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LSB Consultation on the Separation Rules

Response to the Consultation by Peter Adams.

On the philosophy of the rules.

I approach the issue of the separation rules from two positions of philosophy which are fundamentally different from the draftsman of this consultation, and respectfully submit that my philosophies are closer to the will of Parliament than the argument set out in the consultation. It is however right to start by saying that much good and helpful work has gone into the drafting.

The first position of philosophy is that I believe that law making should be rooted in evidence. I believe that "perception" is a close sibling of "spin", and, while not disputing that the presentation of decisions is important, I take the view that presentation follows the decision and should not influence the making of the decision. It follows that I regard the frequent references to "perception" – and to a lesser extent "demonstrably" where it is used synonymously with perception, as detracting from the weight of the arguments they are intended to support.

My philosophy is that it is right to research evidence and then make laws (i.e., in this case, regulations) based on logically addressing evidentially based issues. This has been encapsulated by a quote from Sir Derek Morris when he chaired the Competition Commission:

> "Our only protection [against attacks on judgments] is to be absolutely thorough, absolutely rooted in the evidence, and pursue a consistent approach."[1]

That seems to me the correct approach to the making of robust, fair and effective regulation.

The second position of philosophy is that I believe that when Parliament wrote the following words into Section 30 (2) of the Legal Services Act (LSA)

> (a) that the persons involved in the exercise of its regulatory functions are, in that capacity, able to make representations to, be consulted by and enter into communications with the Board, the Consumer Panel, the OLC and other approved regulators,

it intended that making representations to the LSB should act as a route of appeal by regulatory arms where they felt that their approved regulator had transgressed the provisions of the LSA in some way. It

[1] Financial Times, March 30, 2001.

follows that the LSB's rules should not be written in a way that creates obligations that go further than the LSA, and thus prejudices the proper consideration of the facts which are asserted on appeal as the core of whatever it is that has prompted the disagreement.

The background facts are these:

(a) the LSA appoints the approved regulators;
(b) the LSA requires, absolutely correctly in my view, that the approved regulators do not permit prejudice of the exercise of the regulatory functions by representational functions held within the same legal entity;
(c) in the case of solicitors, the Council is charged with, and responsible for, the overall management of the corporation and the proper discharge of certain statutory obligations;
(d) the legal responsibilities rest with the Law Society; and
(e) Parliament left the responsibilities with the legal entities, with a right for their regulatory arms to appeal direct to the LSB.

It is not at all obvious why Parliament's settlement should be reversed by the rules. It is as though there is an assumption that the approved regulator exercises interference over its regulatory arm in breach of the LSA (for example, see the comments on paragraph 3.26 below): this assumption is driven by perception not evidence. If the regulatory arm were to make a perverse decision – e.g. one that plainly did not meet the regulatory objectives by being, for example, economically inefficient – it is clear that Parliament intended the approved regulator to bear the responsibility and thus to act to redress the perverse decision, with the ability of the regulatory arm to go direct to the LSB by way of appeal.

Where the consultation proposes, largely in the handling of shared services, that this process should be reversed, it is not carrying out the intention of the LSA.

On the Consultation.

Chapters 1 and 2 deal with administration of the consultation and high level principles; in so far as these reflect the statutory provisions, I have no comment to add.

Defining the arrangements

Paragraph 3.10 goes further than the LSA and exposes a conflict between the thinking of the LSB and the thinking of Parliament. The words in parentheses - "free from representative interference, control and

veto" – do not sit comfortably with the fact that Parliament knew the legal structure of, for example, the Law Society when the Bill was very thoroughly reviewed in Committee and in both Houses before becoming an Act. I understand that many of the arguments which support this type of drafting were rehearsed both in public and in Parliament at that time and to the extent they were not carried into the Act, were rejected. Parliament knew that the Law Society would be an approved regulator governed by a Council elected from and by the regulated community, when it laid down that the approved regulator is the Law Society, and that the Law Society, as an approved regulator, must, for example, ensure that the resources "reasonably required" for the discharge of its functions must be provided to its regulatory arm. The words used in paragraph 3.10 of the Consultation disclose a view that assumes freedom from interference, control and veto, *even if the regulatory arm is demanding unreasonable resources*.

