



**THE LAW SOCIETY
of SCOTLAND**

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**Legal Services Board
Wider Access, Better Value, Strong Protection**

The Law Society of Scotland's Response

August 2009

INTRODUCTION

This response to “Wider Access, Better Value, Strong Protection; Discussion paper on developing a regulatory regime for alternative business structures” (“the consultation”) is prepared on behalf of the Law Society of Scotland (“the Society”). It aims to assist the Legal Services Board to improve access for all to high quality legal services within a competitive market which is appropriately regulated to ensure public protection and maintain quality.

The Society has been a strong supporter of alternative business structures (ABSs) in Scotland, and published its own policy paper *Delivering Scottish Legal Services* in April 2008. It has also responded to the Scottish Government’s consultation on ABS, *Wider Choice and Better Protection*.

The Society is currently in the process of exploring how to regulate ABS, and we hope our input will be helpful. The Society believes ABS will be beneficial to both England and Wales and Scotland, and these initiatives will support a thriving market for legal services throughout the UK. We have responded only to those questions where we believe our input is valuable, and although there are differences in our legal systems and our approach to ABS there is much we can learn from each other.

SPECIFIC COMMENTS

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

It is difficult to predict all the effects of opening up the legal services market. However, the Society believes we can anticipate a number of changes, and that most of these changes will be positive.

Services and Expertise

Opening up the market for legal services will allow firms to benefit from a broader range of

expertise and to offer clients a wider range of services.

The LDP model allows non-lawyer owners to have significant influence on the legal practice, and can include a non-lawyer Chief Executive, or a Director of Finance, IT or Human Resources.

Permitting legal practices to extend the option of an equity stake may allow them to attract and retain expertise in fields such as IT and human resources. Such expertise will allow these firms to better compete at both the national and international level. The formation of MDPs may further allow firms not only to benefit from a range of expertise, but also to offer a one-stop shop for a range of different services. Furthermore, access to different forms of funding can potentially allow for growth of services. ABS will also assist in succession planning and senior staff retention.

Access to Justice

The effect of ABS on the geographical distribution of legal services is difficult to predict. On the one hand, MDPs could result in greater concentration of legal services within urban areas, with large MDPs drawing work away from smaller practices in small towns and rural areas. On the other hand, MDPs may offer firms the possibility of creating a diverse partnership offering a wide range of services which could help sustain legal practices in small and remote communities, where otherwise a solicitor's practice would not be viable. Sub brands and franchises will also become available.

A consequence of permitting external ownership could be the concentration of the supply of legal services into a small number of large suppliers and could have implications for access to justice. However, there is already a trend towards larger urban practices and this is likely to continue irrespective of permitting new structures. Also, access to justice may be serviced if clients find they can obtain legal services from a local provider from whom they already buy other goods and services. Access to certain kinds of legal services such as representation in court may be particularly at risk if the trend towards larger urban practices continues. Particular care need to be taken in order to ensure continued access to justice.

In a similar way, ABS could also lead to incentives to focus on certain legal services. This, however, is already happening under traditional business models. Furthermore, over time we expect that developments in IT could make the issue of geographic location increasingly less relevant in many cases, with more services being offered electronically or by telephone. As acknowledged by the *Digital Britain White Paper*, steps need to be taken to ensure that those who do not have access to the internet nevertheless have appropriate access to, amongst other services, legal advice.

Increased International Competition

Allowing flexibility of business structures, along with increased expertise as noted above, could allow UK firms to better compete in the global marketplace. The ABS regime may also improve firms' competitiveness by allowing them access to external investment capital.

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?

The interests of consumers have been at the forefront of initiatives to allow ABS, and the Society believes consumers could see many benefits to the opening of the legal services market. Some of these benefits include:

- ABS could allow firms to offer clients a one-stop shop for a range of different services, which could be attractive for clients.
- Members of different professions will be able to share overhead costs. These savings could be passed on to clients, resulting in lower legal costs.
- ABS could allow legal professionals to share skills and expertise with other professionals, either through offering other services or allowing other professionals to act as managers and influence firm decisions. This sharing of skills and knowledge may enhance the quality of services.
- The sharing of skills and expertise could be particularly relevant to IT initiatives. New

business systems may enable improved accessibility to networks of consumer bases and more efficient and cost-effective means of delivering services. Allowing new providers and ways of delivering legal services will allow consumers to benefit from these innovations.

