

HERTFORDSHIRE LAW SOCIETY RESPONSE TO LSB CONSULTATION PAPER on ALTERNATIVE BUSINESS STRUCTURES: APPROACHES TO LICENSING

General Comments

A large volume of legal services are currently being provided by unregulated entities with little or no consumer protection. If properly arranged, the introduction of ABS's could draw a fair proportion of that activity into the regulated sector. We do not think it is right that financial institutions for instance can hive off non-reserved activities to an unregulated entity when Firms of Solicitors cannot. We don't have a level playing field as it is. If the LSB grasps the nettle and says that if an ABS wants to do reserved work then all of their legal services have to be regulated (and let's face it, that's hardly unreasonable), we will not only have a level playing field for the first time, but it will also protect consumers much better going forward. Most Solicitors do care about consumers of legal services being protected, which is why we need to remember that their interests, and not commercial interests, are the justification behind the Legal Services Act.

We fear that the LSB may buckle under corporate pressure and not grasp that nettle, with the result that in future even more legal services will be unregulated and we cannot see how that protects consumers.

We accept that with the present system, calling for all legal services to be regulated would create a closed shop for qualified lawyers, but with the advent of ABS's (which can be of any size potentially) that objection falls away, and arguably paves the way for this to happen. There is much therefore that we believe may be of benefit potentially regarding the introduction of ABS's. In this response we have focused upon areas of potential concern, but this should not be seen as negative, nor should it be assumed that we are merely trying to maintain the status quo for protectionist purposes. Our concern is not about the creation of ABS's as such, but about taking the trouble (and time) to get the framework right; what is being proposed here is a sea change in the legal services market and if we get it wrong, the consequences for the industry and, more importantly, consumers could be disastrous. .

We have general concerns about the proposals to move away from regulation of individual lawyers towards entity based regulation especially when coupled with the proposed introduction of large ABSs, although we realise that this is now all but inevitable. There is a very real potential conflict between the interests of the consumer and that of a company providing legal services. We would remind you that the concept of limited liability is designed to protect the shareholder, not the consumer. We can envisage situations where ABSs (of whatever size) enter the legal services market and utilise the corporate veil to leave debts/problems behind them and simply set up again down the road with a different corporate identity.

There seems to be a desire to introduce ABSs with undue haste. We agree with Lord Hunt that it is more important to get the right Regulatory Framework in place than to offer ABS Licences by a particular date. The main argument used to justify ABS's is that increased competition will drive down costs. That fails to take account of the fact the legal services market is already a very crowded place and that costs have already been driven down very substantially for many areas of work by competition amongst existing providers. There are also a large number of providers of unreserved legal services that are wholly unregulated and the government has consistently refused to extend regulation to such individuals/entities. That is one of the areas where we feel that Government attention should have been focused if they were truly concerned about protecting consumers. We remain concerned that the introduction of ABSs may operate against the interest of consumers since many of the elements which are crucial to protecting consumers (professional standards, quality of service, technical expertise, proper regulation etc) are often inconsistent with low cost (and that is assuming ABSs can deliver lower costs, which remains to be seen). We feel that having recently introduced LDPs, a little time should be allowed to see how they operate in practice before pressing ahead with the next raft of reforms.

The Act allows for the introduction of ABSs on the premise that it will be of benefit to consumers. The driver for the introduction of ABSs should therefore be consumer interest, not the interests of large commercial organisations, nor the desires of "empire building" regulators. By way of example, Solicitors as a profession voted against the introduction of referral fees, but they were imposed anyway partly due to pressure that was brought to bear by large commercial interests. This Society was against the introduction of referral fees and remains convinced that they are not in the interest of the consumer but rather serve the interest of commercial organisations who get a kick back from making referrals without any regard as to whether the

referral benefits the consumer. Unsurprisingly, the regulation of referral fees has proved to be wholly unsatisfactory.

We are also concerned that the FSA appears to be being upheld in some quarters almost as a model of regulatory efficiency. Most observers agree that inadequate regulation of the banks by the FSA contributed to the near collapse of the UK banking sector, and that this was only narrowly avoided by aggressive Government intervention. The “light touch regulation” practised by the FSA effectively allowed banks and other financial institutions to do what they wanted without any proper control, and this had near-disastrous consequences. The same must not be allowed to happen with ABSs.