This is not a theoretical issue, but is real and goes to the heart of evidence based decision making. When the SRA asked for funding for its IT programme, the Law Society's Management Board questioned the basis on which some of the request was put forward, and it was subsequently withdrawn. When it was re-presented, with a better argued business justification and, particularly, more care taken over the project management systems to be put in place, the funding was approved. This has been represented in some quarters as a reluctance to provide funds, but I was present at the relevant meetings and I know that the principle consideration after satisfying ourselves that the investment proposal was robust, was to meet the requirement to provide reasonable resources..

If the proposal as expressed by the wording of paragraph 3.10, were implemented, where would the checks and balances that impose management discipline be applied? The whole thrust of good business management, as evidenced by, for example, the Combined Code, is to provide the challenge mechanisms that ensure well thought through and tightly managed business processes. Removing the ability to challenge as part of a management process is hostile to efficient regulation and, as it incurs unnecessary expense, is also against the public interest.

Parliament set up a structure that provides for those checks and balances, by

- placing approved regulator responsibilities over the top of the regulatory arms,
- requiring the approved regulator to behave in restricted ways in dealing with its regulatory arm, and
- placing the LSB over the top of the approved regulator to discipline it should it fail in its duty.

As a management system, that has a great deal more merit than imposing prescriptive rules that break the chain of checks and balances.

The issues recur in paragraph 3.11. In normal circumstances, I would agree that the business objectives should be set by the regulatory arm without interference. But if the approved regulator becomes aware that its regulatory arm is perhaps setting objectives which will lead to the approved regulator being exposed to a fine, or other penalty, then the approved regulator has a duty to interfere. If the regulatory arm considers that interference to be unjustified it will exercise its right to refer the issue to the LSB.

Once again, this is not theoretical. The Legal Complaints Service was given a degree of freedom because its work may expose regulatory misdemeanours. The LSB will be aware that the Law Society has had to pay a substantial fine (and been threatened with another) on the demand of the Legal Complaints Commissioner because of certain failures by the LCS.

Question 1 – The exercise of the regulatory arm's functions should be "ring-fenced", but the ring should be a fence and not a barricade. The difference is in the economic efficiency of the regulation, where perverse activity was intended by parliament to be initially the responsibility of the approved regulator to manage and where it is common ground that shared services can and should be more efficiently managed jointly. The Law Society introduced a model of working in this way ahead of the introduction of the LSA and has adopted the requirements of the LSA before it came into force. That model has been road-tested and subject to some fine-tuning, and has never been the subject of any assertion, nor has any evidence been produced, that there has been a transgression of the terms of the LSA. It is thus eminently suitable as a model to be followed.

Regulatory Board Appointees

I support the first half of paragraph 3.15, first bullet point, but disagree with the principle that there should be a built-in majority of non-lawyers. It is illogical to be so clear about merit, equal opportunities, probity, etc. and in particular "nor of nomination … on the basis of sectional interest or background" and then to ban certain classes from exceeding a nominal figure on the basis of background. This is all the more the case as the class sought to be limited is the very class which will bring to the table the importance of the statutory objective of promoting the rule of law. They are also likely to be of a class of person most closely associated on a day-to-day basis with delivering satisfactory customer service and so protecting and promoting the public interest.

There is every reason for the regulatory arm to be led by a lawyer. Clementi believed in profession-led regulation, and a lawyer will bring expertise to the function – he or she will also have a thorough understanding of the principles of the rule of law and also the value of the profession's export trade to the UK economy and how that can be influenced by a foreign view of the profession. However merit is the key criterion.

This does not appear to me to have been sufficiently thought through and is possibly an area where the presentational demands (perception) have been allowed to overrule the logic. The way most likely to produce a robust and lasting solution fit for purpose is to draw the logical conclusion from an analysis of the relevant facts:

- Parliament did not require a built-in majority of non-lawyers, so there is no statutory basis for this.
- Parliament set up the Law Society as approved regulator for solicitors in the full knowledge that it was led by a council of solicitors. The same principle is true of all the approved regulators, which suggests that Parliament thought regulation in the legal sector ought to be led by the relevant professional disciplines.

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- The regulatory arm needs people with the skills and experience of delivering legal services to the public.
- The differing streams of legal advice sought by the public (e.g., criminal, immigration, dispute resolution, family, commercial) are so diverse that the demands of delivery have a wide spectrum, unlikely to be covered in a few people.
- The governing Board of the regulatory function needs to be small enough to avoid being an unnecessary burden on the process
- The governing Board needs to have on it people with differing training and experience who can bring a variety (including non-legal) of viewpoints to the table
- The governing Board needs to be fully cognisant of the statutory and constitutional framework within which it operates: particularly the regulatory objectives and the legal relationships of the LSB, the approved regulators and their regulatory arms.

