Alternative Business Structures

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Chapter 1: History and background

Office of Fair Trading Report and Clementi

The last 50 years have seen a fundamental change in the legal services market. Before the Second World War, and for a long period after it, law firms were owned and run exclusively by a relatively small number of solicitors, who prided themselves on being part of an honourable and elite profession. To be accepted as an articled clerk (the forerunner of the trainee solicitor) the applicant had to be interviewed by a panel of solicitors nominated by the Law Society, who assessed his (or occasionally her) character and background for suitability. Once qualified, it was assumed that a solicitor would know how to behave in a gentlemanly manner and the regulation and guidance given was therefore extremely limited.

It was not until 1960 that the Law Society felt it necessary to issue the first Guide to the Professional Conduct and Etiquette of Solicitors, a necessity partly brought about by the comparatively large influx of new entrants to the profession after demobilisation. Some of these new entrants would, it was felt, welcome guidance on what was and was not proper behaviour. Even then, the guidance concentrated on the perceived evils of touting for business, advertising, attracting business unfairly, and undercutting accepted charging levels to attract business. These were also dealt with in Rules 1 and 2 of the then current Solicitors’ Practice Rules. The practice of ambulance chasing was also outlawed. It was clear from the guide that the profession expected solicitors to run their practices for the benefit of their clients rather than themselves and had every expectation that they would wish to do so.

A number of factors contributed to the increase in the size of subsequent Guides, and the complexity of the Rules. The more the profession became open to all, the less practitioners subscribed to a commonly held set of behavioural norms. Rules had to be made more explicit to cover this. The legal market became more specialised, especially in the City, and this resulted in firms becoming larger and more business-like than professional practices had been traditionally. At the same time, pressure was growing to remove the restrictive practices that protected the profits of solicitors. In the London suburb of Harrow, a club was formed in the 1960s designed to exploit a loophole in the law and permit conveyancing to be done at below the rate fixed by the Law Society. Eventually, this and other pressures resulted in the abolition of scale fees and the creation of low fee, high volume specialist conveyancing firms competing with more traditional general practices.

As many firms grew larger and more competitive, the need for business, as distinct from professional, skills increased. Some firms resorted to inventive ways to circumvent the prohibitions on sharing profits with non-solicitors. Firms became more international
and needed to form relationships with foreign lawyers. This created a demand from within some parts of the profession for a relaxation of the Rules to permit flexibility. At the same time, complaints from the public were increasing and the profession came under attack for being a closed shop with outdated restrictive practices and a regulatory system run by those against whom the complaints were being made.

Competition was increased by the formation of the Council for Licensed Conveyancers (CLC) to supervise non-solicitor conveyancing practitioners under the Administration of Justice Act 1985 (AJA) and this increased rather than reduced the pressure for fundamental reform.

Further pressure came from the increase in the provision of tax advice by accountants, which – at least as far as the legal advice element of it was concerned – had been to a large extent the preserve of solicitors and barristers. As accountancy firms extended their consultancy and other non-accountancy businesses, they not only started to employ more solicitors and barristers but also to compete more directly with solicitors’ firms in other areas as well.

In 2001 the Office of Fair Trading (OFT) produced a report entitled ‘Competition in Professions – A report by the Director General of Fair Trading’. This report recommended that restrictions on competition in the provision of legal services should be abolished, except insofar as they were necessary for the benefit of the consumer or for economic efficiency. Implementation of the recommendations in the report would make it necessary for the activities of any new providers to be regulated, and in 2003 the Department for Constitutional Affairs published ‘Competition and Regulation in the Legal Services Market’. The government promptly commissioned the Clementi review of legal service regulation. Sir David Clementi’s report was published in December 2004.

In the foreword to the Clementi Report, Sir David firmly rejected the concept of the distinction between a professional practice and a business (see paragraph 10). He also proposed a shift towards regulation of the economic unit providing a service and away from the regulation of the individual practitioner. One of the main principles of the proposed reforms was to enable structures of all types to compete to provide legal services, and the regulatory regime needed to be able to accommodate this intention. He proposed that a risk-based approach should be adopted by the new overseeing regulatory body, which would set the framework under which the subsidiary regulators, such as the Law Society, would operate. This approach had already been adopted for the supervision of, for example, the banks.

Although Clementi was not in favour of MDPs or firms where the owners were investors rather than managers of the business, the report recommended the authorisation of ABSs because it would enable non-lawyers to take part in management and ownership and would permit lawyers from different branches of the profession to join forces. However, the government of the day felt that the suggestions in the Clementi Report did not go far or fast enough and published a White Paper, ‘The Future of Legal Services: Putting Consumers First’, in 2005. On page 21 it set out what it was trying to achieve for consumers:

- ‘High quality legal services from all legal practitioners delivered to suit consumers, not providers’
- ‘Business models and practices which support this...’
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- Systems that foster innovation and diversity.