We have not followed your Consultation Paper in any particular order but have dealt rather with issues of concern to us.

Regulatory Framework

- We believe that there should be a proper regulatory framework in place before any licences are granted for ABSs. However, we have concerns about the speed with which these proposed reforms are being forced through. The reality is that there is likely to be a change of Government well before any ABS licences will be granted and we are concerned that a lot of time, effort and money may be spent paving the way for ABSs only to find that an incoming administration has little or no appetite for them.
- We have come to the settled conclusion that if ABSs do come into being the ring-fenced model is by far and away the preferred option and we have grave concerns about the workability of the multi-disciplinary practice model for the various reasons set out below.
- Regulating small entities by focussing upon outcomes may be appropriate where only a few consumers will suffer when things go wrong. We are concerned however that this form of regulation may not be appropriate for very large ABSs where large numbers of consumers could be affected adversely before the regulator is alerted to what is happening. Furthermore, an ABS may be so big that no intervention agent will be able to cope if intervention is required following regulatory breaches. With very large ABSs we take the view that prevention is better than cure because large institutions can do an enormous

amount of damage in a relatively short period of time. Business models that permit very large numbers of consumers to be serviced by them obviously carry inherent risks. The practice of intervening after the event (as currently happens with Solicitors in the main) appears reasonable when the practitioners themselves have all been through a recognised and robust qualification process. If we are now to move away from that individual regulation in favour of entity based regulation, we believe that greater care will be needed to prevent bad practice and in some cases this will require more rigorous regulation than is necessary for traditional firms and LDPs..

Reserved/Non-Reserved Legal Activities:

- We are strongly in favour of ABS's being regulated both in relation to reserved or non-reserved legal services. This is essential for proper consumer protection
- We believe that all providers of legal services whether reserved or non-reserved should be subject to proper regulation just as Solicitors are at the moment. It has to be a level playing field
- We feel that unreserved legal services should be provided through regulated entities and that ABSs should be subject to the same regulation as the current regulated providers of legal services.

Access to justice:

- We feel that there is a very real danger that large commercial providers may drive other forms of legal services providers out of business and have grave concerns that this will have a negative effect on access to justice. New entrants into the legal services market will be bound to cherry pick profitable areas of work. Solicitors have been effectively cross subsidising less profitable areas of work (most notably publically funded work) for many years. If those profitable work centres are eroded, existing providers will be unable to continue to cross subsidise less profitable areas of work, which we cannot see new providers being interested in. We are concerned that the assumption in the Act that access to justice/legal services will be improved through ABSs may very well be a false premise.

- We do not see in practice how regulators can force ABSs to provide particular legal services. We believe that ABSs will not be interested in many of the reserved legal activities, especially publically funded work, and that existing providers will find it uneconomic to continue with such activity if other profit centres are eroded. We have a very real concern that access to justice in particular will suffer. There may be increased competition for the provision of certain types of legal service, but the act ignores the fact that the current market place is already very crowded and many legal services (both reserved and unreserved) are already provided very cheaply. Increased provision of legal services will not be an improvement if standards and quality are not maintained.
- We are deeply concerned about the potential clash that may arise within an ABS between a Solicitor (who is an officer of the Court with a professional duty to act in the best interests of each client) and a non lawyer director (who must act in the best interests of shareholders under company law). So far as we are aware, when the Legal Services Bill was before Parliament, HMG rejected any attempt to include a clause expressly confirming that the professional duty must override the company law duty, and we cannot see how that helps consumers; the Act purports to advance consumer interests, but we believe this is yet another example of large commercial interests prevailing over the consumer with Government blessing.

Availability of legal Services

“Consumer value” does not always mean the least expensive. The introduction of ABSs may very well lead to a decline in the total number of providers of legal services. Technology may in time play a role in redressing that problem, but there are many vulnerable members of society (especially amongst the elderly and those with capacity issues) who are in desperate need of access to local legal services and we do not see this changing in the short to medium term.

The Fit and Proper Test for External Owners

- In principle, we believe that those with significant equity and control of an ABS should be subject to more rigorous checks than those with a more modest stake.

