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Department for
Constitutional Affairs
Justice, rights and democracy

The Future of Legal Services: Putting Consumers First



October 2005



The Future of Legal Services: Putting Consumers First

**Presented to Parliament
by the Secretary of State for Constitutional Affairs and Lord Chancellor
by Command of Her Majesty
October 2005**

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Foreword

This White Paper sets out the Government's agenda for reforming the regulation and delivery of legal services, in order to put the consumer first.

Consumers need, and deserve, legal services that are efficient, effective, and economic. They want to have choice, and they want to have confidence in a transparent and accountable industry.

Legal services are crucial to people's ability to access justice. They must therefore be regulated and made available in such a way as to meet the needs of the public – individuals, families, and businesses.

The professional competence of lawyers is not in doubt. The calibre of many of our legal professionals is among the best in the world. But despite this, too many consumers are finding that they are not receiving a good or a fair deal.

In 2001, the Office of Fair Trading found that many of the rules of the legal professions were unduly restrictive, resulting in consumers receiving poorer value for money than they would have done under more competitive conditions.

In 2002 my department carried out a wide-ranging public consultation exercise. Consumers told us clearly that their needs were not being met. They felt legal services lacked sufficient orientation towards the consumer; they did not have confidence in self-regulation alone; and experiences of poor complaints handling had undermined confidence.

Subsequently, in 2004, Sir David Clementi completed a report to me on reforming the regulatory framework. His report confirmed that the case for reform is clear, and reform is overdue.

The Government's policy is to create a regulatory framework that directs regulation at those areas where it is needed. The proposed regulatory framework sets the parameters within which firms can deliver consumer focused legal services. If those services are provided, both the consumer and the profession will benefit, with individual lawyers providing high quality services that meet individual client needs.

We will create a Legal Services Board, an Office for Legal Complaints, and we will take steps to enable firms to provide services under alternative business structures to those presently available.

Our vision is of a legal services market where excellence continues to be delivered; and a market that is responsive, flexible, and puts the consumer first. This paper sets out the steps we will take to achieve it.

The image shows a handwritten signature in black ink. The signature is written in a cursive style and appears to read 'Charlie Falconer'. The first name 'Charlie' is written on the top line, and the last name 'Falconer' is written on the line below it.

Lord Falconer of Thoroton
Secretary of State for Constitutional Affairs
and Lord Chancellor

Executive summary

This White Paper sets out the Government's proposals for reform of the regulatory framework for legal services in England and Wales. The purpose of the changes is to put the consumer first. The Government has set up a Consumer Panel to advise it as it takes forward reform.

The changes will mean an end to the current regulatory maze. The aim is a new regulatory framework, which better meets the needs of consumers and which is fully accountable.

The current system involves Front Line Regulators, like the Bar Council and the Law Society, as well as higher level regulators, such as the Secretary of State for Constitutional Affairs, the Master of the Rolls and the Office of Fair Trading. The front line legal professional bodies generally seek to regulate their members and represent their interests at the same time. This can lead to concerns that they are not putting the interests of consumers first, particularly in handling complaints.

The anti-competitive effects of some of the rules of the legal professional bodies have also caused concern.

In July 2003, the Government appointed Sir David Clementi to carry out an independent review of the regulatory framework. He recommended:

- the creation of a new Legal Services Board (LSB) to provide oversight regulation
- statutory objectives for the LSB
- that regulatory powers should be vested in the LSB, with powers devolved to Front Line Regulators where they meet its standards
- that Front Line Regulators should be required to separate their regulatory and representative functions
- the establishment of a new Office for Legal Complaints to handle consumer complaints
- the facilitation of legal disciplinary practices, to allow different kinds of lawyers and non-lawyers to work together.

The Government has accepted Sir David Clementi's recommendations. The Government's main proposals cover:

- **putting consumers first:** the objectives of the regulatory framework and principles of the legal profession will be set out in legislation. Consumers will be clear about the system, and will be able to hold all partners in the framework to account for delivering these commitments. Front Line Regulators will be required to separate their regulatory and representative functions. These steps will increase confidence in the regulatory system and in legal professionals.

- **simplifying regulation:** the new structure will be simpler, ensure consumers are protected and ensure that regulation is proportionate. A new **Legal Services Board** will have clear powers and responsibilities. It will authorise **Front Line Regulators** to carry out day to day regulation where they meet its standards. Sector expertise will be maintained in the regulatory system through the Front Line Regulators.
- **new ways of delivering for consumers:** the White Paper sets out how consumers will benefit from the development of **alternative business structures**. These will enable legal and certain other services to be provided to high standards and in ways that suit different consumers. The arrangements will ensure competition and innovation can continue to flourish.
- **protecting consumers:** because the legal services market will continue to change, the White Paper describes how safeguards for consumers will quickly be put in place where new gaps in protection open up.
- **complaints:** a new **Office for Legal Complaints (OLC)** will be created. This will enhance consumer confidence by creating a single, independent complaints handling service. The OLC will provide quick and fair redress where things go wrong.
- **costs:** the costs of the new system will be met by the sector.

Legislation will be needed to make most of these changes. The Government will publish a draft Legal Services Bill for pre-legislative scrutiny in the current Parliamentary Session. After that, legislation will be introduced as soon as Parliamentary time allows.

These changes will deliver a simpler, more consistent regulatory framework that puts the needs of consumers at the centre of the system.

Introduction

This White Paper sets out fundamental changes in the way that legal services will be regulated in England and Wales. The driving force behind these reforms, as with all the priorities of the Department for Constitutional Affairs, is a shift from responding to the needs of service providers to delivering on the priorities of the public they serve.¹

Almost everyone will need to use legal services at some point – whether it is to move house, resolve a family dispute or carry out business. The Government's aim is to establish a modern and simple regulatory framework that puts consumers first.

The Government has set up a **Consumer Panel** to advise on these reforms. Lord Falconer announced this at a stakeholder conference on 21 March 2005, which the DCA co-hosted with Citizens Advice, the National Consumer Council and Which?. Membership of the Consumer Panel is set out at Appendix A. Their involvement has been invaluable, and their role will continue throughout the process of reform to ensure that the consumer voice is heard.

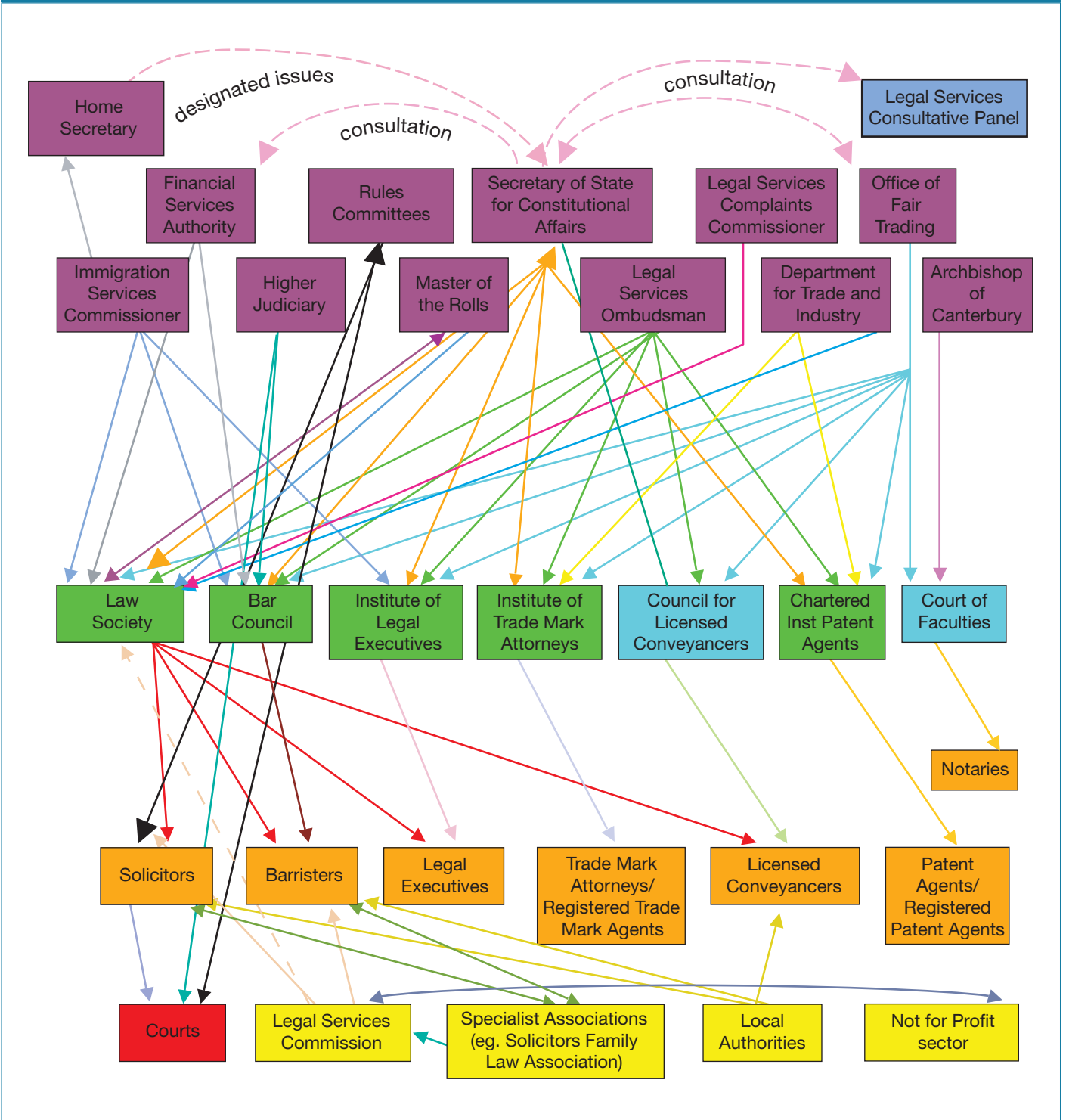
As a result of the reforms set out in this White Paper, consumers can have greater confidence that their interests are at the heart of regulation. They will have more choices about the way in which they tap into services. The system will be clearer and demonstrably independent. Greater consumer confidence and choice benefits providers too. Both consumers and providers will benefit from greater flexibility, which will enable innovation and competition in a dynamic and growing market.

Figure 1 shows the **current system**, which has been called a 'regulatory maze'. The Government has concluded that it is outdated, inflexible, over-complex and not accountable or transparent enough.²

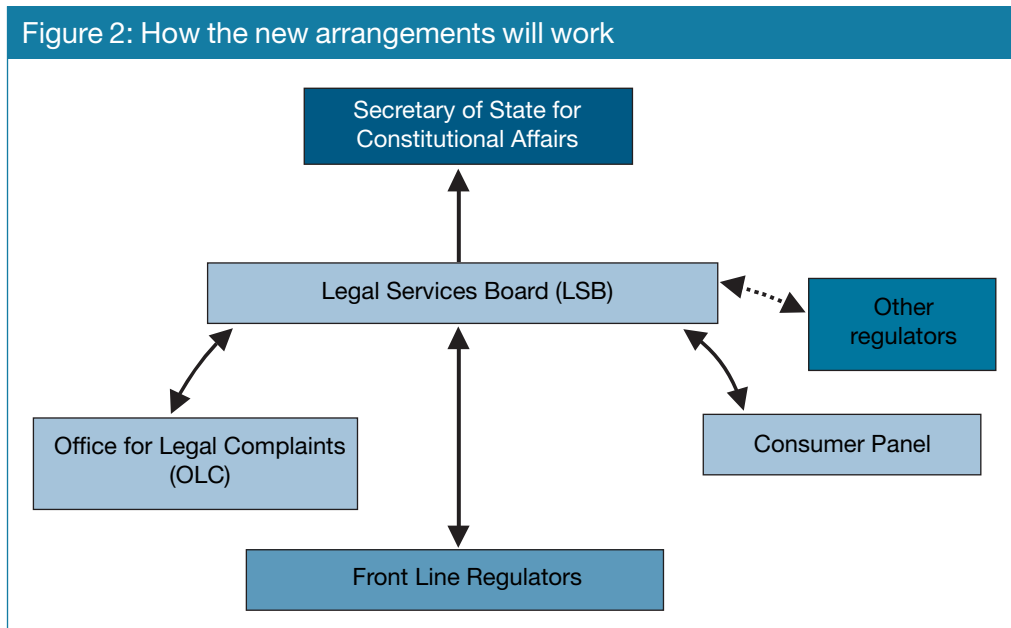
¹ Department for Constitutional Affairs, 2005.

² Department for Constitutional Affairs, 2003.

Figure 1: The Current System



This White Paper sets out proposals for a new regulatory framework that removes the existing maze of oversight regulators. Instead, there will be a new oversight regulator – the Legal Services Board – that better meets the needs of consumers.



Chapter 3 summarises what the Government is trying to achieve for consumers. The Chapters that follow provide background on the legal services sector, the pathway to reform and the details of the Government's proposals.

The Government has engaged with stakeholders throughout this process and will continue to do so as we take forward reform. Comments on this White Paper are welcome. These should arrive by 20 January 2006 and should be sent:

- in writing to:
Katie Leslie
Legal Services Reform Team
Department for Constitutional Affairs
3.09 Selborne House
54 - 60 Victoria Street
London SW1E 6QW
- or by email to:
legalservicesbill@dca.gsi.gov.uk

The Government will also publish a draft Legal Services Bill for pre-legislative scrutiny in the current Parliamentary Session.

Part 1 – The Legal Services Sector

Chapter 1: The Legal Services Market

1.1 The market for legal services today

The legal services market is extremely valuable, and has grown considerably in recent years.

The Legal Services Market

- In real terms the growth in the turnover of legal activities rose by almost 60 per cent between the period 1995 and 2003 when turnover reached £19 billion.
- In 2003 UK legal services exports totalled £1.9 billion, three times that of 1995.
- In 2004 there were 14,364 practising barristers (11,564 of whom were in independent private practice) compared with 1990, when there were 6,645 barristers in independent private practice.
- In 2004 there were 96,757 solicitors, of whom 75,079 were working in private practice. This compares with 1990 when there were 54,734 practising solicitors. Both the Bar and the solicitors' profession are significant employers. The total recorded employment for the solicitors' profession and the Bar (fee earners and administrative staff) in 2003 was 267,503.
- Elsewhere in the legal services sector, in 2004 there were:
 - 22,000 members of the Institute of Legal Executives. Most legal executives work for solicitors' firms, although a few work independently from solicitors
 - 850 licensed conveyancers in England and Wales, and around 1,300 in training
 - 857 registered trade mark attorneys and 1,500 United Kingdom registered patent attorneys and
 - approximately 900 public notaries in practice, of whom around 30 are scrivener notaries, and 815 are general notaries who are also in practice as solicitors.
- Not-for-profit organisations providing advice to individuals on areas such as debt include:
 - 468 Citizens Advice Bureaux in England and Wales
 - just under 1,000 members of AdviceUK (formerly the Federation of Information and Advice Centres) and
 - 57 law centres in the Law Centres Federation.

As well as being a growing market, the legal services market is also becoming increasingly fragmented. In fact, the Government's view is that it is not one market but 'a range of increasingly fragmented and fast-moving market places, in which a wide spectrum of consumers is being supplied by an expanding range of different services, supplied by providers who may have nothing in common other than the fact that their services have some legal element'.³

Today's consumers are very different in the types of legal services they purchase, how often they engage with legal service providers and their level of knowledge of both the law and legal service providers. They need services delivered in ways that are flexible enough to suit their different needs.

1.2 The current regulatory system

Currently, seven forms of legal service are subject to statutory regulatory control. These are:

- the right to conduct litigation
- the right of audience in the courts
- the provision of immigration services
- certain probate services
- conveyancing
- notarial services
- acting as a commissioner for oaths.

These are described in more detail at Appendix B. The Government is introducing legislation in the Compensation Bill that aims to add claims management to this list.

As the Introduction showed (Figure 1), current machinery for regulating legal services is complicated. A host of **Front Line Regulators**, including legal professional bodies like the Bar Council and the Law Society, have a direct impact on the provision of those services. Regulation is focused on the nature of the provider, rather than the type of service delivered.

In addition to the Front Line Regulators, the system involves a number of **higher level regulators**, such as the Secretary of State for Constitutional Affairs, the Master of the Rolls and the Office of Fair Trading.

The legal professional bodies have generally sought to regulate their members and represent their interests at the same time. This has led consumers to believe that the legal professions operate in their own interests. Consumers cannot have confidence that the organisations charged with regulating their members **and** representing them will put the interests of consumers above

³ Lord Chancellor's Department, 2003.

those of their members. This is also bad for providers of legal services since it affects their standing – and can potentially limit the number of their customers.

1.3 Problems with complaints handling

The problems with the handling of complaints against solicitors first came to light in the mid 1980s. Some consumer complaints had not been considered for up to two years since they had first been received. Annual reports of the Legal Services Ombudsman have since that time also been critical.

The Law Society has made significant efforts to change this position and there have been improvements. In February 2004, the Secretary of State asked the Legal Services Ombudsman, Ms Zahida Manzoor CBE, to take on a new role of Legal Services Complaints Commissioner (LSCC) and to work with the Law Society further to improve the handling of complaints. The Government welcomes the progress that the Law Society and LSCC are making. The Law Society is also establishing a Consumer Complaints Board from 1 January 2006 with a non-lawyer majority to oversee its handling of complaints. This is another welcome step.

But consumers are demanding more when they have complaints about **any** legal service. Change is needed to meet their reasonable demands. Most importantly, they need to be satisfied that complaints are handled independently, without self-interest; that they are handled efficiently, fairly and quickly; and that complaints are used to correct faults in the system.

1.4 Problems with anti-competitive professional rules

In March 2001, the Office of Fair Trading (OFT) identified⁴ a number of rules of the legal professions that were potentially unduly restrictive, and that may have negative implications for consumers. These rules could affect the quality and price of legal services. The OFT recommended that rules governing the legal professions should be fully subject to competition law and that unjustified restrictions on competition should be removed.

Following that report, the legal professions made a number of changes to their rules. For example, both the Bar and the Law Society removed their restrictions on comparative fee rates, and the Bar introduced rules which provide for direct access by non-lawyer clients in certain circumstances.

This is an important step forward. But there is still a risk that under the current structures, a perception will remain that the rules are not set in the public interest and may be anti-competitive.

⁴ Office of Fair Trading, 2001.

The Government responded to the OFT report with a consultation paper⁵ that highlighted a number of concerns about the regulatory framework and proposed setting up a review:

“ This paper is concerned with a number of separate and in some instances limited issues, such as implementing existing statutory provisions to extend the market in conveyancing and probate services. The Government is aware, however, that the legal services market is changing in nature and that some of the matters discussed below (for example, removing the barriers to legal services being provided through new business structures) would add to and accelerate that change. In addition, the current regulatory framework, involving a wide range of regulators with overlapping powers and responsibilities, is complex and in some respects is not delivering what the public has a right to expect, for example, a quick, effective and comprehensive scheme for compensating those who suffer from bad or negligent service. The Government has therefore decided to undertake a review of the regulatory framework for legal services, the first step in which will be to settle the detailed parameters of the exercise and the machinery for completing it”.

The DCA Report which followed⁶ confirmed the view that: *“the current framework is out-dated, inflexible, over-complex and insufficiently accountable or transparent”*. It concluded that:

“ Government has therefore decided that a thorough and independent investigation without reservation is needed.

The terms of reference are:

- to consider what regulatory framework would best promote competition, innovation and the public and consumer interest in an efficient, effective and independent legal sector; and*
- 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.”*

Chapter 2 deals with that independent review.

⁵ Lord Chancellor's Department, 2002.

⁶ Department for Constitutional Affairs, 2003.

Chapter 2: Reforming legal services

2.1 Sir David Clementi's Review

In July 2003 the Government appointed Sir David Clementi to carry out the independent Review of Regulation of Legal Services in England and Wales.

As part of his Review, Sir David Clementi published his own consultation paper in March 2004.⁷ He published his full report in December 2004.⁸

2.2 Findings of the Independent Review

Sir David Clementi agreed with the Government's conclusion that *"the current framework is out-dated, inflexible, over-complex and insufficiently accountable or transparent"*. He found that:

- the system had insufficient regard for the interests of the consumers
- the governance structures of the main professional bodies were inappropriate for their regulatory tasks
- the oversight regulatory arrangements for professional bodies were over-complex and inconsistent, and
- there were no clear underlying objectives and principles.

On complaints, Sir David Clementi found that there were problems:

- at an operational level with the efficiency of the system
- at an oversight level with the overlapping powers of the oversight bodies, and
- at a level of principle with whether systems run by lawyers themselves could achieve consumer confidence.

He also found that:

- those with non-legal skills necessary for running a modern legal practice could not act as principals in those businesses
- there were concerns about whether the restrictive practices of the main professional bodies could still be justified, and
- there was pressure for change from those who represent consumer interests, and also from many within the legal profession.

⁷ Clementi 2004a.

⁸ Clementi 2004b.

The main recommendations of the Review were:

- the creation of a **Legal Services Board (LSB)** to provide consistent oversight of front-line professional bodies
- the setting of **statutory objectives** for the LSB, to include promotion of the public and consumer interest
- **regulatory powers** should be vested in the LSB, with powers to devolve regulatory functions to front-line bodies, subject to the LSB being satisfied with their competence and governance arrangements
- front-line bodies should be required to make governance arrangements to **separate their regulatory and representative functions**
- a new **Office for Legal Complaints (OLC)**, a single independent body to handle all consumer complaints, should be established
- **legal disciplinary practices** should be facilitated. These would be law practices that would allow lawyers from different front-line bodies – for example, solicitors and barristers – to work together on an equal footing, and which would permit non-lawyers to be involved.

2.3. The Government's proposals for reform

The Government broadly accepted Sir David's recommendations when his report was published.⁹ At the major stakeholder conference in March 2005,¹⁰ Lord Falconer set out the framework for reform.

Chapter 3 sets out what the proposals for reform will deliver for consumers.

⁹ Official Report, Hansard, Lords, 15 Dec 2004, Column WS84.

¹⁰ Official Report, Hansard, Lords, 21 Mar 2005, Column WS4.

Part 2 – Putting consumers first

Chapter 3: The reform programme – delivering for consumers

3.1 Putting consumers at the heart of the changes

Ensuring that the needs of different consumers are met should be at the heart of any regulatory system. This White Paper sets out new structures and ways of working to ensure that happens when consumers are using legal services.

What are we trying to achieve for consumers?

- The interests of consumers, not providers, drive decisions about regulation
- An end to the regulatory maze
- A new system that is transparent and accountable so that consumers know what to expect
- Regulation that is proportionate and based on best practice, so that consumers are protected in the right way, when it is necessary
- Consumers are confident that regulation is independent of providers and Government

How will we deliver it?

- New bodies – the **Legal Services Board** and the **Office for Legal Complaints** – will ensure independence
- Objectives will be set out in legislation so that consumers are clear about what to expect and can hold regulators to account
- All partners in the regulatory framework will have to adopt best practice and a risk-based approach

The new regulatory bodies

The proposals in this White Paper will put an end to the regulatory maze, by replacing a range of existing oversight regulators with a single and demonstrably independent **Legal Services Board**. This will ensure that consumers are clear about how regulation works and can be confident that it is designed to suit their needs, not the needs of providers.

“An independent legal services regulator will not only give people the greater protection they deserve, but it will also help restore confidence in a system that has failed consumers for too long. If the new regulator is to be successful, it is vital that it sets strict standards, exerts close scrutiny and, where necessary, is ready to bare its teeth.”

Dame Deirdre Hutton, former Chair of the National Consumer Council, speaking at ‘Future of Legal Services – Putting Consumers First’ conference, 21 March 2005.

The Legal Services Board will:

- provide independent oversight. It will be made up of a majority of non-lawyers
- authorise **Front Line Regulators** to carry out day to day regulation if they meet its standards
- have powers to act if Front Line Regulators fail
- enable consumers to have the confidence that regulation is working in their interests because Front Line Regulators will be required to separate their regulatory and representative functions
- set up and maintain a **Consumer Panel** to ensure that the voices of consumers are heard and inform its decisions
- be independent of Government.

The objectives of the regulatory framework

Regulators must have clear **objectives**. These guide them in exercising their functions. They also act as a way for consumers to call regulators to account. The objectives for the regulation of legal services will be set out in legislation, and all parts of the system will need to work together to deliver them.

The objectives will be:

- To support the rule of law
- To improve access to justice
- To protect and promote consumers' interests
- To promote competition
- To encourage a strong and effective legal profession
- To increase public understanding of the citizen's legal rights
- To maintain the principles of those providing legal services (independence, integrity, the duty to act in the best interests of the client, and client confidentiality).

Best practice and a risk-based approach

Effective regulation ensures that consumers are protected. But too much regulation is damaging because it imposes costs, stops consumers getting what they need and puts unnecessary burdens on providers. Regulation must be proportionate and based on an assessment of risk. Risk-based regulation

means identifying and assessing the risk, determining the strategy for managing the risk and communicating the risk.

All parts of the new regulatory framework will need to take account of developments in regulation and the sector and adopt best practice.

3.2 New ways of meeting consumer needs

Today’s consumers have higher expectations than ever before. Consumers are right to expect services delivered in ways that suit them, not the providers. This is happening across all sectors, and legal services need to change to keep pace with consumer expectations.

What are we 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
- Systems that foster innovation and diversity.

How will we 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.

These reforms will deliver greater flexibility in the way legal services are provided. Consumers will benefit from innovation and efficiency. There will be strong safeguards for the operation of these **alternative business structures (ABSs)** to protect consumers. The new system will also ensure that quality and integrity are maintained across the board.

