



The Law Society

Draft Legal Services Bill Joint Committee consideration

**Preliminary submission from the Law Society
June 2006**

Introduction

1. Sir David Clementi's recommendations have the potential to improve the way in which the legal services market operates for consumers and practitioners alike. However, the Society considers that in a number of important respects, the proposals in the draft Bill fall far short of what is needed to establish an effective, proportionate, risk-based regulatory regime for the 21st century.
2. Sir David's report recommended that the regulation of legal services should continue to be carried out primarily by the long-established professional bodies (and other existing front-line regulators) subject to a number of important changes:-
 - The establishment of a light-touch Legal Services Board to act as the supervising regulator, replacing the variety of different supervisory arrangements which apply to the different branches of the legal profession at present.
 - A requirement that those professional bodies which carry out representative as well as regulatory responsibilities should separate the two roles, so that there is no improper representational influence on regulatory decision-making.
 - The establishment of a new Office for Legal Complaints, wholly separate from all the professional bodies, to deal with consumer complaints about lawyers.
 - Measures to permit so-called Legal Disciplinary Practice (LDPs) in which non-lawyers could be partners in law firms (or senior managers of incorporated law firms), and external bodies could own law firms, subject to appropriate safeguards.
3. The Law Society strongly supports Sir David Clementi's conclusion that regulation of legal services should continue to be based on the professional bodies. The Society believes that profession-led regulation is necessary to ensure the proper independence of the legal profession and of its regulation from Government; to ensure that regulation is well informed – and thus effective; to maximise the willing acceptance of regulation within the legal profession; and to ensure that regulation is cost effective.

4. The Law Society also supports in principle all the main changes proposed by Sir David Clementi. Indeed the Law Society has for some time itself been seeking powers to enable it to regulate LDPs effectively. The Society has already established arrangements for the governance of its regulatory functions which ensure that all decisions on regulatory matters (except for rule-making, which cannot lawfully be delegated under present legislative powers) are taken by the independent Regulation Board, and not by the Council.
5. The principal defects in the draft Bill are:-
 - The arrangements for the appointment of the Legal Services Board, and the arrangements for subsequent involvement of the Secretary of State in its decision-making, fail to secure the necessary independence of the legal profession and its regulation from Government.
 - The proposals for the operation of the Legal Services Board fail to ensure that it will operate as a light-touch supervisory regulator, and instead create an over-intrusive primary regulator. This would detract from the principle of regulation continuing to be based on the professional bodies and would substantially increase the costs and delays associated with regulation, to the detriment both of consumers and the legal profession.
 - The proposals for regulating Alternative Business Structures (ABSs) would create a regulatory regime which will lead to duplication and inconsistency, and would give the Legal Services Board an inappropriate role as front-line regulator
 - The provisions for the creation of the Office for Legal Complaints fail to provide an appropriate demarcation between the role of the OLC and the role of the approved regulators on disciplinary matters; and fail to ensure that the OLC provides the approved regulators with the information they will need to carry out their regulatory responsibilities effectively.

This note expands on each of these points and suggests ways in which the Bill might be amended to meet the Law Society's concerns.

Overall assessment

6. The overall effect of the present draft Bill is that the approved regulators would be little more than the administrative arms of the Legal Services Board. The result would effectively be to create an overbearing Legal Services Authority by the back door. This would have serious consequences both for the cost and effectiveness of regulation, and for the perceived independence of the profession. Doubts about the profession's independence would in turn have a serious impact on the ability of law firms in England and Wales to become established overseas and would consequently jeopardise the £1.9 billion of earnings the UK economy derives from law firms' overseas activities.
7. In the case of the Law Society, criticism of our performance as regulator has been directed almost entirely at the handling of consumer complaints – which is to be transferred to the new OLC – rather than on the regulatory responsibilities the Law Society will retain. Serious disciplinary matters are already dealt with by a tribunal independent of the Law Society, the Solicitors

Disciplinary Tribunal. It is important to note Sir David Clementi's own conclusion:-

"The current system has produced a strong and independently minded profession, operating in most cases to high standards, able to compete successfully internationally. These strengths would suggest that the failings of the system, identified in the scoping study and covered in this review, should be tackled by reform starting from where we are, rather than from scratch."