The White Paper then stated how the government would deliver this:

- ‘Removing barriers to make it easier for new providers to enter the market through alternative business structures, stimulating competition and innovation
- Reductions in costs as a result of efficiencies can be passed on to consumers
- One-stop-shops which deliver packages of legal and other services that better meet consumers’ needs will provide greater convenience for consumers
- Tapping into external investment and allowing different types of lawyers as well as lawyers and non-lawyers to work together on an equal footing will enable firms to upgrade their infrastructure and generate fresh ideas about providing services in consumer-friendly ways
- Robust safeguards to ensure that standards of legal practitioners remain high and consumers are protected.’

It is clear from the White Paper that the government favoured the concept of ABSs and that it intended to tilt the regulatory balance to the advantage of larger and more corporate bodies, which it perceived would pose less risk and be more amenable to firm-based regulation.

The Legal Services Act 2007 and implementation up to October 2011

The Legal Services Act 2007 (LSA) set the White Paper’s proposals into law with little amendment. It received the Royal Assent on 30 October 2007. The Act created the Legal Services Board (LSB) as the single supervisory body to oversee, and if necessary act as a backstop to, the existing approved regulators and any others that may in future become approved. These are the Law Society, the General Council of the Bar, the Institute of Licensed Conveyancers, the Institute of Legal Executives, the Master of the Faculties, the Chartered Institute of Patent Attorneys, the Institute of Trade Mark Attorneys, and the Association of Law Cost Draftsmen. It also created the Office for Legal Complaints as the point of contact for consumer complaints relating to the provision of legal services.

The LSA also created, in sections 71 to 111, a self-contained regulatory structure to regulate ABSs providing reserved legal activities to the public, but it did not create a full regulatory structure for the provision of legal services as a whole. Instead, the ABS reserved legal activity rules are added to the existing structures by which the legal sector in its various forms is governed. Therefore solicitors, for example, remain governed by the Solicitors Act 1974, as amended by Schedule 16 of the LSA, and licensed conveyancers are governed by the AJA 1985 with equally substantial amendments in Schedule 17 of the LSA. As a result, ABS firms operate under the regulatory framework of the LSA but compete with traditional law firms whose regulations derive from other statutes and ethical backgrounds.

One of the requirements of the LSA was that authorised regulators should be separated from the representative part of the professional bodies that had formed them. The Law Society had already started, in the Legal Complaints Board, to separate these functions but the process was completed by the creation of the Solicitors Regulation Authority (SRA). The Bar created the Bar Standards Board.
It was clear that, to accommodate the general requirements of the LSA and to attempt to create a level playing field between the different providers, the conduct rules governing solicitors in particular would need a drastic overhaul. The two greatest changes to the regulatory system are the move towards regulation based on perceived risk rather than conduct and the change in enforcement by penalising in most circumstances the entity within which an offence is committed rather than the individual who committed it. The effect of these changes is discussed further in Chapter 3.

The changes brought about by the LSA highlighted the anomaly that some activities carried out by solicitors could be carried out by anyone, whether a solicitor or not, and that the term ‘lawyer’ was not exclusively reserved to solicitors or barristers. In the more distant past most people went to a solicitor for legal advice, knowing that that individual was qualified and regulated. As firms became bigger, a client could easily find that the advice given came from someone other than the solicitor, but the solicitor owned the practice, controlled and was responsible for how it operated, and was personally liable for negligence or professional conduct failures committed by his employees. One of the fundamental purposes of the Law Society was to instil in the public the concept that a solicitor and his firm could be trusted. With the coming of ABSs and the consequent change towards risk-based rather than conduct-based regulation, the public might find it more difficult to differentiate between a regulated ABS employing solicitors and an unregulated one performing the same services.

The other protection for the public is that the reserved legal activities as defined in the Solicitors Act 1974, can legally only be performed by bodies that are authorised to do so.

The LSA attempted to deal with these issues by creating the structure to permit licensing bodies to be authorised in some or all of the reserved legal activities and to regulate licensed bodies accordingly in those activities. Therefore an ABS fully authorised by the SRA, which is authorised to license all reserved legal activities, can perform all reserved legal activities with the exception of certain notarial activities which remain individually based. The CLC applied for permission to regulate advocacy and litigation but this was rejected and today an ABS regulated by that body is therefore more restricted in the work that it can undertake. The Council has stated that it intends to reapply in 2013.

Because the licensed body will have managers, owners, or employees who are not themselves authorised persons, the LSA also provides in section 90 that they ‘must not do anything which causes or substantially contributes to a breach by –

(a) the licensed body, or
(b) an employee or manager of the licensed body who is an authorised person in relation to an activity which is a reserved legal activity, of the duties imposed on them by section 176.’

