

# Legal Regulation Review

*An Independent Review of the Regulation of Law Firms by the Rt Hon Lord Hunt of Wirral MBE*

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## Call for Evidence

**January 2009**

## Preface

The purpose of this Call for Evidence is to provoke thought and debate; and also, we hope, to stimulate a flood of responses. The consultation period begins with the publication of this paper on Thursday 15 January 2008 and, in line with standard practice, runs for twelve weeks, which takes us to Maundy Thursday, 9 April 2009.

In the early summer we shall produce an Initial Response to Evidence, in which we shall endeavour to give a clear indication of our lines of thinking and likely final conclusions. There will then be another, shorter period of consultation and a number of road-shows outside London. The final report will be published by the early autumn.

This document has a simple structure:

**Chapter 1** is a personal **introduction** to this review from Lord Hunt.

**Chapter 2** provides some **background** to regulation, both generally and in the specific context of the legal profession.

**Chapter 3** is more **historical**, taking the reader through a brief account of the foundations of the legal system and Law Society, then coming rapidly into the present day and the era of Clementi, the Legal Services Act and the LSB.

**Chapter 4** is the longest section of the document and sets out some of the **possible lines of inquiry** we have identified in the early stages of the review. Some questions are suggested, but they are intended only to provide a starting point and some stimulation for possible respondents.

**Chapter 5** contains the necessary **contact details** and other "housekeeping" information. There are also 10 **appendices** available, all of which in some way support the main document.

This review will be only as good as the responses it provokes. We begin this process with an open mind and look to you to provide us with the wisdom, experience and insights that will provide the foundations of our final report. Thank you in advance for any contribution you may feel moved to make. We need you!

## The Review Team

## Chapter 1 – Introduction by the Rt Hon Lord Hunt of Wirral MBE

- 1.1. I think it is excellent that the Law Society has decided to initiate this independent Review of the regulation of lawyers and law firms and I was personally very pleased indeed when I was asked to lead the Review. The sector is about to undergo the most radical transformation in its history and it is critically important that the regulatory system should keep up with the rapid pace of change we are about to witness. Regulation has at its heart the consumer and public interests, but for regulation to be a success, it is demonstrably necessary that the regulated community too should have its say. The new regulatory regime must be flexible if it is to be sustainable, and to develop and retain credibility.
- 1.2. I have been fortunate in having three distinct but inter-related careers: in the law; in politics; and in the world of financial services. In all three of these areas of activity I have been heavily involved with questions of professional standards, regulation and the public interest and public service. In 2007-2008, for instance, I was President of the Chartered Insurance Institute (CII) and my theme was "professionalism"<sup>1</sup>. I had already served as the first independent chairman of the CII's Professional Standards Board and it has long been my mantra that individuals working in financial services should aspire to the highest professional standards.
- 1.3. In the 1990s, as Public Service Minister, I set up the Committee on Standards in Public Life (the "Nolan Committee"), a controversial action at the time, which effectively ended centuries of self-regulation for parliamentarians. Such was the public mood that I still believe there was no viable alternative and it is certainly difficult now to imagine that system of independent and transparent scrutiny ever being abolished totally.
- 1.4. These days, all three sectors – legal, financial and political – operate within a framework of overlapping and sometimes bewildering sets of regulatory and

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<sup>1</sup> Appendix 1

professional principles. For instance, the "Nolan" Committee seeks to promote seven principles of public life: selflessness; integrity; objectivity; accountability; openness; honesty; and leadership<sup>2</sup>. These cannot be translated perfectly and *in toto* into a commercial environment, but I do intend to bear them in mind as I proceed with this Review.

- 1.5. It fell to a later government to introduce the Better Regulation Task Force, latterly the Better Regulation Executive (BRE). The BRE promulgates a set of principles, to which I shall refer repeatedly in this Call for Evidence document and which I expect will play a major part in my thinking as I frame my final proposals in due course. These are, in brief, that regulators and/or regulations should be *proportionate; accountable; consistent; transparent; and targeted*<sup>3</sup>.
- 1.6. Recent developments, most notably but by no means exclusively in the field of regulating financial services, indicate a clear trend towards principles-based regulation, moving away from detailed and prescriptive rule-making in favour of setting out desired regulatory outcomes. This is naturally and effectively allied to a risk-based approach to regulation, and facilitates the flexibility of regime to which I referred above, allowing regulators to consider factors that a more rigid set of rules might fail to take into account, such as the external cultural climate, or the reputation of an entity or sector.
- 1.7. The Financial Services Authority (FSA) has in recent times moved towards principles-based regulation, marking a fundamental change in its approach. During the passage of the Legal Services Bill I cited the FSA model as one to be usefully borne in mind as we crafted the basis for the future of legal regulation and I still think the FSA principles are helpful and relevant. In Appendix 4 to this document I include a full list of the eleven principles for business adopted by the FSA. I draw particular attention to the language in

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<sup>2</sup> Appendix 2

<sup>3</sup> Appendix 3

which the principles are expressed, which to me is the language of professionalism: "integrity"; "skill, care and diligence"; "proper standards of market conduct"; "manage conflicts of interest fairly"; and so forth. I set out the current situation with regard to legal services in the following chapter.

- 1.8. It strikes me that the vital thread running through all this complicated field - across the legal services sector, financial services, public life and numerous other areas of human endeavour – is public confidence. Regulatory regimes exist to protect the public interest and to prevent consumer detriment, especially where there is an asymmetry of information between provider and purchaser, a situation that by definition tends to characterise the dealings between those working in the professions and their clients.
- 1.9. Working methods are ever-changing, however, and the introduction of new Alternative Business Structures (ABSs) will serve only to increase the pace of change within the legal services market. As businesses must be flexible and pragmatic, so too must regulators. That is why the five regulatory principles set out by the BRE are my foundation stone as I embark upon this review. I intend to go right back to first principles and these five seem to me as good a starting point as any.
- 1.10. What I aim to establish through this Review is what effective regulation looks like, and how its performance can (and should) be assessed and evaluated. In seeking to achieve this, I want to learn not only from best practice in other sectors, but also from the experiences of other jurisdictions.
- 1.11. It is worth mentioning that, as part of its overall review of the future regulation of law firms, the Law Society has also commissioned a separate, independent reviewer, Nick Smedley, to consider whether the present arrangements for regulating law firms serving corporate clients are satisfactory. This work will form a distinct, more narrowly focused sub-strand of this overarching Legal Regulation Review. Mr Smedley will publish his report by the end of February 2009 and I will take his findings and recommendations into consideration when drafting my initial and final reports.
- 1.12. I hope you will find this document, and the consultation process it

inaugurates, to be thought-provoking, genuinely open and ultimately worthwhile. Above all, I exhort you to play your part, by reading this Call for Evidence document, reflecting upon the issues it raises and then telling me what you think.

1.13. I look forward to hearing from you.

**Rt Hon Lord Hunt of Wirral MBE**

**January 2009**

## Chapter 2 - Background

2.1. It is the starting point for me and my team, and the very cornerstone of our work on this Review, that our recommendations should be consonant with the best possible regulatory principles. This approach is embodied in our Terms of Reference from the Law Society:

*'In light of current and forthcoming changes in the legal services market, the differing needs of different types of client, current regulatory debates and the need to promote equality and diversity, to consider the appropriate regulatory rules, monitoring and enforcement regime to ensure high standards of integrity and professionalism for solicitors and their firms in all sectors, and to make recommendations.'*

### Why regulate?

2.2. The public and professionals equally have incentives to impose restrictions on professionals. The question “why regulate?” is most often answered in the economic terms of the correction of market failures. Consumers need to overcome the market failures and shortcomings of non-regulatory mechanisms: asymmetry of information; credence goods; and externalities.

2.3. “Information asymmetry” refers to the disparity between the level of technical and factual knowledge and understanding that exists between the service provider on the one hand and the consumer or customer on the other. The FSA found that a lack of information was second only to a lack of money as a reason for not buying financial products: some 77 per cent of inactive consumers definitely agreed with, or tended to agree with, a lack of money being the reason for not investing; scarcely more than the 70 per cent who responded positively to the assertion “I don't know enough about financial matters to choose suitable products”.<sup>4</sup>

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<sup>4</sup> Better Informed Consumers: Assessing the Implications for Consumer Education of Research by BMRB, Financial Services Authority, April 2000

- 2.4. “Credence goods” describes the intangible nature of professional services and the difficulty of ascertaining quality before purchase. Consumers may struggle to assess the quality of the service they have bought, as a consequence both of information asymmetry and also of the often ambiguous relationship between the quality of the service provided and the outcome of legal proceedings. The long time it takes for some advice or services to register or bear fruit can also be perplexing.
- 2.5. Finally, “externalities” refers to any impacts (beneficial or adverse) on third parties which arise from decisions made by professionals and/or their clients.
- 2.6. It is essential to base a regulatory system in a strong theoretical framework, in order to provide it with the necessary resilience to adapt to the changing world in which it operates. It is difficult (or even impossible) for a regulator to predict future service innovations, but it is at least possible for it to respond to changing risks if it is able to refer back to clearly articulated first principles. The excellent regulatory principles promulgated by the Better Regulation Executive must be translated into the legal regulatory environment. The recent financial crisis has raised many questions about how to define “effective regulation”<sup>5</sup> and to understand how to promote and achieve a judicious balance between protecting consumers from excessive risk and allowing providers to develop innovatively and offer new opportunities to them.