Independence of the profession

8. The Law Society has long recognised that the old concept of self-regulation of the legal profession needs to be updated. In particular, it is important to ensure that regulatory decisions are free from improper representational influence, and that there is sufficient lay involvement in regulatory decision-making to ensure that it properly reflects the needs of consumers of legal services and of the wider public. That is why the Law Society supports the proposals for separation of regulatory responsibilities from representation, and has itself implemented arrangements which enshrine that principle as far as can be achieved within existing legislation.
9. But the need for reform on those lines should not be used as an opportunity to secure improper Government involvement in the regulation of the legal profession. The independence of the legal profession – and of its regulation – from Government is crucial to maintain public confidence in the profession (which often needs to represent the citizen against the State); and to uphold its reputation – and hence its economic success – internationally. Maintaining the independence of the legal profession from Government ought to form one of the regulatory objectives in the Bill.
10. The draft Bill provides for all the members of the Legal Services Board to be appointed by the Secretary of State alone, although the explanatory notes recognise the need to follow the Code for Public Appointments. The Bill also provides for the Legal Services Board to consult the Secretary of State in a number of aspects of its decision-making.
11. The Law Society believes these provisions need to be amended in order to reduce the risk of the Legal Services Board operating in a way which is too close to Government. In particular:-
 - The regulatory objectives in the Bill should be amended to include a specific reference to maintaining the independence of the profession from Government.
 - Ministerial functions should fall to the Lord Chancellor, rather than to the Secretary of State, especially as if the powers are given to the Secretary of State they could be transferred to any Secretary of State.
 - Appointments to the Legal Services Board should be made by the Lord Chancellor and the Lord Chief Justice or the Master of the Rolls jointly.
 - The provisions throughout the Bill under which the Legal Services Board would consult the Secretary of State prior to exercising particular functions (such as applications to become an approved regulator, and giving directions to approved regulators) should be reconsidered. The Lord

Chancellor will need to have a role in relation to matters where secondary legislation is needed to give effect to the Board's decisions, but that should not stretch into a general consultative role on the Board's activities.

Establishing a light-touch Legal Services Board

12. The Law Society supported Sir David Clementi's recommendation for the establishment of a Legal Services Board on the basis that it would act as a light-touch supervisory regulator, leaving the principal responsibility for regulation with the front-line regulators. The Law Society accepted that bodies which had regulatory and representative responsibilities would need to establish governance arrangements which ensured that regulatory responsibilities could not be subject to improper representational interference.
13. The Law Society accepts that the Legal Services Board needs effective powers to intervene when there is a serious regulatory failure. But the range of powers in the draft Bill is far wider than is needed to achieve that, and the draft Bill fails to provide a clear and appropriate definition of the approach the Legal Services Board should take to the exercise of its powers. This creates a serious risk that the Legal Services Board will adopt an unduly interventionist approach.
14. The Bill appears to be drafted on the assumption that approved regulators would be inherently untrustworthy. It provides for a range of powers which might be appropriate if there were to be no distinction in future between professional bodies' representative and regulatory roles, but which cannot readily be justified in the light of the changes to regulatory arrangements which have been made. The Law Society's regulatory functions are now the responsibility of an independent Board, appointed entirely on Nolan principles. Seven of the sixteen members are lay persons. No member of the Law Society's Council is eligible to serve on the Regulation Board. The Law Society has thus established governance arrangements for regulation which fully meet modern public needs. It is important that – having implemented these reforms – approved regulators are able to get on with their task, subject only to light-touch supervision, rather than being subject to continual micro-management and second-guessing
15. A number of changes to the draft Bill are needed to ensure that the LSB operates in a proportionate and light touch way:-
 - The proposed powers of the Legal Services Board should be streamlined. We accept that a power to give directions to approved regulators is needed. However, the powers to set targets, to fine, and to intervene in regulatory functions are inappropriate, and risk encouraging the LSB to micro-manage approved regulators. Since all approved regulators will need to establish satisfactory governance arrangements which provide a proper separation of regulation from representation, the proposed power to fine is particularly inappropriate, as it would involve fining the profession for the failings of its independent regulatory arm.
 - Powers to give directions should arise only where the Legal Services Board concludes that the action or inaction of an approved regulator risks serious damage to the regulatory objectives, and the matter cannot be resolved informally.