An authorised body will therefore be able to undertake the reserved legal activities that its licensing body can authorise, but it will also have to carry out non-regulated activities in accordance with the terms of its licence. By contrast, a ‘law firm’ that only carries out non-reserved activities does not have to be regulated at all.
Reserved legal activities
The reserved legal activities are as follows:

The exercise of a right of audience –
LSA Schedule 2, paragraph 3
This does not include a right to appear in a court or proceedings where there is no restriction placed on a person exercising that right, but, subject thereto, is the right to appear before and address the court, and includes the right to call and examine witnesses. The right of audience may be restricted. For example, a barrister has a right of audience in all courts but a solicitor will not normally have the right of audience in the Crown or High Court without having a higher right of audience qualification, and an employee of a housing management body may only have a right of audience in a county court before a district judge limited to certain housing proceedings.

The conduct of litigation –
LSA Schedule 2, paragraph 4
There is a slight anomaly here in that the Act states that the definition does not include any such activity which was not restricted prior to the coming into force of the LSA, but then widens the definition of the conduct of litigation contained in section 119(1) of the Courts and Legal Services Act 1990. Conduct of litigation is now defined as:

‘(a) the issuing of any proceedings before any court in England and Wales,
(b) the commencement, prosecution and defence of such proceedings, and
(c) the performance of any ancillary functions (such as entering appearances to actions)’

in relation to such proceedings. It should be noted that the Court of Appeal has construed the meaning of ‘ancillary’ quite narrowly. In Agassi v Robinson (Inspector of Taxes) (2005) EWCA Civ 1507, Lord Justice Dyson stated:

‘The word “ancillary” indicates that it is not all functions in relation to proceedings that are comprised in the “right to conduct litigation”. The usual meaning of “ancillary” is “subordinate”. A clue to what was intended lies in the words in brackets “(such as entering appearances to actions)”. These words show that it must have been intended that the ancillary functions would be formal steps required in the conduct of litigation. These would include drawing or preparing instruments within the meaning of section 22 of the 1974 [Solicitors] Act and other formal steps.’

Therefore it follows that some steps, such as dealing with correspondence or taking witness statements in the course of litigation, do not fall within the definition of conduct of litigation.

Reserved instrument activities –
LSA Schedule 2 Paragraph 5(1) and section 12(1)(c)
This is often regarded as making conveyancing a reserved activity, but the reality is somewhat more complicated. It means:

‘(a) preparing any instrument of transfer or charge for the purposes of the Land Registration Act 2002 (c.9),
(b) making an application or lodging a document for registration under that Act, and
(c) preparing any other instrument relating to real or personal estate for the purposes of the law of England and Wales or instrument relating to court proceedings in England and Wales.’
It follows that the preparation of an instrument to enable a legal transfer of personal property is a reserved instrument activity, whereas many activities which form part of a normal conveyancing transaction are not.

The definition excludes the preparation of farm business tenancies carried out by a Fellow of the Central Association of Agricultural Valuers or a Member or Fellow of the Royal Institution of Chartered Surveyors (LSA Schedule 3, paragraph 3(5) & (6)), or where the activity is carried out by a person employed merely to engross the instrument or application (paragraph 3(9)), or where it is carried out otherwise than for, or in expectation of, any fee, gain, or reward (paragraph 3(10)). There are transitional provisions and savings in respect of instrument activities related to certain court proceedings in respect of which there were no restrictions before the LSA came into force (LSA Schedule 2 paragraph 5(2)).

The existing regulators, other than the Institute of Legal Executives and the Association of Law Costs Draftsmen, are approved in relation to reserved instrument activities.

Probate activities – LSA Schedule 2 paragraph 6
This is defined as ‘preparing any probate papers for the purposes of the law of England and Wales or in relation to any proceedings in England and Wales’. ‘Probate papers’ are papers on which to found or oppose a grant of probate or letters of administration, and does not include the administration of an estate or the drawing up of a will. With the exception of the Institute of Legal Executives, the Chartered Institute of Patent Agents, the Institute of Trade Mark Attorneys, and the Association of Law Costs Draftsmen, all the existing regulators are approved in relation to probate activities.

Notarial activities – LSA Schedule 2 Paragraph 7(1) and section 12(1)(e)
These are defined as the activities, other than those of reserved instrument or probate activities or the administration of oaths, which were customarily carried on by notaries in accordance with the Public Notaries Act 1801. The only regulator approved in relation to notarial activities is the Master of the Faculties. Most notaries are also solicitors and therefore conduct non-notarial work under the regulation of the SRA. Others practice only as notaries doing commercial, property, and private client work. The bulk of much notarial work is in the authentication of documents for use abroad or for commercial purposes.