None of that argues for a built-in majority of non-lawyers; the logic strongly supports a built-in majority of lawyers well versed in these complex issues, but merit, etc., should make up the key criteria.

I support the proposition that the regulatory board should not have persons appointed to represent certain sectors.

The reality of the appointment board is that it should answer to the approved regulator, which bears the responsibility, but that the process should be transparent, conducted by persons of integrity and free from detailed interference, having been set clear objectives. My approach to the appointment panel would be for the approved regulator, which is ultimately responsible, to write the objectives for the positions to be filled and a job description. The approved regulator should then seek advice from recruitment experts about the market and the best way to find the people who best fill the criteria. This should be done openly and transparently (subject to any justifiable HR redactions). As set out in the LSA, the regulatory board, if it believes that the provisions of the LSA are not being scrupulously applied, has the right to raise the matter with the LSB. It is a sound management axiom that it is unwise to separate power from responsibility: the LSB's proposals in bullet point 3 seek to separate the responsibility vested in the approved regulator by parliament to exercise the regulatory function from the responsibility for failure, leaving the latter with the approved regulator. I.e., if the LSB's proposals produced a perverse and inefficient regulatory function, it is the approved regulator that the LSB would fine.

I agree that appraisal of board members should be objective and could be carried out by a third party. However, if such an appraisal disclosed the equivalent of a "needs to improve", then the approved regulator must consider what action needs to be taken to fulfil its statutory obligation to regulate in accordance with the regulatory objectives. In practice, any action taken would either be taken with the consent of other regulatory board members or would be characterised as a transgression of the LSA duties and appealed to the LSB.

In summary, to question 2 I have agreed with or recommended alternative mechanisms more closely aligned to the LSA requirements, and to question 3 the answer is "no".

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Management Resources

I draw the attention of the LSB to its drafting of paragraph 3.16 where it is said that

> "The LSA is explicit in requiring us to make rules which *provide* for the regulatory function … to be reasonably resourced." (my italics.)

This is not accurate: the LSA states that the rules

> "must also require each approved regulator ... to take such steps …. To ensure that it provides such resources …"

The LSA does not impose the obligation on the LSB to go further than to say in the rules "approved regulators are required to take such steps…" etc. The LSB runs a serious risk of challenge to its vires if it exceeds the authority set out in the LSA.

I am confident that the Law Society is well aware of its obligation under S30(3)(a). I have been present in the meetings that the Law Society's Management Board expressly applies the "reasonably required" test when the budget is reviewed. In the infancy of the LSA regime, the Management Board considered what test might be applied to distinguish between reasonableness and unreasonableness and quickly determined that with no history, it was impossible to determine; therefore it was under a statutory obligation to approve the budget. Since that time, a dispute resolution body has been approved (and is in the process of being set up) with independent membership holding a balance.

I draw the attention of the LSB to the risks associated with "insulation": the Law Society (unfortunately) has a less than perfect track record on delivering major IT programmes – of course it is far from unique in this – and in this context it needs to be borne in mind that the "Law Society" means the unified body under the leadership and management of many of the same people who now hold office in the SRA as well as elsewhere in the corporation. When proposals were brought forward by the SRA for updating of its IT (acknowledged to be necessary) Management Board questioned a number of aspects of the proposal. The questions raised touched on improving the likelihood of the investment successfully delivering what the SRA wanted. The SRA withdrew its request, reworked it, and re-presented its proposals and the request was approved. This was the management board successfully performing its checks-and-balances role, and this is what rules imposing strict "insulation" will destroy. It is very clearly my contention that the result of the removal of these checks and balances would be less efficient regulation to the detriment of all stakeholders, including the public interest. Vesting in the regulatory arm the ability to ignore this process is equivalent removing the process.

The LSB's proposals on "insulation" expose the approved regulator to very considerable risk. Let it be supposed that the LSB proposes to use it powers under S31, et seq. and it sets performance targets. The approved regulator, under the LSB's proposals is powerless to influence the meeting of those targets – this is analogous to what happened with the fines levied or proposed by the Legal Complaints

Commissioner. It is wholly beyond the bounds of natural justice that the approved regulator should be exposed to the risk of punishment for acts or omissions it is powerless to influence.