“We support the principle of alternative business structures because they have the potential to encourage innovation and competition, and offer the consumer convenience, ease of access and cost savings.”

National Consumer Council, June 2004

3.3 Protecting consumers if new problems occur

We need to introduce mechanisms to ensure that protection for consumers can be put in place quickly and easily where that becomes necessary. The current system does not easily allow for this.

What are we trying to achieve for consumers?

- Greater certainty that protection can be quickly put in place where necessary to plug new gaps.

How will we deliver this?

- The Legal Services Board will be able to implement voluntary schemes and, where necessary, recommend that the law is changed to require new services to be regulated
- It will consult in advance with its Consumer Panel and others
- The process will be quicker to ensure that consumers are protected.

The problem

The problem is that at present there may be gaps where regulation is needed and so consumers are not protected. Under the current arrangements, an Act of Parliament is generally required to provide the protection that consumers need. This means it is difficult to put safeguards in place quickly when new problems arise.

Closing the gaps

The LSB will have the flexibility to determine the best form of safeguards for consumers. These could include voluntary schemes operated by trade or other bodies aimed at improving standards. However, if following its review and consultation the LSB thinks it necessary, it will make a report to the Secretary of State for Constitutional Affairs recommending that the activity is brought under its regulatory control.

So that change can be made quickly, the Secretary of State will be able to do this by means of secondary legislation, subject to Parliamentary approval.

3.4 Complaints – what happens if things go wrong?

The legal professional bodies have sought to improve their complaints handling systems, with the Law Society in particular making considerable recent efforts. But consumers have told us that they need more.

“Self-regulation isn’t working. People complain to Which? time and again about the second-rate service they receive from solicitors, often during stressful times. Other professions can’t get away with this type of behaviour and it’s time for the Government to rein in this complaint-riddled industry.”

Nick Stace, Director of Campaigns and Communications, Which?, speaking at ‘Future of Legal Services – Putting Consumers First’ conference, 21 March 2005.

Consumer demands:

- **Independence:** consumers do not have enough confidence in the current system. They are not reassured by bodies that act as both the team manager and the referee
- **Timeliness:** where things go wrong, consumers have a right to expect that their complaints will be dealt with quickly and efficiently
- **Consistency and clarity:** consumers need to know where to go when they have a complaint. There should be no overlaps or gaps from the consumer's point of view
- **Best practice:** professional bodies now largely set their own standards, which may not always be consistent nor represent best practice. Quality and best practice – within the legal services sector and beyond it – should be identified and driven through the whole system.

A new approach to complaints handling

The Government will establish a single complaints handling body, the **Office for Legal Complaints (OLC)**, to deal with all consumer complaints. It will be a new organisation, independent of the legal profession.

The creation of the OLC will ensure that consumers get a better deal in complaints handling. They will be clear about where to direct their complaint. Where things go wrong, there will be quick, fair and accessible measures to put them right. Consumers can have confidence that complaints will be dealt with transparently and independently. The chair and majority of members will be non-lawyers.

“I believe that the very notion of complaints handling by the profession has now lost all legitimacy among consumers.”

Zahida Manzoor CBE, Annual Report of the Legal Services Ombudsman for England and Wales 2003-04

3.5 Paying for the new arrangements

The Government considers that the legal sector should meet the costs of the new arrangements.

3.6 Next steps

The Government intends to publish a Legal Services Bill for consideration in draft during the current 2005/06 Session of Parliament. Following that, legislation will be introduced as soon as Parliamentary time allows.

Ahead of that, the Government is taking a number of steps to ensure that consumers are further protected. For example, the Government is planning to introduce measures in the proposed Compensation Bill in this Session of Parliament in order to regulate claims managers.

Part 3 – How the new arrangements will work

Chapter 4: A new regulatory framework

4.1 Putting consumers at the centre of the new system of regulation

The new **Legal Services Board (LSB)**, the **Front Line Regulators (FLRs)** and the new **Office for Legal Complaints (OLC)** will all have a part to play in the regulation of legal services. Their roles are set out in more detail in later chapters. This section provides an overview of how they will work together in partnership, putting the consumer first and ensuring quality and best practice in the provision of legal services.

Regulators must have clear **objectives**. These guide regulators in exercising their functions. They also act as a way for consumers to call regulators to account. The objectives for the regulation of legal services will be set out in legislation, and all parts of the system will need to work together to deliver them. They will also have to act in a way that maintains the **principles** of the legal profession.

There is broad support for the objectives and principles set out in Sir David Clementi's final report. We have heard some suggestions for small changes, and where there is a clear overall benefit we have included these.

The 7 objectives and 4 principles for the regulation of legal services will be set out in legislation. All partners in the regulatory framework – the Legal Services Board, the Office for Legal Complaints and the Front Line Regulators – will have to deliver these.

The objectives are to:

- **Support the rule of law:** all those involved in the regulation and delivery of legal services have an important part to play in actively supporting the rule of law to ensure the equal treatment of all people before the law, fairness and human rights.
- **Improve access to justice:** access to justice for all members of our society is fundamental. But there are particular aspects to which legal regulators need to pay special attention. For example geographic considerations, such as rural access, and access for those who are disadvantaged or have special needs must be considered. Regulators must ensure that access to justice for all is maintained, and also that they actively seek ways to improve it.

- **Protect and promote consumers' interests:** those involved in the regulation of legal services must ensure that they not only protect the interests of consumers, but that they actively promote them. Regulators must also ensure that consumers have appropriate means to receive redress for poor service.
- **Promote competition:** partners in the regulation of legal services must ensure the prevention of unnecessary or unjustified restrictions on the supply of legal services. They should encourage competition in legal services and the promotion of choice. They must balance competition with the need to safeguard consumers' interests.
- **Encourage a strong and effective legal profession:** front line regulatory bodies must ensure that individual practitioners meet appropriate quality standards. This includes setting appropriate entry standards, both for the qualification of legal professionals, and for front-line regulatory bodies. Supporting new entrants to the market could help the public interest by enhancing access to justice, maintaining a healthy supplier base for publicly funded work and maintaining pro bono initiatives.
- **Increase public understanding of the citizen's legal rights:** all partners in the regulatory framework have a duty to ensure that providers set out for clients their rights, their choices and the consequences of these. And to promote, inform and empower the public in understanding what they are doing.
- **Maintain the principles of those providing legal services:** regulators have a duty to maintain the principles of those providing legal services, particularly in exercising their control over professional codes and standards.

The principles of those providing legal services are:

- **Independence:** legal professionals should at all times maintain their duty to act with independence in the interests of justice.
- **Integrity:** legal professionals should act with integrity towards clients, the courts, 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:** legal professionals should 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.
- **Client confidentiality:** legal professionals should keep their clients' affairs confidential.

The Government has not ranked the objectives and principles. The partners in regulation will be best placed to do this on a case-by-case basis. They may need to balance these if there are tensions between some of the objectives or principles in particular instances.

Pro bono initiatives by the legal professions are entirely consistent with the objectives of the new regulatory system. The Government is committed to ensuring that the public continues to benefit from *pro bono* legal advice under the new regulatory arrangements.

It will be possible to amend the objectives and principles if circumstances change in future, subject to Parliamentary approval. Changes will be made by secondary legislation.

Changes to the objectives and principles will be made by secondary legislation subject to the approval of Parliament.

4.2 Embedding best practice

To ensure that consumers continue to benefit from fresh thinking and new developments in how services are provided, all those in the regulatory framework should adopt best practice in carrying out their functions.

The **Better Regulation Executive (BRE)** has set out **principles** of good regulation. The Government strongly supports the adoption of these by regulators.

The BRE guidelines say that regulation 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:** regulators should be focused on the problem, and minimise side effects.

Best practice should also embrace identifying information about the quality of legal services. The Legal Services Board and Front Line Regulators will work together to do this. This will help consumers who are seeking legal services to make better informed choices between providers.

Legislation will require all partners in the regulatory framework to adopt best practice in carrying out their functions.

4.3 A risk-based approach

The Hampton Review of Inspection and Enforcement¹¹ recommended that all regulatory agencies should adopt a risk-based approach to regulation. The Government accepted all the Review's recommendations. All regulatory activity for legal services should be on the basis of a clear, comprehensive risk assessment.

Regulators should be able to justify their activities on the basis of risk, and communicate this effectively. Good regulators use the full range of tools at their disposal, such as providing good advice to facilitate better compliance as well as making a proportionate response to non-compliance.

Risk-based regulation can mean:¹²

- setting standards/rules which are applied to a whole set of regulated firms/organisations on the basis of assessments of the risks posed to society by the activities of firms of that type
- setting standards tailored to fit the particular risks to which the conduct of particular firms gives rise
- introducing internal risk management systems within the regulatory agency
- allocating resources, mainly inspection and enforcement resources, based on an assessment of the risk that a regulated person or entity poses to the regulator's objectives.

Proportionate measures, based on an assessment of risk, mean that consumers of legal services can have confidence that they are protected in the right way when it is necessary.

Legislation will require all partners in the regulatory framework to adopt a risk-based approach to regulation.

¹¹ Hampton, 2005.

¹² Black and Cave, 2005.

Chapter 5: Simplifying regulation

5.1 The Legal Services Board: a new independent regulator

A new oversight regulator, **the Legal Services Board (LSB)**, will be established. It will be independent of Government and providers of legal services. The LSB will be at the head of the new regulatory framework.

The LSB will have a full range of **powers** set out in statute to ensure that it can provide the oversight that consumers need.

Front Line Regulators (FLRs) will carry out day-to-day regulation. They will need to be authorised by the LSB to do this. The LSB will first need to be satisfied that they are fit for purpose. FLRs will include the existing professional bodies – the Bar Council, the Law Society, the Council for Licensed Conveyancers, the Institute for Legal Executives and others – if they meet the LSB's high standards.

These powers and requirements mean that consumers can be satisfied that quality, high standards and consumer needs are embedded in the new system from the start. If things go wrong, consumers will be sure that the LSB can take tough action.

We envisage the LSB to be a Non-Departmental Public Body, operating at arm's length from Government, and funded by the sector it regulates.

Legislation will establish a new Legal Services Board (LSB), with regulatory power vested in it. The LSB will authorise Front Line Regulators (FLRs) that satisfy it that they are competent to regulate. The LSB will be able to modify or remove the authorisation if an FLR fails, and to carry out regulatory functions in those circumstances.

5.2 The Legal Services Board and Front Line Regulators

The LSB and FLRs will work together in line with statutory objectives (set out in Chapter 4) to deliver for consumers. The power to authorise and to have effective control over FLRs will be vested by statute in the LSB. Consumers have highlighted the importance of this to ensure that deadlock does not arise.

Consumers can have confidence in the new arrangements because the LSB will have a range of powers over FLRs (see paragraph 5.6. below). It will authorise FLRs to regulate their members in providing legal services, and as a last resort have the power to de-authorise an FLR.

Existing FLRs will need to demonstrate to the LSB that they have appropriate governance arrangements in place. For most this will mean demonstrating a clear separation between their regulatory and representative functions. This will provide the assurance that consumers need that FLRs are not driven by the interests of their members.

However, we recognise that this may present practical difficulties for smaller FLRs. It will be for the LSB to consider suitable arrangements that maintain the integrity of this principle but also provide for the challenges faced by smaller FLRs.

Legislation will require existing regulatory bodies to satisfy the LSB of the appropriateness of their governance arrangements.

5.3 A Consumer Panel

The LSB will establish and maintain a **Consumer Panel**. The members of the Panel will have experience of consumer affairs. They will be appointed on merit in accordance with the rules of the Office of the Commissioner for Public Appointments.

The Consumer Panel will ensure that the views and concerns of consumers are heard. This will enable the LSB to take expert advice on the needs and aspirations of consumers. The Panel will be a valuable partner for the LSB in taking forward its regulatory objectives of protection and promotion of consumer interests and increasing public understanding of the citizen's legal rights. Consumer panels play an important role in other regulatory regimes, for example the Financial Services Consumer Panel which advises the Financial Services Authority.

The Consumer Panel will be developed in the light of the Government's proposals for strengthening and streamlining consumer advocacy in a number of sectors.¹³

Legislation will require the Legal Services Board to establish and maintain a Consumer Panel.

5.4 Membership of the LSB

The LSB will be governed by a Board rather than a single individual, in order to bring together a wider range of expertise and backgrounds. This will benefit consumers as well as providers. Stakeholders support this approach, which is also in line with the Better Regulation Executive's recommendation on Independent Regulators.¹⁴

¹³ Department for Trade and Industry, 2005.

¹⁴ Better Regulation Task Force, 2003.

There need to be enough members to provide a range of expertise, but not so many that the LSB becomes unwieldy and inefficient. Different sectors take different approaches to this: the Financial Services Authority (FSA) for example has 15 Board members; the Food Standards Agency has 14 and the Office of Gas and Electricity Markets (Ofgem) has 12 Board members; the Office of Communications (Ofcom) has 9 Board members.

The Better Regulation Executive's Report on Independent Regulators says: *"Boards will necessarily vary in size. In the main 10 or 12 people seemed the average – although 12 would be on the large side for a private company."*

There should be some scope for flexibility on size. It is also important to allow for future changes to ensure that the LSB can continue to meet the needs of consumers over time.

Legislation will set the size of the Board of the LSB at 9 to 12 members. It will be possible to change this by secondary legislation, subject to Parliamentary approval.

To meet the needs of different consumers, the members of the Board of the LSB will between them have experience of:

- consumer affairs
- the provision of legal services
- the lay advice sector
- civil or criminal proceedings and the working of the courts
- competition issues
- legal education and training
- the maintenance of the professional standards of persons who provide legal services
- the maintenance of standards in professions other than the legal profession
- complaints handling
- commercial affairs
- experience or knowledge of the needs of diverse consumers within society.

The LSB will have a Chair, who will be supported by a Chief Executive.

To command consumer confidence:

- all appointments will be made on merit
- the first Chair of the Board of the LSB will be a non-lawyer
- the majority of members of the LSB Board will be non-lawyers.

5.5 Appointments to the LSB

The Secretary of State for Constitutional Affairs will appoint the Chair of the Legal Services Board. The Secretary of State will appoint the members of the LSB, following consultation with the Chair.

Legislation will provide for the Secretary of State to appoint the Chair of the LSB. The Secretary of State will appoint the members of the LSB, following consultation with the Chair. All appointments will be in accordance with the rules of the Commissioner for Public Appointments.

5.6 A strong and effective regulator: powers of the LSB

The powers of the LSB will be set out in legislation. They will be comprehensive to enable it to be effective on behalf of consumers. But the LSB will have to use its powers in a proportionate way (as set out in Chapter 4). The LSB will also have a range of sanctions at its disposal to use if things go wrong. This will ensure that the LSB has real teeth, and also that it can act to put things right.

To provide additional consumer protection, the Government proposes that the LSB should apply for designation as an enforcer under Part 8 of the Enterprise Act 2002.¹⁵ This would provide the LSB with the power to seek “**stop now**” (or consumer enforcement) orders. In effect this means that the LSB will be able to obtain a court order to require practices or individual practitioners immediately to cease carrying out a specified activity, where that activity breaches certain legislation and harms the collective interests of consumers. This can be used in rare cases of flagrant and particularly damaging abuse.

“It is my belief that if the consumer is to see improvements in the way in which legal services are regulated and delivered, the LSB will need to have clear powers, ensuring that professional bodies regulate their members effectively.”

Zahida Manzoor CBE, Annual Report of the Legal Services Complaints Commissioner 2004/5.

¹⁵ The Enterprise Act covers a range of measures designed to enhance enterprise. It strengthens the UK’s competition framework, transforms the approach to bankruptcy and corporate rescue, and empowers consumers.

To allow for the fact that consumers' needs change, it will be possible to amend the powers of the LSB by secondary legislation, subject to Parliamentary approval.

The LSB should seek to be added to the list of organisations with 'stop now' powers under the Enterprise Act.

Legislation will provide for the powers of the LSB to be amended by secondary legislation, subject to the approval of Parliament.

Legislation will provide the LSB with the following powers to carry out regulation:

Authorisation of Front Line Regulators (FLRs)

- to authorise FLRs if it is satisfied that they will regulate in the consumer interest.

Controls over FLRs

- to require FLRs to provide it with information (subject to privacy/confidence) to carry out its duties
- to issue regulatory guidance to FLRs
- to approve fees to be raised by FLRs¹⁶
- to set requirements for indemnity insurance arrangements of FLRs and practitioners
- to set compensation fund requirements.

Sanctions over FLRs

- to set regulatory targets for FLRs and to monitor compliance
- to impose financial penalties on FLRs for failing to meet targets or achieve compliance
- to direct an FLR to take a specific regulatory action
- to strike down or amend rules of an FLR.

In most cases the LSB will want to work alongside the FLR in areas of weakness to improve them. However, where an FLR continues to fail, the LSB will be able to:

- remove the authorisation of the FLR in a particular area or areas of regulation and either identify an alternative FLR or carry out the regulatory functions itself.

Ultimately, the LSB would be able to recommend secondary legislation fully to remove the authorisation of an FLR entirely. Following consideration of any wider public interest issues, the Secretary of State would be expected to carry through the LSB's recommendation in such a case.

¹⁶ Including any fees raised under the arrangements provided for by sections 46 and 47 of the Access to Justice Act 1999.

Legislation will provide the LSB with powers in relation to the new Office for Legal Complaints, in relation to alternative business structures and to enable it to obtain advice and information.

Powers in relation to the Office for Legal Complaints

- to appoint the Chair of the OLC, subject to the approval of the Secretary of State
- to appoint the OLC Board
- to set and monitor performance targets for the OLC
- to approve the budget of the OLC
- to remove the Chair of the OLC, subject to the approval of the Secretary of State, for example in cases of poor performance, misconduct, or bringing the OLC into disrepute.
- to remove members of the OLC Board, for example in cases of poor performance or misconduct, or bringing the OLC into disrepute.

Controls over alternative business structures

- to authorise FLRs to license (or in the absence of an ABS regulator to license itself) ABS firms which meet the required standards
- to exclude a person from holding a position in an ABS firm
- to set and modify the safeguards for ABS firms (e.g. a fit and proper test, nominated Head of Legal Practice and Head of Finance and Administration).

Powers in relation to advice

- to appoint and maintain a Consumer Panel
- to request advice from the Consumer Panel
- to require any person or organisation to provide it with information in connection with its functions.

5.7 Consultation by the LSB

The LSB, like all the other bodies in the system, will operate openly and transparently so that consumers understand its decisions and can hold it to account. A key part of this is consultation, both with consumers and others with an interest.

In addition to regular discussions, the LSB will be required to consult particular organisations and individuals in certain circumstances.

Legislation will require the LSB to consult formally with its Consumer Panel, the Secretary of State for Constitutional Affairs, the Office of Fair Trading¹⁷ and the higher judiciary¹⁸ when it is considering taking the following action:

- making a recommendation to the Secretary of State to authorise new FLRs, or to remove the authorisation of existing FLRs, in whole or in part
- making a recommendation to the Secretary of State that unregulated activities should be brought under the scope of its regulatory control
- carrying out specific regulatory functions itself
- reviewing or setting the targets or funding of, or the sanctions available to, the Office for Legal Complaints
- issuing a directive to alter any of the rules of a FLR.

To aid consultation, a number of the smaller professional bodies have suggested that a professions' advisory panel should also be established. They are concerned that otherwise their interests might be marginalised. They see this as a particular problem when the LSB takes regulatory decisions that could affect their operations significantly. They propose that a non-lawyer member of the Board of the LSB chair a panel which includes one member each from those bodies subject to regulation by the LSB.

However, representative organisations will still have a role in ensuring that their members' views are heard. It will be open to the LSB to make other arrangements for consultation. This could include a professions' advisory panel, but the Government does not propose to prescribe this in legislation.

5.8 Accountability of the LSB

The LSB will be accountable to Parliament through the Secretary of State for Constitutional Affairs as sponsoring Minister. It will be required to present an annual report to the Secretary of State, who will lay it before Parliament and make it available publicly. The annual report will include the LSB's assessment of:

- the discharge of its functions
- how it has met the regulatory objectives
- its performance against standards of service delivery and
- its statement of accounts.

The LSB will also have a duty to report to the Secretary of State for Constitutional Affairs at his request on any matter concerning the discharge of its duties.

¹⁷ on whether the proposed action would have an adverse effect on competition.

¹⁸ consultation with the higher judiciary is important given the implications for the courts, particularly in respect of litigation services and advocacy. The Lord Chief Justice, Master of the Rolls, President of the Queen's Bench Division, President of the Family Division and the Chancellor of the High Court now constitute the higher judiciary.

The Government anticipates that the Constitutional Affairs Select Committee may wish to scrutinise the LSB's work by calling the Chair or other members to give evidence under existing select committee powers.

The Chief Executive of the LSB will act as the accounting officer for the LSB. This will include responsibility for the propriety and regularity of finances, for keeping proper records, and for safeguarding assets. As accounting officer, the Chief Executive will be responsible to the Permanent Head of the Department for Constitutional Affairs as accounting officer of the sponsoring Department.

Legislation will require the LSB to publish an annual report, to be laid before Parliament. The LSB will have a duty to provide a report on relevant issues to the Secretary of State for Constitutional Affairs as requested.

Legislation will provide the Secretary of State with powers to:

- bring forward secondary legislation on the advice of the LSB to widen the scope of regulation
- bring forward secondary legislation on the advice of the LSB to authorise new FLRs, or to alter or remove the existing authorisation of an FLR
- remove the Chair or members of the LSB (in the latter case, having consulted the Chair) in specific limited situations (e.g. misconduct)
- direct the LSB to take action to implement international agreements
- bring forward secondary legislation to amend the powers of the LSB
- initiate value for money scrutinies or major reviews of regulation from time to time, e.g. where there has been criticism from a Parliamentary committee
- consider and resolve any approach from the OFT where it has raised competition concerns with the LSB and is not satisfied with the LSB's response.

5.9 Relationships with other statutory regulators

The LSB and FLRs (including regulators of alternative business structures) will need to establish working relationships with regulators in other relevant sectors to ensure seamless protection for consumers. FLRs will want to decide whether they consider it appropriate to allow the provision of services that are regulated under other legislation, for example financial services or consumer credit.

In the case of financial services, there is an existing model under the Financial Services and Markets Act. This allows non-mainstream financial¹⁹ services to be regulated by the firm's existing regulator. Where a firm undertakes mainstream financial services, it requires an additional authorisation from the Financial Services Authority.

Similar arrangements will apply under the new regime and are supported in principle by the Financial Services Authority. Where an individual provides non-mainstream financial services, the delivery of those services will be regulated by the FLR concerned. Where an individual provides mainstream financial services, regulation will remain the responsibility of the Financial Services Authority.

The LSB, FLRs and other regulators will work together closely to ensure consumers are protected.

The LSB will need to make specific arrangements in relation to immigration advice. The Office of the Immigration Services Commissioner (OISC), an existing statutory regulator, will continue to regulate immigration advisers in the UK who are not members of designated professional bodies and pursue those who flout their regulatory scheme. The OISC will remain the responsibility of the Home Secretary. The LSB will take over the OISC's current responsibility, in England and Wales, to monitor the professional bodies' regulation of their members who provide immigration advice. The LSB and OISC will develop a Memorandum of Understanding to set out co-operation between the two organisations, particularly in respect of quality and standards of service for dealing with complaints.

5.10 Promoting competition in legal services

The Government considers that the LSB and OFT should have specific responsibilities in relation to the competition objective. The LSB will be required formally to consult the OFT when authorising new FLRs, or adding to or removing from the list of reserved legal services (see Chapter 7 and Appendix B). Additionally, the OFT will have an ongoing duty to consider regulating provisions (e.g. rules, guidance) once FLRs have been authorised. It will be open to the OFT to report to the LSB directly on any other competition issues, as it sees fit.

The LSB will be required to respond directly to the OFT, after consultation with the FLRs and its Consumer Panel on any reports the OFT makes. Any response from the LSB will need to balance competition issues with the LSB's other regulatory functions and objectives.

¹⁹ The Financial Services and Markets Act 2000 (FSMA) requires firms that carry on 'mainstream' financial activity to be regulated directly by the Financial Services Authority. Mainstream financial activity will include direct advice to clients on the choice of investment products, discretionary investment management and certain types of corporate finance activities such as listings and public offers. Section 327 of FSMA provides for certain other financial activity (connected to a professional service) to be supervised and regulated by a designated professional body (DPB) rather than the FSA.

Where the LSB concludes that there are competition issues to be addressed, appropriate action will be taken. However, where the OFT is dissatisfied with the LSB's response, the matter will be referred to the Secretary of State for resolution. The Secretary of State will seek the views of the Competition Commission.

The LSB and OFT will require the power to request information relevant to any competition investigation, and this power will be enforceable under contempt of court provisions.

Legislation will provide for the OFT to:

- have an ongoing duty to scrutinise regulating provisions of all authorised FLRs, and
- to report to the LSB on competition issues relating to professional rules prior to authorisation of any new FLR.

The LSB will be under a statutory obligation to respond to any OFT report published, and to take appropriate action.

Legislation will give the Secretary of State the power to resolve issues, following the taking of advice from the Competition Commission, in the event of a disagreement between the OFT and the LSB.

Chapter 6: Confidence and choice – new ways of delivering for consumers

6.1. The new arrangements

Chapter 3 set out what the Government aims to achieve for consumers by liberalising the way in which legal services can be delivered. It described the benefits for consumers of **alternative business structures (ABS)** and the safeguards that will be put in place.²⁰ This chapter deals in more detail with the regulation of alternative business structures. It sets out how the safeguards will work in practice.

