



INVESTORS IN PEOPLE

**Zahida Manzoor CBE**  
Legal Services Complaints Commissioner  
Legal Services Ombudsman for England and Wales

**Office of the Legal Services  
Ombudsman  
3<sup>rd</sup> Floor  
Sunlight House  
Quay Street  
Manchester, M3 3JZ  
www.olso.org  
tel: 0161 839 7262  
fax: 0161 832 5446**

**Office of the Legal Services  
Complaints Commissioner  
19<sup>th</sup> Floor  
West Riding House  
67 Albion Street  
Leeds, LS1 5AA  
www.olscc.gov.uk  
tel: 0113 261 5420  
fax: 0113 261 5440  
Please send all correspondence to  
this address**

James Hutchinson  
Legal Services Board  
7<sup>th</sup> Floor Victoria House  
Southampton Row  
London  
WC1B 4AD

5 August 2009

Dear James

**CONSULTATION RESPONSE  
“WIDER ACCESS, BETTER VALUE, STRONG PROTECTION”**

I am pleased to provide a response in my capacity as both Legal Services Ombudsman for England and Wales and Legal Services Complaints Commissioner, to the Legal Services Board's consultation on developing a regulatory regime for alternative business structures.

My views in relation to the specific questions in the consultation paper are as follows:

***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?***

The LSB is quite right to identify the ABS project as a high priority, and one that could bring considerable benefit to consumers if introduced in a controlled and effective way.

Sir David Clementi produced his report into legal services in December 2004, at that point if it were said that it would take seven years before the first ABS licensing would start, it would have appeared to be a modest ambition. However, we are less than two years away from the timetable suggested by the LSB, and the Solicitors Regulatory Authority (SRA) - a large player in the regulatory market - is preparing for firm based regulation. Whilst I do not make comment on this being in any way a failing on SRA's behalf, I do wonder how effectively this change to regulation will have embedded by the time the SRA would be expected to potentially regulate new ABS entities. More importantly, whether there would be any opportunity to assess fully the effectiveness of firm based regulation given the short period available before the LSB's target date for ABS licenses.

Having said this, I believe that momentum must be maintained for ABS, as it has the potential to change the way legal services are provided for the better. So I was pleased to see at 3.6 in your consultation paper that you are establishing a high-level, cross-stakeholder ABS Implementation Group. This should start to flush out any barriers to the target date you propose. It would be useful to have regular updates from this forum, to understand how and when the practical implementation of ABS will take effect.

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

As I have mentioned above it is important to understand further all the potential barriers to the ABS timetable, whether perceived or real. Organisations such as the Co-operative Legal Services and Halifax Legal Solutions have already found ways of entering the legal market without the need for an ABS licence.

For those players looking to develop new markets or opportunities, delay caused by the need to develop an effective regulatory system would be a cause for concern. However, there is a need to balance this against the requirement to ensure that the regulation protects consumers of legal services. This is a fine balance to get right, but utilising the enthusiasm of those who wish to take advantage of ABS status would be a powerful tool to ensure the momentum is maintained at the right pace.

***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?***

This is not something that should be considered lightly, and it is interesting that the LSB has felt the need to raise this as a serious alternative in order to meet its timeframe. I anticipate that you have a feeling for the ability of existing and potential regulators of ABS to be ready for 2011, and know the tipping-point at which your proposal becomes a viable alternative. However, the resources required for the LSB to take this role on would be considerable, and once effort is started to make this a reality, there would be a break even point where it would be wrong to stop, even if other regulators have made up lost ground in their development.

I am not convinced from how you have described the existing situation, that we have reached the tipping-point, and would hope that the proposed ABS Implementation Group would give you greater clarity on this. What I would say in support of your proposal, however, is the LSB should not be held to ransom over the ABS start date by a large regulator because of its inability to gear up effectively within a reasonable timeframe. Although there is provision in the Act, I feel at this stage it would be inappropriate for the LSB to become a front line regulator. This should only be considered as a final resort.