### **How, whom and what to regulate?**

- 2.7. Regulation of professionals has taken many forms. Traditionally, a strong focus on *ex-ante* (“before the event”) self-regulation has predominated, with the professional body itself setting prescriptive rules about entry, standards of behaviour and continuing education. *Ex-ante* regulation can also have the

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<sup>5</sup> Alistair Darling's speech to Labour Party Conference, 9 September 2008

effect of damaging competition. In recent times many people have come to the view, rightly or wrongly, that self regulation is no longer effective at overcoming the perceived risk that, where professional interests diverge from those of consumers, the professions will disguise this, for example by setting disproportionately stringent *ex-ante* rules, citing the public interest as a justification. The regulatory balance for the professions is now changing discernibly, with a growing emphasis on *ex-post* ("after the fact") regulation and external, independent regulation.

- 2.8. In *ex-post* regulation, professionals are sanctioned for breaching professional rules or service commitments. *Ex post* regulation involves the proactive monitoring of the quality of services, handling consumer complaints, punishing miscreants and ensuring proper redress is available for inadequate service. Because consumers may not be confident in the profession's impartiality, *ex-post* regulation might be further complemented by external regulation.
- 2.9. Particularly in the past decade, the established model of professional self-regulation has been called into question, with significant pressures to reform. Reforms have created a new regulatory model of "front-line regulators". Front line regulators are accountable to a new tier of sectoral oversight regulators, across professional industries such as law, accounting, and healthcare. Oversight regulators such as the Council for Healthcare Regulatory Excellence (CHRE), the Financial Reporting Council (FRC), and the new Legal Services Board (LSB) are ultimately accountable to Parliament. They are charged with providing sustained oversight of the front-line regulators. They do not create an extra tier of regulation as such, but rather rationalise and simplify oversight mechanisms. Such bodies have been designed expressly to address concerns about traditional regulators, namely that self-regulatory bodies have been more responsive to practitioners' concerns than to those of the general public. The Legal Services Act gives the LSB the power to censure, fine or replace the front-line regulators, possibly becoming the front-line regulator of last resort itself if it judges a

front-line regulator to have failed totally.

## Generally Applicable Principles of Regulation

2.10. One of the Government's stated objectives in the Legal Services Act 2007 was to tackle the "regulatory maze"<sup>6</sup>. Any pursuit of this laudable objective is still hampered by the continued existence of so many overlapping sets of rules, regulations and principles, not all of which are driven from within the legal sector itself. For example we are heavily affected by legislation emanating from the European Union; and both the UN and the WTO have also made significant statements that have an impact upon professional practices. In search of applicable first principles, I find myself strongly drawn to the five principles of good regulation set out by the Better Regulation Executive (BRE). These five principles are designed to be applied to every type of regulation, and they were explicitly incorporated into the Legal Services Act 2007.

2.11. The BRE principles state that regulations should be:

**Proportionate:** Regulators should only intervene when necessary. Remedies should be appropriate to the risk posed, and costs identified and minimised.

**Accountable:** Regulators must be able to justify decisions, and be subject to public scrutiny.

**Consistent:** Government rules and standards must be joined up and implemented fairly.

**Transparent:** Regulators should be open, and keep regulations simple and user-friendly.

**Targeted:** Regulation should be focused on the problem, and minimise side

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<sup>6</sup> The Future Of Legal Services: Putting Consumers First, Department For Constitutional Affairs, October 2005, Page 5

effects.

2.12. In 2005 the Government accepted the recommendations made by the then Better Regulation Task Force (the BRTF, latterly the BRE) in its report *Regulation – Less is More. Reducing Burdens, Improving Outcomes*. This led to Departments using standard cost models to measure administrative burdens, in line with new guidelines designed to tackle unnecessary and/or over-complicated regulation. The BRTF identified two pillars of good regulation.

2.13. The **first pillar** is for rules to be *principles-based*. Prescriptive regulation can encourage routine compliance rather than the development of new ideas. As a general rule the BRTF found that principles-based regulation, focusing from the outset on outcomes rather than processes or procedures, can stimulate innovation rather than stifling it. This is because it requires organisations and individuals to find their own ways of achieving required outcomes, by developing appropriate and proportionate solutions to individual situations. It also requires a greater degree of judgment on the part of the individuals concerned.

2.14. The **second pillar** of good regulation is that regulators should adopt a *risk-based* approach to enforcement. The BRTF argued that a risk-based approach could contribute to a significant reduction in the burdens imposed on those being regulated, and also allow regulators to increase operational efficiency. The focus for a regulator should be to ensure that those being regulated meet appropriate standards of good practice. This demands courage, for a certain level of risk does necessarily have to be tolerated. Regulators cannot, and should not, seek to guarantee the removal of all risk. Risk must be identified, minimised and managed. It cannot be obliterated.

2.15. Also in 2005 Gordon Brown asked Sir Philip Hampton to report on the effects

of regulatory inspection and enforcement<sup>7</sup>. Hampton recommended that:

- comprehensive risk assessment should be the foundation of all regulators' enforcement programmes;
- there should be no inspections without reason;
- data requirements for less risky businesses should be lower than those for riskier businesses;
- resources released from unnecessary inspections should be redirected towards advice to improve compliance;
- there should be fewer, simpler forms; and
- when new regulations are being devised, regulators should plan to ensure enforcement can be as efficient as possible.

## The Specific Needs of Legal Regulation

2.16. So much for general principles for good regulation. Considering the particular challenges posed by a rapidly-evolving legal services market, Sir David Clementi, in his final report in December 2004<sup>8</sup>, explicitly made the important distinction between regulatory objectives and professional codes and standards. He identified six main objectives for a regulator of legal services:

The **first** was *maintaining the rule of law*: "those charged with regulating legal service providers should have an important part to play in ensuring the rule of law by creating conditions necessary for its delivery".

The **second** was *access to justice*: " [which] has a geographic dimension ...

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<sup>7</sup> Reducing Administrative Burdens: Effective Inspection And Enforcement, Sir Phillip Hampton, March 2005

<sup>8</sup> Appendix 5

but it is critically also an issue about access for those who are disadvantaged and in particular those who cannot afford to pursue their legal rights".

The **third** suggested objective was the *protection and promotion of consumer interests*: "first to ensure that consumers have sufficient information about the standards of the services provided so that they are able to take informed decisions about these services; and second, given that consumers may not always be 'informed', to have powers to act in the market, for example, to prohibit oppressive marketing practices, raise or set standards, develop information/awareness programmes, resolve disputes and protect vulnerable groups."

The **fourth** was *promotion of competition*: "the prevention of unjustified restrictions on the supply of, and encourage competition in, the provision of legal services and the promotion of choice in both the number and type of providers, subject to the proper safeguard of consumers' interests."

The **fifth** objective was the *encouragement of a confident, strong and effective legal profession*: "to ensure access to justice, the maintenance of a healthy supplier base for publicly funded work and continued support for pro bono initiatives, thereby serving the public interest ... It would also underpin the international efforts of our legal sector."

The **sixth** and final suggested objective was *promoting public understanding of the citizen's legal rights*: "any new legal services regulator should ... maintain the professional obligation on lawyers to set out for clients their rights and the consequences of different options".