The objectives and principles of the regulatory framework apply here too and regulation will be proportionate and risk based.

“It’s an opportunity to create a dynamic legal market which offers a better deal for consumers, and also better opportunities for the legal profession.”

Edward Nally, Law Society, speaking at DCA Conference ‘Future of Legal Services – Putting Consumers First’ conference 21 March 2005.

The key features of the new system are that:

- safeguards for consumers will ensure high standards of quality, propriety, and independence in the delivery of all services
- prospective ABS firms will have to be licensed by an authorised ABS regulator (or by the LSB itself in the absence of an ABS regulator)
- different types of lawyers (e.g. solicitors and barristers), and lawyers and non-lawyers, will be able to work together on a equal footing in ABS firms
- ABS firms will be able to tap into external investment
- existing Front Line Regulators will be able to apply to the LSB for permission to regulate ABS firms
- if things do go wrong, consumers will be able to complain in the usual way: first through the firm’s in-house complaints arrangements, and if necessary to the new Office for Legal Complaints.

Consumer bodies are in favour of greater flexibility, combined with protection for consumers. The Law Society is keen to relax its restrictions on partnerships with non-lawyers and external investment, and has pressed for the changes necessary to ensure consumer protection to enable them to do so. Potential investors in law firms are also seeking change.

²⁰ The term ‘alternative business structure’ or ‘ABS firm’ refers to any structure that could potentially deliver a reserved legal service, other than the structures currently used to do so in private practice. Possible examples include: multi-disciplinary partnerships, limited liability partnerships, unlimited liability incorporated practices, private limited companies, public limited companies and mutual societies.

Different consumers and providers will look for different benefits from alternative business structures. The potential benefits are set out below in more detail.

Potential benefits for consumers:²¹

- **more choice:** consumers will have greater flexibility in deciding from where to obtain legal and some non-legal services.
- **reduced prices:** consumers should be able to purchase some legal services more cheaply. This should arise where ABS firms realise savings through economies of scale and reduce transaction costs where different types of legal professionals are part of the same firm.²²
- **better access to justice:** ABS firms might find it easier to provide services in rural areas or to less mobile consumers.
- **improved consumer service:** consumers may benefit from a better service where ABS firms are able to access external finance and specialist non-legal expertise.²³
- **greater convenience:** ABS firms can provide one-stop-shopping for related services, for example car insurance and legal services for accident claims.
- **increased consumer confidence:** higher consumer protection levels and an increase in the quality of legal services could flow from ABS firms which have a good reputation in providing non-legal services. These firms will have a strong incentive to keep that reputation when providing legal services.^{24 25}

Potential benefits for legal service providers:

- **increased access to finance:** at present, providers can face constraints on the amount of equity, mainly debt equity, they can raise. Allowing alternative business structures will facilitate expansion by firms (including into international markets) and investment in large-scale capital projects that increase efficiency.²⁶

²¹ Many of the consumer benefits we would expect to see result from increases in market efficiency. Brealey and Franks, 2005, and Dow and Lapuerta, 2005, show, the current restrictions impinge on efficiency, and correspondingly the relaxing of those restrictions would be expected to lead to an increase in market efficiency.

²² Love, and Patterson, 1994, have noted that a combination of technology, regulatory change and the removal of the ban on advertising has resulted in reductions in the prices of conveyancing services.

²³ Dow and Lapuerta, 2005, have argued that permitting external financing of law firms would be key to the introduction of more information technology to reduce the costs of personal legal services that involve relatively small but numerous transactions of a similar nature, and that under the current rules similar transformation would be unlikely to take place. Washington State Bar Association, 2001, discusses the example of a US law firm that created a technology department to manage its clients' multi-district mass tort litigation, and to assist creditors and collection agencies cut the cost of recovering on bankruptcy claims.

²⁴ Blanes i Vidal, Jewitt and Leaver, 2005.

²⁵ Grout, 2005, using data provided by The Law Society, shows that claims of "dishonest practice" are disproportionately generated by smaller law firms measured by number of partners. If size of law firms is related to good consumer outcomes, at least on one measure, then facilitating mechanisms that would make it easier for firms to expand, and thus benefit from scale economies and greater division of labour, could deliver significant consumer benefits.

²⁶ Dow and Lapuerta, 2005.

- **better spread of risk:** a firm could spread its risk more effectively among shareholders.²⁷ This will lower the required rate of return on any investment, facilitate investment and could deliver lower prices.
- **increased flexibility:** non-legal firms such as insurance companies, banks and estate agents will have the freedom to realise synergies with legal firms by forming ABS firms and offering integrated legal and associated services.²⁸
- **easier to hire and retain high-quality non-legal staff:** ABS firms will be able to reward non-legal staff in the same way as lawyers.
- **more choice for new legal professionals:** ABS firms could contribute to greater diversity by offering those who are currently under-represented more opportunities to enter and remain within the profession.²⁹

There will be a robust licensing regime under which Front Line Regulators (FLRs), which have been approved to do so by the Legal Services Board (LSB), will license ABS firms. In these firms, it will be possible for non-lawyers and lawyers to be partners or directors. External investment in alternative business structures will be permitted and will benefit consumers and providers.

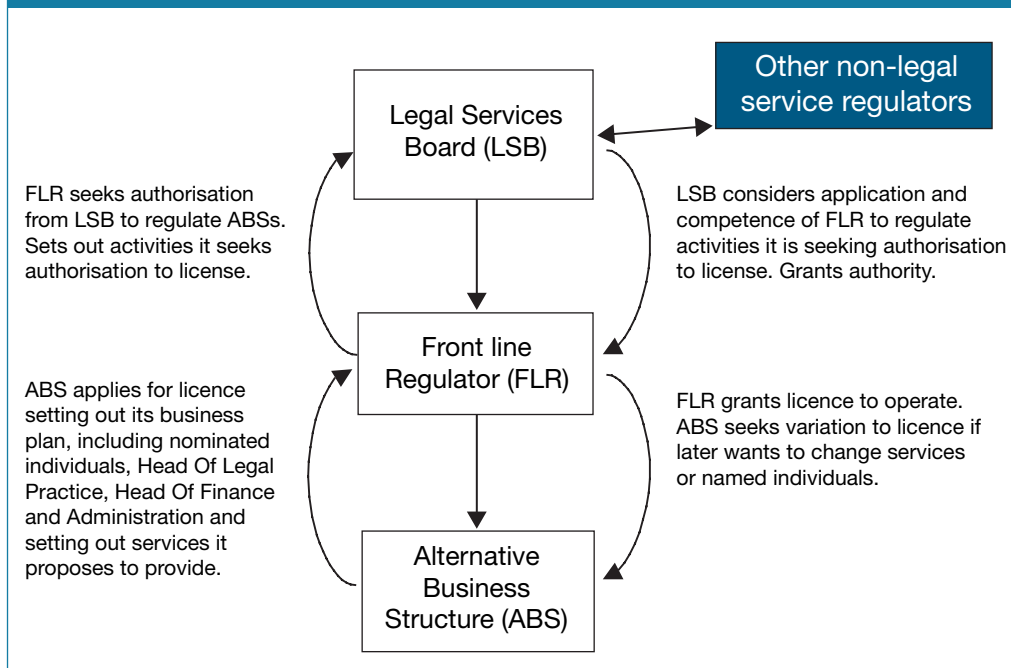
The LSB and the ABS regulators will exercise their judgement in awarding licences to firms. They will need to consider the business proposals and the risks and the safeguards in place to protect consumers.

²⁷ Brealey and Franks, 2005.

²⁸ Brealey and Franks, 2005, have argued that the strong competitive position of English law firms is likely to be maintained only if the legal profession is adaptable.

²⁹ Blanes i Vidal, Jewitt and Leaver, 2005, show that in the Bar as a whole, women are under-represented, and that once in the Bar, women are more likely to practice from the employed Bar. Amongst solicitors, again women are under-represented in the profession as a whole, and of those that do enter, women are more likely to be in employment rather than acting as a partner or a sole practitioner than men.

Figure 3: How the new arrangements will work



Legislation will provide for a flexible and robust licensing scheme for alternative business structures. This will allow lawyers and non-lawyers to work together to provide legal and certain associated services. External investment will be permitted.

6.2 Regulators of Alternative Business Structures

The LSB will need to be satisfied about a Front Line Regulator’s competence and standing before authorising it to license ABS firms (and also if the regulator later applies to extend its licence).

The Government expects that the Legal Services Board will want to be satisfied that a Front Line Regulator that wants to be authorised as a regulator of an ABS firm:

- is already authorised by the LSB to regulate one or more reserved legal services
- has the competence to regulate an ABS firm
- has proper governance arrangements
- has proper rules to regulate an ABS firm. These might include procedures for handling clients' money and dealing with complaints
- has rules that do not restrict different kinds of lawyers (e.g. solicitors and barristers), and lawyers and non-lawyers, working together on an equal footing
- has rules that are consistent with the LSB's decision on external investment
- has the ability to take enforcement action
- has arrangements for ensuring appropriate indemnity insurance
- has compensation fund arrangements as a last resort for consumers.

Front Line Regulators that want also to regulate ABS firms may need to have their existing powers extended to enable them to provide effective regulatory control. Additional powers will be granted by the LSB as part of its authorisation of an FLR to act as a regulator of alternative business structures. Additional powers will include the power to:

- direct an ABS firm to alter its management or ownership arrangements
- fine the ABS firm
- alter a licence
- remove a licence if the firm subsequently fails.

As with existing law firms, all of the services provided by ABS firms will be subject to regulatory control by the ABS regulator whether they are reserved legal services or not.

Legislation will provide for the modification of Front Line Regulators' powers by secondary legislation proposed by the Secretary of State for Constitutional Affairs, following a proposal from the LSB.

6.3 Licensing alternative business structures

Potential ABS firms will need to seek a licence to operate from an FLR that has been authorised by the LSB to regulate ABSs. If no FLR has been authorised by the LSB, the LSB will be able to license ABS firms directly.

The LSB will decide what information it expects applications from prospective ABS firms to contain. The Government considers that applications from firms should include the following information:

- details of their proposed management structure, including a nominated Head of Legal Practice and a nominated Head of Finance and Administration
- information on the proposed ownership structure, including type of ownership entity and, where appropriate, details of the owners
- details of the equity (i.e. shareholdings of the investors) to be invested
- information on all the services that they propose to provide: these must include one or more reserved legal service.³⁰

Firms will be able to apply to **any** Front Line Regulator authorised to grant the relevant licence. This will provide an element of competition between regulators. LSB oversight will ensure appropriate standards of protection are provided by all Front Line Regulators.

“Changes in delivery of legal services will produce an improved market where legal professionals compete on a level playing field and where consumers are properly addressed. But such developments must not be at the expense of standards and safeguards.”

Guy Mansfield, Bar Council, speaking at “Future of Legal Services – Putting Consumers First” conference 21 March 2005.

6.4 Safeguards: the Head of Legal Practice and Head of Finance and Administration

Front Line Regulators will assess the proposed management structure of ABS firms to ensure they meet the standards required by the LSB.

Legislation will require that the Front Line Regulators of ABSs ensure that firms identify a Head of Legal Practice and a Head of Finance and Administration.

The Head of Legal Practice (HOLP) will be a lawyer responsible for ensuring that the ABS firm adheres to the rules of the FLR; that services are provided only by those properly qualified; and that the ABS firm operates within the terms of its licence. The HOLP will also be required to report to the regulator any violation or attempted violation of rules.

The HOLP will have to demonstrate appropriate competence to perform the role. It will not be possible for the firm to remove the HOLP without the consent of the regulator.

The Head of Finance and Administration (HOFA) will be responsible for maintaining appropriate accounts, ensuring that the required administrative systems are in place and ensuring separation and management of client funds.

This role will not necessarily have to be conducted by a lawyer. The HOFA will need to demonstrate to the regulator appropriate competence.

³⁰ see Appendix B.

Provided the ABS regulator is content, the HOLP and HOFA should not automatically be prevented from having other roles in the practice. In smaller firms the same person, subject to the approval of the regulator, could hold the two roles.

6.5 Safeguards: lawyers in the majority?

In addition to the HOLP and HOFA, the regulator will need to consider the wider arrangements for control of the ABS firm. It will take a decision on a case-by-case basis on whether lawyers should be in the majority.

Consumers can benefit from the provision of legal services where non-lawyers are permitted to have positions of control³¹ in ABS firms (i.e. partner or director). ABS firms will provide greater opportunities for high calibre non-legal professionals, leading to new ideas and skills being brought into the legal sector. Non-lawyers will also bring other specialist skills such as IT, HR and finance expertise to enhance the operation of ABS firms. These developments will create wider opportunities for better quality and cheaper services for consumers.

Some argue that lawyers should be in the majority to prevent non-lawyers from bringing too much commercial influence. But this would unduly restrict the potential for development of ABS firms.

It has also been suggested that lawyers should be in the majority at the start, and that this restriction could be removed at a later date if it became unnecessary. But this would still restrict the potential for development of alternative business structures. This would not be in consumers' interests.

There will be no requirement for an overall majority of lawyers in all ABS firms. The LSB will decide whether the services provided by some ABS firms require a certain level of lawyer control.

6.6 Safeguards: preventing investment by undesirable individuals

Allowing external investment in legal practices will give consumers greater flexibility when purchasing legal services. ABS firms will have access to low cost capital that could be used for upgrading infrastructure, and expanding the business, potentially resulting in more choice and better service for their customers. Investment from other sectors such as retailing or banking could bring increased customer service and information technology skills.

³¹ In this context control is meant as in the Companies Act 1985, i.e. it is the directors who control the direction of a company, not necessarily its owners/shareholders. Under the partnership model however, the owners are also a firm's directors.

However, consumers must be confident that investors in ABS firms are suitable. Authorised ABS regulators will therefore apply a robust fit and proper test to external investors in ABS firms.

The focus of an ABS regulator will be on the prospect for conflict of interest and investor influence over the firm's management. An assessment will be triggered if the sum to be invested is above particular thresholds.

So that regulation of external investment is proportionate and risk based, ABS regulators might want periodically to review share movements in particular listed companies. But generally they would not want to screen smaller investors and/or those transactions likely to have a negligible effect on a firm's management.

External investment in ABS firms will be permitted, and will be based on a fitness to own test, covering:

- honesty, integrity and reputation
- competence and capability, and
- financial soundness.

6.7 Safeguards: the amount of external investment allowed

Stakeholders have different views on whether a limit should be placed on external investment. The Government's view is that a flexible, risk-based approach is necessary. It is not clear that a particular level of external investment would offer more or less consumer protection than any other.

This is also necessary to take account of differences in firms. Partnerships, typically firms of solicitors, can find it difficult to raise equity for expansion, diversification, or for large-scale investment in information technology.³² Limiting external investment could prevent the development of new ways to deliver legal services. If we adopted a one-size fits all approach, we would risk reducing competition and not realising some potential consumer benefits.

"We think that with suitable regulatory oversight by the Legal Services Board, concerns about external investors can be overcome."

Diane Burleigh, Secretary General, Institute of Legal Executives, speaking at 'Future of Legal Services – Putting Consumers First' conference, 21 March 2005.

The LSB will determine the extent of external investment in ABS firms according to the type of business and acting in line with its regulatory objectives.

³² Brealey and Franks, 2005, and Dow and Lapuerta, 2005.

6.8 Safeguards: sanctions

If things go wrong, consumers must be confident that regulators of ABS firms have powers to act. Consumers will be able to complain to the new Office for Legal Complaints (OLC) just as they will be able to for other legal services. The OLC will investigate all complaints and refer any issues of misconduct to the FLR concerned, monitoring the decisions. This is set out in more detail in Chapter 8.

Legislation will provide for consumers to complain to the new Office for Legal Complaints.

ABS regulators will pass cases of misconduct to the relevant disciplinary body.

In addition:

ABS regulators will be able to require the removal of a director or partner in an ABS firm and to prohibit them from holding any position of control in an ABS firm, either for a fixed period, or indefinitely.

ABS regulators will be able to alter or remove an ABS firm's licence to offer services.

6.9 Safeguards: dealing with conflicts of interest

Conflicts of interest can arise within law firms even with the current restrictions on business structure. Law firms have to put in place arrangements to deal with potential and actual conflicts. The LSB and Front Line Regulators will put in place rules so that consumers using ABS firms have appropriate assurances.

The potential leverage that owners may have on an ABS firm will depend on the size of their stake in it. If a bank owns, or is a major investor in, an ABS firm, there is likely to be a higher risk in allowing the firm to act for a client where the bank has an interest. An example might be advising a client on loan documentation to which the bank was a party.³³

It may be possible for the LSB to determine a percentage level of ownership where a conflict of interest is not significant. For example, there are many publicly listed companies with a large number of different investors, each with a small stake, who have very little effect upon the company. The LSB could consider applying a specific percentage of ownership as a limit beyond which it considers a conflict of interest is likely to become a concern. This could be determined on a case-by-case basis or be a universal level.

³³ Brealey and Franks, 2005, and Blanes i Vidal, Jewitt and Leaver, 2005.

The LSB will provide clear rules relating to the prevention of conflicts of interest in respect of services provided by ABS firms.

6.10 Safeguards: ensuring that inappropriate services cannot be provided

Once the Front Line Regulator of an alternative business structure has satisfied itself that the business plan of the prospective ABS firm is acceptable, it will need to ensure that the combination of services proposed are not incompatible with or inappropriate for the delivery of legal services.

Decisions of the Solicitors Disciplinary Tribunal inform the Law Society in determining which services it is inappropriate for a law firm to provide. The LSB will need to ensure that ABS regulators develop systems to ensure that they do not allow inappropriate services to be delivered by an ABS firm which they licence.

ABS regulators must not permit ABS firms to provide any service likely to be incompatible with the principles of the legal profession.

6.11 Safeguards: ensuring access to justice

Outside ownership may enable large firms to realise efficiency gains that smaller firms cannot compete with. This could run the risk of reducing consumer choice. In particular, some argue that this could have implications for access to justice in rural areas. Others argue that it could increase rural access as large firms could utilise a range of new business services to satisfy their customers' needs (such as in telephone and internet services). New business techniques could result in lower prices that would also increase access to justice.

The Government recognises the potential risk of diminished access. The LSB and ABS regulators will have a duty to consider the impact of their decisions on their statutory objectives (see Chapter 4), and in particular the objective of improving access to justice.

Legislation will require the LSB to monitor the provision of legal services across different sectors and geographically, and use the results of that work to inform its regulatory decisions. This will include the authorisation of, and imposition of any conditions upon, ABS regulators.

6.12 Flexibility in ownership structures

Providers need to have flexibility to respond to different consumers' needs, and new demands from consumers. Permitting different ownership structures for ABS firms will help to achieve these. These could include limited liability partnerships, unlimited liability incorporated practices, private limited companies, public limited companies, and mutual societies.

Allowing flexibility in the forms of ownership structure could result in increased benefits to consumers. These could include increased transparency and consistency as required by the Companies Act 1985, easier access to capital (especially for a public limited company that can issue shares), greater scrutiny of the legal services market and individual firms by investors, and – for public listed companies – further control coming from the rules of their chosen stock exchanges and the FSA.

In practice, those providing legal services may find some structures more efficient for providing some legal services than others.³⁴ The LSB may also decide that some business structures are inappropriate for the delivery of some legal services.³⁵

The Government does not want unduly to restrict the ownership structures available to alternative business structures.

The FLR will be able to exercise discretion in deciding whether to issue a licence in all the circumstances, including the type of ownership model.

6.13 Legal Professional Privilege

Consumers will not distinguish between the professional backgrounds of individuals in ABS firms: they simply want the right service. But they need to be clear about how the information they give will be treated within the firm.

³⁴ Brealey and Franks, 2005, and Dow and Lapuerta, 2005, argue that there is no reason to believe that different structures might not co-exist within the same market with, for example, both partnerships and plc structures co-existing in the legal services market, with plc status more attractive the more commoditised the legal services being delivered are, and the more easily observable quality is. Partnerships become more attractive the more specialised the services being delivered.

³⁵ Dow and Lapuerta, 2005, argue that specific ownership structures should only be prohibited if they can reasonably be anticipated to persist in the market over time while simultaneously delivering services at a quality below an accepted level.

Within an ABS firm lawyers and non-lawyers will be able to work together to provide a variety of services to the same consumers. So lawyers working under legal professional privilege (LPP) constraints could work with those who have a professional duty to disclose information.³⁶

At this stage the Government does not propose to extend LPP to include communications between a particular client and non-lawyer members of ABS firms. Current arrangements regarding LPP should remain.

Where an ABS firm includes non-lawyers, the LSB will need to ensure that ABS regulators and the firms concerned have appropriate arrangements in place to ensure that the consumer's interest in respect of their right to legal professional privilege is maintained and safeguarded.

LPP should not be used inappropriately to obstruct investigations.

6.14 The Not for Profit sector

The Not for Profit (NFP) sector will be brought within the regulatory scope of the LSB and the ABS licensing scheme. This will ensure the same level of protection for consumers no matter where they obtain their legal services. The LSB will keep the level of services in this sector under review, with particular regard to access to justice.

The NFP sector has different priorities and fewer resources than the private sector. The LSB and Front Line Regulators may exercise flexibility in applying the usual ABS licensing arrangements to this sector, if that would be in the public interest. This will help to maintain and enhance access to justice, while ensuring that high standards of service are delivered. These options could include:

- **group licensing:** instead of issuing a licence to each business unit, a national organisation (such as Citizens Advice) could be licensed. The licence would be granted to the umbrella organisation, which would then be responsible for ensuring that individual business units complied with it. Citizens Advice currently operates under an arrangement of this kind in relation to the licensing of their debt advice by the Office of Fair Trading.

³⁶ LPP is essentially an element of common law, but statutory provisions and court decisions shape its scope and interpretation. Against this background LPP is an absolute privilege against disclosure of a document to a third party. It encompasses two distinct privileges: litigation privilege and legal advice privilege. Litigation privilege is restricted to proceedings or anticipated proceedings in a court of law. Legal advice privilege covers assistance and advice in relation to public law rights, liabilities and private law rights. Legal advice privilege is not confined to telling the client the law and includes advice as to what should prudently and sensibly be done in the relevant legal context. Where LPP exists and is not waived by the client, it is paramount and absolute and not subject to the balancing exercise of weighing competing public interests against each other.

- **waiving the licence on competency grounds:** where the criteria demonstrated by quality assurance schemes, such as the Legal Service Commission's Quality Mark, overlap with those sought by regulators, it will be possible to waive the requirement to re-submit information. The Immigration Services Commissioner uses a similar approach when authorising LSC-accredited organisations to provide immigration advice.
- **waiving the licence to increase access to justice:** regulators will be able to waive the normal requirement for a licence where this would impose such a burden on an organisation that it would not be able to provide services. This might be the case, for example, with a very small organisation. Or it might arise in the case of a charity for which legal services are ancillary to their main business and rarely called for.

The Not for Profit sector will fall within the regulatory scope of the LSB and the ABS licensing scheme. The LSB and Front Line Regulators will have the power to waive or alter ABS licensing requirements in specific cases where it is in the public interest.

Chapter 7: Protecting consumers if new problems occur

Chapter 3 set out what the Government is trying to achieve in protecting consumers if new problems occur. This chapter deals in more detail with the way in which the arrangements will work in practice.

7.1 The current position

We need to ensure that protection for consumers can be put in place quickly and easily where that becomes necessary. The current system does not easily allow for this. This chapter sets out when and how this will happen in future. The Government is already acting to close the gap on claims management.

The delivery of legal services is subject to different levels of control. This was set out in Chapter 1. Certain services³⁷ are **reserved** – subject to statutory controls. This means that only authorised individuals can provide them. People who provide these services are also subject to regulation by their professional or regulatory bodies under statutory provisions (see Appendix B).

Legal professional bodies may still regulate services that are outside the regulatory net, because they regulate all services provided by their members.

The problem at present is that any person can provide unreserved services without any form of regulation (other than the general law) and this is where most damage occurs. A recent example is the difficulties that consumers have experienced as a result of unregulated **claims managers**. The Government is seeking to address this through primary legislation in the Compensation Bill.

So at present there may be gaps in regulation. This means that consumers are not protected. Furthermore, it is difficult to put safeguards in place quickly when new problems arise. The current system is not flexible enough.

7.2 The role of the Legal Services Board

The Legal Services Board (LSB) will monitor the legal services sector to ensure that regulatory gaps are anticipated and tackled before consumers are put at risk.

The LSB will have a statutory duty to determine whether a legal service should be regulated.

“It is now up to the legal industry to show they can work constructively with a new regulatory regime and put consumers’ interests first. We urge the Government to ensure that the new regime covers the whole of the legal industry, especially claims farmers, insurers, assessors and other firms giving consumers direct legal advice.”

Teresa Perchard, Director of Policy, Citizens Advice, speaking at ‘Future of Legal Services – Putting Consumers First’ conference 21 March 2005.

³⁷ See Appendix B.

The LSB will work closely with its **Consumer Panel** to ensure that it receives early warning about consumer concerns and can take proportionate steps to protect consumers when necessary.

The precise factors which the LSB will need to take into account will be a matter for it to develop. **The Government considers that these should include:**

- the advice of the Consumer Panel
- information acquired in the course of the LSB's own work
- evidence from enquiries and complaints to the LSB or OLC
- the views of other interested parties, such as businesses, academics, trade associations or consumer groups
- the views of Government departments, trading standards departments, and other regulators, including the Office of Fair Trading.