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

I note your intention to consult on this next year. The LSB has sufficient other activities which appear to have priority over this at this time, and would recommend that it focuses on those, because the potential for conflicts of interest may prove difficult and divert resources from other essential work. I also feel that the question of who should pay for this and whether it is affordable may be an unnecessary distraction at this time.

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

As I have mentioned above, organisations are already able to enter the legal market. The absence of ABS licensing is not therefore presently a barrier to their entry into legal services market.

Organisations such as the AA, are household names and have a brand reputation to protect. For them to take full advantage of ABS they would need to be convinced that legal services align with their strategic portfolio. So it is less certain how much impact this would have on the existing market, or how attractive, as an acquisition, many law firms would be to them. However, their presence may act as a catalyst for improvements to the level of customer service expected by consumers. Their clients would expect that they would receive the same level of service they already enjoy from other products provided by these players. How traditional law firms respond to this challenge will be interesting.

In rural communities there may not be a sufficiently large market for a household name to provide services. However, a local law firm, accountancy firm and estate agent may see benefit in working together under an ABS umbrella and reduce costs through sharing services. The merging of professional services such as these should also bring benefits to consumers through the sharing of best practice in client care.

I would be looking for the licensing regime to be able to react to innovation, provide sufficient controls and to accept not everything will succeed, but those that do may be the start of a revolution in improved client care for consumers of legal services.

**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?**

My answer concentrates on individual private consumers of legal services, and for those I believe there are four areas where it may be possible to achieve benefits:

- client care;
- value;
- choice; and
- increased access to justice.

### **Client care**

Client care is probably the most likely to be improved if major brand organisations enter the market. This is because they will aim to expand their range of legal products to existing and new clients. They are also less likely to act unethically or in a way that may be seen as possibly detrimental to their existing loyal customer base. I anticipate they would use their experience of retail to make their service and its' cost transparent, user-friendly and competitive. The benefit of this should spread across the legal market for individual private users, as other firms aim to compete. The redistribution of clients will probably be by reputation of the provider. Such a change may begin to erode the high incidence of 'word of mouth' selection of legal provider by consumers, as they may be drawn to trusted brand names.

### **Value**

Supermarkets have demonstrated the link between volume and cost, without sacrificing quality. The challenge for the legal market is to make its costs more transparent and competitive. A study published by the American Bar Foundation<sup>1</sup> found that an increase in volume of cases reflected in lower prices without a reduction in quality, and in some cases improved quality against traditional providers of legal services. There is no reason why in an effectively regulated legal services market similar benefits should not be achieved.

### **Choice**

It is not certain who will be new entrants to the market or how existing providers will adapt in the new world, but what regulation must ensure is that there are no unnecessary barriers to entry for new entrants. Organisations such as the Co-operative Legal Services have created a loyal client base from existing members. If it and others choose to adopt an ABS approach, this will increase the choice for consumers, and present a free-market challenge to the traditional legal services. Because this type of provider has a brand reputation to maintain it is unlikely to cut-corners to make profit. This could act as a stimulus for improvement across the whole of the private client legal market.

### **Increased access to justice**

This is the most difficult to predict - whether a redistribution of existing clients will occur or whether those currently excluded (e.g. those just above the legal aid means test) will have more access to justice is not yet known. In your paper [4.8] consumer representative groups see this as a key success of ABS. I would recommend to your Consumer Panel, that as this is a key success for ABS, they should commission research into how this may be achieved on the ground to allow increased access to justice to happen. The LSB should not be afraid to be bold and upfront on this issue. In other sectors, public/private partnerships, these are underpinned by social benefits being realised (and in some instances subsidised) by private sector investors (e.g. housing developers providing community facilities as part of a development).

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<sup>1</sup> Muris, T.J. and McChesney, F.S. (1979) 'Advertising and the Price and Quality of Legal Services: The Case for Legal Clinics', *American Bar Foundation Research Journal*, vol.4, no.1, NJ, Blackwell Publishing.

**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?**

Increasing opportunities for lawyers, in-house lawyers and non-lawyer employees through the range of organisations offering legal services under ABS should be a positive step. There will be an opportunity for all lawyers and non-lawyers to become partners in firms, increasing the commitment and influence to make the business successful.

