage over non-ABS.

You are proposing that ABS may be able to have lower minimum cover to non-ABS. This would presumably, given them a financial advantage because their insurance would probably be cheaper than that of a non-ABS required to have the current minimum cover.

It is difficult to see how an authorised regulator could agree to lower minimum cover for ABS without it being disproportionate and inconsistent for it to require higher minimum cover for non-ABS.

My firm mainly does low risk work, and cover of £50,000 would amply insure us against any claim that could conceivably be brought against us by 95% of our clients. It would suit us down to the ground to pay a lower premium for lower cover generally, and to have much higher cover for the small number of clients who have a significant money claim. If an ABS can do this, so should a non-ABS be able to.

In relation to successor practices, I note that in paragraph 144 on page 38 you say that if there is no successor practice to an existing SRA regulated firm that wants to become an ABS, then the firm would have to provide six years run-off cover. I am not sufficiently familiar with the successor practice rules to know whether this statement is accurate, but if it is not possible for an ABS to become the successor practice to a non-ABS, the successor practice rules should be altered. If, for instance, I wished to become an ABS using the mechanism that I have outlined above, I would be very put off indeed if the ABS could not become the successor practice of the current partnership. There doesn't seem to be any legitimate reason for this, and it may simply be that the current successor practice rules were not drafted in contemplation of ABS, and can be amended without controversy.

The issue of the compensation fund is tricky. It is probably the case that the size of ABS will generally be within the range of sizes of current firms and it therefore seems unlikely that any call on the compensation fund by an ABS would exceed the sort of calls that are made by traditional firms. However, there is nothing to stop a really major player coming into the market, and you need to make sure that the compensation fund arrangements are such that no individual organisation can jeopardise the viability of the compensation fund and those who contribute to it.

Another difficulty lies with the nature of the fund. It is a mutual fund and it exists to protect the reputation of the profession, through protecting the interests of the profession's clients. Detailed work will need to be done to ensure that the compensation fund cannot be used to benefit clients who would not have been eligible if the ABS had been a non-ABS, nor to benefit unfairly non-solicitors who gain through their involvement with an ABS. The definition of whose dishonesty is needed to trigger a potential claim is very important. In a large partnership it is unlikely that all the partners will be dishonest. However a huge, quoted, company (eg Enron) might have quite a small board of directors, and so might trigger a catastrophic liability that, to my mind, should be borne by shareholders rather than the profession.

Q6. What do you think of our approach to access to justice?

I think that the approach requires some further work.

You need to distinguish between access to legal services and access to justice. If you conflate the two, you run the risk of not noticing that increased access to legal services may be masking decreased access to justice.

I would say that there are three categories of client – those who are wealthy and knowledgeable enough to buy whatever they need, regardless of geography; those who are entitled to legal aid; and those who are not wealthy and knowledgeable enough to buy whatever they need, but also not entitled to legal aid.

The first group can probably look after themselves. The introduction of ABS will not affect their ability to access justice via the providers of legal services.

The second group will include people without much money who are knowledgeable, organised and resourceful. They may well be able to benefit from legal aid, or other, services that do not involve face to face contact. However, there are other people who are entitled to legal aid services, and desperately need them, who are not particularly knowledgeable, organised or resourceful. In fact they may find it very difficult to cope, live in chaotic circumstances, and need a great deal of help in sorting out their legal issues.

For either group, if they do need face to face services, those face to face services need to be local because most people who are financially eligible for legal aid don't have a lot of money to spend on transport.

The third group covers the bulk of the population and includes people who are poor enough to be eligible for legal aid but whose problems are not covered by legal aid. As with the previous group, these people's abilities will vary considerably, and their need for face to face local services will also vary.

Paragraphs 207/208 on page 54 propose that ABS applicants must explain how they anticipate they will improve access to justice, and that licensing authorities must not consider the impact on access to justice solely or mainly based on requirements such as the provision of face to face services, the number of traditional firms in a given area, or categories of legal advice provided. This seems too prescriptive. It suggests that in no individual application by a potential ABS may the licensing authority base its decision simply on all or any of the above criteria.

There may well be many applications by ABS where the above criteria would be irrelevant, however, there may be others where one or all of those criteria would be highly relevant. For instance, a supermarket in a small market town might decide to set up an ABS providing conveyancing and will writing services. It would be able to complete successfully with local firms by providing perfectly legitimate inducements that the local firms were not able to match. The consequence might be that the one high street firm that still offered legal aid services to the people of the town would have to close because it had been relying on the profit from conveyancing and will writing to keep the firm going, as it obtained no profit from doing the legal aid work.

It could be argued that those who wish to have their wills written or their houses conveyed would have increased access to legal services but it would certainly then be the case that those in need of legal aid services would have very reduced access to justice, and perhaps have no realistic access to justice at all, in the sense that they would not be able to travel to the nearest legal aid provider.

It seems quite wrong that licensing authorities should be forbidden from taking this sort of thing into consideration when deciding on an application for a licence. This may not be what paragraph 208 intends, but it is certainly the impression that is given.

Conclusion

I hope my comments will be seen as constructive criticism. The profession and its clients will benefit greatly from having regulation that meets their diverse needs,

Lucy Scott-Moncrieff
24 January 2010