2.17. The statutory regulatory objectives listed in the very first Section of the Legal Services Act 2007<sup>9</sup> are closely aligned to those Clementi suggestions:

***"The regulatory objectives***

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<sup>9</sup> Appendix 6

- (1) *In this Act a reference to “the regulatory objectives” is a reference to the objectives of—*
- (a) *protecting and promoting the public interest;*
  - (b) *supporting the constitutional principle of the rule of law;*
  - (c) *improving access to justice;*
  - (d) *protecting and promoting the interests of consumers;*
  - (e) *promoting competition in the provision of services within subsection (2);*
  - (f) *encouraging an independent, strong, diverse and effective legal profession;*
  - (g) *increasing public understanding of the citizen’s legal rights and duties;*
  - (h) *promoting and maintaining adherence to the professional principles.”*

2.18. So much for the regulatory objectives. As Clementi put it in his Report, "as well as setting regulatory objectives, any regulatory framework for legal services would need to ensure that the professional codes and standards to which lawyers operated were consistent with certain professional principles and precepts"<sup>10</sup>. It is these to which sub-section (h) in the excerpt above refers. Clementi's suggested principles, to work in tandem with the regulatory objectives, were as follows:

**Independence** – Lawyers have a duty to act with independence in the interests of justice;

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<sup>10</sup> Appendix 5, Paragraph 15

**Integrity** – The codes of conduct maintained by the main legal professional bodies generally require their members to act with integrity towards clients, the courts, lawyers and others, to maintain high standards of professional conduct and professional service, and not to bring the profession into disrepute;

**The duty to act in the best interests of the client** – The codes of conduct of the main legal professional bodies generally require their members to act in the best interests of the client, except where it would be unlawful to do so or where the interests of justice would be compromised; and

**Confidentiality** – The codes of conduct of the legal professional bodies generally require lawyers to keep clients' affairs confidential. Communications between a client and his lawyer may be subject to Legal Professional Privilege (i.e. certain communications between a client and legal adviser in the context of obtaining legal advice or assistance are protected from disclosure, even in legal proceedings).

2.19. Parliament decided that the professional principles belonged on the face of the new *legislation*, and they were translated into Section 3 of the *Legal Services Act 2007*:

“(3) *The “professional principles” are—*

- (i) that authorised persons should act with independence and integrity,*
- (j) that authorised persons should maintain proper standards of work,*
- (k) that authorised persons should act in the best interests of their clients,*
- (l) that persons who exercise before any court a right of audience, or conduct litigation in relation to proceedings in any court, by virtue of being authorised persons should comply with their duty to the court to act with independence in the interests of justice, and*

(m) *that the affairs of clients should be kept confidential.*"

## **The Code of Conduct**

2.20. I first became a lawyer in 1965, when I was articled to a former President of the Law Society, Sir Denys Hicks. I learned from him the importance of professionalism, as embodied in the very high standards expected of us by the Law Society. The regulation of legal services has until recent times been largely dependent on a detailed rule book, the Code of Conduct for Solicitors. The recent revision has moved more towards a principles-based approach, but has not yet moved fully away from detailed rule setting. This is, perhaps, unsurprising, for the regulated have an understandable and legitimate desire for certainty of regulatory outcomes; and moving to principles-based regulation does require a certain degree of re-education of the regulated community, particularly in relation to the enforcement and 'penalty' regime. The new principles in Section 3 of the Act are closely aligned with the existing Law Society Solicitors Code of Conduct, which is intended to "define the values which should shape your professional character and be displayed in your professional behaviour", and lists the following "core duties"<sup>11</sup>:

### **1.01 Justice and the rule of law**

You must uphold the rule of law and the proper administration of justice.

### **1.02 Integrity**

You must act with integrity.

### **1.03 Independence**

You must not allow your independence to be compromised.

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<sup>11</sup> Appendix 7

#### **1.04 Best interests of clients**

You must act in the best interests of each client.

#### **1.05 Standard of service**

You must provide a good standard of service to your clients.

#### **1.06 Public confidence**

You must not behave in a way that is likely to diminish the trust the public places in you or the profession.

2.21. The (non-mandatory) guidance accompanying these core principles is eloquent and elegant in equal measure, as this excerpt demonstrates: "In serving society, you uphold the rule of law and the proper administration of justice. In serving clients, you work in partnership with the client making the client's business your first concern. The core duties contained in Rule 1 set the standards which will meet the needs of both clients and society." As Clementi so rightly observed, whatever the details of the new regulatory regime may be, it will necessarily be buttressed by professional principles, and cannot be fully understood in isolation from them.

2.22. In January 2007 The Law Society adumbrated the requirements of the imminent Legal Services Act by establishing the Solicitors Regulation Authority (SRA), which developed out of the previous arrangement, the Law Society Regulation Board. The SRA is composed of all non-Council members with 8 solicitor and 7 lay members, and a solicitor Chair. The SRA handles all regulatory functions, including setting the standards for qualifying as a solicitor; drafting rules of professional conduct; administering the roll of solicitors; and investigating (non-consumer) concerns about solicitors' standards of practice. The SRA Board is one of six boards reporting into the Law Society's Council, which consists of 100 members, all of whom are solicitors. The Council determines all matters relating to the SRA Board structure and contracts of members; and the removal of anyone from the

Board can be imposed by Council only. The SRA Board is charged with all matters relating to monitoring, regulation, investigation, adjudication, discipline, intervention, prosecution, enforcement, civil litigation and cost recovery. It also deals with all matters relating to the setting of standards for entry into the profession and the education and training of solicitors. It makes all regulatory decisions (including rule-making, compliance and decisions in individual cases) and does not need Council approval for these decisions. The corporate structure chart from the Society's website is at Appendix 10.

2.23. Complaints about solicitors are now to be handled by the independent Legal Complaints Service (LCS), previously known as the Consumer Complaints Service (CCS) and before that, the Office for Supervision of Solicitors (OSS). The LCS Board consists of 7 lay and 6 solicitor members, with a Lay Chair. The Law Society recognises that its LCS is transitory, and is planning for the handling of consumer complaints passing to the Office for Legal Complaints (OLC) in 2010. The Law Society is governed by the elected representatives who constitute its Council. The Royal Charter of 1845 provided for the incorporation of the Society and the establishment of Council to be the Society's governing body. In July 2008 the Council formally delegated its rule-making powers to the SRA. The Society did not have the power to delegate the decision on changes to the rules until it was given that power by the Legal Services Act. Until July 2008 the SRA had made the rules which then had to be ratified by Council. Desmond Hudson, Chief Executive of the Law Society, stated at the time: *"The Law Society has now fully complied with its duties under both the spirit and the letter of the Legal Services Act... It means that the profession's rules are now made by a body with a duty to act in the public interest rather than one which has a representative role."*<sup>12</sup>

2.24. In Schedule 4, the Act 'passports' in existing bodies such as the Law Society and the Bar Council as Approved Regulators. The Law Society's governing

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<sup>12</sup> [www.lawsociety.org.uk/newsandevents/pressreleases/view=newsarticle.law?NEWSID=412861](http://www.lawsociety.org.uk/newsandevents/pressreleases/view=newsarticle.law?NEWSID=412861)

body, its Council, holds the regulatory functions which, in the spirit of separation, have been delegated to the SRA.

2.25. Section 51 of the Legal Services Act defines a practising fee as “a fee payable by a person under the approved regulatory arrangements in circumstances where the payment of the fee is a condition which must be authorised by the approved regulator to carry on one or more activities which are reserved legal activities”. The LSB has been given powers to make rules which set out the purposes for which funds raised through the fee may be used. Whilst the practising fee is envisaged as a regulatory fee, the Act also states that the rules must allow practising fee revenues to be used for six purposes, some of which are not strictly regulatory in nature:

- The regulation, accreditation, education and training of relevant authorised persons and those wishing to become such persons,
- The payment of a levy imposed on the approved regulator,
- The participation by approved regulators in Law Reform and the legislative process,
- The provision by relevant authorised persons, and those wishing to become relevant authorised persons, of reserved legal services, immigration advice or immigration services to the public free of charge,
- The promotion of the protection by law of human rights and fundamental freedom,
- The promotion of relations between the approved regulator and relevant national or international bodies, government or the legal professions of other jurisdictions.

2.26. As well as defining how revenues raised from the practising fee may be disbursed, the LSB will also approve the level of the fee. At the moment the Law Society, through Council, recommends a level, which is then subject to

approval by the Master of the Rolls. In the past, the purposes for which fee revenues may be used have been partially prescribed by a Memorandum of Understanding with the Ministry of Justice. This is altered by Section 51 of the LSA. The consolidated report and financial statements published on 31 December 2007 state that the £950 fee for 2007/8 will be apportioned:

- Law Society: £122 (13 per cent)
- SRA: £466 (49 per cent)
- LCS: £362 (38 per cent)

## What I Need From You

2.27. The purpose of this Call for Evidence document is straightforward. I want to encourage the widest possible debate on the future regulation of lawyers and/or law firms. I want to hear from individual and corporate users of legal services; from solicitors and legal executives; from barristers and in-house counsel; from academics, think-tanks and informed commentators; from legislators and their advisers; from regulatory experts; and from anyone else who has something of value to add. Whilst I will report to the Law Society of England and Wales, and therefore take those two territories as my jurisdictional remit, I am naturally very keen indeed to hear from both regulators and "the regulated", or indeed anyone else with useful experience to share, from outwith England and Wales.

2.28. The information received will be summarised and interpreted in a Initial Response to Evidence document, which I hope to publish towards the middle of 2009. That will furnish me with the opportunity to tease out further ideas based on the evidence already compiled and assimilated. I shall solicit feedback on what has been found to date and I will undertake some road-shows. After the second consultation stage has closed a final report will be published, before the end of the year. Beyond my adherence to the widely-accepted BRE principles set out above, I begin my task with few, if any, preconceptions about the way forward. My approach will be rigorous, open-

minded and practical; but ultimately I am depending on you having your say.