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

It is difficult to assess the impact, but that increases the need for the LSB and approved regulators to ensure any change is positive. I agree with your recommendation that there is a need to effectively monitor the impact ABS has on this important area, and to act swiftly if the change is not positive.

The baseline position as of now shows that there are significant gender and minority ethnic earnings gaps in the legal profession. The development of ABS should include the narrowing of these gaps as one of its key success criteria.

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

I agree that no additional requirements should be placed on ABS, as this may act as a restriction to the market. I welcome the fact that the LSB intends to explore this further and would look forward to commenting on your findings.

**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?**

Much will depend on who enters the market. Supermarkets have weathered the economic downturn by changing the products they provide to match the needs of their customers. Some have made increases in market share because of the perceived value for money they provide. If they were existing providers of legal services they would equally aim to match predicted volume and type of service required to their clients needs, which will change – less need for conveyancing, more need for debt advice. Whoever is providing a legal service in a downturn has to adapt their business model to meet demand. Reducing the restrictions as you set out does not inherently appear to affect whether one business model will survive over another.

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

In any significant change such as this it is inevitable that there will be a risk of some business models failing, but equally there is the possibility of innovation and a new business model providing improved and increased services. The LSB and approved regulators will need to monitor the impact of the changes and react only where significant risks are apparent.

All sectors have inherent risks - current failures in financial services exemplify this. Good regulation will manage and adapt to the risk without stifling innovation. I see no obvious reason why the legal services market should not adapt and prosper under an ABS regime.

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

It is not obvious why new business models will present more of a risk than say a sole-practitioner, and yet these have survived many changes and requirements from their regulator. I am convinced that those risks set out in your paper [5.5-5.10] are ones that can be managed, and that no one business model should provide an unnecessary level of risk.

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

I think your list at 5.11, sets out those areas that must be managed through regulation. Some of these are challenges that, in some form, firms of solicitors face now. Experience from existing approved regulators on their ability to limit the risks in these areas would be useful for the LSB to learn from. But I see it as important for the LSB to set out what it sees as the minimum levels of professional principles that must be adhered to in order to reduce or eliminate any new or emerging risk.

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

The SRA in its consultation paper – Regulating alternative business structures - sees ABS as presenting some new complications, but is of the view that it will not fundamentally alter the regulatory challenge. Whilst this has a common-sense view, what is currently more of a challenge for SRA is changing to effective entity-based regulation of its existing members before it faces up to any additional complications that ABS may bring.

The timeframe set by the LSB for ABS does mean that success by SRA is an imperative. Given some of the recent failures in the financial services market - which is entity-based regulation – it would be good for the LSB to set out what it sees as the risk in introducing ABS in a period where entity-based regulation for legal services may not have been thoroughly tested.

***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?***

It is important that those that present the highest level of risk should receive most attention from their regulator. As I have said earlier, I would not wish to see unnecessary barriers placed on ABS entities that would prevent their entry into the legal market. It is therefore important for regulators to be transparent in their regulation of traditional and ABS entities, so that they are able to justify the level of regulation based on the actual risks envisaged.

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

I feel the example you give of the Office of the Legal Services Commissioner in New South Wales, is something that has merit. It looks like it enables firms to grow through proportionate regulation, but gives greater regulatory certainty to those who wish it.

Whilst I understand your comments at 6.13, that there are less systemic risk in the legal market than those faced by the FSA's principle-based regulation, it is necessary to reflect on the actions of a number of firms of solicitors in the Coal Health Compensation cases. Here, a systemic approach occurred because some solicitors found a way of making profit quickly at the expense of sick miners. So it would be necessary for the LSB to ensure a more prescriptive approach to regulation by licensed regulators happens where the risk to individuals is greater.

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

This appears an unnecessary barrier to entry for ABS firms. As you set out at 6.22, there are other ways of managing the risk of minority-lawyer management/ownership structures. As evidence, I return to the example I gave to Question 5, what would be the incentive to a firm of accountants or estate agents to form an ABS, if there were a requirement to have a majority of lawyer managers?