Furthermore, to ensure that consumers have maximum protection, the LSB will be required to act if particular groups report concerns.

Legislation will require the LSB to investigate aspects of the market if requested to do so by its Consumer Panel, the Office of Fair Trading, or the Secretary of State for Constitutional Affairs.

7.3 The impact on consumers

The LSB will decide how it will investigate the functioning of the market for a particular service. A crucial factor for it will be whether intervention is necessary to improve the service to consumers. If so, the LSB will also want to consider what sort of intervention will be most effective. The LSB will want to seek the views of its Consumer Panel on this.

The LSB might also wish to consider:

- the size and nature of the market for that service
- whether there are any significant identifiable potential market or other public interest failure(s) and their extent.

7.4 Closing the gap: statutory regulation

The LSB will make an assessment of the risks involved in leaving an activity unchecked, judged against its statutory objectives (Chapter 4), including the implications for consumers, for competition and access to justice.

If the LSB proposes to bring an activity under its regulatory control, it will be expected to consult widely, including with the sector. Following that, the LSB will consult formally its Consumer Panel, the Secretary of State for Constitutional Affairs, the Office of Fair Trading and the higher judiciary about its conclusions and proposals.

Following consultation, the LSB will have the power to make a report to the Secretary of State for Constitutional Affairs recommending that the activity is brought under its regulatory control.

The change will be made through secondary legislation, subject to Parliamentary approval.

Legislation will give the LSB the power to:

- investigate the prospect of market intervention
- make a report to the Secretary of State
- propose that additional activities are brought under its regulatory control by means of secondary legislation.

Legislation will require the LSB to consult in advance its Consumer Panel, the Secretary of State for Constitutional Affairs, the Office of Fair Trading and the higher judiciary.

The LSB will have the power to:

- authorise appropriate regulator(s) for any newly reserved activity, or, as a last resort, regulate the activity directly itself
- make a charge to the sector for any costs involved in new regulation.

Legislation will enable new areas to be brought within the regulatory net by secondary legislation, subject to the approval of Parliament.

7.5 Closing the gap: non-statutory options

The LSB should have the flexibility to determine the best form of safeguards for consumers where new gaps in regulation arise. So it will be able to put in place other forms of regulation if that would be of greater benefit to consumers. This might follow an investigation by the LSB, or as a result of concerns it receives, including from its Consumer Panel. The options might include:

- trade bodies working on a voluntary basis with the LSB to raise their standards

- the LSB approving a trade body under a non-statutory voluntary regime and
- the LSB encouraging bodies to seek, via the OFT Consumer Codes Approval Scheme, approval of their codes of practice.

This multi-stage approach is consistent with the recommendations of the Hampton review.³⁸

7.6 Options for de-regulation

The LSB will also be able to remove activities from its regulatory control if it believes that this would be in the best interests of the consumer.

The LSB will make an assessment of how well a market is likely to function if an activity were to be taken out of its regulatory control. The LSB will be expected to consider the benefits of de-regulation and whether or not the benefits directly impact on the consumer, the potential risks involved and the costs.

If the LSB proposes to remove an activity from its regulatory control it will be expected to consult in the same way as if it were going to regulate a service, as set out in paragraph 7.4.

Following consultation, it will be open to the LSB to make a report to the Secretary of State for Constitutional Affairs recommending that the activity be removed from its regulatory control.

Because of the significance of this, the deregulation of reserved activities set out in primary legislation will only be possible through Regulatory Reform Order or primary legislation. This will ensure that consumers are fully protected.

Legislation will enable the LSB to:

- **investigate, including taking advice from the Office of Fair Trading, the prospect of removing a service from its statutory oversight**
- **make a recommendation to the Secretary of State to propose that a service should be removed from the statutory oversight of the LSB. This would be given effect by Regulatory Reform Order or primary legislation, subject to the approval of Parliament.**

7.7 Defining the LSB's remit

Legislation will need to define the LSB's remit, and to set the boundaries of possible further extensions in the future.

Legislation will provide for those legal services that currently may only be provided by certain qualified members of the legal profession to form the core activities over which the LSB will have regulatory control.

³⁸ Hampton, 2005.

As set out in Chapter 1, these are³⁹:

- the right to conduct litigation
- a right of audience in the courts
- the provision of immigration services
- certain probate services
- conveyancing
- notarial services
- acting as a commissioner for oaths

Subject to Parliamentary approval of the Compensation Bill, claims management services will be added to this list. In order to reach decisions on bringing activities in and out of its scope, the LSB will need clarity on a **definition of legal services**. This is set out in Appendix C.

Legislation will provide that where the LSB proposes to the Secretary of State that additional activities should be brought within or out of its regulatory control, those activities must fall within the definition of legal services.

³⁹ See Appendix B.

Chapter 8: Complaints – what happens if things go wrong?

Chapter 3 set out what the Government aims to achieve to ensure that consumers receive appropriate redress if things go wrong. This chapter deals in more detail with the way in which the arrangements will work in practice.

8.1 The current system

Under the current arrangements, each of the legal professional bodies maintains its own complaints and discipline system. If consumers are not happy with the way a professional body has handled their complaint, they can take the matter to the Legal Services Ombudsman for England and Wales free of charge.

The majority of complaints are about the standard of service that consumers have received. There are far fewer concerns about how the professional bodies discipline their members when they break their rules.

Mrs B complained about what she felt were unreasonable charges made following an “informal discussion” with a solicitor about her and her husband’s joint will. “I first wrote to the solicitor and then appealed to the Law Society – who had recommended the solicitor in the first place. I felt they were definitely protecting the solicitor. They said the Small Claims Court was the only solution. I felt uneasy challenging a solicitor in court, so I declined and paid. The Law Society even told me that the fee was a ‘small amount’!”

Received by Which? Consumer Survey, February 2004

Mr E complained to the OSS (now the Law Society’s Consumer Complaints Service) after his own solicitor told him that if she looked into his complaint “it would add to the cost of the work”. Following Mr E’s complaint to the OSS an agreement was finally reached, but he felt there were a number of ways in which his solicitor did not comply. He tried to complain again about these subsequent mistakes but was told by the OSS that it would be “inequitable to reopen the file to look at matters that formed part and parcel of the conciliated agreement”. Mr E doesn’t feel he’s been well treated by the system, particularly since he’s had to end up doing most of the work himself.

Received by Which? Consumer Survey, February 2004

8.2 The new system

The new system will be easier for consumers to understand and use.

“We all welcome the proposals on complaints handling via a single gateway.”

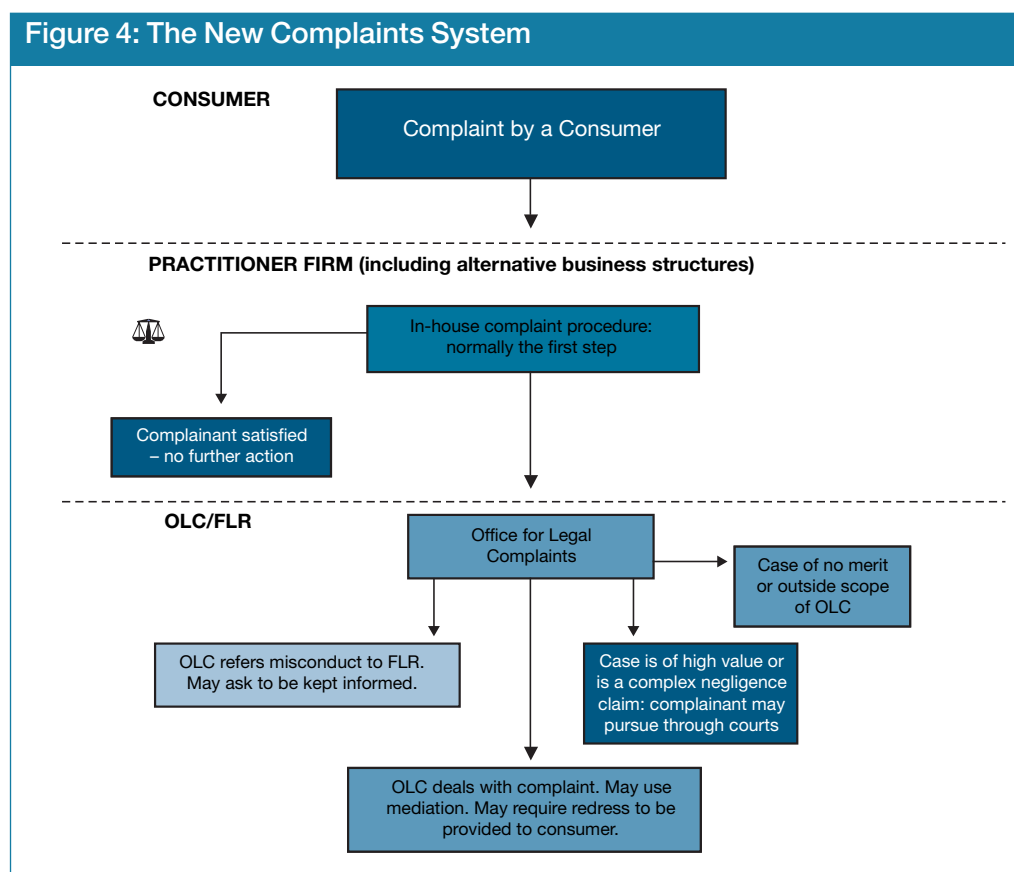
Diane Burleigh, Secretary General, Institute of Legal Executives, speaking at “Future of Legal Services – Putting Consumers First” conference, 21 March 2005

Legislation will establish the new Office for Legal Complaints with clearly defined powers. It will deal with all consumer complaints about legal service providers who are members of bodies or organisations regulated by the LSB.

The OLC will be independent from Government and providers of legal services. It will be accountable to the LSB and will be funded by the sector.

The OLC will investigate all complaints and refer any issues of misconduct to the FLR concerned, monitoring the decisions. The LSB will oversee their disciplinary arrangements.

Figure 4 shows how the new system will work.



8.3 How will the OLC work?

The OLC will be governed by a Board in order to bring together a wide range of expertise and backgrounds. The Board will be chaired by a non-lawyer and the majority of its members will also be non-lawyers.

The OLC Board will set policy and rules in relation to complaints handling, ensuring that best practice is promoted and that high standards are maintained. There will be between 7 and 9 members, reflecting the narrower remit compared with the LSB. It will be possible for this to be varied by secondary legislation, subject to Parliamentary approval.

The OLC, like other similar bodies, will be expected to comply with the Independent Commission's Good Governance Standard for Public Services,⁴⁰ and with the criteria laid out for complaints handling bodies by the British and Irish Ombudsman Association.⁴¹

Legislation will set the size of the OLC Board at 7 to 9 members. It will be possible to change this by secondary legislation, subject to the approval of Parliament.

To meet the needs of different consumers, the members of the OLC will between them have experience of:

- consumer affairs
- the provision of legal services
- complaints handling
- the wider advice sector
- civil or criminal proceedings and the working of the courts
- legal education and training
- the maintenance of the professional standards of persons who provide legal services
- the needs of diverse consumers within society.

⁴⁰ The Independent Commission for Good Governance in Public Services, 2005.

⁴¹ These criteria are available at www.bioa.gov.uk/BIOA-New/criteria.htm

The OLC Board will appoint arbiters who will make decisions on individual complaints. To command consumer confidence, legislation will provide that:

- all appointments to the Board of the OLC will be made by the LSB on merit, in accordance with the rules of the Commissioner for Public Appointments
- the Chair will be a non-lawyer and will be appointed by the LSB with the approval of the Secretary of State for Constitutional Affairs
- the Board of the OLC will consist of a majority of non-lawyers
- the LSB will be able to remove the Chair of the OLC with the agreement of the Secretary of State in cases of poor performance or conduct, or of bringing the OLC into disrepute
- the LSB will be able to remove members of the Board in the same circumstances.

The OLC will be fully independent in the handling of individual complaints. The OLC will be accountable to the LSB in respect of its targets and funding.

8.4 A strong and effective OLC: powers

Legislation will provide the OLC with the following powers, which will apply to those regulated by the LSB (including ABS firms):

- **The power to require evidence:** in order to determine a case fairly, the OLC will need the power to require individuals to provide it with relevant information and documents. The OLC will also have powers in relation to the attendance and examination of witnesses.
- **The power to dismiss cases:** the OLC will normally have to ensure that all cases are investigated. But in certain circumstances it will be able to decline to deal with complaints where there is a good reason. This will include situations where the OLC believes that a complaint is frivolous or vexatious, or if legal proceedings have been brought concerning the subject matter of the complaint. The OLC will also be able to refuse to consider a complaint if the complainant has not first exhausted the practitioner's in-house complaints procedures. These are powers available to the Financial Ombudsman Service. The OLC will also be able to dismiss cases at different points during the handling process.
- **The power to enforce decisions:** if the OLC considers that redress should be made to a consumer, it needs the power to ensure that this happens. The

OLC will be required to set out the criteria by which it will ensure that such orders are fair and proportionate, and will publish its guidelines. These guidelines will require the endorsement of the LSB.

The options available to the OLC will include the power:

- to require the provider to make an apology to a complainant
 - to require the provider to re-do the work, or otherwise remedy the faults in the service provided to the complainant
 - to require the provider to waive some or all of the fee
 - to require the provider to take other steps in relation to the complainant as the OLC considers just
 - to order a payment for poor service, loss or distress. Such an award will be enforceable as a debt.
- **The power to make decisions in all the circumstances of a complaint:** each of the legal professional bodies currently makes an assessment to decide whether a complaint involves elements of inadequate professional service, professional misconduct or negligence. There are different processes for treating the complaint depending on this assessment. Consumers do not make these distinctions: they simply want redress for what they consider has gone wrong. For this reason, the OLC will take decisions considering all factors it deems appropriate. This is separate to any disciplinary action that the FLR may take.⁴²

Consumers will be able to complain to the OLC about providers working in alternative business structures in the same way as traditional law practices. The OLC will be able to require the ABS firm to award redress.

In cases where another statutory regulator regulates the service, the OLC will consider whether the issues relate to overall service and may also refer the consumer to the statutory regulator concerned (or its redress body).

To ensure that the OLC's powers remain adequate, it will be possible to amend them by secondary legislation, subject to the approval of Parliament.

In addition, the OLC will inform the FLR if it finds problems with a firm's **in-house arrangements** for dealing with complaints. All legal professionals are already required by their professional bodies to put these in place. The Front Line Regulators will have rules setting out the minimum requirements for in-house schemes. These rules will be subject to LSB oversight in the usual way.

⁴² Given the potential financial and human rights issues, cases of high value negligence may still need to be resolved in the courts. An explanation of what constitutes inadequate professional service, professional misconduct and negligence can be found at page 53 of Sir David's final Report.

In general, consumers should use the in-house arrangements as a first step. The OLC will set out circumstances in which consumers might need to go to the OLC straight away, for example where fraud is suspected.

8.5 A power to delegate the investigation of complaints to FLRs?

Some professional bodies, including the Bar Council, the Council for Licensed Conveyancers and the Court of Faculties, have proposed that the OLC should have the discretion to delegate the handling of consumer complaints to individual FLRs, if it is satisfied with their ability to do so.

However, consumers have made clear that the system must be demonstrably independent if they are to have confidence in it: there must be no appearance of professionals judging their own. In the handling of complaints, as with all other parts of the reform programme, the Government's view is that the interests of consumers should be paramount and that the measures open to consumers should be as clear and straightforward as possible.

For these reasons, the Government proposes that the OLC should remain the single and independent complaints handling authority for consumer complaints and that it should **not** delegate the handling of consumer complaints to FLRs.

8.6 Dealing with misconduct

Generally, consumers have confidence in the ability of legal professional bodies to deal with misconduct by their members – that is, breaches of their professional rules. As regulators, they have a keen interest in ensuring that their members abide by their rules of conduct. Under the new system, **FLRs** will deal with any **misconduct** issues to ensure consumer confidence is maintained.

At present, a number of disciplinary proceedings are brought against legal professionals by their own professional bodies following, for example, compliance visits. But most potential breaches of conduct rules are uncovered in the investigation of consumer complaints. The OLC will therefore have an important role in identifying potential misconduct as part of its consideration of a consumer complaint.

Once the OLC has identified a potential breach of a regulator's rules, it should refer the matter to the relevant FLR to consider action. The OLC may require the FLR to tell it whether it has decided to bring disciplinary proceedings. It will be open to the OLC to make a report to the LSB where it is concerned that an FLR may not adequately be performing its regulatory function. This may occur, for example, where an FLR has decided not to pursue a series of potential misconduct matters. The LSB will take action with the FLR if necessary.

Legislation will enable the OLC to make a report to the LSB where it is concerned that an FLR is not properly carrying out its duties in relation to discipline. It will then be for the LSB to take action with the FLR as necessary.

Section 8.12 below deals with oversight by the LSB of the FLRs' disciplinary arrangements.

8.7 Ensuring quick and fair redress

The OLC must operate in a way that provides quick redress for consumers where necessary, and is fair to both consumers and providers.

The Government does not believe that a separate, external appeals process from decisions of the OLC is necessary to achieve fairness.

Not all complaints handling bodies are structured to provide for a right of appeal against their decisions. The Law Society no longer provides a right of appeal against decisions made by its Consumer Complaints Service, and the Financial Ombudsman Service has no external appeal against its decisions. The recent N2+2 review of the Financial Services & Markets Act⁴³ found that more than 60% of respondents did not favour adding an external appeals process, with most consumers and most of the industry opposed to it. The House of Commons Treasury Committee supported this finding.⁴⁴

The primary objective of setting up an Office for Legal Complaints is fast, efficient handling of complaints, and fast redress. Provided that the OLC's procedures for handling complaints in the first instance are structured properly and fairly, it is not clear that an external appeals process will add enough value to the consumer to justify putting this objective at risk. The OLC will need to ensure that all parties are given the chance to put forward relevant evidence and are heard fairly. It will be open to either party to make representations about the way a case is handled within the OLC at any stage of the process before adjudication.

Therefore, the Government does not propose to set up an external appeal body for decisions of the OLC. Its decisions will be open to judicial review in the courts.

⁴³ Financial Services Authority and Financial Ombudsman Service, 2005.

⁴⁴ House of Commons Treasury Committee, 2004.

8.8 Sharing information about complaints with consumers

Consumers will benefit from the OLC making information available about complaints it upholds against providers. This is potentially a useful source of information for consumers about quality. It could help consumers seeking to choose between providers, as well as providing reassurance about good providers.

The Government strongly supports the principle of informing the public about providers' performance. It is important to make information accessible to consumers while maintaining the level of detail and sophistication necessary to make it genuinely meaningful. The OLC will be best placed to decide on how to do this most fairly and effectively.

When making its decisions, the OLC will have available to it the recommendations of the Government's Legal Services Market Study. This study was tasked with considering the principles that should underlie schemes seeking to inform consumers about all aspects of the quality of legal services providers.

The OLC will consider how best to make information available to consumers about the complaints records of providers.

8.9 Sharing information about complaints with Front Line Regulators

It is important for consumers that systemic problems revealed by complaints are identified and remedied. The Front Line Regulators need information about complaints if they are to do this quickly and effectively.

Some professional bodies have raised a concern that when their complaints handling function is removed, Front Line Regulators will lose a vital source of information about the provision of legal services. It will be vital that the OLC communicates effectively with FLRs. Regulators need information on the performance of both individual practitioners or firms and the profession as a whole. The OLC will also benefit from the accumulated knowledge of the FLRs. When handling complaints or disciplinary cases about a particular provider, both the OLC and the FLR should have access to as much information as possible on that provider. This might extend to inviting the FLRs to provide the OLC with their views on particular aspects of individual complaints.

Effective sharing of information should alleviate fears of duplication of effort between the OLC investigating a consumer complaint and an FLR investigating a misconduct charge. This would be an unnecessary expense and could lead to inconsistent findings, which would not be in the interest of consumers or providers.

The LSB will ensure that the OLC agrees protocols with the FLRs regarding sharing of information.

8.10 Sharing information: the OLC's performance

The OLC will compile data on its own complaints handling and use this as a basis for its liaison with FLRs and the LSB. The OLC should include information on its own performance, including an analysis of its complaints handling, in an annual report to the LSB. This will be presented to the Secretary of State for Constitutional Affairs to lay before Parliament and publish.

Legislation will require the OLC to monitor and prepare reports on trends in complaints handling and outcomes.

Legislation will require the OLC to produce an annual report, to include details of its performance.

8.11 How should the level of redress for consumers be set?

Legislation will set an upper limit on financial awards by the OLC. It will be possible to change that quickly over time when it becomes necessary.

If the OLC were permitted to make an award for an unlimited or very high level of redress, it could have implications for indemnity insurance and lead to increased costs to the consumer. Most consumer complaints involve relatively small amounts. The Law Society's average award for redress in 2004/05 was £405.53; the Bar Council's was £427.78.⁴⁵

On the advice of its Independent Complaints Commissioner, the Law Society has recently accepted that the level of redress which it applies should be increased from £5,000 to £15,000. This is the highest level of redress in the legal sector. However, the Government notes that the Estate Agents Ombudsman is able to award £25,000, and the Financial Ombudsman Service currently has a limit of £100,000. Given that the implementation of these proposals will take some time, the Government proposes that under the new system, awards made by the OLC will be subject to an upper limit of £20,000.

It will be possible to amend this upper limit by secondary legislation. The Secretary of State will introduce this, acting on the advice of the LSB and the OLC. The LSB will want to listen carefully to the views of its Consumer Panel on whether the upper limit remains set at the right level over time. The Front Line Regulators will be consulted on any proposed change.

⁴⁵ Legal Services Ombudsman, 2005.

Legislation will provide for an upper limit of £20,000 for awards by the OLC. It will be possible to amend this by secondary legislation, subject to the approval of Parliament.

8.12 Discipline

Under the current disciplinary arrangements, each of the legal professional bodies has its own disciplinary arrangements. These would usually involve some form of dedicated disciplinary tribunal responsible for hearing allegations of misconduct against members of their profession. These tribunals are independent of, but usually funded by, the related professional bodies.

Tribunals are empowered to take disciplinary actions such as reprimanding, fining or suspending a practitioner for a fixed or indefinite period. Tribunals have a mixture of professional and non-lawyer representation, and the prosecution function is carried out by the regulator that has investigated the case.

Disciplinary powers over barristers are exercised in accordance with the constitution of the Council of the Inns of Court, and the four Inns have delegated many of their disciplinary functions to the Bar Council.

Under the new arrangements, the Legal Services Board will oversee disciplinary arrangements, as with other regulatory functions. In his final report, Sir David Clementi found that the existing disciplinary arrangements were broadly working well and should not be radically altered. He recommended a number of modifications to ensure consumer confidence. The Government has accepted these recommendations.

Legislation will provide that:

- each tribunal should review its powers and provide an annual report to the LSB
- the LSB or the relevant tribunal will be able to recommend to the Secretary of State variations of its powers and procedures
- the Secretary of State will be able to amend the powers or procedures of tribunals by secondary legislation, subject to Parliamentary approval.

Chapter 9: Cost and funding of the new arrangements

9.1 Funding the new regulatory framework

The Government starts from the position that the legal profession should pay the cost of its regulation. The LSB will therefore make a charge on all FLRs to pay for the cost of its regulation. Charges will be in proportion to the LSB's effort in exercising oversight regulation of FLRs, and ABS regulators.

The LSB will make an additional charge on FLRs seeking authorisation as **ABS regulators**. FLRs will be expected, in turn, to levy charges on firms that want to be licensed as alternative business structures. These charges are likely to vary depending upon the scale and nature of the application or licence. The Government will expect all such costs to be proportionate and appropriate. It will be for the LSB and the FLRs to determine these charges.

In terms of the OLC, the Government agrees with Sir David Clementi's recommendation that funding of the OLC should come in part from a **general levy** on the profession, and in part as a payment from those against whom complaints are made (the 'polluter pays' principle). Both consumer and professional bodies support this approach. Based on the Financial Ombudsman Service model, around 30% of the revenue might come from a general levy on the profession and 70% from the polluter pays mechanism. However, the target levels would be set by the LSBs; different balances might be set over time.

The Government's view is that the Front Line Regulators and OLC should reach a decision on the precise arrangements. They will have regard to the objectives of the regulatory framework in doing so.

Similarly, the Front Line Regulators and the OLC will need to agree on the payment of the general levy. The LSB will include in the charge that it makes on each FLR an amount to fund the general levy elements of the OLC's costs. The cost of this levy will be split between the various legal professional bodies, and these bodies will want to ensure that this split is proportionate and fair. If the professional bodies cannot come to an agreement, then the LSB will adjudicate.

The costs of the LSB should be met by the providers of legal services.

The costs of the OLC should be met by providers through a general levy and the polluter pays principle.

The LSB will determine the precise balance. The OLC and the FLRs will determine how the general levy will be allocated among them.