- The possibility of creating practices with other professionals offering a range of services including legal services may help to sustain legal practices in small communities where otherwise a solicitors practice would not be viable, thereby enhancing access to justice.
- Ownership by large companies could result in economies of scale, access to existing customer bases and enhanced competition with reduced costs, easier access and wider choice for the consumer. We note, however, that such ownership may also pose some risks to access to justice, as discussed under question 5.

The opening up of the legal services market is likely to lead to other efficiencies and increased innovation throughout the profession, and the Society looks forward to seeing how these developments will improve services for consumers.

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?

Overall, ABS are likely to benefit firms, solicitors and employees, offering many opportunities to innovate and compete. Some of the advantages of ABS include:

- Solicitors and advocates will have more choice about how to deliver their services most effectively and how to share profits between them.
- Solicitors and other professionals will be able to share costs.
- It would give solicitors the opportunity to share skills and knowledge with members of other professions, which will benefit both solicitors and clients.
- MDPs will allow greater financial and personal commitment from non-solicitors by allowing firms to offer them fuller career development opportunities, such as the ability to become principles.
- The ability to create a practice with other professionals offering a range of services including legal services may help to sustain legal practices in small communities,

where otherwise a solicitor's practice would not be viable.

- Firms may have access to external investment capital, enabling them to expand and compete more effectively against global competition.
- Firms could reward staff, including retired staff, with a shareholding in, and a continued interest in the success of, the practice.

With these opportunities will come some challenges for firms, regulators and governments. Some disadvantages of allowing ABS that the Society has identified include the following:

- One of the Society's biggest concerns is the potential risk to the core values of the legal profession. There could be greater commercial or other pressures on solicitors in an MDP which could compromise a solicitor's duty to give independent advice, and conflicts of interest may be more common. However, solicitors face a range of pressures within traditional practices or as employed lawyers which they are generally able to overcome because of their training and commitment to the ethos embodied in the core values. It cannot be assumed that pressures within an MDP would create greater risks, but appropriate regulation would be essential to guard against erosion of core values.
- The issue of conflict between different regulatory codes is a significant challenge to the development of MDPs. The Society does not believe an entity could be allowed to operate where individual principles within it were subject to conflicting codes of professional regulation. A solution would need to be found to any such conflicts before members of different professions could form an MDP, and the Society believes there is a need for the legal profession to work with other professions to examine ethical principles and identify common strands.
- The Society is concerned that legal professional privilege may come under significant threat unless satisfactory legislative and practical provisions are made for its protection in respect of legal services offered by an ABS. In considering this issue, it is also necessary to take into account the implications of recent European legislation and case law¹.

¹ Article 25 of the Services Directive (2006/123/EC); *EU Commission v Italian Republic (Case C-531/06)*.

- There are concerns that external owners could use their influence and control to pressure solicitors to acting in illegal or improper ways. Potential risks and conflicts of interest could be greater where there is external ownership of an entity. Appropriate regulation would be essential to guard against corruption and to ensure that only fit and proper persons had significant influence or control of an entity.

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

It is very difficult to predict the impact that ABS will have on diversity within the legal profession. It may be useful to conduct an impact assessment, as more data is needed. Some of the issues to consider would include:

- The impact of corporate structures, which will remove the legal status of partnership and may assist issues of equality
- A comparison of women's progress within a partnership model and a non-partnership model
- A comparison of the gender pay gap for lawyers in the private sector and the public sector compared with the pay gap in corporate structures
- A comparison of diversity within the legal profession and other professions likely to be involved in ABS, such as accountants.

The Society is concerned about the impact of ABS on diversity and believes continued monitoring is needed.

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

Educational programmes should equip solicitors with the skills required for modern practice, whatever form that might take. The Society has a programme of pre- and post-qualification education and training for solicitors and paralegals, which is flexible and capable of adaptation to changing business environments.

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?

The Society believes that ABS could allow firms to innovate, which may help them survive in the event of a future recession. For example:

- ABS will permit legal practices to extend an equity stake to non-legal professionals, allowing them to attract expertise in a variety of fields. Firms may make better decisions when they are able to draw from a wider range of business expertise. .
- ABS could allow firms to broaden the range of services they are able to offer, which may protect them if particular kinds of legal services are particularly hard-hit by a recession.
- ABS could allow solicitors in an MDP to share overhead costs with other professionals.
- Lifting restrictions on ownership and financing will allow firms to receive funding and support from a wider variety of sources; however, reduced income resulting from the sale of an equity stake in a legal practice may not be attractive unless capital is required for expansion, particularly expansion by acquisition. Bigger, by virtue of gearing, may not be better as recent experience in the financial sector has shown.

The Society believes these developments may make it easier for solicitors and firms to survive in the event of a future economic downturn.