- Our primary concern is the quality of the employees of an ABS who are providing legal advice and legal services and the commercial pressures to which they may be subjected.

Conflict of Interests

We are concerned that certain organisations may have an adverse interest. We can envisage numerous scenarios where certain owners of ABSs will have such adverse interests, for example a mortgage lender insisting that would-be borrowers use the lender's own conveyancers, and financial services providers leaning on legal services clients to invest monies obtained through those services with the financial services company itself. All Solicitors are familiar with the principle that they should not interfere with a client's inherent right to instruct a Solicitor or legal services provider of their choice, but we have grave misgivings about whether large ABSs will abide by that principle.

Ring-Fencing

The intention going forward is clearly to regulate entities rather than individual lawyers. We struggle to see how ABSs can fail to be ring fenced unless regulation continues to be on the individual. At the present time, for example, in house lawyers working for large corporations are regulated individually and are subject to the Solicitor's Code of Conduct, and this appears to work quite well. If regulators want to move in the direction of entity based regulation, we believe it is essential that ABSs are ring fenced, and that regulation will be ineffective if they are not.

Indemnity Insurance

- We believe that the same levels of professional indemnity insurance should be procured by all providers of legal services. Tesco plc is not released from the obligation to insure its fleet of road vehicles just because it is a large organisation with deep pockets and the same principle should apply to professional indemnity insurance.

- Once again, we believe that adequate professional indemnity insurance for legal services can only be established effectively if the ABS is ring fenced. If an insurance company is providing legal services, careful consideration needs to be given as to whether it can procure professional indemnity insurance from within the same group.

Compensation Fund Requirements

- We are concerned that the failure of a large ABS could have catastrophic consequences. Unless the ABS has made a proportionate contribution to the existing Compensation Fund, we believe serious consideration should be given to splitting the fund between ABSs and other providers of legal services.
- On balance, we believe the safest option would be to create two funds. We believe that it is irresponsible to reduce the minimum conditions for insurance for ABSs (presumably on the assumption that they have deep pockets), especially in the light of some of the failures that we have seen recently of blue chip financial services companies. It is wholly inequitable in our view for the government to set in motion a mechanism to create ABSs and then for the regulators to engineer a set of circumstances whereby the failure of a large ABS could impact financially on existing providers of legal services, many of whom may have opposed the creation of ABSs in the first place! In view of that, we believe the only safe option would be to have a separate compensation fund for ABSs.

Conflict between different regulators

In the current climate, there is a danger in holding the FSA up as a model of how regulation should work whether in a multi-disciplinary context or otherwise. It is possible to envisage MDPs that encompass not just two or three separate professional disciplines but half a dozen or more. MDPs could become so diverse that there is a very real danger that no regulator takes responsibility for regulating the entity adequately. If the legal services function of the ABS is ring fenced, this concern will not arise.

Special and Low Risk Bodies

- We are concerned that it is potentially dangerous to have providers of legal services (whether for profit or otherwise) subject to different levels of regulation. Pro bono lawyers are subject to the same regulation as all other lawyers and we believe the same principle should apply to all providers of legal services.
- As a general observation we do not feel the issue of profit should be the bench mark for the level of regulation. Consumers need to be protected against shoddy work and poor advice whether they pay for it directly, receive it as a membership perk or simply get it free of charge.

Accounting procedures

- All providers of legal services must hold client money separately and we believe that the only way that this can be conducted is if they are subject to accounting rules identical to the Solicitors Accounts Rules. We have very real concerns about whether any regulator, including the SRA, will have the necessary expertise to assess these issues. We do not believe that it is possible to protect consumers against the risk of a collapse of a big ABS. If ABSs enter the market that is simply a risk that HMG and the LSB will be imposing on consumers. The FSA has demonstrated that it is incapable of adequately regulating the banking sector. The SRA is very good at regulating solicitor sole practitioners, but concerns about its ability to regulate even large firms of Solicitors is a matter of public record. We remain concerned therefore about the ability of such regulatory bodies to regulate adequately large ABSs which are likely to be far more complex than existing large solicitor practises. We believe that the ability to regulate is likely to be much less problematic if ABSs are ring fenced.

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