9.2. What will the new arrangements cost?

In his final report,⁴⁶ Sir David Clementi made some broad estimates of the operating costs for the proposed new LSB and the OLC. These were based on financial data collated from each of the regulatory bodies for Sir David by Ernst & Young and assumptions of structures and staffing levels made by the Sir David Clementi's review team. The results of this analysis, which were appended to Sir David Clementi's Report, estimated that :

- the **operating cost** of the **current regulatory framework** was estimated to be around **£81 million** during the year 2003/4
- the **operating cost** of the **proposed new regulatory framework** was estimated to be **£79.5 million** annually. This consisted of:
 - the **operating cost** of the **LSB** at £4.5million annually
 - the **operating cost** of the **FLRs** at £46 million annually
 - the **operating cost** of the **OLC** at £23 million annually
 - the **operating cost** of the **disciplinary** systems at £6 million annually

Making these assessments was a complex exercise and the estimates were subject to a number of important qualifications set out in Sir David Clementi's report. The Government is concerned to ensure that going forward, up to date

⁴⁶ Clementi, Sir David, December 2004, Review of the Regulatory Framework for Legal Services in England and Wales – Final Report.

costs are available and so is carrying out further work in this area. In presenting their findings to Sir David Clementi Ernst & Young were keen to ensure that their estimates were considered in an appropriate context and therefore set out in the report a number of key assumptions and limitations as well as a caveat.⁴⁷

In addition to the operating costs, Sir David Clementi also considered the costs associated from transferring from the existing regulatory framework to the future recommended regulatory model. These included transition costs relating to people, facilities, technology, and set up. Sir David engaged Ernst & Young to carry out some work to help him estimate the level of these costs. Ernst and Young based their work on a number of key assumptions made by the review team, which were detailed in their report on transition costs as well as a caveat.⁴⁸ The outcome of this assessment suggested that costs would be in the region of:

- almost £4 million for the **LSB**, and
- slightly over £9 million for the **OLC**.

⁴⁷ Key assumptions and limitations were set out in Section 2 of Ernst & Young's report to Sir David Clementi dealing with the operating costs of the new regulatory framework, as well as the following caveat; "This report has been prepared on the instructions of, and solely for the purposes and use of the Review Team. It is issued subject to the limitations outlined above and in our agreed terms and conditions. The contents of the report should not be depended upon by third parties. We shall have no responsibility to any third party in respect of the contents of this report which may not have considered issues relevant to such third parties. Any third party use of this work is entirely at their own risk."

⁴⁸ Key assumptions were set out in Section 2 of Ernst & Young's report to Sir David Clementi dealing with the transition costs to the revised regulatory framework, as well as the following caveat; "At your request and direction, we estimated the transition costs for the regulatory framework. The procedures performed are outlined in Section 2 of this report. Any differences between the procedures set forth in this report and those set forth in our engagement letter dated 2 November 2004, reflect modifications that were made at your request or discussed with you during the course of the engagement. The procedures that we performed are advisory and do not constitute an audit of the regulatory framework's historical financial statements in accordance with generally accepted auditing standards, nor do they constitute an examination of prospective financial statements in accordance with the established standards. We performed no procedures to evaluate the reliability or completeness of the information obtained. Accordingly, we express no opinion or any other form of assurance on the historical or prospective financial statements, management representations or other data of the regulatory framework included in or underlying the accompanying information. In addition, we have no responsibility to update this report for events or circumstances occurring after the date of this report. In performing the procedures, we have accumulated data, written various memoranda for our own use and have had various meetings with representatives of the Review Team. In carrying out this report, we have worked solely under the instructions of Sir David Clementi and the members of the team of the Review of the Regulatory Framework for Legal Services in England and Wales for their purposes. Our report may not have considered issues relevant to any third parties. Any use which third parties may choose to make of our report is entirely at their own risk and we shall have no responsibility whatsoever in relation to any such use."

Part 4 – Next steps

Chapter 10: List of Government proposals

Chapter 4: A new regulatory framework

4.1 The 7 objectives and 4 principles for the regulation of legal services will be set out in legislation. All partners in the regulatory framework – the Legal Services Board, the Office for Legal Complaints and the Front Line Regulators – will have to deliver these.

Changes to the objectives and principles will be made by secondary legislation subject to the approval of Parliament.

4.2 Legislation will require all partners in the regulatory framework to adopt best practice in carrying out their functions.

4.3 Legislation will require all partners in the regulatory framework to adopt a risk-based approach to regulation.

Chapter 5: Simplifying regulation

5.1 Legislation will establish a new Legal Services Board (LSB), with regulatory power vested in it. The LSB will authorise Front Line Regulators (FLRs) that satisfy it that they are competent to regulate. The LSB will be able to modify or remove the authorisation if an FLR fails, and to carry out regulatory functions in those circumstances.

5.2 Legislation will require existing regulatory bodies to satisfy the LSB of the appropriateness of their governance arrangements.

5.3 Legislation will require the Legal Services Board to establish and maintain a Consumer Panel.

5.4 Legislation will set the size of the Board of the LSB at 9 to 12 members. It will be possible to change this by secondary legislation, subject to Parliamentary approval.

5.5 Legislation will provide for the Secretary of State to appoint the Chair of the LSB. The Secretary of State will appoint the members of the LSB, following consultation with the Chair. All appointments will be in accordance with the rules of the Commissioner for Public Appointments.

5.6 The LSB should seek to be added to the list of organisations with ‘stop now’ powers under the Enterprise Act.

Legislation will provide for the powers of the LSB to be amended by secondary legislation, subject to the approval of Parliament.

Legislation will provide the LSB with the following powers to carry out regulation:

Authorisation of Front Line Regulators (FLRs)

- to authorise FLRs if it is satisfied that they will regulate in the consumer interest.

Controls over FLRs

- to require Front Line Regulators to provide it with information (subject to privacy/confidence) to carry out its duties
- to issue regulatory guidance to FLRs
- to approve fees to be raised by FLRs
- to set requirements for indemnity insurance arrangements of FLRs and practitioners
- to set compensation fund requirements.

Sanctions over FLRs

- to set regulatory targets for FLRs and to monitor compliance
- to impose financial penalties on FLRs for failing to meet targets or achieve compliance
- to direct an FLR to take a specific regulatory action
- to strike down or amend rules of an FLR.

In most cases the LSB will want to work alongside the FLR in areas of weakness to improve them. However, where an FLR continues to fail, the LSB will be able to:

- remove the authorisation of the FLR in a particular area or areas of regulation and either identify an alternative FLR or carry out their regulatory functions itself.

Ultimately, the LSB would be able to recommend secondary legislation to remove the authorisation of an FLR entirely. Following consideration of any wider public interest issues, the Secretary of State would be expected to carry through the LSB's recommendation in such a case.

Legislation will provide the LSB with powers in relation to the new Office for Legal Complaints, in relation to alternative business structures and to enable it to obtain advice and information:

Powers in relation to the Office for Legal Complaints

- to appoint the Chair of the OLC, subject to the approval of the Secretary of State
- to appoint the OLC Board

- to set and monitor performance targets for the OLC
- to approve the budget of the OLC
- to remove the Chair of the OLC, subject to the approval of the Secretary of State, for example in cases of poor performance, misconduct, or bringing the OLC into disrepute
- to remove members of the OLC Board, for example in cases of poor performance or misconduct, or bringing the OLC into disrepute.

Controls over alternative business structures

- to authorise FLRs to license (or in the absence of an ABS regulator to license itself) ABS firms which meet the required standards
- to exclude a person from holding a position in an ABS firm
- to set and modify the safeguards for ABSs (e.g. a fit and proper test, nominated Head of Legal Practice and Head of Finance and Administration)

Powers in relation to advice

- to appoint and maintain a Consumer Panel
- to request advice from the Consumer Panel
- to require any person or organisation to provide it with information in connection with its functions

5.7 Legislation will require the LSB to consult formally with the Consumer Panel, the Secretary of State for Constitutional Affairs, the Office of Fair Trading⁴⁹ and the higher judiciary⁵⁰ when it is considering taking the following action:

- making a recommendation to the Secretary of State to authorise new FLRs, or to remove the authorisation of existing FLRs, in whole or in part
- making a recommendation to the Secretary of State that unregulated activities should be brought under the scope of its regulatory control
- carrying out specific regulatory functions itself
- reviewing or setting the targets or funding of, or the sanctions available to, the Office for Legal Complaints
- issuing a directive to alter any of the rules of a FLR.

5.8 Legislation will require the LSB to publish an annual report, to be laid before Parliament. The LSB will have a duty to provide a report on relevant issues to the Secretary of State for Constitutional Affairs as requested.

⁴⁹ on whether the proposed action would have an adverse effect on competition.

⁵⁰ consultation with the higher judiciary is important given the implications for the courts, particularly in respect of litigation services and advocacy. The Lord Chief Justice, Master of the Rolls, President of the Queen's Bench Division, President of the Family Division and the Chancellor of the High Court now constitute the higher judiciary.

Legislation will provide the Secretary of State with powers to:

- bring forward secondary legislation on the advice of the LSB to widen the scope of regulation
- bring forward secondary legislation on the advice of the LSB to authorise new FLRs, or to alter or remove the existing authorisation of an FLR
- remove the Chair or members of the LSB (in the latter case, having consulted the Chair) in specific limited situations (e.g. misconduct)
- direct the LSB to take action to implement international agreements
- bring forward secondary legislation to amend the powers of the LSB
- initiate value for money scrutinies or major reviews of regulation from time to time, e.g. where there has been criticism from a Parliamentary committee
- consider and resolve any approach from the OFT where it has raised competition concerns with the LSB and is not satisfied with the LSB's response.

5.10 Legislation will provide for the OFT to:

- have an ongoing duty to scrutinise regulating provisions of all authorised FLRs, and
- to report to the LSB on competition issues relating to professional rules prior to authorisation of any new FLR.

The LSB will be under a statutory obligation to respond to any OFT report published, and to take appropriate action.

Legislation will give the Secretary of State the power to resolve issues, following the taking of advice from the Competition Commission, in the event of a disagreement between the OFT and the LSB.

Chapter 6: Confidence and choice – new ways of delivering for consumers

6.1 Legislation will provide for a flexible and robust licensing scheme for alternative business structures. This will allow lawyers and non-lawyers to work together to provide legal and certain associated services. External investment will be permitted.

6.2 Legislation will provide for the modification of Front Line Regulators' powers by secondary legislation proposed by the Secretary of State for Constitutional Affairs following a proposal from the LSB.

6.4 Legislation will require Front Line regulators of ABSs to ensure that firms identify a Head of Legal Practice and a Head of Finance and Administration.

6.5 There will be no requirement for an overall majority of lawyers in all ABS firms. The LSB will decide whether the services provided by some ABS firms require a certain level of lawyer control.

6.6 External investment in ABS firms will be permitted, and will be based on a fitness to own test, covering:

- honesty, integrity and reputation
- competence and capability, and
- financial soundness.

6.7 The LSB will determine the extent of external investment in ABS firms according to the type of business and acting in line with its regulatory objectives.

6.8 Legislation will provide for consumers to complain to the new Office for Legal Complaints.

ABS regulators will pass cases of misconduct to the relevant disciplinary body.

ABS regulators will be able to require the removal of a director or partner in an ABS firm and to prohibit them from holding any position of control in an ABS firm, either for a fixed period, or indefinitely.

ABS regulators will be able to alter or remove an ABS firm's licence to offer services.

6.9 The LSB will provide clear rules relating to the prevention of conflicts of interest in respect of services provided by ABS firms.

6.10 ABS regulators must not permit ABS firms to provide any service likely to be incompatible with the principles of the legal profession.

6.11 Legislation will require the LSB to monitor the provision of legal services across different sectors and geographically, and use the results of that work to inform its regulatory decisions. This will include the authorisation of, and imposition of any conditions upon, ABS regulators.

6.14 The Not for Profit sector will fall within the regulatory scope of the LSB and the ABS licensing scheme. The LSB and Front Line Regulators will have the power to waive or alter ABS licensing requirements in specific cases where it is in the public interest.

Chapter 7: Protecting consumers if new problems occur

7.2 The LSB will have a statutory duty to determine whether a legal service should be regulated.

Legislation will require the LSB to investigate aspects of the market if requested to do so by its Consumer Panel, the Office of Fair Trading, or the Secretary of State for Constitutional Affairs.

7.4 Legislation will give the LSB the power to:

- investigate the prospect of market intervention

- make a report to the Secretary of State
- propose that additional activities are brought under its regulatory control by means of secondary legislation.

Legislation will require the LSB to consult in advance the Consumer Panel, the Secretary of State for Constitutional Affairs, the Office of Fair Trading and the higher judiciary.

The LSB will have the power to:

- authorise appropriate regulator(s) for any newly reserved activity, or, as a last resort, regulate the activity directly itself
- make a charge to the sector for any costs involved in new regulation.

Legislation will enable new areas to be brought within the regulatory net by secondary legislation, subject to the approval of Parliament.

7.6 Legislation will enable the LSB to:

- investigate, including taking advice from the Office of Fair Trading, the prospect of removing a service from its statutory oversight
- make a recommendation to the Secretary of State to propose that a service should be removed from the statutory oversight of the LSB. This would be given effect by Regulatory Reform Order or primary legislation, subject to the approval of Parliament.

7.7 Legislation will provide for those legal services that currently may only be provided by certain qualified members of the legal profession to form the core activities over which the LSB will have regulatory control.

Legislation will provide that where the LSB proposes to the Secretary of State that additional activities should be brought within or out of its regulatory control, those activities must fall within the definition of legal services.

Chapter 8: Complaints – what happens if things go wrong?

8.2 Legislation will establish the new Office for Legal Complaints with clearly defined powers. It will deal with all consumer complaints about legal service providers who are members of bodies or organisations regulated by the LSB.

The OLC will be independent from Government and providers of legal services. It will be accountable to the LSB and will be funded by the sector.

The OLC will investigate all complaints and refer any issues of misconduct to the FLR concerned, monitoring the decisions. The LSB will oversee their disciplinary arrangements.

8.3 Legislation will set the size of the OLC Board at 7 to 9 members. It will be possible to change this by secondary legislation, subject to the approval of Parliament.

To meet the needs of the different consumers, the members of the OLC will between them have experience of:

- consumer affairs
- the provision of legal services
- complaints handling
- the wider advice sector
- civil or criminal proceedings and the working of the courts
- legal education and training
- the maintenance of the professional standards of persons who provide legal services
- the needs of diverse consumers within society.

The OLC Board will appoint arbiters who will make decisions on individual complaints. To command consumer confidence, legislation will provide that:

- all appointments to the Board of the OLC will be made by the LSB on merit, in accordance with the rules of the Commissioner for Public Appointments
- the Chair will be a non-lawyer and will be appointed by the LSB with the approval of the Secretary of State for Constitutional Affairs
- the Board of the OLC will consist of a majority of non-lawyers
- the LSB will be able to remove the Chair of the OLC with the agreement of the Secretary of State in cases of poor performance or conduct, or of bringing the OLC into disrepute
- the LSB will be able to remove members of the Board in the same circumstances.

8.4 Legislation will provide the OLC with the following power, which will apply to those regulated by the LSB (including ABS firms):

- the power to require evidence
- the power to dismiss cases
- the power to enforce decisions
- the power to make decisions in all the circumstances of a complaint.

To ensure that the OLC's powers remain adequate, it will be possible to amend them by secondary legislation, subject to the approval of Parliament.

8.6 Legislation will enable the OLC to make a report to the LSB where it is concerned that an FLR is not properly carrying out its duties in relation to discipline. It will then be for the LSB to take action with the FLR as necessary.

8.8 The OLC will consider how best to make information available to consumers about the complaints records of providers.

8.9 The LSB will ensure that the OLC agrees protocols with the FLRs regarding sharing of information.

8.10 Legislation will require the OLC to monitor and prepare reports on trends in complaints handling and outcomes.

Legislation will require the OLC to produce an annual report, to include details of its performance.

8.11 Legislation will provide for an upper limit of £20,000 for awards by the OLC. It will be possible to amend this by secondary legislation, subject to the approval of Parliament.

8.12 Legislation will provide that:

- each tribunal should review its powers and provide an annual report to the LSB
- the LSB or the relevant tribunal will be able to recommend to the Secretary of State variations of its powers and procedures
- the Secretary of State will be able to amend the powers or procedures of tribunals by secondary legislation, subject to Parliamentary approval.

Chapter 9: Cost and funding of the new arrangements

9.1 The costs of the LSB will be met by the providers of legal services.

The costs of the OLC should be met by providers through a general levy and the polluter pays principle.

The LSB will determine the precise balance. The OLC and the FLRs will determine how the general levy will be allocated among them.

Chapter 11: Next steps and delivery

11.1 A partnership approach

The Government welcomes the positive approach to reform that consumers and practitioners have adopted. The Government will continue to engage with stakeholders throughout the process of reform and implementation of these wide-ranging changes.

There will be a transitional period during which the LSB will assume its full powers and satisfy itself about the governance arrangements that the professional bodies will be required to be put in place (see section 5.2). The Government proposes that existing professional bodies that are authorised to regulate reserved legal services (e.g. Bar Council, Law Society, ILEX) will be authorised, **provided** they can satisfy the LSB about their governance arrangements. The Government welcomes the changes that some professional bodies, notably the Law Society and the Bar Council, are already making to their governance arrangements.

Building on the OFT's earlier work, we are working with the professional bodies to assess their existing rules (see section 11.2 below). The LSB will keep the rules of FLRs under review. It will have a range of powers to address shortcomings or failures by FLRs.

11.2 Other action

The Government is taking a number of other steps to ensure that improvements for consumers are made quickly where it is necessary.

Claims managers

The Government is already taking action to regulate claims managers by introducing the Compensation Bill in this Parliamentary session. Subject to Parliamentary approval, claims managers will have to be regulated by a new front line body, which will ensure that consumers are protected when they use these services. Initially, the Secretary of State will provide oversight; this will pass to the Legal Services Board when it is established.

Audit of professional rules

Lord Falconer announced at the conference on legal services in March 2005 that his department would look at the existing rules of the professional bodies to identify any that did not appear to be in the interest of the consumer, or seemed to be anti-competitive. An initial analysis has been carried out. Work will continue with the professional bodies ahead of the creation of the LSB to ensure that consumers benefit as soon as possible.

Will writing and estate administration

Lord Falconer also announced at the March 2005 conference that his department would consider the case for the regulation of will writing and estate administration services. We have worked closely with consumer bodies and with the profession. Based on the information available, there does not appear to be a compelling argument for statutory regulation. However, the Government's view is that improvements must be made in the control of quality and standards of will writing and related services in order to protect consumers. This could be most effectively achieved by voluntary regulation, such as codes of conduct and consumer education schemes. The Government will continue to work closely with consumer bodies, the providers of will writing services and bodies that represent them to help raise quality, standards and consumer awareness. The overriding aim is that consumers receive a better standard of service, which they have a right to expect and deserve.

Probate and conveyancing

At the March 2005 conference Lord Falconer said that he would consider ways in which the provision of probate and conveyancing services could be further liberalised. This will allow new providers, such as financial institutions, to enter the market ahead of the introduction of the LSB and the Government's wider reform package.

Conveyancing – Section 22 of the Solicitors Act of 1974 provides that only solicitors, together with a few excepted categories (barristers, duly certified public notaries and in 1985 licensed conveyancers), can provide certain conveyancing services for a fee.

The Government proposes to include provisions in the Legal Service Bill which will allow the Secretary of State, following advice from the LSB, to add to the list of persons able to provide conveyancing services for a fee. There will be an approval process to ensure that consumers are protected. In the meantime we will continue to work with stakeholders to identify whether earlier liberalisation is possible.

Probate – Section 23 of the Solicitors Act 1974 prevents any unqualified person (i.e. persons other than a solicitor, barrister or duly certified notary public) from directly or indirectly drawing or preparing for fee, gain or reward, any papers on which to found or oppose a grant of probate or letters of administration. The Government wants to relax this provision to enable others to provide these services. As a first step, the Government will consider with stakeholders whether sufficient safeguards can be put in place now through existing arrangements. If not, we will use the Legal Services Bill to deliver these.

These changes will mean that consumers will have a wider choice of service providers for probate and conveyancing work. For example consumers will be able to select a provider to arrange their mortgage and also carry out their conveyancing work. This will not only offer a wider selection of providers but also introduce healthy competition and enable better consumer choice.

Chapter 12: Conclusion

The proposals in this White Paper represent a significant departure in the way legal services in England and Wales are regulated.

There is much in the current system that is excellent. The vast majority of providers of legal services work to high standards of professionalism and competence. The legal profession in this country rightly has an international reputation.

The Government's proposals will preserve and build on the best of the current system. But the demands of consumers have changed. Providers – both individuals and organisations – need to respond effectively to these new requirements.

Change is necessary to provide consumers with a better deal. Legal services and the way in which they are provided have a real impact on individuals every day. They matter to people – in business and in family life. They can have a profound effect on the choices people make and the outcomes they experience.

Reform is overdue. It is necessary to ensure that consumers are in the driving seat in the provision of legal services. It is also important to ensure that confidence in providers is maintained and increased.

The Government will implement this comprehensive package of reforms, working in partnership with both consumers and providers of legal services to deliver change as quickly as possible.

Appendix A

Consumer Panel Membership

James Sandbach – Citizens Advice

Alice Leonard – Equal Opportunities Commission

Stephen Alambritis – Federation of Small Businesses

Steve Brooker – National Consumer Council

Emma Harrison – Which?

Special adviser to Panel

Grahame Horgan – Office of Fair Trading

Appendix B

Legal services subject to statutory regulation

Currently, seven forms of legal service are subject to statutory regulatory control.

1. Litigation

The right to conduct litigation is reserved to certain categories of professional under the provisions of the Courts and Legal Services Act 1990 (CLSA), section 28. This section provides that “appropriate authorised bodies” whose “qualification regulations and rules of conduct have been approved” shall have the power to grant a “right to conduct litigation in relation to any proceedings.”

By virtue of CLSA, section 29, each authorised bodies’ qualification regulations and rules of conduct must be approved by the Secretary of State for Constitutional Affairs under the procedures set out in CLSA, Schedule 4 before they may grant the right to conduct litigation.

CLSA, section 28(5), designates the following as “authorised bodies” for the purpose of granting the right to conduct litigation:

- (a) the Law Society;
- (b) the General Council of the Bar;
- (c) the Institute of Legal Executives; and
- (b) any other professional or other body which has been designated by Order in Council.

To date, the following orders have been made under this section designating further authorised bodies:

- The Chartered Institute of Patent Agents Order 1999 (1999/3137);
- The Institute of Trade Mark Attorneys Order 2005 (2005/240).

2. Advocacy

Rights of audience before the courts are reserved to certain categories of professional under the provisions of the Courts and Legal Services Act 1990 (CLSA), section 27. This section provides that “appropriate authorised bodies” whose “qualification regulations and rules of conduct have been approved” shall have the power to grant a “right of audience before a court in relation to any proceedings.”

By virtue of CLSA, section 29, each authorised body's qualification regulations and rules of conduct must be approved by the Secretary of State for Constitutional Affairs under the procedures set out in CLSA, Schedule 4 before they may grant rights of audience.

CLSA, section 27(9) designates the following as "authorised bodies" for the purpose of granting the right to conduct litigation:

- (a) the General Council of the Bar;
- (b) the Law Society;
- (c) any other professional or other body which has been designated by Order in Council.

To date, the following orders have been made under CLSA, section 27(9)(c) designating further authorised bodies:

- The Institute of Legal Executives Order 1998 (1998/1077);
- The Chartered Institute of Patent Agents Order 1999 (1999/3137);
- The Institute of Trade Mark Attorneys Order 2005 (2005/240).

3. Immigration Services

The regulation of immigration services throughout the United Kingdom is governed the Immigration and Asylum Act 1999, Part V.

Section 82(1)(a) of the Act defines "immigration services" as meaning:

"the making of representations on behalf of a particular individual-
in civil proceedings before a court, tribunal or adjudicator in the
United Kingdom, or
in correspondence with a Minister of the Crown or government
department in connection with one or more relevant matters."

"Relevant matters" are defined in S. 82(1)(a) of the Act and include claims for asylum and a number of other matters that relate to immigration.

Section 83 of the Act provides for the appointment by the Secretary of State (in consultation with Scottish Ministers) of an Immigration Services Commissioner (the Commissioner) who is given responsibility for the regulation of the provision of immigration services.

Under S. 84 of the Act, the provision of immigration services is restricted to "qualified persons." "Qualified persons" include "registered persons" and those "authorised by a designated professional body to practise as a member of the profession whose members the body regulates." By virtue of section 86 of the Act, the Law Society, the General Council of the Bar and the Institute of Legal Executives are "designated professional bodies" for the purposes of the Act, as are their Scottish and Northern Irish equivalents.

4. Probate Services

The Solicitors Act 1974 (SA), S. 23(1) establishes a general prohibition on non-solicitors providing probate services:

“Subject to subsections (2) and (3), any unqualified person who, directly or indirectly, draws or prepares any papers on which to found or oppose –

- (a) a grant of probate, or
- (b) a grant of letters of administration,

shall, unless he proves that the act was not done for or in expectation of any fee, gain or reward, be guilty of an offence and liable on summary conviction to a fine not exceeding the first level on the standard scale.”

In this provision, the term “unqualified person” means a person who is not qualified under SA section 1.

There are a number of exceptions to this general prohibition on non-solicitors providing probate services. The prohibition “does not apply to barristers or duly certificated notaries public” by virtue of SA, s. 23(2). The prohibition also does not apply to recognised bodies by virtue of the Administration of Justice Act 1985, section 9(3).

Furthermore, since the enactment of the Courts and Legal Services Act (CLSA) 1990 (Commencement No 11) Order 2004, CLSA section 55 has provided for the possibility of further exemptions to the prohibition on non-solicitors providing probate services. CLSA, section 55(1) provides that the prohibition on the provision of probate services by unqualified persons established by SA, section 23(1) “shall not apply to any person to whom exemption from those provisions is granted by an approved body.” An “approved body” is defined by S 55(3) as being “ a professional or other body which is approved by the Secretary of State under Schedule 9.” To date, there have been no applications from any bodies for “approved body” status.