2.29. The timing of this Review is ideal. The Legal Services Act 2007 sets out the foundations for radical changes in the structure of regulation. The new Legal Services Board will have to ensure that the front-line regulators of the future are sufficiently flexible, responsive and well resourced to guarantee the effective regulation of one of the most diverse professions there is. The front-line regulators and the Legal Services Board will, as elements within the regulatory regime, need to work in concert to uphold the principles, and achieve objectives that have now been set out in statutory fashion for the first time in the legal field.

2.30. Solicitors are not homogeneous. They range from the sole practitioner, who may be either a specialist or a generalist, to the City corporate firm whose ambitions may be truly global. They serve all types of organisation, industry and individual. Crude "one-size-fits-all" regulation simply cannot be applied across the board. The question is, can certain fundamental principles be applied and maintained when the activities in which solicitors are engaged are so diverse? I intend to go back to first principles in this Review; and that is an approach I shall also be commending to the regulators.

2.31. The legal services sector will only grow more complicated as globalisation continues and the sector here in England and Wales moves through the half-way house of Legal Disciplinary Partnerships (LDPs) towards the advent of the new Alternative Business Structures (ABSs), with whole new vistas of possible ownership and business models opening up.

2.32. This revolution will transform the legal sector beyond recognition, and its regulators must keep ahead of the game. My ambition for this Review is that we should help to devise a suitably robust, flexible and sustainable system for ensuring that outcome. I shall achieve that only if I hear from as many stakeholders as possible. I and my team are depending on you.

## The History

- 3.1. The independence of the legal system from arbitrary actions by the executive was first asserted in Magna Carta in 1215, when King John was pressured by rebellious barons into agreeing to this historic (and still applicable) clause:

*No free man shall be seized or imprisoned, or stripped of his rights or possessions, or outlawed or exiled, or deprived of his standing in any other way, nor will we proceed with force against him, or send others to do so, except by the lawful judgement of his equals or by the law of the land.*

- 3.2. Thus were laid the foundations of an independent judicial and legal system. It was in the early 17th Century that the distinguished Chief Justice Edward Coke asserted that the pursuit of law under the rule of law should be the sole responsibility of a legal profession. In his view English law was a specialist science which could and should be practised only by those who had demonstrably mastered its workings. He actively discouraged James I from judging cases in person by pointing out that legal 'reason' could not be equated with common sense, or imposed by royal fiat. It should be applied by reference to "the artificial reason and judgement of the law... which requires long study and experiences."<sup>13</sup>

- 3.3. This necessitated the creation of a system within which students of law could master their subject and then receive credit for the knowledge and experience they had acquired. At first a proliferation of law clubs was created organically. The consequence was a mixture of professional standards, especially as the clubs were concerned principally (sometimes exclusively) with the well-being of their members. Then, in (or around) 1739 the Society of Gentlemen Practisers sprang up out of the coffee houses of Lincolns Inn Field. This was the first association of solicitors which imposed upon itself the

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<sup>13</sup> A Brief History Of The Law Society, The Law Society, David Sugarman, 1994

dual purpose of protecting the interests of its members, whilst also improving the conduct of the profession as a whole.

3.4. The Society's overt commitment to furthering the wider public interest resulted in its members coming to be highly regarded within the solicitors' profession. In June 1832 the Society was reborn as the Incorporated Law Society. Then the Solicitors Act of 1845 formalised its position as the regulator of solicitors in England and Wales, and allowed it to assume ownership of the practising register ("the Roll"). Ever since the 1845 Act the regulation of solicitors has been the principal and exclusive function of the Law Society, though of course the legal landscape has been reshaped from time to time by means of statutory developments, for instance when the Administration of Justice Act 1985 removed the monopoly that solicitors, barristers and notaries public had hitherto enjoyed in the field of conveyancing law. We shall be drafting new stanzas for what has already been quite a long song.

3.5. Introducing the Legal Services Bill 2006-2007 in the House of Lords, the then Lord Chancellor and Secretary of State for Constitutional Affairs, Lord Falconer, clearly set out the intentions behind the legislation<sup>14</sup>:

*"The Bill puts consumers' interests at the heart of the regulatory arrangements. It provides for a Legal Services Board to provide strong, independent oversight with day-to-day regulation left to front-line regulators; statutory objectives for those with regulatory duties and principles for the legal profession; alternative business structures to enable lawyers and non-lawyers to work together on an equal footing to deliver legal and other services—external investment will also be possible; a single and fully independent Office for Legal Complaints; and a mechanism to protect consumers if new problems occur"*<sup>15</sup>.

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<sup>14</sup> Appendix 8

<sup>15</sup> House of Lords Official Report, 6 December 2006, Column 1162

3.6. Those are the fundamental aims behind the legislation that prompted this Review and, ultimately, will underpin the conclusions it brings forward in due course.

3.7. The framework for the regulation of law firms had been considered prior to 2001. For example, the Law Society had investigated different practice types such as 'Legal Practice Plus' and had also started discussing the possibility of differential regulation dependent on the various types of client being served, but it was a report from the Office of Fair Trading (OFT) in March of that year that gave the debate new impetus. The report, *Competition in Professions*<sup>16</sup>, was commissioned by HM Treasury in 1999 and covered lawyers, accountants and architects. Its Terms of Reference invited it to:

*"Identify restrictions, whether arising from law, professional rule or other source, which had the effect of preventing, restricting or distorting competition in professional services to a significant extent"*.

3.8. It was to identify any consumer benefits claimed for the restrictions, but to leave for further consideration whether these benefits justified the restrictions.

3.9. The OFT set out in its report the rationale, from its perspective, behind regulating professions, namely that *"their customers, or consumers, are generally not in a position to assess the quality of the professional services they buy ... By the very nature of professional services there is an asymmetry of information between suppliers and consumers ... In order to protect consumers from exploitation of their position of relative weakness, some restrictions on supply may be justified"*.<sup>17</sup>

3.10. For the purposes of the OFT review, these restrictions were broken down into

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<sup>16</sup> Competition In The Professions, Office Of Fair Trading, March 2001, Para 5

<sup>17</sup> Competition In The Professions, Office Of Fair Trading, March 2001, Para 8

three categories, namely restrictions on: entry to a profession [*"including indirect restrictions through limiting the permissible structures within which professionals may provide their services"*]; members' conduct; and demarcation [*"limiting how far members of one profession should be allowed to compete in offering services usually supplied by members of another (or another part of the same profession)"*].

3.11. In 1986 the then Director General of Fair Trading had advocated the development of Multi-Disciplinary Partnerships (MDPs) and in 2001 this OFT Report also picked up that torch, advocating the liberalisation of business models within the legal sector. Appended to the OFT report is a separate report, commissioned by the OFT from the consultants LECG. The LECG Report states baldly that:

*"Restrictions on MDPs have potential competition effects in that they may inhibit new entry and prevent the exploitation of possible economies of scale and scope. MDPs might achieve advantages in branding, overhead cost savings, the ability to transfer resources in response to fluctuations in demand and a seamless service to clients. All these factors could increase the intensity of competition (in both accountancy and legal markets)."*<sup>18</sup>

3.12. The OFT reacted to that proposition with a clarion call for liberalisation:

*"We have generally concluded that rules that prevent the establishment of MDPs restrict competition. For example they inhibit the formation of fully integrated practices bringing together accountants and lawyers; integrated property services practices that might involve surveyors; estate agents and solicitors; and financial services practices that might involve financial advisers in partnership with accountants and solicitors."*

*"These restrictions on MDPs may inhibit new entry and prevent the*

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<sup>18</sup> Restrictions On Competition In The Provision of Professional Services, December 2000, Para 323

*exploitation of possible economies of scale and scope. MDPs might achieve advantages in branding, overhead cost savings, and the ability to transfer resources in response to fluctuations in demand and to give a seamless service to clients. While these advantages may benefit firms of all sizes, they are likely to be especially marked at the level of the high-street firm. The opportunity to provide combinations of high-street professional services under one roof should unlock potential cost efficiencies and enhance customer choice and convenience at this level of the market.*"<sup>19</sup>

3.13. A protracted revolution had been initiated. The DTI laid down a timetable for response, and the Department of Constitutional Affairs responded by publishing a consultation paper in July 2002, entitled "*In the Public Interest?*".

3.14. In its post consultation report, "*Competition and Regulation in the Legal Services Market*", the DCA made the following observations:

- Our analysis has confirmed that the current framework is out-dated, inflexible, over-complex and insufficiently accountable or transparent.
- An indication of the *maze-like nature of the current framework* is the fact the study identified 22 regulators.
- To complicate matters further, some regulation is of the *service*, irrespective of who provides it, while other regulation is based on *professional status*.
- The problems associated with the "*regulatory maze*" can therefore be seen in terms of *regulatory proliferation, confusion and fragmentation*.

