

## THE LAW SOCIETY'S APPROACH TO ABS

1. This note summarises the Law Society's current approach to the regulation of ABS.

### Background

2. In October 1999 (in what was regarded as a debate on MDPs) the Council decided that it favoured solicitors being free to provide legal services through any entity, subject to ensuring that appropriate consumer protections were provided. The Council recognised that legislation was likely to be needed to achieve that, and it asked its MDP Working Party to develop interim solutions.
3. The MDP Working Party concentrated on Legal Practice Plus (which would have enabled solicitors firms to have non-solicitor partners, but would not have widened the range of services a solicitors firm can provide). The work on Legal Practice Plus eventually ran into the sand following legal advice that the Society could not regulate non-solicitor partners through contractual arrangements, and that a change in the law would thus be necessary for the Law Society to be able to regulate such practices effectively.
4. In March 2002, when considering the restrictions in the Employed Solicitors Code, the Council decided that it had no objection in principle to solicitors employed by non-solicitor entities providing services to their employer's customers, so long as the necessary consumer protections were maintained. In practice, this was thought to mean:
  - Controls over the 'fitness to own' of external owners.
  - Ensuring that any legal practice owned by a legal commercial body was fully ring-fenced from the rest of the entity, in much the same way as banks owned by supermarkets are ring-fenced from the rest of their business.
  - Ensuring that all the same rules applied to the ring-fenced entity, as applied to an ordinary law firm.
5. This proposition became described as "Tesco Law". In 2003, Sir David Clementi was commissioned by the Government to consider the regulatory framework for the legal sector. As part of that, he examined the restrictions on the ways in which legal services could be provided to the public. Sir David Clementi consulted on a number of possible models of what have now become known as Alternative Business Structures. They were:
  - Legal Disciplinary Practice (LDP): firms which could include a mix of different categories of lawyers as partners, as well as non-lawyer partners. The assumption was that a majority of the partners would have to be lawyers.
  - Multi Disciplinary Practice (MDP): firms which could provide services which were outside the legitimate scope of a solicitors' firm (such as accounting services) and involved some services which were regulated by other regulators.
  - External ownership (which might apply to either or both of LDPs and MDPs).

6. The Law Society's response to Sir David Clementi's consultation paper was:
- The Law Society's long term objective remains to permit MDPs on an unrestricted basis, subject to establishing the necessary consumer protections.
  - LDPs (which the Society regarded as very similar to the Society's own proposal for Legal Practice Plus) would be a good first step toward Multi-Disciplinary Practice.
  - Where solicitors employed by a commercial body provide services to their employers' customers, this should be through a ring-fenced part of the employer's business, to which all the normal rules concerning solicitors' practice would apply. In addition, the Law Society would need powers to ensure that external owners were fit to own.
  - LDP's should be regulated by those bodies (such as the Law Society, or for some services the Council for Licensed Conveyancers) which regulate other law firms.
  - Even when the regulatory problems were solved, the Government should undertake a thorough analysis of the potential impact of LDPs on access to justice generally prior to permitting them to operate.
7. Those early Council decisions were taken whilst Council held both regulatory and representative responsibilities – and thus inevitably represented some balancing of those roles. Accordingly, in November 2006 the Corporate Governance Board considered whether it should invite the Council to reconsider its support for ABS, now that the Council had delegated regulatory responsibility to its Regulation Board (subsequently re titled SRA). However, the Corporate Governance Board decided not to suggest that Council should carry out a fundamental review of its policy. That view was reported to, and accepted by, the Council at its meeting in January 2007.
8. The Council also considered ABS in responding to the Legal Services Board consultation on ABS in July 2009. The Council's response on that occasion reaffirmed the Council's previous policy position of support for ABS, subject to safeguards.