5. Conveyancing

SA, S. 22(1) establishes a general prohibition on non-solicitors providing conveyancing services:

“Subject to subsections (2) and (2A), any unqualified person who directly or indirectly –

- (a) draws or prepares any instrument of transfer or charge for the purposes of the Land Registration Act 2002, or makes any application or lodges any document for registration under that Act at the registry, or
- (b) draws or prepares any other instrument relating to real or personal estate, or any legal proceeding,

shall, unless he proves that the act was not done in the expectation of any fee, gain or reward, be guilty of an offence and liable on summary conviction to a fine not exceeding level 3 on the standard scale.”

By virtue of SA, section 22(2)(a) barristers and duly certificated notaries public are among those exempted from this prohibition. Furthermore, by virtue of the Administration of Justice Act 1985, section 11(4) the prohibition does not apply to any act done by a licensed conveyancer in the course of providing conveyancing services:

“Section 22(1) of the Solicitors Act 1974 (restriction on person preparing certain instruments when not qualified to act as a solicitor) shall not apply to any act done by a licensed conveyancer in the course of the provision of any conveyancing services ...”

By virtue of the 1985 Act, section 11(2), a “licensed conveyancer” is a person who holds a licence in force under the 1985 Act, Part II. The Council for Licensed Conveyancers (“the CLC”), established under the 1995, s. 12, has the power to issue such licences under the 1985, s.15.

By virtue of CLSA, section 53, the CLC “shall have the powers necessary to enable it to become –

- (a) an authorised body for the purposes of granting rights of audience under section 27(2)(a);
- (b) an authorised body for the purposes of granting rights to conduct litigation under section 28(2)(a); and
- (c) an approved body for the purposes of granting, in accordance with section 55, exemption from the provisions of section 23(1) of the Solicitors Act 1974 (preparation of probate papers).”

6. Notarial Acts

The Public Notaries Act 1801, section 1 provides that “no person in England shall be created to act as a publick notary, or use and exercise the office of a notary, or do any notarial act, unless such person shall have been duly sworn, admitted, and inrolled, in the court wherein notaries have been accustomed to be sworn, admitted and inrolled.”

The Public Notaries Act 1843, section 10(1) provides that “in case any person shall, in his own name, exercise, or execute or perform, any act, matter, or thing whatsoever of or in anyway appertaining or belonging to the office, function, or practice of a public notary, for or in expectation of any gain, fee or reward, without being able to prove, if required, that he is duly authorised so to do, he shall be guilty of an offence and liable on summary conviction to a fine not exceeding level 3 on the standard scale.”

By virtue of the SA, sections 87(1) and 89(7), a reference in any enactment to a “duly certificated notary public” means a notary public who either (1) has in force a practising certificate as a solicitor, duly entered in the Court of Faculties of the Archbishop of Canterbury in accordance with rules made by the Master of the Faculties; or (2) has in force a practising certificate as a notary public issued by the Court of Faculties in accordance with rules so made.

7. Oaths

Section 1(2) of the Commissioner for Oaths Act 1889 provides that “a commissioner for oaths may, in England or elsewhere, administer any oath or take any affidavit for the purposes of any court or matter in England...”

SA, section 81 provides that “every solicitor who holds a practising certificate which is in force shall have the powers conferred on a commissioner for oaths by the Commissioners for Oaths Acts 1889 and 1891 and section 24 of the Stamp Duties Management Act 1891.”

CLSA, section 113 provides that “authorised advocates” (other than solicitors) and “authorised litigators” (other than solicitors) and “any person who is a member of a professional or other body prescribed by the Secretary of State” shall have “the powers conferred on a commissioner for oaths by the Commissioners for Oaths Acts 1889 and 1891 and section 24 of the Stamp Duties Management Act 1891.” (CLSA, s. 119 defines an “authorised advocate” as “any person (including a barrister or a solicitor) who has a right of audience granted by an authorised body in accordance with the provisions of this Act.” It further defines “authorised litigator” as “any person (including a solicitor) who has a right to conduct litigation granted by an authorised body in accordance with the provisions of this Act.”)

The Commissioners for Oaths (Prescribed Bodies) Regulations 1994 (1994/1380) and the Commissioners for Oaths (Prescribed Bodies) Regulations 1995 (1995/1676) recognised the Council for Licensed Conveyancers and the Institute of Legal Executives respectively as prescribed bodies for the purposes of s. 113.

Also under section 113, “general notaries” are given “the powers conferred on a commissioner for oaths by the Commissioners for Oaths Acts 1889 and 1891.”

Therefore, under the provisions of section 113, barristers, licensed conveyancers, legal executives, notaries, patent agents and trade mark attorneys may all act as commissioners for oaths.

The Government is bringing forward legislation to add the provision of claims management services to this list of reserved legal services.

Appendix C

Defining Legal Services

In order to reach decisions on bringing activities in and out of its scope, the LSB will need clarity on a definition of **legal services**.

In his Final Report, Sir David Clementi took the view that while a definition of legal services was desirable, there were difficulties in prescribing the boundaries of any industry, particularly where questions arise at the margins, and as new activities develop:

“It is right to acknowledge that a precise definition [of legal services] is not possible; it needs some flexibility, given the need to accommodate the inevitable change which occurs over time in the boundaries of what is considered to be ‘legal’.”

The Government agrees that LSB will need to be able to exercise judgement in drawing the boundaries of “legal services”. The following suggested definition would nevertheless be a useful basis:

- advice, assistance and representation in relation to the operation or exercise of legal rights and the performance of legal obligations; and
- advice, assistance and representation in relation to all forms of resolution of legal disputes

The definition would **exclude**:

- any form of judicial or quasi-judicial function (including mediation)
- academic work or writing of books on legal issues, and
- advice
 - which is not given in the course of a business
 - on which individuals are not intended to rely.

Appendix D

Partial Regulatory Impact Assessment

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1. Title of proposal

1.1 Legal services reform

2. Purpose and intended effect

Objective

- 2.1 This proposal delivers a new, simplified framework for the regulation of legal services that creates independent oversight of the front line regulators (FLRs) of legal services. It reduces the multiple layers of overlapping regulators and eliminates the ‘regulatory maze’¹ that currently exists. It also increases accountability and transparency in the regulatory system for legal services, and improves the way consumer complaints are handled. Furthermore, it facilitates a more flexible and dynamic legal services market, responsive to consumer demands, engendering greater competition, innovation, and consumer choice.
- 2.2 The new regulatory framework for legal services will:
- support the rule of law
 - improve access to justice
 - protect and promote consumer interests
 - promote competition
 - encourage a strong and effective legal profession
 - increase public understanding of the citizen’s legal rights
 - maintain the principles of the legal profession.
- 2.3 Our aspiration is that the new regulatory framework will increase public trust and confidence in the legal sector. The new framework aims to ensure that consumer interests are represented effectively, competition is not unjustifiably restricted, appropriate standards of education, training and conduct are maintained, and that the complaints and disciplinary mechanisms are improved. The framework is designed to ensure that access to justice is provided and improved, and that the independence of the legal profession from outside influences is maintained.

Devolution

- 2.4 This proposal applies to England and Wales only.
- 2.5 The Office of the Immigration Services Commissioner (OISC), an existing statutory regulator, will continue to regulate immigration advisers² in the UK who are not members of designated professional bodies and pursue those who flout their regulatory scheme. The OISC will remain the

¹ Legal Services Ombudsman, 2002.

² These advisers include members of the Law Society, the General Council of the Bar and the Institute of Legal Executives.

responsibility of the Home Secretary. The LSB will take over the OISC's current responsibility, in England and Wales, to monitor the professional bodies' regulation of their members who provide immigration advice. The LSB and OISC will develop a Memorandum of Understanding to set out co-operation between the two organisations, particularly in respect of quality and standards of service for dealing with complaints.

Background

a. The legal services market in England and Wales

- 2.6 Legal services make an important contribution to the UK economy. They generated £19 billion or 1.73% of the UK's gross domestic product in 2003³, which was an increase in real terms of almost 60% since 1995. In 2003, the volume of UK legal services exported totalled £1.9 billion, three times that of 1995. Total imports of legal services were worth £403 million for the same period, showing the value of the legal services sector in terms of net exports (£1.5 billion).⁴
- 2.7 The size of the Bar has increased considerably in the recent past. In 2004 there were 14,364 practising barristers in England and Wales, 11,564 of whom were in independent private practice (251 of whom were not tenants of the 355 chambers) and the rest in employment.⁵ This is a large increase from 1990, when there were 6,645 barristers in independent private practices.
- 2.8 In 2004 29.5% of self-employed barristers and 43.7% of employed barristers were female. Of those female barristers, 26.4% practised from the employed Bar (as opposed to 16.2% of male barristers). Moreover, in 2003 2.2% of female barristers left the Bar to become solicitors (as opposed to 1.3% of male barristers).⁶ In addition, 10.9% of all practising barristers were from minority ethnic groups.⁷
- 2.9 The solicitors' profession has also grown markedly in the recent past. There were 54,734 solicitors in England and Wales with practising certificates in 1990, while in 2004 there were 96,757 solicitors, of whom 75,079 were working in private practices. In addition, the number of solicitors from England and Wales located abroad has increased more than nine times between 1990 and 2004 from 355 to nearly 3,400, now located in 71 countries abroad.
- 2.10 In contrast, the number of solicitors' firms fell from 10,120 in 1997 to 9,211 in 2004. Sole practitioners made up 45.3% of solicitors' firms and a

³ Data taken from the Office for National Statistics Annual Business Inquiry. [<http://www.statistics.gov.uk/abi>]

⁴ Office for National Statistics, 2004.

⁵ General Council of the Bar, 2005b.

⁶ Blanes i Vidal, Jewitt, and Leaver, C., 2005.

⁷ General Council of the Bar, 2005.

further 39.7% had four or fewer partners, but 69.2% of solicitors worked in firms of five partners or more. The number of large practices (those with 26 partners or more) has increased in recent years, and in 1999-2000 these firms generated 50.2% of the total £10.52 billion generated by the profession.

- 2.11 In addition, there were 3,310 solicitors with rights of audience in the higher courts in April 2005.⁸
- 2.12 In 2004 40.5% of all solicitors with practising certificates were female, and 8.3% were from minority ethnic groups. Of those female solicitors, 15.7% practised as partner or as sole practitioner, compared with 38.1% of all male solicitors.⁹
- 2.13 Both the Bar and the solicitors' profession are significant employers in the UK with figures from International Financial Services London¹⁰ showing that total recorded employment for the solicitors' profession and the Bar (fee earners and administrative staff) in 2003 totalled 267,503.
- 2.14 Elsewhere in the legal services sector in 2004, there were
- nearly 22,000 members of the Institute of Legal Executives. Most legal executives work for solicitors' firms, although a few work independently from solicitors;
 - 850 licensed conveyancers in England and Wales, and around 1,300 in training;
 - 857 registered trade mark attorneys and 1,500 United Kingdom registered patent attorneys; and
 - approximately 900 public notaries in practice, of which around 30 are scrivener notaries, and 815 are general notaries who are also in practice as solicitors.
- 2.15 The Not for Profit (NfP) sector is a vital channel for providing access to justice where the need is greatest. This sector encompasses some of the legal services publicly funded by legal aid through the Legal Services Commission (LSC), volunteer services offered by members of the public and pro bono work where lawyers provide their services free of charge. There are also a number of NfP organisations providing legal advice, representation and other non-legal services to individuals. These organisations include:
- 468 Citizens Advice Bureaux in England and Wales

⁸ A solicitor usually briefs a barrister on a case in the higher courts. The barrister then presents the case to the court. However, a solicitor may choose to gain higher rights in order to offer a complete service to a client – from initial advice through to case preparation and presentation before the courts.

⁹ Law Society, 2005.

¹⁰ International Financial Services London, 2005.

- just under 1,000 members of AdviceUK (formerly the Federation of Information and Advice Centres)
- 57 law centres in the Law Centres Federation.

2.16 The LSC is a key consumer of legal services. It delivers civil and criminal legal and advice services, publicly funded via legal aid, through its Community Legal Service (CLS) and Criminal Defence Service (CDS) schemes. In 2003-04 the LSC spent in excess of £2 billion on lawyers and NfP caseworkers who performed legal aid work, amounting to 10.9% of the total turnover of the legal services in the UK, and provided more than 2.6 million acts of assistance through CLS and CDS schemes.

b. Review of Regulatory Framework for Legal Services in England and Wales

2.17 In its report¹¹ published in July 2003, the Department for Constitutional Affairs (DCA) concluded that the current regulatory framework for legal services was “*outdated, inflexible, over complex and insufficiently accountable or transparent*”. Following on from this report, the Government announced an independent review of the regulatory framework for legal services in England and Wales, led by Sir David Clementi, Chairman of Prudential plc.

2.18 In his final report,¹² Sir David highlighted his concerns about the current regulatory framework for legal services:

“... The current system is flawed. In part the failings arise because the governance structures of the main front-line professional bodies are inappropriate for the regulatory tasks they face. A further cause is the over-complex and inconsistent system of oversight regulatory arrangements for existing front-line regulatory bodies.¹³ ... There are no clear objectives and principles which underlie this regulatory system; and the system has insufficient regard to the interests of consumers. Reforms have been piecemeal, often adding to the list of inconsistencies. The complexity and lack of consistency has caused some to refer to the current system as a maze.”

2.19 To simplify the current regulatory framework, Sir David recommended the establishment of the Legal Services Board (LSB), a new legal regulator to provide consistent oversight of the front line regulators (FLRs). He recommended that regulatory power should be vested in the LSB, with powers to devolve regulatory functions to the FLRs, subject to their competence and governance arrangements.

¹¹ Department for Constitutional Affairs, 2003.

¹² Clementi, 2004b.

¹³ The existing front-line professional bodies for legal services are the Law Society, the Bar Council, the Institute of Legal Executives, the Chartered Institute of Patent Agents, the Institute of Trade Mark Attorneys and the Council for Licensed Conveyancers, Court of Faculties, and the Immigration Services Commissioner.

- 2.20 He also recommended that FLRs should be required to make governance arrangements to separate their regulatory and representative functions to remove the harm to consumers resulting from the inevitable conflicts of interest for FLRs when combining both roles in one body. In addition, the statutory objectives of the LSB should ensure that the regulatory framework would be designed to promote public and consumer interest, and to facilitate competition in the legal services market.
- 2.21 Sir David also emphasised his concerns about the restrictive nature of current business structures in the provision of legal services in his final report:
- “...business practices have changed. In particular the skills necessary to run a modern legal practice have developed; but whilst those with finance or IT skills may sit on the management committee of a legal firm, they are not permitted to be principals in the business. There is concern also about whether the restrictive practices of the main legal professional bodies can still be justified...”*
- 2.22 Sir David recommended the facilitation of legal disciplinary practices, which would bring together lawyers from different legal professions, for example solicitors and barristers working together on an equal footing, and would permit non-lawyers to be involved in management and ownership of these practices.
- 2.23 In his final report, Sir David also highlighted his concerns about the complaint handling arrangements in the provision of legal services:
- “There is considerable concern about how consumer complaints are dealt with. The concern arises at a number of levels: at an operating level, there is an issue about the efficiency with which the systems are run; at an oversight level, there is a concern about the overlapping powers of the oversight bodies; and at a level of principle, there is an issue about whether systems for complaints against lawyers, run by lawyers themselves, can achieve consumer confidence. A large number of the responses to the Consultation Paper expressed dissatisfaction with the current arrangements.”*
- 2.24 To increase the independence of the complaint system and to simplify the system for consumers and suppliers of legal services, Sir David recommended the establishment of the new Office for Legal Complaints (OLC), a single independent body to handle consumer complaints in respect of all members of FLRs, subject to oversight by the LSB.

Rationale for existing regulation of legal services

- 2.25 Effective competition within the legal services industry can deliver two key benefits:
- Lawyers in effective competition with each other develop new ways to deliver services to their customers, using new delivery methods and new business structures. As innovations reduce costs or improve the quality of the services on offer, consumers benefit as the price of legal services falls.
 - Those lawyers (and their firms) that offer better value for money can expand at the expense of the inefficient. This not only improves outcomes for domestic consumers it also improves the competitiveness of the UK legal services industry in an increasingly global market.
- 2.26 Markets in which competition is weak not only allow inefficient firms to survive, but can also weaken their incentives to innovate. In the extreme, firms in an uncompetitive environment can use market power to raise prices and restrict output, and hence earn higher profits at their customers' expense.
- 2.27 Free markets will only deliver efficient outcomes if a significant number of consumers have full information about the nature of the goods or services provided including the price/quality trade-off to be able to make purchasing judgements. The legal services market fails to do so as it does not display these characteristics.
- 2.28 Lawyers' customers often lack the detailed knowledge necessary to make an accurate assessment of the value for money of the services they procured or indeed whether legal advice and representation they received can resolve their problems.¹⁴ In addition, the 'credence' nature¹⁵ of legal services means that even after the consumer has received the expert advice, they may still be unable to judge the quality of the advice or representation received. The problem is exacerbated by the fact that many legal services are purchased infrequently, which means that consumers do not have the opportunity to compare the quality of advice they received against previous purchases. This problem can have the following consequences:
- If many consumers are unable to distinguish between high-quality and low-quality suppliers, there is a risk that bad suppliers will drive out good suppliers by offering poor-quality services.¹⁶

¹⁴ These are examples of problems caused by information asymmetries.

¹⁵ Darby and Karni, 1973.

¹⁶ This is an adverse selection problem.

- Many consumers do not have sufficient knowledge to judge whether the legal services being provided by lawyers are necessary or adequate. When consulted by consumers, lawyers will usually diagnose the legal problem, suggest remedies and implement them. In circumstances where lawyers may have private interests that differ from their customers, there may be incentives for lawyers to over-provide their services (in terms of quantity or quality) above the socially desirable level.¹⁷

2.29 The existence of information asymmetries in the legal services market suggests regulation of this market is required. Indeed, self-regulatory bodies, such as the Law Society and the Bar Council, have imposed regulations on entry to the professions, conduct and business structures on their members in an attempt to correct the market failures. Monitoring and complaint mechanisms and punishments for possible breaches of rules are also in place to ensure that members of the professions adhere to the regulations.

Rationale for Government intervention: Why independent oversight regulation and complaint handling is needed

- 2.30 Self-regulation by the legal professions offers three distinct benefits. First, self-regulatory bodies typically have a greater degree of expertise and technical knowledge about the professions than an external regulatory authority. This information advantage allows the self-regulatory bodies better to guarantee quality of services, monitor compliance and enforce the necessary codes of conduct. Consequently, costs of information for the formulation and interpretation of quality standards, monitoring, and enforcement can be reduced. Second, self-regulatory bodies may be able to draft and review regulations more quickly and flexibly to respond to changes in consumer preferences. Third, the costs of regulations are borne by the regulated sectors of the professions themselves when they are self-regulated, via membership fees – although there is a risk that a part of the regulatory costs may be passed on to the consumers of legal services.¹⁸
- 2.31 Despite self-regulation, the risk remains that market failures due to information asymmetries will persist. The lack of consumer focus in the current regulatory framework, coupled with the dual role of regulation and representation held by some of the self-regulatory bodies of the legal professions,¹⁹ may lead to the risk that regulations on entry to the

¹⁷ This is a moral hazard problem.

¹⁸ This is especially so if the demand for legal services only changes a little even after a large change in the price of these services.

¹⁹ Although self-regulatory bodies are required to distinguish between their regulatory and the representative functions and to break them out separately in the annual practising certificate fee under the Access to Justice Act 1999, they are not required to split the two roles explicitly.

professions, conduct and business structures could be set more strictly than necessary, to the benefit of existing suppliers.²⁰ This may lead to a restriction of competition in the legal services market, prevention of the development of new forms of competition, and limitations in opportunities for innovation and for pooling investment risks amongst potential new entrants, to the detriment of consumers. There is a risk that the negative consequences of restrictions on competition resulting from the stricter-than-necessary regulations outweigh any potential benefits of self-regulation.

- 2.32 Indeed, in a report titled '*Competition in Professions*',²¹ the Office of Fair Trading (OFT) identified a number of professional rules set by self-regulatory bodies (the Law Society and the Bar Council) which were potentially unduly restrictive to effective competition, and which may have negative implications for consumers both in terms of the quality of the legal services that they purchased and the price they paid.
- 2.33 The current regulatory framework is inconsistent. A supplier, unauthorised by a FLR, is able to provide legal services that are outside the current regulatory net without being subject to any regulation. Meanwhile a supplier authorised by a FLR, when providing the same services, is subjected to similar regulations that he or she faces when providing services that fall within the regulatory net. The fact that many consumers do not have enough information to distinguish the two creates a risk that unregulated services may drive out regulated ones, reducing quality and diminishing choices. The regulation asymmetry may also create significant anomalies between lawyers regulated by different front-line bodies, and between lawyers and non-lawyers, in terms of both consumer protection and regulatory burdens.
- 2.34 Moreover, under the current regulatory framework, legal service activities can only be brought under regulatory control by primary legislation. The result of this is that as the legal services market develops and new forms of legal services emerge, there is a risk that, without new primary legislation, consumers will not be adequately protected.
- 2.35 A lack of consumer representation within the FLRs, combined with systems for complaints against the professions that are run by the professions themselves, will not inspire consumer confidence. An absence of a significant non-legal/consumer input into the disciplinary process may impose a risk that the punishment regime for breaches is designed in such a way that makes it insufficiently credible or does not

²⁰ Shaked and Sutton, 1981.

²¹ Office of Fair Trading, 2001.

offer enough 'bite' as a deterrent. Self-regulatory bodies without significant non-legal or consumer influence may be perceived as lacking in accountability and transparency, which may then risk reducing regulatory certainty and raises the possibility of regulatory capture.²²

- 2.36 It is therefore vital to design a new regulatory framework for the legal services market that makes it possible to benefit fully from the information advantage of the professions, and simultaneously minimises the risks of anti-competitive practices and the resulting welfare loss. Moreover, the need to increase consumer confidence in the current framework justifies an investigation into appropriate institutional arrangements that can cope with the possible deficiencies of self-regulation without putting its benefits at risk.
- 2.37 The market failures described above, along with the lack of consumer confidence in some parts of the current regulatory framework for legal services, point to the need to create clear, simple oversight of regulation. In addition, a single point needs to be established to provide the oversight to eliminate the current proliferation of regulation. This will ensure greater regulatory transparency, consistency and accountability than exists currently, benefiting both consumers and suppliers of legal services.

²² Regulatory capture occurs when regulators advocate the interests of the suppliers that they regulate rather than the consumer.

3. Consultation

Within Government

- 3.1 Officials from the Department for Constitutional Affairs (DCA) have liaised with colleagues in other departments, in particular HM Treasury, the Home Office, the Cabinet Office, the Department for Trade and Industry and the Legal Secretariat to the Law Officers.
- 3.2 DCA officials have held discussions with other public bodies, in particular the Office of Fair Trading, the Legal Services Commission, the Financial Services Authority, the Office of the Legal Services Ombudsman, the Office of the Legal Services Complaints Commissioner, the Office of the Immigration Services Commission, the Better Regulation Task Force, the Scottish Legal Services Ombudsman and the Financial Ombudsman Service.

The Judiciary

- 3.3 DCA have consulted with members of the judiciary, including the Office of the Lord Chief Justice of England and Wales.

Public consultation

- 3.4 DCA officials have held discussions with key stakeholders, including Which?, Citizens Advice, National Consumer Council, the Federation of Small Businesses, the Equal Opportunities Commission, the Law Society, the General Council of the Bar, the Institute of Legal Executives, the Institute of Trade Mark Attorneys, the Chartered Institute of Patent Agents, the Council for Licensed Conveyancers, the Faculty Office, the Council of the Inns of Court and RAC Legal Services. A full list of the consultees is available on request.
- 3.5 During these discussions, the key stakeholders expressed their broad support for the proposals, and their views have been taken into account during the development of the proposals.
- 3.6 DCA officials will continue to engage with stakeholders during the development of the proposals. In addition, the Regulatory Impact Assessment will be developed further in light of responses to the White Paper.

4. Summary of options considered

4.1 There are three main parts to the overall proposal:

- reforming the regulatory framework for legal services;
- facilitating alternative business structures in the provision of legal services; and
- reforming the complaint handling arrangements in legal services.

4.2 Individual regulatory impact assessments have been produced for each of the three areas, listed in sections 5-7. A summary of the options preferred by the Government is listed in section 8.

4.3 The table below summarises the options in the proposal considered by the Government and assessed in the following parts of the Regulatory Impact Assessment.

	Options assessed in the Regulatory Impact Assessment
<p>a) Reforming the regulatory framework for legal services [see section 5]</p>	<p>i) Do nothing</p> <p>ii) Create a new single regulatory authority, the Legal Services Authority (LSA)</p> <ul style="list-style-type: none"> • The LSA to exercise full regulatory control over all legal professions, and to carry out day-to-day regulatory functions <p>iii) Establish an independent oversight regulator, the Legal Services Board (LSB)</p> <ul style="list-style-type: none"> • All regulatory roles and responsibilities of existing oversight regulators²³ to be abolished, and to be assumed by the LSB • All regulatory power to be vested in the LSB • Day-to-day regulatory functions delegated to front-line regulators (FLRs), subject to competency and governance requirements.

²³ The existing oversight regulators for legal services include the Secretary of State for Constitutional Affairs, the Master of the Rolls, the Higher Judiciary, the Immigration Services Commissioner, the Patent Office, and the Office of Fair Trading.