3.15. The principal outcome of this process, so far as the legal services sector was concerned, came with the appointment in July 2003, of Sir David Clementi, to produce a set of definitive proposals for reform of the regulation of law firms.

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<sup>19</sup> Competition In The Professions, Office Of Fair Trading, March 2001, Para 30

His terms of reference were clear and bold:

- *To consider what regulatory framework would best promote competition, innovation and the public and consumer interest in an efficient, effective and independent legal sector.*
- *To recommend a framework which will be independent in representing the public and consumer interest, comprehensive, accountable, consistent, flexible, transparent, and no more restrictive or burdensome than is clearly justified.*

3.16. Sir David undertook a period of consultation and consideration, producing a consultation paper in March 2004 which covered:

- Issues relating to the current institutional structures and what the Scoping Study referred to as “the regulatory maze”;
- Issues relating to the level of self-regulation and professionalism within the legal services industry;
- Issues relating to the handling of complaints against lawyers and disciplinary matters;
- Issues relating to unregulated providers and “regulatory gaps”; and
- Issues relating to new business structures, including employed lawyers, legal disciplinary practices and multi-disciplinary practices.

3.17. David Clementi's final report and recommendations were issued in December 2004 and all the main areas probed in the consultation period were covered by his recommendations, which included:

- A new regulatory regime, defined by a two-tiered structure within which a newly-constituted **Legal Services Board** would delegate regulatory duties to front line regulators, and then oversee regulation by those front-line regulators (which might include established bodies such as

the Law Society, the Bar Council and the Council for Licensed Conveyancers, all subject to their meeting tests on separation of regulation from representation, under the LSB's oversight);

- A new **Office of Legal Complaints** (OLC) – a single, independent body to deal with consumer complaints about lawyers (other than conduct or disciplinary issues);
- Facilitation of alternative forms of practices with four main types; to be introduced through a **step-by-step approach**, starting with Legal Disciplinary Practices (law practices which permit lawyers from different professional bodies to practice together as equals). Clementi also concluded that non-lawyers should be permitted to be managers of such practices, subject to the principle that lawyers should be in a majority by number in the management group (though there is no such requirement on the face of the Legal Services Act 2007);
- Moving to allow outside ownership of LDPs (with such ownership subject to a 'fit to own' test; but with the main focus of the regulatory authorities on the identity of the management team, in particular the Head of Legal Practice and the Head of Finance and Administration, and the management systems that they employ) and raising the longer-term possibility of evolution towards Multi-Disciplinary Practices (practices which bring together lawyers and other professionals to provide legal and other services to third parties);
- A proposal that attention should focus on the setting up of a new regulatory system for lawyers with the LSB at its centre, and the authorisation of LDPs. "This would represent a major step towards MDPs, if at some subsequent juncture the regulatory authorities considered that sufficient safeguards could be put in place."

3.18. Consequent to the proposals, it was also proposed that the focus of the regulatory system should be upon the economic unit, rather than the

individual lawyer. The principle to be applied is that of 'lead regulation by reference to economic unit, residual regulation by reference to professional qualification'.

3.19. The Government came forward with a draft Legal Services Bill in May 2006 and this was subjected to thoroughgoing and detailed pre-legislative scrutiny by a cross-party Joint Committee of MPs and members of the House of Lords. I had the honour and pleasure of chairing that Committee between May and July 2006 and, particularly in light of the deliberately diverse nature of its membership I was struck at once by the broad consensus of views that emerged. In due course, we were able to produce a report that was unanimous, greatly enhancing its authority. Where ministers had departed from the original Clementi recommendations, by and large the Joint Committee advocated a return to them.

3.20. The Bill departed from the Clementi recommendations in that it was bolder about facilitating *ab initio* the full panoply of Alternative Business Structures (see section 4.3 of this paper). A major area of disagreement between the Committee and the Government was over the regulatory objectives, where Clementi's stated view that "in a regulatory body the public interest should have primacy"<sup>20</sup> had not explicitly found its way onto the face of the draft Bill. Instead, the "consumer interest" alone was stated as one of the six proposed regulatory objectives. The Joint Committee observed that "the public interest and the consumer interest do not always equate to the same thing, particularly in matters of law, and we are concerned that the necessity for a public interest criterion has been lost as the reforms have developed"<sup>21</sup>. After a long process of arbitration, "protecting and promoting the public interest" was added at the head of the list of regulatory objectives during the passage

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<sup>20</sup> Appendix 5, Para 13

<sup>21</sup> Joint Committee on the Draft Legal Services Bill Volume I: Report, The Stationery Office Limited, July 2006, Para 2

of the Bill.

3.21. Another major theme of the Clementi report was the need to separate professional regulatory functions from representative functions. Clementi envisaged a regime, in short-hand known as Model B+<sup>22</sup>, which provided for the setting up of a new Legal Services Board as an oversight regulator. The Board would have regulatory powers vested in it, which it would delegate to recognised front-line bodies, “where it was satisfied as to their competence and that appropriate arrangements, in connection with governance issues and the split between regulatory and representative functions, had been made”. The Legal Services Act establishes a slightly different balance of power within the regulatory structure, in that the regulatory powers are vested directly in the front-line regulator. The role of the LSB is then to monitor the performance of the front-line regulator and divest it of those powers if it proves not to be adequate to its task.

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<sup>22</sup> Appendix 9

## Chapter 4. Areas to Explore

### Introduction

4.1. The questions at the very heart of this Review can be summarised as:

- *What new regulatory challenges and opportunities does the Legal Services Act create?*
- *What are the characteristics of "good regulation"?*

4.2. By establishing an oversight regulator in the shape of the LSB, the Legal Services Act 2007 has created a significant new dynamic within legal regulation. The LSB will be responsible for establishing the new legal regulatory framework and its ways of working; for developing the necessary licensing regimes; and for providing oversight of approved regulators. It should be fully operational by early 2010.

4.3. The Act also provides for the creation of ABSs, which the Government believes will allow for increased flexibility: non-legal firms such as insurance companies, banks, surveyors and estate agents will have far greater freedom to realise synergies with legal firms by offering integrated professional services. Managing the relationship between legal professionals and those who provide external capital (or exercise external control) will be a significant new regulatory challenge.

4.4. The Legal Services Act also establishes the parameters of the regulatory landscape within which these providers will operate. My job is to assess what the future of the legal services market might look like and to advise on what best regulatory practice might be in such an environment. This section of the Call for Evidence contains some questions to consider. The list is neither prescriptive nor exhaustive, so what is contained in here should not and cannot be considered a definitive list of possible lines of questioning, nor do I anticipate that any respondents will wish to cover all the areas raised. If you think I have missed areas that need to be discussed, then please tell me

about them and, if there are specific questions I should be asking, please feel free both to pose them and also to answer them. I want to hear from the broadest spectrum of individuals and organisations, on the widest range of topics, and I am particularly keen to hear the views (and benefit from the experiences) of those from other regulated sectors, or who have knowledge of other jurisdictions.

### **The Legal Services Board**

- 4.5. The Clementi Review concluded that the legal profession's regulatory systems were flawed and cited: the insufficient regard to consumers; the governance structures of the main front-line bodies being inappropriate for the regulatory task they face; the over-complex and inconsistent system of oversight regulatory arrangements; and the lack of clear objectives and principles which underlie this regulatory system.
- 4.6. Professional bodies such as the Law Society and the Bar Council had already started to move towards ring-fencing their regulatory arrangements by the time the Clementi recommendations were accepted by Government, and they continue to evolve. In 2006, the Bar Council separated out its regulatory function with the creation of the Bar Standards Board (BSB). This Board has entirely separate membership from the Bar Council, and a lay chair. The BSB has final say on all changes to the Code of Conduct and other regulatory processes, including consumer complaints, which are handled by the Complaints Committee and overseen by the independent Complaints Commissioner. In future, all such front-line regulators in the legal arena will come under the aegis of the new LSB, which will be expected to develop its own regulatory expertise and will be able to order a front line regulator to change its rules, in the form of an intervention direction (Sections 41-44 of the Act).
- 4.7. However, in his recommendations Clementi did not go so far as to say there should be no role for the professions in regulation. Indeed in recommending "Model B+" (see appendix 9) he wanted to build on the strengths of the

existing system and acknowledged that “*leaving day-to-day regulatory rule-making and oversight as far as possible at the practitioner level is more likely to increase the commitment of practitioners to high standards; such commitment is important, particularly in the area of professional conduct rules, where rules of behaviour and ethical standards should be seen as an aid to raise standards, not as a constraint to be circumvented.*”

- *What should be the nature of the relationship between the profession and the regulators of legal services?*
- *How has professional expertise been harnessed in similar regulatory models?*
- *How can regulatory independence balance professional input to regulation?*

4.8. The recently-appointed inaugural Chair of the Legal Services Board, David Edmonds, is a powerful and outspoken advocate of regulators enabling a ‘consumer-citizen’ approach. This approach can be defined as combining the consumer's desire for competitive pricing and good service with a socially responsible outlook and a commitment to the greater good. The assumption is that consumer and public interests are intertwined and that they can feed off each other. Mr Edmonds was quoted in the *Solicitors Journal* as saying “If I, as a consumer-citizen, want to take legal action against someone who I believe has treated me unfairly, I want to know it's within a process where these citizenship issues are firmly embedded – honesty and integrity of the supplier – and his responsibility to the court is a key part of my relationship with him. Just as much as my ability to hire somebody I can afford.”<sup>23</sup> During the passage of the LSA there were numerous debates on whether the duty of lawyers to the public interest would be diluted by liberalising the market. The Government gave the LSB the responsibility of ensuring that the liberalised

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<sup>23</sup> *Solicitors Journal*, 25 November 2008, p.10

legal market it oversees will not have any erosion of professional standards.