Shared Services

In para 3.22, I do not understand the phrase "enforceable Service Level Agreements". The approved regulator and its regulatory arm are legally one and the same, so the enforceability is problematic. However, I support the principle of SLAs between central service functions and their internal customers, so this is probably not an issue – enforcement would be by good management with the threat of involvement of the LSB.

My only reservation is that SLAs can, because they encourage inflexibility, become a tool for inefficiency, and they can consume unreasonable resources to negotiate – SLAs are not a panacea. In commercial organisations or government, these issues, when they arise can be disposed by a single unifying authority (the board or Secretary of State, for example); unfortunately, the greater the proposals for insulation, ring fencing, etc., the weaker the unifying authority and therefore the greater the likelihood that the terms of the SLA will be disputed both on inception and in on-going practice. As SLAs are generally beneficial, this is thus a further recommendation for thinking very carefully before changing the system of checks and balances set up by parliament.

I agree the need for effective shared services management arrangements. The dispute resolution board has already been created by the Law Society. The objective in managing shared services should be to minimise the number of disputes, and I believe that the Law Society's Management Board should be more transparent to the SRA, by, for example, having SRA representation at all management board meetings (subject, presumably, to the representatives need to withdraw if they feel their position is compromised on a purely representation issue). The details of this contribution are less important than the right to be present and the need to report accurately and fully to the SRA Board on the Management Board's deliberations (and vice versa).

I do not agree that line management responsibility (in shared service functions) should channel through the regulatory board – it is completely in conflict with the concept of an SLA. What is proposed by the LSB is that there should be an "enforceable" SLA but that the staff members responsible for delivery should report to the internal customer and not the service deliverer. That is a recipe for disaster.

I support the proposal for robust arrangements against conflict of interest. The approved regulator is responsible under the statute and must ensure compliance with its obligations. Robust arrangements should ensure that regulatory obligations under the LSA are understood, so that the regulatory arm is subordinate to the approved regulator, but has the freedom from interference conferred by its delegations and the LSA.

The regulatory arm should consult on proposed changes to terms and it should follow a common policy, in the interests of economic efficiency, where this does not conflict with the regulatory objectives. The common policies cover a number of different locations and will need to be tailored to the needs and objectives of those locations, with the overall aim of attracting, retaining and motivating suitable staff at

all levels. Disputes will go to the dispute resolution body already referred to, and if a departure from common terms is not then agreed, the issue can be referred to the LSB.

I do not agree with the rules and guidance proposals in paragraph 3.24. Rules are required by the LSA and those rules should be clear and concise. If they subsequently need to be changed they should be changed. Breach of the rules carries penalties it is not a satisfactory arrangement that the liability to penalties should rest on the interpretation of guidance. Regulators (including the LSB) have a duty to be absolutely clear with the regulated community on the obligations to be followed[2]

In summary, as to Question 4, I absolutely disagree, as not authorised by the LSA, with any rule that goes further than requiring approved regulators to take steps to ensure sufficient resourcing of the regulatory arm. There are certain practices outlined in these paragraphs on which I have commented – in particular where the suggested practice is impractical. As to question 5, I do not agree with the proposal for formal rules and informal guidance.

Monitoring and supervisory arrangements: Intervention and monitoring

The concept of regulatory capture is so well known that I doubt if the objective expressed as

> "so as to put beyond doubt – including to the consumers of legal services – that regulation is being carried out in accordance with the regulatory objectives"

is achievable. The problem that arises from pursuing an unachievable objective is that the regulations become more and more prescriptive, burdensome and unworkable. It is more realistic to require the spirit of the LSA to be observed, and every right-minded person engaged in the practice of law will give their full support to that.

This issue comes into focus in the last sentence of paragraph 3.26, where the LSB's statement is in direct conflict with the will of parliament expressed in the LSA. At paragraphs 3.9 and 3.25, the consultation acknowledges that the approved regulator has the responsibility under the LSA for delivery of the regulatory objectives, and this is not in dispute. Parliament was well aware at the time this decision was enacted that some approved regulators are controlled by councils elected by the regulated community, so it (with perfect logic) imposed the non-interference obligations. On what basis, therefore, can it now be justified to suggest that parliament got it wrong and that those councils should not, after all, control the regulatory arm, always, of course complying with the law and in particular the non-interference provisions of the LSA? This question has even more force when it is borne in mind that the consequences of failure to deliver the regulatory objectives satisfactorily bear down on those same councils.