**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?**

It is important for the LSB to ensure that this does not become so prescriptive that it limits the pool of people available to ensure good compliance in ABS firms. It is necessary for the HoLP and HoFA to be 'fit and proper' as set out in the Legal Services Act, I agree with your sentiments that additional entry requirements to the Act should be something regulators should prescribe only where absolutely essential.

I am pleased to see that you intend to look at approaches to the test in other regulators, such as the FSA. Their experience should help ensure that the LSB is able to strike the right balance in the test.

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

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

In taking these two questions together, I re-iterate that ABS should be beneficial for the legal market and for consumers. Regulators, creating unnecessary barriers to entry would be unfortunate. There will be risks involved in those ABS assessed as having a higher risk. However, it is important to understand that even in the present regulation of solicitors some firms are by their very nature a higher risk to consumers

than others. So risk must be based on a transparent assessment by regulators, not blanket approaches to ABS firms as being a higher risk than traditional firms.

***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?***

I agree with your position that it should be unlikely that the access to justice criterion should be the only basis for rejecting an application, until we understand more fully the impact ABS is having on the market.

If ABS firms are to be innovative, then their assessment of how the market will react, and whether this will improve access to justice, cannot guarantee what will actually happen when the services are provided. But regulators must act swiftly to control providers, which clearly are limiting access to justice either by location, or service.

There could also be a mechanism of periodic reviews of existing licences on a local or regional basis, to take account of factors such as accessibility, demographics and local feedback. This might eventually enable the LSB (after say 5 or 10 years) to review the effect ABS is having on access to justice.

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

It is important for regulators to protect the client's interest and money if a firm faces insolvency. It is not clear why there would need to be a separate procedure for ABS firms. It seems more appropriate that all firms and individual practitioners have appropriate cover, and that regulators have a means of compensating clients if the firm is not able to do so.

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

It is important that the provider of legal services handles complaints effectively. My experience is that many of the complaints received by the Legal Complaints Service (LCS) could have been handled more effectively and resolved before they reach LCS.

If major brand organisations enter the market, I am certain that they will wish to provide a high level of service to their clients in order to retain their loyalty to the remainder of their services. I expect they will look to resolve disputes before they escalate to the OLC. If this transpires it would be good for the regulators and the LSB to learn from the experience with the intention of improving the standard of complaint handling throughout the legal profession.

I do not see any reason why complaints should be regulated differently for ABS, it is important for all legal professionals to resolve disputes early and where necessary provide compensation for their errors.

What is absolutely vital is that consumers are clear at the point of 'purchase', regardless of provider, how to complain if necessary, and the further stages in the process if the complaint cannot be resolved by the firm.

**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?**

Clients choose their lawyers for different reasons; they are dependent on the firm to tell them if there is a conflict of interest. It is important for the regulators to ensure that those who control or have an interest in the ABS do not influence how the lawyers provide their service to individual clients. Clients need to be certain that their lawyer is acting in their best interest. The fitness to own criteria will provide a degree of assurance, particularly if those holding a controlling interest have to face more onerous tests as you suggest.

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

This is an important area as consumers may not be able to distinguish between the services they are receiving. As such it is essential that regulators ensure the service received by consumers should not carry additional risks to those they face now. I am pleased that you are asking your Consumer Panel to consider this issue and would welcome a debate on how this risk can be managed effectively.

**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?**

The risks are similar but not the same as other ABS, including poor advice, failure to act in the client’s best interest, the risk of insolvency and having an ineffective complaints handling process. As with other ABS this needs to be regulated proportionately based on the risk.

**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?**

I think the example you give for the FSA and credit unions regulation is equally sound in the legal services market. I would welcome a similar approach by licensing authorities for ABS organisations.

**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?**

This has been a thorough debate on the issues faced in regulating ABS entities; I have no further issues to make.

I hope you find my comments helpful and I look forward to the LSB's conclusions following the consultation period.

*Best wishes,  
yours ever,  
Zahida.*

**ZAHIDA MANZOOR CBE**