- *How can the LSB ensure that appropriate professional standards are established, kept up to date and fully implemented in practice?*
- *What criteria should the LSB use when considering the level and presentation of the practising fee? What should be the extent of the analysis it undertakes?*

## **The Law Society and the Solicitors Regulation Authority**

4.9. The terms of reference of this Review relate explicitly to the substance of regulation rather than the organisational arrangements that are set up to deliver it, but the two matters are inevitably connected in various ways. The Legal Services Act makes it clear the Approved Regulator is obligated to create a structure where its regulatory functions are independent from its representative arm. Section 29 states that “*Decisions relating to the exercise of an approved regulator’s regulatory functions are, so far as reasonably practicable, taken independently from decisions relating to the exercise of its representative functions.*” It will be the role of the LSB to ensure that the Approved Regulator maintains an appropriate level of separation; Section 30 of the Act gives the Board the powers to carry out its role.

4.10. It remains to be seen whether the current arrangements establishing the SRA will meet the criteria that the LSB will set in due course, to judge the effectiveness both of the regulatory-representative separation and also of the regulatory arrangements themselves.

- *What changes have there been in regulatory practice since the SRA was set up?*
- *Are the respective roles of the SRA and Law Society with regard to regulation clear and readily understood?*
- *How is the role of the approved regulator perceived? Do people still think in terms of regulation by the Law Society, or do they increasingly*

*perceive the SRA as a corporate entity in its own right?*

## **How should a legal regulator regulate?**

4.11. Section 1 of the Legal Services Act consists of 8 Regulatory Objectives, 5 professional principles and a few words of definition and explanation. It is easy to imagine scenarios within which conflicts might exist between Objectives and/or Principles and I think it is critically important that this Review should tease out some of these arguments. Principles-based regulation can succeed and be sustained only if risks and conflicts are openly and effectively managed.

- *Are there tensions between consumer demands, business requirements and professional values? If so, what are they and how can they be resolved?*
- *Where are there other tensions between the objectives and/or principles and how can they be resolved?*

4.12. The Joint Committee on the draft Legal Services Bill advised the Government against a shift in emphasis from the public interest towards the consumer interest (see para 3.20, above. Ministers took our point and accepted our recommendation, agreeing that protecting and promoting the public interest should be included as one of the headline regulatory objectives.

- *How should the LSB and the SRA manage any conflict between the specific interests of consumers and the wider public interest?*

4.13. The objectives to be achieved through regulation in the legal sector are now, for the first time, set out in statute, in the Legal Services Act, so both the LSB and the approved regulators will need to work in support of the delivery of these objectives. The extent of their success is likely to be judged in no small measure by how they have been achieved. Similarly, they are the key to a risk-based approach, for the allocation of time, activities and effort is likely to

be evaluated at least in some measure to the risk to the objectives.

- *What role is there for a regulator in supporting the constitutional principle of the rule of law?*
- *How can a regulator improve access to justice?*
- *What role can or should a regulator have in increasing the public understanding of the legal rights and duties of the citizen?*
- *What are "proper standards of work"? Who should define these and how should compliance be monitored?*

4.14. Solicitors are required to uphold the rule of law, act in the best interest of their clients and not allow their independence to be compromised. Solicitors' duty to the court is also set out in the Solicitors Act 1974. These core duties define the values that shape the profession and help to give clients confidence that their solicitor will behave with integrity. David Clementi also highlighted that he had independence twice in his terms of reference – the independence both of the framework and of those operating within it. He judged both to be important.

- *How can regulation support providers of legal services to assimilate and reconcile the various requirements under which they must work?*
- *How can a lawyer both act in the best interests of his or her clients and be sure of complying with the duty to the court?*
- *How can independence of professional judgement be maintained and protected under the new regulatory regime?*

4.15. All regulators of legal services have a duty to protect and promote the interests of the consumer. Consumer interests are generally best served when the market allows would-be purchasers to make an informed choice between competing providers of a product or service. In its purest form, competition encourages those who provide a service to enhance quality and

bear down on price.

- *Should a regulator promote competition? If so, by what means?*

4.16. The regulatory regime has responsibility for setting the qualification standards which a person has to reach in order to become a solicitor. The regulators must also monitor the training organisations that assess candidates against those standards. The public need to be confident that all solicitors, however they have qualified, have the appropriate knowledge, skills and abilities that a client would expect from a professional. It is also important that all those who have the ability and desire to meet the required standards are able to become an accredited legal professional. There should be no artificial or arbitrary barriers to entry to the profession. The SRA is currently piloting a new framework for work-based learning, which it believes will provide applicants with a more flexible route to qualification.

- *Are the standards that the SRA require applicants to meet sufficiently robust and quality assured to secure the public's confidence in the profession?*
- *Is the career of solicitor accessible to all, regardless of background, gender, ethnic origin and sexual orientation?*

### **The Five Principles of Effective Regulation**

4.17. The relevant five words are oft quoted, but some readers may find it helpful to remind themselves of the more detailed explanation that was given when they were first published by the BRTF (see Appendix 3).

#### **Proportionality**

4.18. *Regulators should only intervene when necessary. Remedies should be appropriate to the risk posed, and costs identified and minimised*

4.19. Proportionality is an established concept in EU law and a basic principle of human rights law. Proportionality arguments allow the administrative court to

look at and assess the balance a regulator has struck between competing considerations in its decision making. In recent times proportionate has been otherwise described as “light touch”, an interpretation that risks losing the need for effectiveness. During the passage of the Legal Services Bill, Bridget Prentice MP, the Parliamentary Under-Secretary of State, said:-

*“One of my aims in the debates on the Bill and in my discussions with stakeholders, whether they are from the legal professions, consumers or colleagues, is to ban the phrase “light touch”. This is not about light touch, but about proportionality. I want everyone, if I can persuade them, not to use the words “light touch” or any reference to touch, but the term “proportionate regulation”. I will then feel that I have achieved something”<sup>24</sup>*

- *What are the competing factors most likely to arise in a legal regulatory environment? Is there any overriding factor?*
- *What are the important characteristics of a proportionate regulatory regime?*
- *How might they manifest themselves in the context of legal regulation?*

4.20. At the time of writing there are approximately 108,000 regulated solicitors and 10,000 private practices, ranging from the largest city firms, through medium-sized practices to sole practitioners. Solicitors are also engaged in businesses, government departments, regulators and local authorities, amounting to 15,694 organisations in total.<sup>25</sup>

- *How can any one front-line regulator effectively regulate so large and diverse a profession, remaining true to the regulatory objectives and principles?*

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<sup>24</sup> Bridget Prentice MP, House of Commons, 12 June 2007

<sup>25</sup> Trends In The Solicitors' Profession Annual Statistical Report 2007, The Law Society, p.6

- *Do all those who use legal services need the same protection?*

4.21. Specified categories of the officers and staff of institutions regulated by the FSA are required by the Financial Services and Markets Act 2000 to be approved to perform controlled functions. Once the FSA has approved an individual, he or she must remain fit and proper to carry out the relevant functions. This includes acting at all times with integrity, skill, care and diligence.

- *What is the balance to be struck between regulation of individuals and regulation of entities? Should there be a hybrid system?*

## **Accountability**

4.22. *Regulators must be able to justify decisions and be subject to public scrutiny.*

4.23. Accountability takes a number of different forms, a number of which are listed below. Not all apply to every regulator but each is being used in a regulatory environment and often a number of methods are combined:

- Annual reports to Parliament
- Select Committee oversight
- Post-establishment periodic review
- Accountability under PCA jurisdiction
- Regular public meetings
- Consumer and/or professional panels

4.24. Regulators should be accountable for the efficiency and effectiveness of their activities, while remaining independent in the decisions they take.