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

The Society has two primary concerns about ABS, and these are maintaining access to justice and the protection of professional principles. The Society believes these concerns can largely be mitigated through appropriate action by regulators, governments and legal professionals.

The Society also believes that there needs to be a level playing field for organisations providing legal services and that the same level of public protection for those seeking to use those services is available.

Access to Justice

The effect of ABS on Access to Justice cannot be accurately predicted. There is a real concern that ABS may concentrate the supply of legal services into a small number of large suppliers, which could have implications for access to justice. However, it has to be noted that there is already a trend towards larger urban practices and this is likely to continue irrespective of permitting new structures. Furthermore, ABS may improve access to justice by allowing firms to innovate in technology and communications (for example, the electronic delivery of some services would make geographic location less relevant). Also, ABS may allow solicitors to create diverse partnerships offering a wide range of services, which could help sustain legal practices in small and remote communities where a solicitor's practice may not otherwise be viable.

The Society takes the view that the Government has the most power to promote fair and equal access to legal services and needs to be ready to respond to changes in the market to ensure that access. This can be achieved in a number of ways. The creation of functional community legal services involves partnership between the public sector, private provision and the third sector. Primarily the onus is on Government to encourage, support and create structures and provide resources which meet the needs of the citizen and provide genuine access to justice. Fundamentally, the best way to promote access to justice is to make the prospect and the reality of working in areas of law impacting on access to justice more attractive to encourage more people to work in such areas.

Protection of Professional Principles

The introduction of ABS should be done in a way that ensures the core values of the profession are protected. The Society is concerned that ABS could place greater commercial

or other pressures on solicitors which could compromise the duty to give independent advice. The Society is also concerned there may be conflict between the regulatory codes of different professions that are likely to work together in an MDP, particularly on the principles of conflict of interest and confidentiality. A solution would need to be found to these conflicts before members of different professions could form an MDP.

Legal professional privilege may not be available across all professionals within an MDP. This is a significant issue which the Society believes must be resolved satisfactorily, possibly through legislation, to allow MDPs to develop. Proper systems will be needed to ensure that a solicitor or advocate would be able to protect communications with a client from disclosure.

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

In the Society's view, the most obvious conflicts of interest are likely to come in circumstances where individuals from different professions are owners of alternative business structures or where some owners are non-professionals.

Where different professions are involved, there may be questions for individuals about confidentiality and conflict of interest where the codes of conduct of those professions conflict or take different approaches. This issue can best be addressed through regulation of entities. There will be a need to examine the ethical principles and codes of conduct held by each profession, so that common strands can be identified and regulators can ensure there is a level playing field.

Situations involving non-professional owners may be easier. As such owners will need to be licensed by the regulator, it seems likely there will be a requirement for them to sign up to a broad code of practice or conduct. However, where different regulators have different codes of practice or rules, this may lead to regulator shopping which might see, for example, a business seeking to be regulated by a regulator with less stringent standards.

It may also be the case that packaged products or services offered by an ABS may give rise

to inbuilt conflicts.

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

So far as the Scottish solicitor profession is concerned, many aspects of regulation, such as financial compliance, professional indemnity insurance and services complaints, are already entity-based. The current individual focus comes in relation to conduct. The Society would envisage that it will continue to regulate individuals in relation to any alternative business structure where there is a solicitor involved.

Where a licensing authority such as the Society is applying entity-based regulation, there needs to be an ability for the entity, consisting of solicitors and non-solicitors, to be regulated in such a way that it would be possible for the Licensing Authority to either restrict the areas in which the business is able to practice or stop the business practicing and possibly seeking to have individuals disqualified from being Directors in a similar operation in the future. The key to this is going to be the lines of responsibility within the entity itself, which is why there is a need for there to be a Head of Legal Practice, a Head of Financial Compliance, or some sort of practice committee with joint and several liability.

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?

The Society agrees with this view. However, it must be qualified by the fact that any regulator needs to know what it is going to regulate and then carry out some form of risk assessment or model. Work needs to be done on identifying breaches to rules and their potential effect on public protection with a view to establishing what is high, medium and low risk. In terms of issues of financial compliance, the Society is already seeking to develop a risk based approach based on assessment of a number of factors including the impact and effect of breaking particular rules.

In addition, the risks will vary significantly between different firms (eg City v High Street) and a standardised approach will be inadequate. Sophisticated practices need regulation by regulators who understand the risks of the practice in question. The FSA Internal Capital Adequacy Assessment Process (ICAAP) system should provide some pointers.