Administration of oaths – LSA Schedule 2 Paragraph 8 and section 12(1)(f)
This is the exercise of the powers given to a commissioner for oaths by the Commissioners for Oaths Acts 1889 and 1891 and the Stamp Duties Management Act 1891 and is a reserved legal activity which all the existing approved regulators may authorise.

One of the difficulties that arises from having a number of regulators, each with responsibility for regulating its own licensees, is how those who are not licensed, but who nonetheless undertake reserved legal activities, are monitored and dealt with. In the past, the Law Society monitored and prosecuted those who undertook reserved legal activities without proper authority but it is now only one of a number of possible regulators. The LSB has overall responsibility for the sector, but it relies wholly on the bodies it has authorised to regulate to monitor any breaches and prosecute
accordingly. The burden has mainly fallen on the SRA to prosecute what are, after all, criminal offences (LSA section 14), but it is questionable whether the SRA will have the resources to do so, particularly if and when other regulators, such as the CLC, obtain the right to regulate litigation activities. For those considering creating an ABS, questions as to which regulator is the least intrusive, which will defend the position of its regulated businesses, and whether registration as an ABS is indeed necessary are all topics that will be touched on later in this report.

Regulated unreserved activities
Another complication arises because, although the six reserved legal activities are set out in the LSA, there are a number of legal activities that are not reserved but are regulated under other statutes. They are as follows:

Insolvency work
The regulations covering this activity are governed by the Insolvency Act 1986. An insolvency practitioner must be individually authorised through membership of a professional body recognised under the Act (section 391) or by permission of a competent authority (section 392). The recognised bodies are the Institution of Chartered Accountants in England and Wales, the Institute of Chartered Accountants in Ireland, the Association of Certified Chartered Accountants, the Institute of Chartered Accountants in Scotland, the Insolvency Practitioners Association, the Law Society of Scotland, the SRA, and the Secretary of State, and any of these can authorise an insolvency practitioner.

Claims management
The provision of claims management services is governed by the Claims Management Regulator under the Ministry of Justice and the scope of the services regulated is set out in the Compensation Act 2006 and the regulations made under it. Essentially, ‘advice or other services in relation to the making of a claim’ is regulated (section 4(2)(b)), and any business providing regulated claims management services in England and Wales, wherever the business itself is registered or situated, must be authorised, unless it is exempt. Exempt businesses are: solicitors, barristers, and legal executives, which are already regulated under their own regulators; insurance companies, Independent Financial Advisers, and brokers in respect of business regulated under the Financial Services and Markets Act; charities and advice agencies; independent trades unions dealing with their own members in accordance with the appropriate code of practice; and small-scale introducers where this is incidental to their main business and the person to whom the introduction is made takes responsibility for their actions.

Immigration advice and services
Although the White Paper ‘The future of legal services: Putting consumers first’ clearly envisaged that the provision of immigration services would become a reserved activity, this did not happen and they are still governed by the Immigration and Asylum Act 1999 (section 84). Since April 2011 the LSB took over from the Immigration Services Commissioner the responsibility of supervising the qualified regulators set out in LSA Schedule 18, namely the Law Society, the General Council of the Bar, and the Institute of Legal Executives. There is provision for other approved regulators to apply to become qualified regulators of immigration advice and services. Unfortunately, Schedule 18 only applies to
approved regulators under the LSA. It does not apply to those who are not regulated by the approved regulators but who offer advice and services on immigration matters, and these will continue to be regulated by the Office of the Information Commissioner. There is, therefore, not only a potential conflict between different regulators but also an overlap in that rights of audience and litigation remain reserved activities.

Unregulated activities
There have always been and continue to be other legal activities that are not only unreserved but also unregulated. These include non-contentious employment advice or advice on discrimination, will writing, mental health advice, and assistance at a police station. These services can therefore be provided by anyone. However, many of these services are in fact provided by solicitors or other authorised bodies and the service provided in those cases will fall under the protection offered by that regulatory regime. They may therefore be competing at a disadvantage with unregulated providers. Equally, those receiving the advice or service may not be able to appreciate the dangers of taking it from an unregulated source, but Clementi regarded this as a matter for Government to deal with and took the view that any changes should be ‘subject to careful cost/benefit analysis’ (Clementi Report, Chapter E, paragraph 38).

The LSB has decided to recommend that will writing services should become reserved activities but that probate and estate management should not. In general, the LSB regards its obligations under section 3 of the LSA to ensure that regulation is proportionate to the perceived risk as a duty to limit the definition of reserved and regulated activities as far as it reasonably can, and to permit the undertaking of non-reserved activities by regulated and unregulated bodies free from control by regulators. If it succeeds in enforcing this concept, it will have profound consequences for the whole of the legal profession and, in particular, for the way in which ABSs are constructed.

Notes and references
1. See also Office of Fair Trading press release 7 March 2001 announcing the report.
4. For the full text of all UK legislation referred to in this report see www.legislation.gov.uk.