- *How do you think regulatory accountability can best be achieved in the Legal Services Act landscape?*

- *What are examples of good practice of accountability, in particular where this has been demonstrated within an environment predicated on independence?*
- *Where does effective accountability really lie within the new system?*
- *How can the LSB ensure that the front-line regulators are fully accountable?*
- *What arrangements should be established in Parliament to ensure effective accountability of the LSB?*

## **Consistency**

4.25. *Rules and standards must be joined up and implemented fairly.*

4.26. Especially after the introduction of ABSs, a number of different regulators may have an impact on the provision of legal services. Both for the consumer and for the regulated community, reasonable predictability of regulatory outcomes is desirable. Also in order to be flexible and able to respond in a timely manner to different regulatory questions, there is likely to be some scope for interpretation of rules and discretion in their application. This may indeed be heightened by moving to a more principles-based approach. Regulatory decisions must be supported by clearly articulated decision-making criteria, lest they fall foul of accusations that there is at best inconsistency, at worst discrimination or bias, at play. Where there are tiers in the overall regulatory scheme, coupled with different front line regulatory provision, consistency also means horizontal and vertical consistency between regimes.

- *How can the various parts of the regulatory regime ensure consistency of approach and work together in a joined-up way?*
- *How can regulators demonstrate consistency in their decision-making?*

- *How important is consistency (perceived and/or actual) for the credibility of regulators?*
- *In what areas of regulation is a discretionary ability most necessary?*
- *How is regulation driven by EU directives?*
- *How is overlap minimised between UK and EU provisions?*

4.27. The legal services market is far from static. Since 1977 the total number of solicitors holding practising certificates has grown by 230 per cent. In 2007 the estimated total gross fees for firms in private practice was £18,610 million.<sup>26</sup> There is no doubt that over the last 20 years the range of services provided by the legal profession has both grown in size and become increasingly diverse. This creates the challenge of regulating a profession which provides an almost unlimited combination of services.

- *Can the same regulatory policies and methods be applied right across that spectrum?*
- *Should the same rules and approach to compliance apply to all firms, or should account be taken of their size, degree of specialism and/or the characteristics of their clients?*
- *Should the same rules and approach apply to all individuals providing legal services? If not, can the same regulatory principles be adhered to?*
- *Is there a place for service-based regulation?*

4.28. It may also be worth reflecting upon possible regulatory impacts from other sectors, such as the financial services sector; from other jurisdictions; and from multinational bodies such as the European Union, the United Nations

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<sup>26</sup> *Trends In The Solicitors' Profession Annual Statistical Report 2007*, The Law Society

and others. There have been also warnings from other sectors, for instance in the work of the Competition Commission with other economic regulators, that appear to indicate how the effectiveness of regulation can be undermined when regulatory mechanisms fail to work genuinely in concert.

- *Which areas of regulation have potential for duplication or overlap?*
- *Is there a body with lead responsibility?*
- *What can be done to ensure that regulation is carried out in accordance with BRTF principles in all circumstances?*

4.29. The Act provides for the possibility that more than one regulator could regulate the same legal entity. There is a strong possibility regulators will compete to be a regulator of choice. When asked by the Joint Committee on the Draft Legal Services Bill whether the Government was comfortable with regulatory competition, the Minister responsible, Bridget Prentice MP, said “It is for the consumer, in this case the ABS firm, to make the choice. I suppose it is between choosing whether you go to Debenhams or Harrods in some instances, and you might choose one or the other.”<sup>27</sup>

4.30. It will be the responsibility of the Legal Services Board to ensure that all regulators of legal entities meet an acceptable standard. Its first Chair, David Edmonds, has indicated the Board is already considering this issue. “New entrants should not be under any illusion that LSB-approved licensing authorities will have any incentive to achieve market entry by somehow ‘dumbing down’ consumer or CPD standards. Quite the reverse. But the standards must be relevant to the user of the service, not the profession alone.”<sup>28</sup>

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<sup>27</sup> Joint Committee on the draft Legal Services Bill Volume II: Evidence, The Stationery Office Limited, Page 242

<sup>28</sup> David Edmonds speech to a Law Society Breakfast Seminar, 25 September 2008

- *Should individuals and/or firms be able to choose between different regulators?*
- *Might there be instances where the exercise of such choice should be expressly prohibited?*
- *What are the dangers of regulatory competition? How can the LSB or approved regulator negate any such dangers?*

## **Transparency**

4.31. *Regulators should be open and keep regulations simple and user friendly.*

4.32. It has been generally recognised that regulators can develop credibility by improving transparency: it provides reassurance, underpins clarity of objective and also confers greater legitimacy upon sensitive decisions. Transparency should ideally be characterised not only by open access to information, but also by participation. As well as setting objectives in statute this can take the form of setting out the rights, as well as the obligations, of the regulated community.

4.33. The weakest manifestation of transparency may be seen in untailored, non-specific information, random posting of documentation, and consultation overload. All these may be the results of a genuine attempt to communicate and inform, but it is unlikely they will result in true participation across the necessary spectrum of interested parties; and costs may also increase in a manner disproportionate to the benefits realised. A further aspect of transparency, closely allied to accountability, is how regulators justify their choice of enforcement actions year on year to stakeholders, Ministers and Parliament.

- *How might a regulator best communicate? Could the SRA do more to encourage stakeholders to respond to consultations? What role should there be for the representative arm of the Law Society in keeping legal practitioners fully informed about regulatory developments?*

- *What information should each regulator promulgate? At what frequency?*
- *How might stakeholders best be involved in the development of regulation?*
- *How might views be solicited on the regulatory regime as a whole from time to time, as well as on the details of regulation?*
- *What information do stakeholders need, in order to be able to participate actively and positively in information-gathering exercises?*
- *Are there alternatives to the standard, 12-week written consultation format that might improve the regulatory process?*

## **Targeting**

4.34. *Regulation should be focused on the problem and minimise side effects.*

4.35. Outcome-focused regulation, with rules and regulatory interventions concentrated on advising particular goals or remedying prioritised issues, is almost by definition targeted regulation. Targeting can also help to provide fundamental underpinning of proportionate, risk-based regulation by ensuring resources are focused on particular needs. Proper targeting should also reduce compliance costs on the regulated community, as it eliminates any scattergun approach to regulation and seeks to identify and implement mitigating actions, thereby avoiding unintended consequences or unintentionally wide impacts from regulation

4.36. The Legal Services Act lists six reserved legal activities: the exercise of a right of audience; the conduct of litigation; reserved instrument activities; probate activities; notarial activities; and the administration of oaths. The new regime allows for a continuation of the current hybridity of regulation between provider regulation, service-type regulation, and also introduces (through the ABS proposals) entity-based regulation.

- *Given the need to put consumers at the heart of regulation, is there an argument for widening the regulatory net to service types that are currently excluded?*
- *Should the new regulatory regime include regulation defined by service provided, as well as by provider?*
- *Do you envisage that minimum standards should be set for service provision that would apply to all and any providers?*
- *Would this prompt or prevent a 'race to the bottom'?*

4.37. The likely advent of ABSs has also prompted a debate about individual and entity regulation, a subject explored further in section 4.4 below. In summary, this is about whether a regulator's reach is through the regulated individual or the organisation in which that individual works.

- *From the perspective of the consumer, which method of regulation is likely to be most accessible and how will it deliver results if problems arise?*
- *What are the risks in having individual- and entity- based regulation both operating within the same sector?*

4.38. Impact Assessments and Post-Implementation Reviews (previously known as Regulatory Impact Assessments) are an invaluable tool for challenging the supposed need for new regulations. They serve as a continuous process to help policy-makers fully think through and understand the consequences of possible and actual interventions, and also act as a tool to enable evaluation of relevant evidence on the likely side-effects of possible interventions. The use of impact assessments and their predecessors has improved the identification not just of costs and benefits but also of impacts, and the RIA filters have been augmented following reviews of their effectiveness.

4.39. It is possible, or even likely, that UK regulators may soon be expected to help

generate and track reliable estimates of compliance costs within Impact Assessments, including the broader costs to regulated entities of complying with all of a particular regulator's requirements.

- *What role should Impact Assessments have?*
- *Before introducing a new initiative what evidence is gathered? How does one know whether such an initiative has achieved its desired effect?*
- *What information can be usefully gathered in advance of any proposed regulatory change?*
- *What are the tests of value, feasibility and implications of implementation undertaken before commencement? Is consultation meaningful; and if it is not, how could it be improved?*

4.40. As well as considering impacts on various sectors of the domestic regulated community, the assessment should also consider the impact and costs the proposed actions will have on entities operating within global markets. There is also likely to be a place for Post-Implementation Impact Assessments on all regulatory actions.