	Options assessed in the Regulatory Impact Assessment
<p>b) Facilitating alternative business structures in the provision of legal services [see section 6]</p>	<ul style="list-style-type: none"> i) Do nothing ii) Facilitate the formation of legal disciplinary practices (LDPs) <ul style="list-style-type: none"> • lawyers from different legal professions permitted to form LDPs to provide one-stop legal services • Non-lawyers permitted to be managers of LDPs, but not to provide other non-legal services • Outside ownership permitted, subject to safeguards iii) Facilitate alternative business structures (ABS) in the provision of legal and associated non-legal services via a licensing regime <ul style="list-style-type: none"> • Option for FLRs to apply to LSB to become an ABS regulator to regulate ABS firms • Lawyers and other non-legal practitioners permitted to jointly obtain a licence to establish multi-disciplinary ABS firms to provide legal and associated services, subject to authorisation from an ABS regulator • Non-lawyers permitted to be managers of LDPs, and to provide other associated non-legal services • Outside ownership permitted, subject to safeguards

	Options assessed in the Regulatory Impact Assessment
<p>c) Reforming the complaints handling arrangements in legal services [see section 7]</p>	<p>i) Do nothing</p> <p>ii) A single point of entry for all complaints against legal practitioners (the ‘post-box’ option)</p> <ul style="list-style-type: none"> • Single point of entry for all consumer complaints • Complaints passed down to relevant FLRs to deal with <p>iii) Establish a new, independent complaints handling body, the Office for Legal Complaints (OLC)</p> <ul style="list-style-type: none"> • OLC to handle all consumer complaints that cannot be resolved by legal services providers • The Office of the Legal Services Ombudsman and the Office of the Legal Services Complaints Commissioner to be assumed by the OLC • OLC to deal with service complaints and to refer conduct complaints to FLRs • OLC empowered to provide redress (up to £20,000)

Sectors and groups affected

4.3 The following sectors will be affected by the proposals:

- consumers of any legal services
- the legal professions that provide reserved legal services, including barristers, solicitors, legal executives, licensed conveyancers, notaries, and patent and trademark attorneys
- the legal professions that provide unreserved legal services, including general legal advisors, will writers, employment advisors and claims managers²⁴
- businesses and organisations that currently employ ‘in-house’ lawyers
- all NFP organisations that offer legal advice and purchase legal services.

²⁴ The Government is planning to introduce measures in the Compensation Bill in this session of Parliament in order to regulate claims managers.

5. Reforming the regulatory framework for legal services

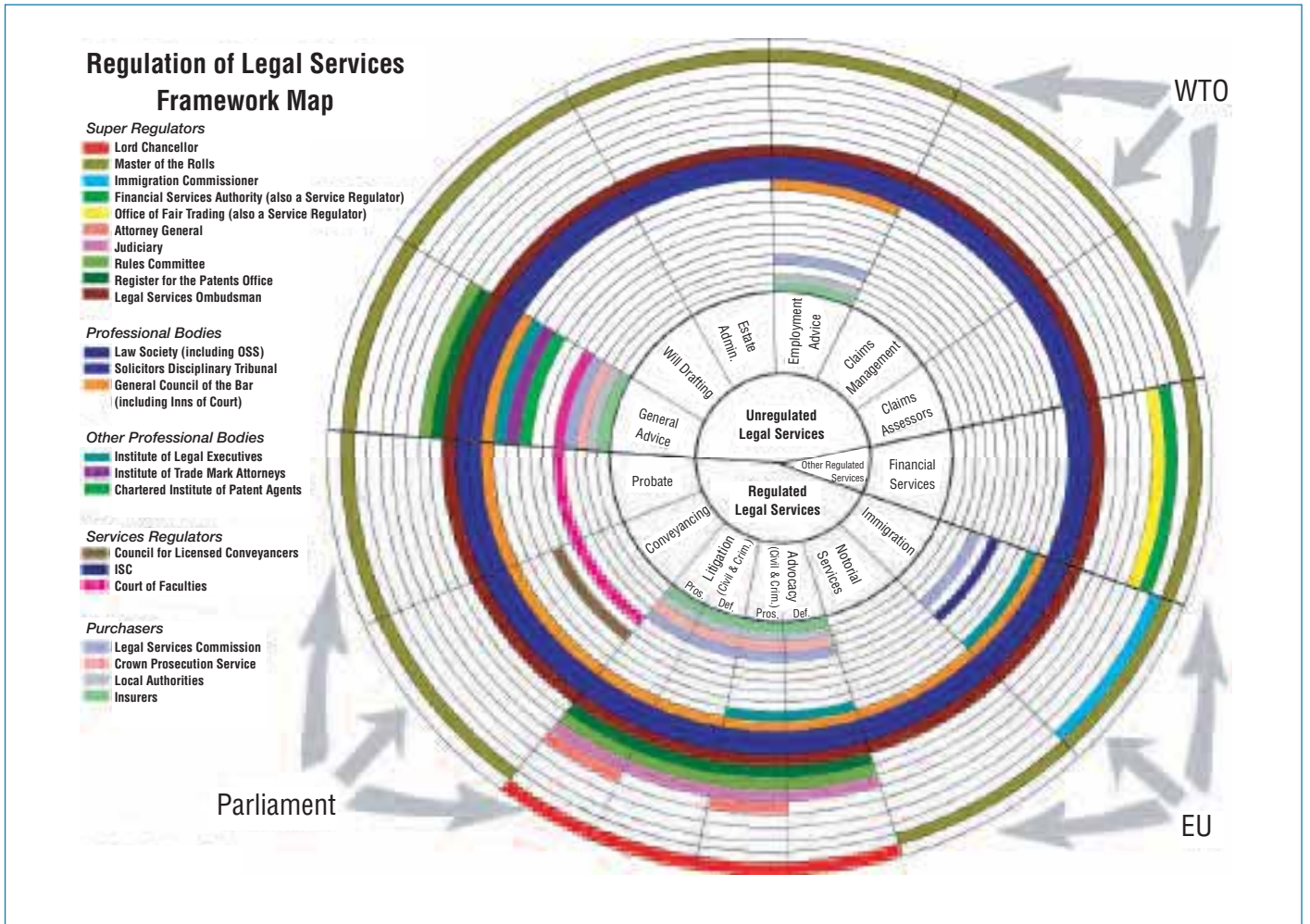
5.1 The aim of reforming the regulatory framework for legal services is to eliminate the ‘regulatory maze’ by reducing the existing multiple layers of overlapping regulators, and so increase accountability and transparency in the regulatory system. Moreover, the new framework aims to ensure that consumer interests are represented effectively, and that competition is not unjustifiably restricted.

a. Rationale for Government intervention to reform the regulatory framework

- 5.2 The current machinery for regulating legal services is vastly complex. A host of regulators have a direct impact on the provision of legal services and regulation is focused strongly on the nature and status of the provider rather than the type of service delivered.²⁵ An indication of the maze-like nature of the current regulatory framework is the fact that 22 regulators have been identified to have been participating in this framework.²⁶
- 5.3 Amongst those regulators, a number such as DCA and the European Commission act as higher level ‘super regulators’ within the regulatory framework. Important purchasers of legal services such as the Legal Services Commission or local authorities also play a quasi-regulatory role, for example by setting their own entry and quality standards.
- 5.4 The problems associated with the current regulatory framework can be seen in terms of regulatory proliferation, confusion and fragmentation, the propensity of the current structure to create regulatory anomalies and gaps, and difficulties of interface and co-operation. The diagram below gives an idea of the present proliferation, fragmentation and overlaps in legal service regulations.

²⁵ Though there have been some fairly recent changes, for example, through the creation of the Council for Licensed Conveyancers and the Office of the Immigration Services Commissioner.

²⁶ Department for Constitutional Affairs, 2003.



5.5 Some of the regulatory anomalies, gaps and overlaps include:

- some participants in the supply of legal services can be regulated but other important actors may be not (e.g. non-fee earners, immigration interpreters, and a range of intermediaries such as claims managers)
- some participants in the supply of legal services can be doubly regulated, whilst others escape regulation (compare solicitors providing non-incident financial services with will writers or claims managers)
- some services, such as legal advice, are regulated if provided by a solicitor or barrister, but not if provided by a non-legally qualified person

- the Secretary of State for Constitutional Affairs has the power to alter rules relating to the qualification or conduct of persons exercising rights of audience or rights to conduct litigation but not rules in respect of the other reserved services relating to conveyancing and probate, nor in respect of complaints
 - the front-line professional bodies are themselves regulated by super regulators such as the Secretary of State for Constitutional Affairs, the Master of the Rolls and the OFT
 - for some legal services, namely litigation and advocacy, providers potentially can be regulated by no fewer than 12 different regulators, ranging from professional bodies or ‘super regulators’, to services regulators or purchasers.
- 5.6 The provision of all services provided by solicitors and barristers are currently self-regulated by the front-line professional bodies. The main self-regulatory functions include standard setting and rulemaking, complaints handling and enforcement activity (including discipline). Where such regulations are set by a self-regulatory organisation, there is a risk that they could be set with insufficient regard to protecting and promoting consumer interests, and promoting competition, in order to create extra income for its members.
- 5.7 In addition, these front-line professional bodies also perform a representative role, acting as advocates for their members. This raises concerns as there would seem to be a real risk that the regulators’ judgements might be swayed by putting the interests of members above those of consumers of legal services, undermining public confidence in the legal services sector. Even when this is not the case, the perception of judgement being swayed may be damaging. However, the Law Society²⁷ and the Bar Council²⁸ have recently announced that they are to establish separate arms to deal with regulation of their respective professions, which will be ring-fenced from representative interests.

²⁷ The Law Society, 2005a.

²⁸ General Council of the Bar, 2005a.

b. Options for reforming the regulatory framework for legal services

- 5.8 The following options for the reform of the regulatory framework for legal services have been considered:

Option 1 – Do nothing

- 5.9 The current regulatory arrangements for legal services would be retained. Under this option, the weaknesses of the current system of regulation for existing front-line professional bodies that is over-complex and inconsistent would remain. Moreover, some existing front-line professional bodies would retain their dual roles of representing and regulating their respective professions. There is a risk that regulations on conduct and business structures would continue to be set with insufficient regard to protecting and promoting consumer interests, and promoting competition.

Option 2 – A new single regulatory authority

- 5.10 Under this option a single regulatory authority, **the Legal Services Authority (LSA)**, would be created. It would be based largely on the Financial Services Authority (FSA) model, and would exercise full regulatory control over the provision of all legal services. The LSA functions would be analogous to those that the FSA possesses, including the setting and enforcement of the rules and codes governing service provision, giving guidance and advice on general policy, and exercising investigative, enforcement and disciplinary powers. Regulatory power would be taken away from existing self-regulating bodies and vested in the LSA, with the existing professional bodies relegated to a solely representative role.

Option 3 – An oversight regulator

- 5.11 Under this option, a new independent oversight body, **the Legal Services Board (LSB)** would be created. The LSB would assume the roles and responsibilities of the range of existing oversight regulators, providing consistent and appropriate oversight of front-line regulators (FLRs). These would be existing (or new) professional or other bodies which could seek authorisation from the LSB to act as FLRs for the provision of reserved legal services,²⁹ to perform the day-to-day regulatory functions. In considering applications for authorisation, the LSB would want to ensure that FLRs met its requirements (e.g. in having appropriate governance arrangements that provide for a clear split in the exercise of their regulatory and representative functions).
- 5.12 In addition, if the LSB were not satisfied with the governance arrangements of the authorised FLR, it would have the power to call for further measures, including the right to de-authorise the failing FLR and bring it under the

²⁹ Currently, these are the right to conduct litigation; a right of audience in the courts, the provision of immigration services, certain probate services, conveyancing services, notarial services, and acting as a commissioner for oaths.

direct control of the LSB. To provide additional consumer protection, the LSB could apply for designation as an enforcer under Part 8 of the Enterprise Act 2002. This would provide the LSB with the power to seek “stop now” orders. In effect this means that the LSB would be able to obtain a court order to require practices or individual practitioners to cease carrying out a specified activity immediately, where that activity breaches certain legislation and harms the collective interests of consumers. This could be used in rare cases of flagrant and particularly damaging abuse.

- 5.13 Additional legal service activities could be brought into, or taken out of, the scope of the LSB’s regulatory reach by secondary legislation. There would be a statutory requirement for the LSB to consult the OFT, the higher judiciary and its Consumer Panel³⁰ about its major regulatory decisions³¹. The LSB would also enter discussions regularly with other statutory regulators, such as the Financial Services Authority (FSA), on regulatory issues.
- 5.14 This is the option preferred by the Government for reforming the regulatory framework for legal services.

c. Benefits and costs of options on reforming the regulatory framework for legal services

Option 1 – Do nothing

Benefits

- 5.15 There would be no additional economic or social benefits arising from this option.

Costs

- 5.16 There would be no additional economic or social costs arising from this option.

Administrative costs

- 5.17 There would be no additional administrative costs arising from this option. Using information provided by the legal professional bodies and others, it is estimated in Sir David’s Final Report that the operational³² costs of the current regulatory framework amount to £46 million annually for the existing self-regulatory bodies.³³ Furthermore, the opportunity cost of the time given by legal professionals at zero cost or on an expenses only basis in carrying out the regulatory functions amounts to an estimated £7.5 million – £9.5 million annually. In addition, the estimates did not fully capture senior judicial and Ministerial time, and therefore understate the total costs of regulation in this respect.

³⁰ The Consumer Panel would advise the LSB on the need of consumers of legal services. The members of the Panel would be appointed on merit in accordance with the rules of the Office of the Commissioner for Public Appointments, and would have experience of consumer affairs.

³¹ See paragraph 5.7 of the White Paper.

³² This includes enforcement, monitoring, rule-making activities and setting entry standards.

³³ Clementi, 2004b.

Option 2 – A new single regulatory authority

Benefits

Economic impacts

- 5.18 As all regulatory functions would be vested in, and carried out by, the LSA, the emphasis on service-driven regulation should reduce the risks of regulations on entry to the professions and conduct and business structures being set more strictly than necessary. This in turn should help promoting competition and innovation in the legal services market. Provided that the LSA can be an effective organisation in ensuring that regulation is in the consumer interest rather than that of producers, prices for legal services should fall and the market should expand, to the benefit of consumers.
- 5.19 The creation of a single and independent regulator that removes the self-regulatory elements within the regulatory framework and has significant non-legal/consumer influence should lead to greater accountability and transparency and increase regulatory certainty. This in turn should increase consumer confidence in the professions, potentially leading to an increase in the demand of legal services.
- 5.20 A single regulator is likely to give rise to the harmonisation of regulation and the reduction of regulatory inconsistencies for the legal sector. The resulting reduction of regulatory burden stemming from duplication of regulations, and increases in efficiencies could lower compliance costs for existing suppliers, and would attract new entrants into the sector and increase competition and innovation. Harmonisation of regulation should also prevent suppliers from taking advantage of the operation of different regulation covering the same services by choosing the one most convenient for them, reducing the risk of regulations being weakened and consumer protection endangered. Quality of legal services should improve as a result, to the benefit of consumers.
- 5.21 A single regulator should help in facilitating more consistency in training and entry standards, permitting common training between different legal service providers and making it easier to transfer between them. This should lower the barriers to entry to the legal services market for potential new entrants.
- 5.22 A single regulator should provide a clear forum for dealing with any conflicts in the objectives within the regulatory regime. It is better that resolution of such conflict rests within one accountable body, rather than in separate bodies where deadlock may arise.
- 5.23 The fact that the LSA would have the power to set and impose directly rules, standards of services and rules of conduct consistently across the legal professions, would mitigate the risk of regulatory capture. This would ensure that decisions are taken independently and would facilitate consumer input into the decision making process, thus protecting consumer interests.

- 5.24 A single regulator should permit significant flexibility in the system. The emergence of new services that require regulation would not require the setting-up of new bodies to regulate them in the future. This would reduce the propensity to create regulatory anomalies and gaps. It would also make it easier to regulate firms with alternative business structures (ABS), which bring together lawyers and other providers of associated non-legal services to organise themselves in new ways.

Social impacts

- 5.25 There would be no additional social benefits arising from this option.

Costs

Economic impacts

- 5.26 There would be a substantial risk that by increasing workload after its creation and without sound management, the LSA could become an overly bureaucratic and inefficient organisation, with consequent issues of costs and unwieldy procedure. In addition, it is possible that regulatory expertise would be lost during the transitional period. Moreover with all regulatory functions being performed by the LSA, the potential for competition between FLRs would be removed.
- 5.27 Establishing an independent LSA with all regulatory powers vested in it would make it less likely that the information advantage of the legal professions for setting entry standards and training, formulating professional rules, monitoring compliance and enforcing the necessary codes of conduct would be utilised. It would be less likely that the professions would be willing to give up time freely to support the regulatory system, and consequently the cost of information for the formulation and interpretation of quality standards may rise. Without the expertise of the professions, the risk increases for the regulatory framework to be set inappropriately, to the detriment of consumers and the professions. Furthermore, the removal of regulatory functions from the professions may lessen the feeling of responsibility professionals have for the quality standards of their professions and thus increase monitoring and enforcement costs.
- 5.28 There is a risk that the creation of the LSA would produce additional regulatory burdens on the professions, thus incurring significant additional compliance costs for existing and potential new suppliers. This may result in existing suppliers transferring the additional costs to consumers, leading to price increases without any corresponding increase in quality. Moreover, there is a risk that these costs would fall disproportionately on legal practitioners in rural areas and on small practices, and potentially be passed onto their customers, as there would be fewer practitioners in these practices to shoulder the additional cost burdens. The additional costs may also result in a rise in entry cost sufficient enough to deter potential new entrants to the legal services market, stifling competition and reducing the incentives for existing suppliers to innovate.

Social impacts

- 5.29 Although the LSA would be independent from Government and fully funded by the professions, the fact that all regulatory powers would be vested in the LSA may risk raising questions about the independence of the legal professions from outside influence. It has been argued that the resulting detrimental effect on the confidence of the UK legal professions may deter foreign consumers of legal services from using the UK (and London in particular) as a centre for international and commercial litigation and arbitration. Figures show that up to 4,000 international disputes a year take place in London, and above 90% of disputes handled by international law firms in London involve at least one foreign party with monies in dispute totalling over US\$40 billion in 2002.³⁴ Finally, there is a possibility that foreign regulatory bodies of legal services would not recognise some or all parts of the new regulatory framework.

Administrative costs

- 5.30 Using the information provided by the legal professional bodies, the operating cost for the LSA, excluding the complaint and disciplinary functions, were estimated in Sir David's Final Report to be £47 million annually, meaning that the LSA option would incur an estimated £1 million extra annually compared with the 'do nothing' option.³⁵ In the case of LSA it has been assumed that costs would rise, if regulatory functions were moved to a single regulatory authority, from less uncoded practitioner time. Against this, there would be certain economies through collapsing various regulators into one body.
- 5.31 These estimates assume that the underlying nature and volume of regulatory activities under the new LSA would not be substantially different from those performed under the current regulatory framework. They also take into account the costs of adding a Chief Executive and Board with non-executive directors to the LSA, and the remuneration to members of the advisory panels, which is assumed to replace some of those existing legal professionals who currently carry out regulatory duties voluntarily. The estimates also take into account the assumed saving of 10% of current indirect costs, as a result of realising some economies of scale in managing the infrastructure.³⁶
- 5.32 The £1 million annual additional operating costs of switching to the new LSA would not represent a significant proportion of the value of the UK legal services market of £19 billion annually.
- 5.33 In addition to the operating costs, Sir David Clementi also considered the costs associated from transferring from the existing regulatory framework to the future recommended regulatory model. These included

³⁴ International Financial Services London, 2005.

³⁵ Clementi, 2004b.

³⁶ Clementi, 2004b.

transition costs relating to people, facilities, technology, and set up. Whilst Sir David considered that these transition costs were beyond the scope of his review, he nevertheless made some indicative assessments of these costs. Sir David engaged Ernst & Young to carry out some work to help him estimate the level of these costs. Ernst & Young based their work on a number of key assumptions made by Sir David Clementi's review team which were detailed in their report on transition costs as well as a caveat³⁷. The outcome of this assessment suggested that costs would be in the region of slightly over £37 million for the LSA.

Option 3 – An oversight regulator

Benefits

Economic impacts

- 5.34 By providing a single point of consistent oversight regulation, the establishment of the LSB would lead to a reduction of inconsistencies in the current regulatory framework in the form of regulatory proliferation, confusion, fragmentation and anomalies for the legal sector. The process of altering professional rules as a response to changes in market conditions would also be streamlined. This should result in a reduction in the regulatory burden for existing suppliers and an increase in efficiency. Consequently, new entrants should be attracted to the legal services market, increasing competition and driving innovation within the sector.
- 5.35 The flexibility of the system that allows the LSB to authorise new FLRs to regulate their members in the provision of a range of services and to allow existing FLRs to also regulate newly reserved areas of legal work would help facilitate Alternative Business Structures (ABSs). In addition, this flexibility should also increase competition for the rights to regulate the ABS firms that offer the said services. This should lead to efficiency drives amongst the ABS regulators, reducing regulatory burdens for ABS firms. Moreover this flexibility should ensure that consumers are appropriately protected, especially with the legal services market developing rapidly and new forms of legal services emerging.

³⁷ Key assumptions were set out in Section 2 of Ernst & Young's report to Sir David Clementi dealing with the transition costs to the revised regulatory framework, as well as the following caveat: "At your request and direction, we estimated the transition costs for the regulatory framework. The procedures performed are outlined in Section 2 of this report. Any differences between the procedures set forth in this report and those set forth in our engagement letter dated 2 November 2004, reflect modifications that were made at your request or discussed with you during the course of the engagement. The procedures that we performed are advisory and do not constitute an audit of the regulatory framework's historical financial statements in accordance with generally accepted auditing standards, nor do they constitute an examination of prospective financial statements in accordance with the established standards. We performed no procedures to evaluate the reliability of completeness of the information obtained. Accordingly, we express no opinion or any other form of assurance on the historical or prospective financial statements, management representations or other data of the regulatory framework included in or underlying the accompanying information. In addition, we have no responsibility to update this report for events or circumstances occurring after the date of this report. In performing the procedures, we have accumulated data, written various memoranda for our own use and have had various meetings with representatives of the Review Team. In carrying out this report, we have worked solely under the instructions of Sir David Clementi and the members of the team of the Review and Regulatory Framework for Legal Services in England and Wales for their purposes. Our report may not have considered issues relevant to third parties. Any use which third parties may choose to make of our report is entirely at their own risks and we shall have no responsibility whatsoever in relation to any such use.

- 5.36 The clear separation of regulatory and representative functions which the LSB would require FLRs to have in place, would lead to greater accountability and transparency and increase regulatory certainty. The LSB's retention of the right to carry out regulatory functions directly, should front line bodies fail, and the power to seek "stop now" orders, would give the LSB real authority and ensure that FLRs would regulate their professions in ways that are in consumers' interests. Both of these factors should increase consumer confidence in the professions. Quality of legal services should also improve as a result.
- 5.37 An LSB that has a statutory objective to protect and promote consumer interests and regulatory powers vested in it would reduce the risk of regulations on entry to the professions, conduct and business structures being set more strictly than necessary. Provided that the LSB can be an effective oversight body in ensuring that regulation is in the consumer's interest rather than that of providers, this should result in more competition leading to better value for customers and an expansion of the market, to the benefits of consumers. Consumer confidence in the legal services market should also increase.
- 5.38 A regulatory framework that gives responsibility for the regulatory functions to FLRs with an LSB that provides consistent oversight means that the information advantage of the legal professions for setting entry standards and training, formulating professional rules, monitoring compliance and enforcing the necessary codes of conduct would be retained. The risk of losing regulatory expertise during any transitional period should also be reduced. Leaving the day-to-day regulations as far as possible to the FLRs would also be more likely to increase the commitment of suppliers to high standards, reducing the risk of rising monitoring and enforcement costs.

Social impacts

- 5.39 Under the LSB, the front-line regulatory powers would be exercised at FLRs' level, subject to regulatory competencies and governance arrangements. The fact that day-to-day regulatory functions would be performed by FLRs themselves would support the principle that the legal profession should be independent of Government to be demonstrated more clearly, compared to the LSA model. This should mitigate any potential impact on UK legal services' international standing. In particular, this should reduce the risk of withdrawal of foreign purchasers and supplier of legal services from the UK legal services market, and the likelihood of English lawyers being prohibited from carrying out legal work within the foreign jurisdictions post-reform, compared with the LSA option.

5.40 The LSB would be an organisation which is smaller, less bureaucratic and more efficient than the LSA model. As such it would have a greater ability to adjust flexibly to future changes in the legal services market, and to make the appropriate regulatory response. This should aid the future development in the market, in particular the possible expansion of the role of ABS firms in the provision of legal services, which may bring positive benefits in terms of increasing access to justice and diversity within the legal professions.

Costs

Economic impacts

- 5.41 Under the LSB option, the legal professions would be subject to regulations set by the existing FLRs (once authorised by the LSB), unless these regulations go against the regulatory criteria set by the LSB. As such, although suppliers may pass on any additional regulatory costs to consumers, this should be minimal, as the risk of additional regulatory burdens on the professions would be substantially reduced compared to the LSA option. However, in future if the LSB concludes in its assessment that the benefits of regulating those professions which are currently unregulated justify its costs, and decides to bring them into its regulatory net, then there is a possibility that new regulatory costs would fall on practitioners of those professions.
- 5.42 There is a possibility that the FLRs may utilise their knowledge of the current market conditions of the legal services market condition via the day-to-day businesses of their members, to formulate regulations that put the interests of the professions above those of consumers. However, the ability of the LSB to ‘call-in’ rules and impose sanctions, with de-authorisation of the FLR as the last resort, should substantially reduce the incentives of these bodies to set regulations in such a way that harm consumers, reducing the likelihood of this scenario happening.