- The LSB should only be permitted to decline to approve a regulator's proposed rule where the Board considers that the proposed rule would seriously undermine the regulatory objectives.
- The regulatory objectives should be ranked, rather than treated as of equal importance. In particular, the desirability of promoting competition should specifically be made subject to the need to support the rule of law, the need to protect the interests of consumers, and the need to maintain the independence of the legal profession from Government.
- The approved regulators should generally be free to carry out their functions (after appropriate consultation) without advance approval from the Legal Services Board. Advance approval should be required only for significant changes to the governance arrangements, and for major new rules (such as those to permit external ownership of law firms).

Office for Legal Complaints

16. The Law Society supports the proposal to establish an independent Office for Legal Complaints, wholly separate from all the professional bodies, to deal with consumer complaints about lawyers. The Law Society believes public confidence in arrangements for dealing with what are ultimately potential disputes between consumers of legal services and their service provider depends on the adjudication arrangements being wholly independent. This view is fortified by the fact that the Law Society continues to be criticised for its performance in handling consumer complaints despite the fact that on most objective measures it compares well with the performance of other complaints handling organisations.
17. It is important that the roles of the Office for Legal Complaints and of the approved regulators are properly demarcated. The role of the Office for Legal Complaints – like the Financial Ombudsman Service – is to deal with redress for the consumer (whether the complaint arises from what was formerly categorised as a “service” or “conduct” issue) not to deal with any disciplinary sanction which may be necessary. Information derived from complaints handling should be used to improve the regulatory system, but responsibility for regulatory action in individual cases properly rests with the approved regulators, who – as the White Paper emphasised – should take a risk-based approach to their responsibilities.
18. The Bill fails to implement this principle effectively. Instead, the Office for Legal Complaints appears to be set above the approved regulators, in a quasi-supervisory role, rather than having an equal but distinct function. There is no provision in the Bill requiring the Office for Legal Complaints to give the approved regulators the regulatory information they need, at the time they need it; nor is there a power for the OLC to refer to approved regulators general regulatory issues which arise from their handling of complaints. However, the Office for Legal Complaints is given an ill-conceived power to require the approved regulators to report to the OLC on action they take in relation to any reference of a conduct matter. This is likely to cause significant difficulty between the OLC and the approved regulators, especially as regulators increasingly adopt a risk-based, rather than complaint led, approach to disciplinary matters. Giving such a power to the OLC risks distorting the regulatory priorities of approved regulators.

19. The key changes to the Bill necessary to establish the appropriate relationship between the OLC and approved regulators are:-
- The introduction of a clause requiring the OLC to provide approved regulators the information they need to carry out their regulatory functions, at the times they need it. If the OLC believed that the requirements for information were disproportionate, the matter could be resolved by the Legal Services Board.
 - Modification of clause 125 (which as currently drafted enables the OLC to require an approved regulator to report to it on action taken in response to a conduct reference, and to report to the Legal Services Board if dissatisfied with the regulator's response). The clause should be amended so that it applies not to individual conduct matters, but to reports from the OLC drawing attention – on the basis of their experience of complaints handling – to general issues which the OLC believes the approved regulator needs to consider.