4.41. The BRTF suggested in *Less is More* that: *“Departments and regulators should undertake more frequent and better post-implementation reviews of regulation, including reviews of how the UK has implemented EU law. Such reviews should assess whether the measure is working as expected, whether the costs and benefits are as predicted, whether there have been unintended consequences and whether there is scope for simplification. The results of these reviews should feed into future policy making and simplification proposals.”*<sup>29</sup>

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<sup>29</sup> Regulation – Less Is More: Reducing Burdens, Improving Outcomes, Better Regulation Task Force, March 2006, Page 7

4.42. This sits well with the idea of tracking costs and benefits, and also with outcome-focused regulation, which allocates resources according to risk. Furthermore it accords with the principle behind sunset clauses, which were introduced as a preventive measure to stop the accretion of statutes with no in-built requirement to review whether provisions are either effective or necessary.

- *When would be a suitable time to carry out such reviews, in order to provide for a proper assessment of the costs and benefits?*
- *What evidence is there of post-implementation reviews being carried out, and also of what their effects might have been?*

## **Coda**

4.43. The five principles of good regulation have become benchmarks. The House of Lords Select Committee recommended that all regulators have a statutory duty to have regard to the principles in their work.

- What do the BRE principles of *proportionality*, consistency, transparency, accountability and targeting, mean in practice in the context of regulation of legal services?

4.44. The BRTF's significant impact on the regulation debate, combined with the relative maturity of the debate in general, has meant that commentary and recommendations have crystallised around a number of well rehearsed themes – many of which echo and reinforce one another.

4.45. The maturity of the debate has reached a point where the main elements of better regulation have now, by and large, been agreed upon and the BRTF principles have become benchmarks of effective regulation.

## **Alternative Business Structures**

4.46. The Clementi recommendations included the facilitation of new business models. Under the title of ABSs came a range of liberalising measures –

legal disciplinary partnerships and multi-disciplinary practices with the possibility of outside ownership. Whilst Clementi advocated an incremental approach, the Government in legislation went further, subject to the licensing regime to be developed by the LSB. When analysing the possible impacts of the Legal Services Act, Liberal Democrat spokesman Simon Hughes MP asserted “there is a danger that big companies will cherry pick the easier work for bigger profits, while the less fashionable and straight forward cases will go to the wall.”<sup>30</sup> It should also be recognised that many in the legal profession make a judgment every day of how, and in what areas, to practise.

4.47. However, there was a particular fear that the "supermarket business mentality" might lead to a situation where high-street practices in rural areas will not be able to compete for the more profitable areas of work. If this were to drive such firms out of business, some communities would be left without a broad range of legal representation. This is why the Law Society lobbied hard for ‘improving access to justice’ to be included as a statutory regulatory objective. Both David Clementi and David Edmonds have made the point that affordability is also an aspect of access. Currently many believe legal advice is available only to the very rich or to the poor.

4.48. All radical changes are accompanied by potential challenges, but no change at all would be possible if one demanded to know everything about all the possible consequences before making it. Many will be familiar with the phrase: “The perfect is the enemy of the good”. However, it is also right to acknowledge that regulators must be in a position to be able to respond to issues arising as a result of changes, or indeed, be able to justify their reasons for keeping restrictions in place.

- *What benefits to clients may come from different methods of practice?*
- *Currently many believe that legal advice is only available to the very*

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<sup>30</sup> House of Commons, 4 June 2007

*rich or to the poor. How can this be remedied? Do Alternative Business Structures provide a potential means for widening access to legal services?*

- *How might ABSs affect the cost or affordability of services?*
- *Does the possibility that ABSs will increase the overall provision of legal advice, including to those who are neither very rich nor poor, outweigh the perceived risks?*
- *What does the licensing regime need to include?*
- *Should it go back to the step-by-step approach advocated by Clementi?*
- *Are there legal services which should always be provided face to face?*
- *Is ensuring that everyone has access to justice the same as ensuring that everyone has a competitive choice in who provides them with legal services?*
- *What opportunities can ABSs bring for the practice of law? How will these opportunities manifest themselves?*
- *Are there factors that would either encourage/discourage anyone from practising in one of the 'new ways'?*
- *Is there a danger that hybrid organisations will provide only legal services that are highly profitable? How could any such impact be mitigated?*

4.49. Firms that are interested in becoming an ABS will need to apply to a relevant licensing authority for a licence. Part Five of the LSA includes a number of safeguards which firms must fulfil in order to be licensed as an ABS.

- Firms wishing to combine legal and non-legal services will need to satisfy licensing authorities that they are competent to provide such services.

- If non-lawyers own more than 10 per cent of the body, they will be subject to a fitness-to-own test (i.e. whether such ownership is compatible with the statutory regulatory objectives and whether they are fit and proper to own the interest)
- Licensing authorities are *under* a statutory duty to avoid conflicts of interest, so far as is reasonably practicable. This includes not only individual's internal conflicts of interest, but also conflicts of interest between licensing authorities and other regulators (e.g FSA).
- Firms will be accountable *to* licensing authorities through a nominated Head of Legal Practice and Head of Finance and Administration.

4.50. Most of the onus for deciding how best to regulate potential issues which might arise within these new structures will be on the approved regulators and regulatory arrangements. Professor Stephen Mayson states in his paper '*Alternative Business Structures – Something for Everyone?*' that "the regulatory challenges cannot merely be brushed aside, since co-ordinating the regulation of other professionals will be required, and issues of legal professional privilege and possible conflicts of interest will need to be worked through in these multi-talented environments."

- *What conflict of interests could exist within an ABS, how might they cause detriment and how can regulation effectively police and prevent them?*
- *Where ABSs are concerned, should the "legal" part be separately regulated, and the "non-legal" parts be subject to entity-based regulation?*
- *Or should the approved regulator regulate everyone within an ABS?*

4.51. The front-line regulators will enjoy considerable discretion over what standards they should demand from non-lawyers employed in the entities they regulate. For instance, the SRA could demand that non-lawyers who

want to be part of the management structure within legal disciplinary practices abide by the professional principles as laid out in Rule 1 of the Solicitors Code of Conduct. Section 99 of the Act allows licensing authorities to disqualify non-lawyers from working within ABSs they regulate. There is no statutory provision to ban a person from working in an ABS which is regulated by another body, though it remains to be seen whether rules of individual regulation will continue in such cases.

- *Should everyone within an ABS be expected to adhere to the professional principles?*
- *What sanctions should be available for use against non-lawyers who break them?*
- *How should the various parts of the regulatory regime work together to ensure that the client is protected and the system of regulation is not brought into disrepute?*
- *How should the various parts of the regime work to ensure there are no regulatory gaps and also that the various rules work together in support of the development of ABSs?*
- *Are there examples of good collaboration and information-sharing? In which instances have they been most effective?*

## 5. Timetable and Next Steps

5.1. I would welcome as many responses as possible to this call for evidence, to be received by **Thursday 9 April 2009**. In line with the approach set out throughout this document, the questions in section 4 are intended to provoke thought and stimulate responses, not constrain them. For this Call for Evidence I am casting my net wide and taking the broadest interpretation of my terms of reference.

5.2. Similarly, in the course of the evidence-gathering process, I and my review team intend to solicit comments from a wide range of individuals and organisations, including, but by no means confined to, the following:

- The Solicitors Regulation Authority
- The Legal Services Board
- The Bar Council
- The Law Society
- Relevant government departments
- Specialist lawyers
- Smaller and regionally-based law firms
- Parliamentarians
- Corporate law firms
- Sole practitioners
- Consumer Focus
- *Which?*
- Representatives of the not-for-profit sector

- The Office of Fair Trading
- The Competition Commission
- Academics
- The Better Regulation Commission
- The Legal Complaints Service
- Other regulatory bodies
- In-house counsel
- Potential new 'entrants' to the sector

5.3. We are particularly eager to hear about

- views on *the* effectiveness, or otherwise, of current regulatory practice
- examples of best regulatory practice in other sectors and jurisdictions
- the *implications* of the move towards ABSs
- *practical* issues that may need to be addressed by the Legal Services Board and/or the Solicitors Regulation Authority in making any changes

5.4. This review will produce its Initial Response to Evidence in the Spring of 2009 and its final Report and Recommendations by the Autumn. These will be submitted to the Law Society and be publicly accessible. It will then be for the Law Society to decide which, if any, of the recommendations should be acted upon, where appropriate, or else endorsed and passed on to the LSB and/or the SRA for possible action.

Responses should be sent, preferably by email to [legalregulationreview@beachcroft.co.uk](mailto:legalregulationreview@beachcroft.co.uk), or by hard copy to:

Rt Hon the Lord Hunt of Wirral MBE  
Legal Regulation Review  
c/o 100 Fetter Lane  
London EC4A 1BN

- 5.5. Responses will be treated as confidential during the consultation period and any material from them will be quoted and attributed subsequently only with the express permission of the individual or organisation concerned.