#### The Legal Position

9. The Society sought legal advice on issues connected with the ABS Licensing Authority application in December 2010. The advice was sought to ensure that it was indeed for the Law Society Council, rather than the SRA Board, to decide whether to apply. Leading Counsel confirmed that that was the case.
10. The advice also covered the question of the approach the Council would need to take to the application. Leading Counsel advised that the Council is entitled, if it so wishes, to take its decision on the basis of its view of the interests of the profession. It is not obliged to operate according to the regulatory objectives which bind it in its Approved Regulator role.
11. There would thus be no impropriety - in the sense of a breach of the Council's duties under the Legal Services Act – if the Council were to decide, for primarily representational reasons, not to apply for the Society to be designated as an ABS Licensing Authority. The Council might decide that either because it had determined, on further consideration, that it did not

support external ownership of law firms at all, or (for example) because it believed some aspects of the SRA's approach to be grossly inadequate.

12. The question of whether it would be wise to decline to apply on representational grounds depends on a number of factors, including:-
  - Whether it is in the interests of the profession for ABS to be introduced broadly on the lines proposed by SRA.
  - What impact the Law Society declining to apply as a Licensing Authority would have on future development of ABS.
  - (To a lesser degree) what impact declining to apply to license ABSs would have on the Law Society itself.
13. These issues are canvassed in the succeeding sections.

#### ABS and the interests of the profession

14. There is an overwhelming consensus that at least some varieties of ABS are in the interests of the profession. The ability to take a minority of non lawyers into partnership or equivalent roles within a firm is one example. Such arrangements are already possible through LDPs. There has also been a broad consensus in favour of permitting minority equity ownership of firms. That would provide an additional mechanism for raising finance, without ceding overall control of a firm to external interests.
15. The controversy has arisen essentially over majority or sole ownership of legal practices by external commercial entities, the so called Tesco Law model. This concept was not specifically considered when the Council took its original liberalisation decision, in October 1999. It has however been specifically encompassed by the Council's support for ABS since March 2002.
16. Even now, it is almost impossible to give a definitive view as to whether or not legitimisation of that form of ABS is in the interests of the profession as a whole. On the one hand there is clearly a potential risk to some existing firms – particularly smaller firms doing relatively routine work – if well funded new providers were to enter the market. It is not easy to disentangle this threat from the risk posed by the actions of lending institutions, problems with indemnity insurance, and developments in the market generally, but prospective competition from ABS firm's plainly a potential aggravating factor.
17. On the other hand, ABS firms may provide additional career opportunities, particular for those who do not (or do not yet) aspire to be owners of firms. That point has been emphasised in past debates by representatives of younger solicitors. Furthermore, it is likely that if new entrants come into the market they will aim to increase demand for legal services, as well as to take market share from some existing participants. There is obviously scope to increase the market in areas such as will writing. There may also be scope to increase the market in personal injury work, especially if the perceived tackiness of Claims Management companies currently dissuades some potential claimants from pursuing their rights.
18. The Council's previous policy decisions on ABS did not necessarily reflect a view that permitting Tesco Law type developments is likely to be beneficial to the profession as a whole. The decisions may well primarily have reflected a

view that – provided appropriate public and consumer safeguards were in place – there were no sound regulatory grounds on which to resist such a development.