Alternative business structures

20. The Law Society supports the development of new business structures for the delivery of legal services to the public. The Law Society believes that, provided the necessary consumer protection can be put in place, there should be no restrictions on the entities through which legal services can be provided to the public. The Law Society has specifically endorsed the concept of Legal Disciplinary Practices (in which non-lawyers can become partners of law firms and which would permit external ownership of law firms). The Law Society originally hoped to introduce LDPs through its existing regulatory powers, but was advised by leading counsel that it could not do so. The Society has consequently sought new powers to enable it to regulate LDPs effectively.
21. To provide the same consumer protection as is available from existing law firms – and in order to reduce the complexity and cost of regulation – it is important that these new vehicles should be regulated so far as possible in the same way as other law firms, rather than through a wholly separate structure. Alternative Business Structures (ABSs) should be subject to all the rules applying to ordinary law firms. In addition, of course, it will be necessary to have specific rules to deal with the new issues posed by non-solicitor partners, or external owners. These will need to cover:-
- Requirements to show that non-solicitor partners are “fit and proper” to be involved in a law firm.
 - Any requirement for non-solicitor partners to demonstrate understanding of the conduct of business rules.
 - The need to have a register of permitted non-solicitor partners, and of persons who are disqualified from being partners.
 - Rules concerning the ring-fencing of an externally owned law firm from any other part of the owner's business.
 - Stringent rules concerning “fitness to own” including the arrangements for notifying proposed changes of ownership.

22. The draft Bill fails to adopt this approach. Instead, it creates a wholly separate licensing structure for ABS firms. The Bill envisages that the Legal Services Board would be a primary regulator of ABS firms – contrary to the principle that the LSB should be a supervisory regulator rather than a front-line regulator. It is also odd to use the concept of licensing, which in other regulatory concepts generally enables the conditions of the licence to be tailored to individual firms. In the case of legal services, it will be important for the same core rules to apply to all firms regulated by an individual approved regulator.
23. Furthermore, even existing approved regulators would need to make a specific application to the LSB to be authorised to license ABSs. This means that the Law Society, for example, would have to operate two separate regulatory regimes – the regime applying under its existing powers (with whatever additional powers may be introduced through this Bill), and a separate licensing regime for ABSs. Yet many law firms will move from one category to another, as there are changes in the personnel of the firm. Furthermore, the powers the Bill provides in respect of ABS firms are not the same as those available in respect of solicitors' firms. For example, for ABS firms there will be no power to intervene without notice to the ABS concerned. Yet the power to intervene in the business without notice, in the case of suspected dishonesty, is a crucial consumer protection.
24. The main changes to the draft Bill needed in order to establish a workable approach to the regulation of ABSs are:-
- The deletion of the separate regime for ABS firms provided for in part 5 of the Bill, removing the presumption that the Legal Services Board will act as a primary regulator of ABS firms.
 - The inclusion of additional provisions for the Law Society (and any other regulators which wish to regulate ABS firms) to ensure that they have the appropriate powers to do so. Many of these provisions will be modelled on the powers in Part 5.
 - A requirement to secure specific approval from the Legal Services Board for any rules permitting external ownership of law firms.
 - Provisions to ensure that the Law Society can regulate all law firms (not just ABS firms) as entities, rather than merely as a collection of individuals.

Conclusion

25. The Law Society remains supportive of the main objectives of Sir David Clementi's proposals for reforming the regulation of legal services. However, we believe that major amendment is needed to the draft Bill in order to ensure that those objectives are achieved in a way which builds on the strengths of the existing regulatory system, rather than creating an unwieldy, excessive and burdensome new tier of regulation.

The Law Society will be pleased to expand on these points, or to deal with any other issues raised by the Joint Committee, when giving oral evidence. The Society will also submit a further memorandum, by 15 June, setting out our views on the draft Bill in more detail.