In terms of considering issues of financial compliance the Society is already seeking to develop a risk based approach based on assessment of a number of factors including the impact and effect of breaking particular rules.

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

There will need to be a mix of these approaches. Regulators cannot ignore what other regulators are doing. Setting rules for individuals plus services principles is an obvious way to go forward. It also applies as an advantage in circumstances where there may be competing standards as between the regulators of entities individual regulators.

For its recent standards project, which resulted in new Standards of Conduct practice rules and Standards of Service guidelines for Scottish solicitors, the approach the Society took was to set specific rules relating to the conduct of individuals whilst at the same time setting high level standards in relation to the concept of service.

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

The Society is of the view that it is unlikely any legislation would be introduced which would rule out a minority of lawyer managers in an alternative business structure. Where there is a minority of lawyer managers then the question arises as to who is to regulate the entity. The assumption will probably be that the profession of the majority of owners – for example accountants – would determine the lead regulator but this is not inevitable and it may be that

ABS will be able to choose their preferred regulator.

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?

This response should be read in conjunction with the response to question 24, as the issues are intrinsically linked.

As the Society understands it, persons fulfilling these roles are currently being employed by larger practices. In an ABS there may be consideration given to, for example, whether the Head of Financial Compliance is authorised by some other financial body such as the FSA, or has specific qualifications (for example, an individual who is both a solicitor and a chartered accountant). So far as the Head of Legal Practice is concerned, it may be useful to consider factors such as length of experience and whether the person has been a managing partner or a client relations partner. For example, in Scotland an obvious choice might be the designated cashroom partner, who currently already has a degree of personal liability in fulfilling this role.

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

The Society is of the view that this question is impossible to answer at this time; until there are actual criteria for licensing application it is difficult to say what is or is not high risk. However, the test being applied must examine whether a considerable risk in relation to public protection arises.

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?

The Society agrees that it is unlikely that many licences should be rejected on the basis of the access to justice condition. More generally, access to justice can be achieved in a number of ways. The creation of a functioning Community Legal Service involved partnership between the public sector, private provision and the third sector. Primarily the onus is on Government to encourage, support and create structures and provide resources which meet the needs of the citizen and provide genuine access to justice. Fundamentally, the best way to promote access to justice is to make the prospect and the reality of working in areas of law impacting on access to justice more attractive to encourage more people to work in such areas.

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

In Scotland, the Scottish Legal Complaints Commission is clearly charged with handling complaints about inadequate legal services and should be the body charged with handling service complaints about any business structure providing legal services. As they are also the gateway for all complaints against legal professionals, it may be that if they have grounds to believe there is a ‘conduct’ issue arising out of a service issue that it would then need to be referred to the appropriate 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 lawyer’ adherence to their professional principles?

As highlighted in question 18, both responses should be read together as they are two sides of the same issue. An integrated structure is required to cover all personnel involved in the ABS – from owners and controllers to practitioners.

The Society believes that any ABS regulator should specify a ‘fit to own’ test which should apply to anyone owning, or acting as a principal in, an ABS. The Society has expressed agreement with the criteria set out by the Scottish Government in its consultation “Wider Choice and Better Protection,” and believes the test contained therein is equally applicable to England and Wales. Those criteria, as set out in that consultation, include the following

features:

- Criteria that anyone owning all or part of, or operating as a principle in an ABS, must meet standards of:
 - Honesty, integrity and reputation
 - Competence and capability
 - Financial soundness
- Where the owner is a corporate body such as a limited company, it would be open to the regulator to require not just that corporate body but those in control of that body to pass such a test.
- A requirement to demonstrate fitness when requested by the regulator.
- Anyone deemed able to be a partner in a legal practice by either the Society or any alternatively approved regulator would be “fit to own” an ABS.
- The ABS would be required to have a Head of Legal Services and a Head of Practice, who would respectively be personally responsible for ensuring that the legal service was provided in accordance with ethical standards and that the firm was complying with practice standards.
- All ABS must provide an indemnity in respect of any loss of clients’ monies.
- All ABS could not take instructions on a case from a client where an outside owner has an adverse influence or conflict of interest in the legal outcome.
- Outside owners would not be allowed to interfere in individual client cases or have access to client files or other information about individual cases.

The Society suggests looking at the FSA model of identifying “significant influence functions”. These include: “governing functions” (ownership and control); “required functions” (MLRO, Compliance etc); “systems and control functions (HoFA and Designated Cash Room Partner equivalent); and “significant management functions” (HoLP). All these aspects need to be factored into the equation as part of an integrated structure.

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?

The Society has no further issues to raise.



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