#### What Happens with ABS if the Law Society opts out?

19. If the Law Society were to decide it no longer wished to regulate ABS, it is unlikely in the short-term that there is another Approved Regulator which could become a Licensing Authority for most prospective ABS firms. Accordingly, the Legal Services Board would have to license ABS firms direct. The Act requires the Legal Services Board to license direct wherever there are prospective ABS applicants for which there is no other suitable licensing authority. The LSB has recently established Direct Licensing Sub-Committee to work up the way in which it would discharge this role.
20. Direct licensing by LSB would be likely to cause some delay in the establishment of ABS, which would no doubt be welcome if the Council had decided it no longer supported ABS. But any such delay would be likely to be matter of a few months, particularly if LSB recruited the staff SRA have working on the issues – for whom SRA would have no apparent future use.
21. The terms on which LSB would regulate ABS would probably be more unsatisfactory from the Council's point of view than SRA's proposals. In particular, it is not at all likely that LSB would introduce a "separate business" rule for ABS.
22. Furthermore, it would not just be externally owned ABSs which would need to be licensed by LSB. Any firm (whether or not a current LDP) which wished to have a non lawyer partner or manager would have to become an ABS, as would any firm wishing to raise money to allowing external investors to take an equity share in the firm. There are presently just over 300 LDPs, of whom around 200 would have to become ABS.
23. The Society could avoid that situation only if the Society could become designated as an ABS licensing authority for some forms of ABS, whilst leaving external ownership to LSB. The current legal structure does not readily enable the Council to achieve that outcome, because the Act does not permit an application to be made which is limited to particular forms of ABS. Control over the rules governing ABS operation rests with SRA rather than with the Council. Accordingly, the Council could ensure that the Society regulated some ABS firms, but not externally owned ones, only if SRA and LSB were prepared to co-operate, which is far from certain. In any event, that would at best leave the Law Society (through SRA) regulating those entities which look like traditional law firms, whilst LSB regulated (on an entirely uneven playing field) the Tesco Law variety.

#### Impact on the Law Society

24. The Law Society cannot know at this stage the extent to which law firms will opt to become ABS firms. It may be that there is a comparatively modest take up. In that case, the impact on the Law Society of declining to become a ABS Licensing Authority would be correspondingly modest.
25. But it may be that there will be a significant demand from ordinary law firms to convert to ABS status, in order to take advantage of the greater freedoms

which it offers in terms of funding the firm, and composition of the management group within the firm. In that case, a significant proportion of firms currently regulated by the Law Society could opt to become ABS, and be regulated by the Legal Services Board. This is perhaps particularly likely to arise if the LSB regime appeared to offer competitive advantages, such as through the abolition of a “separate business” rule.

26. Only those firms regulated by SRA will contribute toward the Compensation Fund operated by SRA. If the Law Society continued to regulate a high proportion of the most vulnerable firms, the result might be that Compensation Fund claims continued at much the current level, whilst the contributions had to be divided amongst a smaller number of payers.
27. There might in this scenario be real doubt about the sustainability of the Law Society, and about the viability of some of the firms the Society continued to represent. If that resulted from decisions which were in the interests of the profession, it might be a price worth paying. But it is difficult to see how effectively transferring responsibility for regulation of at least a large part of the profession to the Legal Services Board could be in the interests of the profession (or, indeed, of the public).

#### Long Term Significance of the Decision

28. The Council needs to be aware that whatever decision the Council takes in relation to the licensing of ABS is likely to have long term significance for the Society’s role in relation to ABS firms, and thus to regulation of the profession generally.
29. If the Council were to apply for designation as an ABS Licensing Authority, subsequent development of the ABS licensing arrangement would be in the hands of SRA. The Council might be able to secure some assurances from SRA concerning the timescale and process by which they would consider changes to the initial arrangements, but it is unlikely that SRA could lawfully bind themselves on matters of that sort. If SRA subsequently decided to propose changes to the ABS licensing arrangements which were unacceptable to the Society, the Council’s only power would be that it could apply for the Society’s designation as a Licensing Authority to be revoked. That would mean the Society ceased to regulate all ABSs, including those which were essentially solicitors’ firms with a non lawyer partner.
30. A decision not to apply to be designated as a Licensing Authority would also have profound long term effects. It would mean in the short term that LSB would regulate ABS. The Society could subsequently apply for designation if it were to change its mind about the SRAs proposals, or if the current SRA Board (or its successors) were willing to put forward different proposals, which the Council was willing to endorse. Assuming the application succeeded, it appears that the Legal Services Board would be precluded from accepting new applications for ABS firms to be licensed directed by LSB once the Law Society had been designated. But LSB would not be obliged to cease to license direct those firms it already licensed. The LSB would thus have a real foothold in direct regulation of law firms, which is strongly contrary to the Council’s policy, and to the interests of the profession and of the public.