[2] Annecdotally, I note that today's Times (25th June at page 12) carries an article about the excessive use by Local Authorities of powers to create non-drinking zones. It includes a short paragraph: "The Home Office acknowledged that there was a problem with the law, and pointed to revised guidelines issued to police and local authorities in December last year to try to curb overzealous policing." It is, of course, easy to criticise, but the use of "guidelines" encourages a lack of proper intellectual rigour in making the underlying law.

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The last clause of paragraph 3.26 ("and so who could (wittingly or unwittingly) act in a way that is wholly or mainly in the profession's interest") is one that I hope the LSB will withdraw. The "wittingly" suggests that the Law Society, staffed in part and led by solicitors whose continuing ability to practice depends upon their integrity might, with intent, disregard the law. "Unwittingly" suggests incompetence in the application of the law and wholly disregards the role of the appeal process that parliament wrote into the LSA. The drafting displays a prejudice in this consultation wholly unsupported by any evidence.

I point out that parliament has recently passed the Companies Act 2006 which requires directors of limited liability companies to separate their own interests from their companies' interests when considering any decision: there is no requirement for directors to have any training yet parliament did not see a need for special rules to ensure compliance. The LSB appears to take the view that solicitors, who have been carefully trained to weigh up points such as these, are less able than directors to understand the legal distinctions between professional and public interest.

My underlying vision of the rules is that they should reflect quite precisely the requirements of the LSA. It follows that I support the proposition as set out in paragraph 3.28; I recommend that the drafting of the rules adopts, to the extent possible to protect the grammar, the drafting of the LSA – i.e., drafting such as requiring that "the exercise of an approved regulator's regulatory functions is not prejudiced by its representative functions" in place of "respect the principle of separation."

In paragraph 3.31, if an approved regulator has reason to believe that the exercise of its regulatory function is not fit for purpose, it should not have to rely on co-operation of the regulatory arm to launch independent and occasional strategic reviews. The regulatory *may* have a vested interest in hampering the review; if it does the proper course is for it to exercise its right to go to the LSB. In undertaking a review, an approved regulator would, if it is undertaken without the co-operation of the regulatory arm, be likely to be exercising a representative function, so as to inform itself for the purpose of consulting with interested parties on changes to the structure. In those circumstances, I invite the LSB to consider carefully whether the phrase "and acting together with its regulatory arm" (if brought into the rules) does not exceed the LSB's authority under S29(1) LSA.

I can see that if the approved regulator proposed the whole or part replacement of the regulatory arm's governing board, with the consent of that board, it should be legitimised by the concurrence of the LSB. However I see little purpose in applying that to non-consensual replacements, which, if thought to be in conflict with the approved regulators duties, would quickly be brought to the LSB's attention through normal channels.

On monitoring, I agree with paragraphs 3.34-6, 3.38 and 3.39. Monitoring is an internal management process, which is designed to achieve the purposes the LSB sets out at 3.34. A board with independent membership should not be involved in monitoring per se, but may be involved in resolving disputes over what should be monitored.

In summary, in answer to question 6, I

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1. Have severe reservations about the conceptual material disclosed in the introductory paragraphs,
2. Believe that some of the language of paragraph 3.26 is inappropriate
3. Recommend that, in drafting the rules, the LSB adopts the language of the LSA
4. Believe that some of the language of paragraph 3.31 (if it finds its way into the rules) would exceed the LSB's authority
5. Broadly support the intervention and monitoring proposals

Compliance

I do not agree with the "Dual" aspect of the self-certification (and I have not found any supporting rationalisation in the consultation) but otherwise I agree with paragraphs 3.40 to 3.44. Parliament has made the approved regulator responsible to the exercise of its regulatory functions in compliance with the LSA generally and the internal governance rules in particular. It is the approved regulator that is answerable to the LSB for compliance and the "dual" self-certification adds nothing over approved regulator self-certification, but potentially ensures important management information about perceived illegality by-passes the approved regulator.

There are models in industry for compliance programmes that normally involve regular training (with evidence of attendance), an individual personal certification in writing to senior management, and a confidential hotline for whistleblowers. It should not be too difficult to establish an appropriate programme.

These two paragraphs answer questions 7 & 8.

This paper does not address the Section 51 issues, which have been well covered by others and are generally less contentious.

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