Social impacts

- 5.43 There would be no additional social costs arising from this option.

Administrative costs

- 5.44 Using the information provided by the legal professional bodies, the costs of the LSB model, excluding the complaint and disciplinary functions, were estimated to be around £50.5 million annually in Sir David’s Final Report. The key drivers of the difference in costs compared to the ‘do nothing’ option (£4.5 million extra annually) are the additional cost of an LSB, which is offset by the savings from rationalisation of existing oversight functions.

- 5.45 This cost is estimated on the assumption that the LSB would have 55 staff, with a 14-member main board. The estimate also assumes that the underlying nature and volume of regulatory activities under the new LSB would not be substantially different from those performed under the current regulatory framework. The estimate also takes into account the possible costs to FLRs of segregating the governance of their regulatory and representative functions.³⁸
- 5.46 The £4.5 million annual additional operating costs of switching to the new LSB would not represent a significant proportion of the value of the UK legal services market of £19 billion annually.
- 5.47 In addition to the operating costs, Sir David Clementi also considered the costs associated from transferring from the existing regulatory framework to the future recommended regulatory model. This included transition costs relating to people, facilities, technology and set up. Whilst Sir David considered that these transition costs were beyond the scope of his review, he nevertheless made some indicative assessments of these costs. Sir David engaged Ernst & Young to carry out some work to help him estimate the level of these costs. Ernst & Young based their work on a number of key assumptions made by Sir David Clementi's review team which were detailed in their report on transition costs as well as a caveat.³⁸ The outcome of this assessment suggested that costs would be in the region of almost £4 million for the LSB.
- 5.48 Detailed analyses of the estimated operation and transitional costs of the LSB model will be carried out during further development of the Regulatory Impact Assessment.

³⁸ Clementi, 2004b.

d. Summary of benefits and costs of each option

5.49 The table below summarises the expected benefits and costs of the options on reforming the regulatory framework for legal services.

	Benefits	Costs
Option 1 – Do nothing	None.	None.
Option 2 – A new single regulatory authority (LSA)	<p>Economic</p> <ul style="list-style-type: none"> i. Simplification of current regulatory framework which reduces regulatory proliferation, fragmentation and inconsistencies. May lead to lower compliance costs for suppliers. ii. No self-regulatory element within the framework, ensuring that regulatory decisions are made in consumers’ interests. iii. Reduces the likelihood of regulatory anomalies and gaps, offering greater protection to consumers. iv. Reduces the risk of regulations being set to the detriment of competition and innovation. v. Increases the independence of regulatory decisions. vi. Increases consumer confidence via greater accountability, transparency and regulatory certainty. vii. Greater flexibility in the regulatory system, especially with regard to regulation of ABS firms. <p>Social</p> <p>None</p>	<p>Economic</p> <ul style="list-style-type: none"> i. Risk of LSA being overly bureaucratic and inefficient. ii. Lack of potential for competition amongst the FLRs iii. Potential leakage of regulatory expertise. iv. Possible increase in monitoring and enforcement costs for LSA. v. Risk of adding regulatory burdens on legal professions. May be high enough to deter potential new entrants. <p>Social</p> <ul style="list-style-type: none"> i. Perceived lack of independence of the legal professions from Government.

	Benefits	Costs
Option 3 – An oversight regulator (LSB) (preferred option)	<p>Similar expected benefits as in LSA model (option 2).</p> <p>In addition, compared to the LSA model:</p> <p>Economic</p> <ul style="list-style-type: none"> i. Consideration of regulatory roles and responsibilities of the multiple oversight regulators to a single point of consistent regulatory oversight. ii. As a relatively small oversight regulator, LSB will be less bureaucratic and more efficient. iii. Potential for competition amongst FLRs, leading to efficiency gains for FLRs and firms they regulate. iv. Risk of additional regulatory burdens reduced. v. Less likely to lose regulatory expertise during transitional period. <p>Social</p> <ul style="list-style-type: none"> i. Principle of the legal profession being independent of government will be demonstrated more clearly than if the regulatory role were removed from the professional bodies entirely. ii. Greater ability to adjust to future changes in the legal services market and to make the appropriate regulatory response. This will aid the future development in the market, bringing positive benefits in terms of increasing access to justice and diversity within the legal professions. 	<p>Economic</p> <ul style="list-style-type: none"> i. Risk of adding regulatory burdens on those suppliers of currently unregulated legal services, if these services are brought into the LSB's regulatory net. ii. Risk of the professions formulating regulations that put the professions' interests above those of consumers. Risk minimised by LSB's ability to 'call-in' rules and impose sanction to ensure that regulations will not be set in such a way that would harm consumers. <p>Social</p> <p>None.</p>

5.50 The table below summarises the estimated operating costs of the options on reforming the regulatory framework for legal services.

	Estimated operating costs per annum (£m)	Estimated additional operating costs per annum (£m) (compared to option 1)	Indicative transitional costs (£m)
Option 1 – Do nothing	46	–	–
Option 2 – LSA	47	1	37
Option 3 – LSB (preferred option)	50.5	4.5	4

6. Facilitating alternative business structures in the provision of legal services

6.1 The aim of facilitating alternative business structures in the provision of legal services is to encourage a more flexible and dynamic legal services market, responsive to changing consumer demands and expectations that engenders greater competition, innovation and consumer choice.

a. Rationale for Government intervention to facilitate effective competition in the legal services market

6.2 There have also been concerns about unjustified restrictions on competition in the legal services market. UK competition policy³⁹ is grounded in the assertion that competitive markets are the most effective vehicles for generating economic growth. Well-functioning markets provide strong incentives for good performance by encouraging firms to improve productivity, reduce costs and innovate, whilst rewarding consumers with lower prices, higher quality and wider choice. Encouraging efficiency, competition in the domestic market also contributes to UK's international competitiveness.

6.3 In March 2001, the OFT published a report⁴⁰ that identified a number of rules of the legal professions which were potentially unduly restrictive, and which may have negative implications for consumers.

6.4 Examples of these rules identified by the OFT include:

- restrictions on employed solicitors acting for third parties (Employed Solicitors' Code 1990 and Solicitors' Practice Rule 4)
- restrictions on receiving a payment for referring a client (Solicitors' Practice Rule 3)
- fee guidance issued by the Law Society in relation to probate and conveyancing work
- rules preventing barristers from forming partnerships with one another and with members of other professions
- restrictions on barristers having direct access to clients
- rules prohibiting the conduct of litigation by barristers in independent practices.

³⁹ HM Treasury, 2005.

⁴⁰ Office of Fair Trading, 2001.

- 6.5 In the report, the OFT recommended that the legal professional rules should be fully subject to competition law and that in the absence of a clear rationale for current restrictions to be in place, unjustified restrictions on competition should be removed.
- 6.6 In a subsequent report,⁴¹ the OFT welcomed the fact that some of the identified restrictions have been removed or are in the process of being removed. However, it pointed out that the remaining rules that the professional bodies have sought to justify continue to be unnecessarily restrictive⁴² and hamper the freedom for suppliers to compete in the legal services market.

b. Options for facilitating alternative business structures (ABS) in the provision of legal services

- 6.7 The following options for facilitating ABS in the provision of legal services have been considered:

Option 1 – Do nothing

- 6.8 Under this option, restrictions on alternative business structures in the legal professions would remain. In particular, restrictions on the formation of new business structures, both amongst legal practitioners of different types, and between lawyers and non-lawyers, would stay. External financing from non-lawyers into legal practices would continue to be prohibited. This option would not attract any additional costs or create any additional burdens. It would not, however, address the concern that the restrictive practices of the main legal professional bodies, in particular those which prevent different types of lawyers working together on an equal footing, may have adverse effect on competition and innovation in the legal services industry.

Option 2 – Facilitate the formation of legal disciplinary practices (LDPs)

- 6.9 Under this option, lawyers from different legal professional bodies would be permitted to form **legal disciplinary practices (LDPs)**. Non-lawyers would be permitted to be managers of LDPs, with roles to enhance the provision of legal services, but not to provide other non-legal services to the public. Outside ownership would be permitted, provided that the owners were cleared by the regulatory authorities as fit to own the LDP.
- 6.10 In the regulation of LDPs, a recognised front line regulator (FLR) would apply to the LSB for authorisation to regulate the designated types of LDPs. To obtain the authorisation from the LSB, the FLR would need to demonstrate its competence in the legal areas it wants to regulate and to satisfy the LSB of its governance and administrative arrangements. A prospective LDP would apply for a licence to be regulated by a FLR, the

⁴¹ Office of Fair Trading, 2002.

⁴² The rules on business structures are less restrictive for the NfP legal services suppliers.

granting of which would depend on whether the specified legal service areas proposed by the applicant fall within the terms of the authorisation granted by the LSB to the FLR, and on whether the applicant met the relevant safeguard tests. In particular, the prospective LDP must nominate:

- a Head of Legal Practice (HOLP), a qualified lawyer subject to a competency test on the areas in which the LDP will practice
- a Head of Finance and Administration (HOFA), who is subject to a competency test in areas which are central to practice management, particularly handling of clients' monies.

Option 3 – Facilitate alternative business structures (ABSs) in the provision of legal and other associated non-legal services via a licensing regime

- 6.11 Under this option, it would be possible for different lawyers and providers of associated non-legal services to obtain a **licence** to establish ABS firms⁴³ that contained multiple disciplines, with external financing, subject to the approval of a professional body that has obtained an authorisation from the LSB to regulate that form of ABS. Under the proposed arrangement, it would be open to a FLR to seek authorisation from the LSB to regulate ABS firms. The application would need to set out precisely the activities which the prospective ABS regulator is seeking to license, the governance arrangements which it has in place, and its competence to regulate the activities it proposes to license. If one of the activities the ABS regulator is seeking to license involves an area outside the legal profession (e.g. accountancy), the LSB would also have to seek agreement with regulators of other professions (e.g. the FSA) before giving its authorisation.
- 6.12 In addition, the ABS firm would be required to meet the standards set by the FLR. ABS firms could be 100% financed externally at the outset, but the ABS regulator would be required to ensure that the ABS firm acquires appropriate indemnity insurance cover. External investors in ABS firms would also have to pass a robust 'fit to own' test set by the FLR/LSB before being permitted to invest in the firm.
- 6.13 Moreover, a prospective ABS would be required to nominate:
- a Head of Legal Practice (HOLP), a qualified lawyer subject to a competency test on the legal areas in which the ABS will practise
 - a Head of Finance and Administration (HOFA), who is subject to a competency test in areas which are central to practice management, particularly handling of clients' monies.

⁴³ In this context, 'ABS firm' is a generic term for all types of legal business entities (e.g. commercial, NfP) that might be considered for ABS.

- 6.14 Furthermore, the LSB would be able to take appropriate actions against ABS regulators if they violated the terms of authorisation, and against the ABS firm if it violated the terms of its licence.
- 6.15 This is the Government's preferred option for facilitating ABS in the provision of legal services.

c. Benefits and costs of options on facilitating alternative business structures (ABS) in the provision of legal services

Option 1 – Do nothing

Benefits

- 6.16 There would be no additional economic or social benefits arising from this option.

Costs

- 6.17 There would be no additional economic or social costs arising from this option.

Option 2 – Facilitate the formation of legal disciplinary practices (LDPs)

Benefits

Economic impacts

- 6.18 Enabling a wider range of business structures in legal services should benefit consumers and suppliers by allowing the legal services market to work better. This is because competition between existing suppliers, and potential competition from new suppliers and from new forms of supply, would be less restricted as a result of the removal of the current restrictions. In particular, allowing new capital from outside the legal service industry should increase capacity and exert a downward pressure on prices⁴⁴ via increased competition.
- 6.19 In addition, allowing the formation of LDPs would increase the scope of sharing the risks of starting a new firm amongst new entrants to the legal services market, leading to a decrease in financing costs. This would lower the barriers to entry for potential new entrants, potentially increasing the number of suppliers in the market, stimulate more competition and encourage innovation, leading to an increase in the quality of the services.
- 6.20 The exploration of integrated legal practices would bring greater convenience to consumers by allowing a one-stop shop for different types of legal services. In addition, integrated legal practices would provide opportunities for LDPs to gain from economies of scale (economies of scope and/or economies of specialisation). If so, it is

⁴⁴ It has been noted that a combination of technology, regulatory changes and the removal of the ban on advertising have resulted in reductions in the prices of conveyancing services. See Stephen *et al.*, 1994.

expected that the costs of these legal services would fall, as consumers would now have the opportunity of purchasing services from a single LDP, if they prefer, rather than having to purchase from a number of suppliers. The degree of the reduction in costs, however, would depend on the level of competition in the legal services market.

- 6.21 Allowing external investment in LDPs would give these firms access to a wider pool of capital, for example via share issue, that could be used for new investment such as upgrading infrastructure and generating fresh ideas about how legal services can be provided in more consumer-friendly ways, which should then generate scope for further efficiency gains.⁴⁵ Additionally, the increased access to external financing and the inherent flexibility of LDPs would give more opportunities for owners to invest in expanding their businesses to take advantage of any changes in legal services market, and help to maintain or increase the international competitiveness of the UK legal service sector.⁴⁶
- 6.22 External owners of LDPs may seek to float a stake in the stock market which could then improve efficiency by sending a market signal concerning the future prospects of the firm, which prospective recruits and investors may find valuable in choosing among alternative employers and investments, and which the LDP could find useful for evaluating its own performance.⁴⁷
- 6.23 In addition, the reduction of the need for partnership equity in LDPs would lower the barriers to entry for potential new entrants,⁴⁸ potentially increasing the number of suppliers in the market, and should help to simulate more competition and encourage innovation. It would also allow owners and partners of LDPs to diversify their risks, lowering the cost of capital, and would facilitate their withdrawals from the legal services market by making their interests more liquid.⁴⁹
- 6.24 Permitting different types of legal service to be delivered via new business structures should enable more efficient delivery than at present. Corporations, with separate owners and managers, tend to provide personal legal services that involve relatively small but numerous transactions of a similar nature more efficiently, while partnership structures would be best for the more complex, diverse and relatively infrequent transactions.

⁴⁵ Dow and Lapuerta, 2005, have been argued that permitting external financing of law firms would be key to the introduction of more information technology to reduce the costs of personal legal services that involve relatively small but numerous transactions of a similar nature, and that under the current rules similar transformation would be unlikely to take place.

⁴⁶ Brealey and Franks, 2005, have argued that the strong competitive position of English law firms is likely to be maintained only if the legal profession is adaptable.

⁴⁷ Dow and Lapuerta, 2005.

⁴⁸ Brealey and Franks, 2005, have suggested that the illiquidity of partnership equity places the law firm at some competitive disadvantage in recruiting.

⁴⁹ Dow and Lapuerta, 2005, and Brealey and Franks 2005.

6.25 External financiers of LDPs may want to build up the reputation of the newly-established LDPs by developing brands and by ensuring the quality of the services they offer satisfy consumers' demands.⁵⁰ Once the reputation has been established, the LDPs would have strong incentives to maintain a high quality of service such that business would not be lost as a result of tarnished reputations. As a result, the owners may demand stricter operational discipline such as higher level of internal controls with checks and balances in connection with consumers' monies (in particular if the LDP becomes a public limited company) to protect the reputation, which could potentially lead to an increase in efficiency. This should also lessen the likelihood of harm done to consumers due to conflict of interests.⁵¹

Social impacts

- 6.26 It is anticipated that innovations in the legal services market, driven by the expected increase in the level of competition in the market, could lead to the introduction of new customer service techniques and new channels for delivering services. As a result, less mobile consumers and those living in rural areas, may find it more convenient to purchase legal services, enhancing access to justice.
- 6.27 The reduction of the need for partnership equity in LDPs is expected to provide more opportunities to a wider range of individuals, such as female legal professionals⁵² and those from lower income groups,⁵³ who have the required competence but not the capital or time to progress within existing legal partnership arrangements. It should also make it easier for LDPs to hire and retain high-quality paralegal and managerial staff.
- 6.28 The potential increase in the number of suppliers in the legal services market may also raise the possibility of increased training opportunities for law students, including those from under-represented groups. In particular, it has been pointed out that the increased flexibility provided by LDPs would improve the representation of women and their retention at the Bar.⁵⁴ This could also help to increase diversity in the legal professions further.

⁵⁰ Grout, 2005, using data provided by The Law Society, shows that claims of 'dishonest practice' are disproportionately generated by smaller law firms (as measured by number of partners) which tend to have less incentives to build up reputation compared to their larger counterparts.

⁵¹ Blanes i Vidal, Jewitt and Leaver, 2005.

⁵² Blanes i Vidal, Jewitt and Leaver, 2005 have been noted that the current business structures are particularly unsuitable for the progress of female solicitors.

⁵³ Office of Fair Trading, 2001.

⁵⁴ Blanes i Vidal, Jewitt and Leaver, 2005.

Costs

Economic impacts

- 6.29 Although constrained by the existing regulatory framework, many in the legal profession have sought to extend the range of legal and non-legal services that they can deliver. For example, a number of legal practices currently offer financial services as part of an all-round service to their customers. Under this option, LDPs would only be allowed to offer solely legal services, which would be more restrictive than the current system where legal practices can offer compatible services such as financial advice and services, general business advice and estate agency services. This would reduce the incentives for prospective owners to start a new LDP, reducing the scope of competition within the legal services market, to the detriment of consumers of legal services.
- 6.30 Concerns have been expressed that the introduction of outside ownership of LDPs may lead to the leaking of information protected from disclosure under legal professional privilege (LPP) due to unreasonable commercial pressure or conflicts of interest,⁵⁵ compromising the interests of consumers. However, it has been pointed out that the potential harm from conflicts of interest caused to consumers is often induced by the inability of owners to perfectly control managers, rather than by their excessive ability to do so.⁵⁶ In addition, it is expected that the proposed safeguards in place, such as the fitness-to-own test and the incorporation of a HOLP and a HOFA in the LDP, would minimise this risk.⁵⁷ Furthermore, commercial considerations should also play an important role in protecting confidential information.

Social impacts

- 6.31 There is a risk that the anticipated increase in the level of competition in the legal services market may lead to the withdrawal of some inefficient suppliers of legal services from certain areas of the market. In particular, those inefficient suppliers on local high streets and in rural areas may be forced to close down in the face of greater competition from lower cost providers. This raises the potential risk of reducing consumer choices and may have an adverse effect on access to justice. However, this risk should be mitigated by the expected changes in the provision of legal services. In particular, different legal practitioners may form integrated legal practices and be more efficient by taking advantage of the potential

⁵⁵ Brealey, and Franks, 2005, have pointed out that conflicts of interests are the other side of the coin to synergies, and if most operations of the LDP were ring-fenced, then opportunities for synergies in the LDP would be limited. The resulting gains from economies of scale are correspondingly lower.

⁵⁶ Blanes i Vidal, Jewitt and Leaver, 2005.

⁵⁷ Brealey, and Franks, 2005, have argued that conflicts of interest already exist in law firms and that the resulting problems would be better dealt with by regulation rather than by severe restrictions on outside ownership.

gains from economies of scale, thus ensuring that they can continue offering legal services (see para. 6.20). In addition, new innovations in the legal services market, driven by greater competition, would lead to new ways of legal services being delivered to consumers in rural areas, thus ensuring that their access to justice would not be diminished (see para. 6.26).

Option 3 – Facilitate alternative business structures (ABSs) in the provision of legal and other associated non-legal services via a licensing regime

Benefits

Economic impacts

- 6.32 It is foreseen that all the economic benefits listed under the LDP model would apply equally under this licensing model (see para. 6.18 – 6.25). However, it is expected that the scale of these benefits would be greater under the ABS licensing model in some areas.
- 6.33 Firstly, the business structures facilitated under the licensing regime are much less restrictive compared to the LDP model by allowing the ABS firms to be multi-disciplinary practices, offering both legal and associated non-legal services.⁵⁸ The licensing regime is also less restrictive compared to the ‘do nothing’ option as it allows ABS firms to offer reserved and unreserved legal and associated services.⁵⁹ The scope of competition within the legal services market could widen as a consequence.
- 6.34 Secondly, the ABS firms may find it easier to attract external financing than LDPs due to their ability to accommodate legal and non-legal business areas, thus allowing them to offer more service packages which would be more attractive to investors. Also the scope of sharing the risks of starting a new ABS firm would not be restricted to legal practitioners. Reduced risk for new entrants could lead to higher levels of competition than under the LDP model.

⁵⁸ Mark and Cowdroy, 2004, have noted that enactment of the Legal Profession (Incorporated Legal Practices) Act 2000 in New South Wales, Australia, has facilitated the establishment of legal practices with alternative business structures, known as Incorporated Legal Practices (ILPs). In 2005, approximately 60 of the 452 ILPs in New South Wales are multi-disciplinary.

⁵⁹ Mark and Cowdroy, 2004, have also noted that in New South Wales in 2005, approximately 20% of ILPs provide accountancy and / or financial planning services as well as legal services. The data suggests that the most common areas of practice for ILPs are commercial / corporate advisory work, financial services and conveyancing. Over 10% of the legal profession in New South Wales now work in an ILP and this number is steadily increasing.

- 6.35 Thirdly, gains from facilitating integrated practices could be larger, as consumers may benefit from the convenience of purchasing legal as well as associated non-legal services under one roof. The scale of the gains from economies of scale may also be larger, since some ABS firms could be larger than LDPs due to their ability to accommodate practitioners from a wider range of services.⁶⁰
- 6.36 Fourthly, the incentives to maintain high quality would be higher for ABS firms compared to LDPs as more areas of service would be at risk from a bad reputation.⁶¹ Owners of ABS firms may also demand even stricter operational discipline to ensure that the hard-earned reputation is maintained.
- 6.37 Moreover, ABS firms that contain practitioners from different services would allow the sharing of good practice and the sharing of innovation and technological advances across the professions. These should lead to increases in efficiency and better quality of services. The greater scope for flexibility of services that these firms provide should also allow firms to respond rapidly to changing consumer demand by offering new combinations of legal and non-legal service packages.

Social impacts

- 6.38 It is foreseen that the social benefits listed under the LDP model would apply equally under the ABS licensing model (see para. 6.26 – 6.28). However, it is expected that the scale of these benefits would be greater under this model in some areas.
- 6.39 By facilitating more new suppliers in the legal services market, the ABS licensing model may also provide more opportunities for under-represented groups to enter into and to progress within the legal professions than under the LDP model. This could help increase diversity in the legal professions further. In addition, there should also be more training opportunities for law students compared with the LDP model.
- 6.40 The potentially larger gains from economies of scale by ABS firms should mean that ABS firms would be more likely than LDP firms to centralise their back-office operations, minimising costs. This raises the possibility of providing legal services in areas where they did not exist before, e.g. in rural areas. These could now become financially viable and attractive to owners of ABS firms. Through longer opening hours, increased usage of technology and advanced customer care skills, ABS firms would be able to offer consumers better access to a wide range of legal services, enhancing access to justice.

⁶⁰ Davies, 2005.

⁶¹ Dow and Lapuerta, 2005, suggest that this is especially true for large corporations, where one scandal can harm an entire corporation's reputation and business. Moreover, the stakes of large corporations in protecting their reputations can prompt service quality that exceeds minimum acceptable levels.

- 6.41 In addition, increased efficiency and the larger scope of information-sharing with other business areas within the ABS firm may lead to suppliers becoming willing and able to offer more types of legal services that were financially unviable to provide under the present restrictive business structures.
- 6.42 The creation of ABS firms could facilitate more opportunities for civil disputes to be settled via Alternative Dispute Resolution (ADR) methods. As civil disputes often involve multi-disciplinary issues, a one-stop shop with integrated legal and non-legal services would provide a more convenient access to professional advice, which could allow the parties involved to make a more informed decision as to how the disputes would be best settled. This should increase the likelihood of the disputes being resolved using ADR methods, thus reducing the need for the parties involved to incur substantial costs, unwanted stress and uncertainty of litigation. The demand on valuable court time should also be reduced.

Costs

Economic impacts

- 6.43 Allowing alternative business structures may lead to a risk that confusion could rise within the ABS firms that have to satisfy different regulations set by an array of regulators for the various areas of the firms' businesses, raising their compliance costs. The operational costs for the different regulators may also rise, as more resources may have to be employed to ensure that regulations set by various regulators do not contradict each other. More importantly, the possibility of confusion amongst the regulators may increase the risk of certain parts of ABS firms' businesses not being properly regulated, to the detriment of consumers. Potential conflicts arising out of the rules of different regulators may also increase the risk of regulatory capture.
- 6.44 However, the LSB would minimise this risk by entering discussions regularly with other statutory regulators, such as the FSA, on regulatory issues. In addition, the statutory requirement for the LSB to consult the OFT, the higher judiciary and its Consumer Panel about its regulatory decisions, should ensure that confusion of regulations across the services would not arise.

- 6.45 There is a concern, similar to that associated with the LDP model, that the introduction of outside ownership and providers of non-legal services in ABS firms could lead to the leaking of information protected from disclosure under LPP due to conflicts of interest or professional duty to disclose information (e.g. auditors), compromising the interests of consumers. However, the ‘fit to own’ test for external investors and the incorporation of a HOLP and a HOFA would apply to the ABS firm. ABS firms would also be required to make clear to all potential clients the extent to which LPP would apply and in relation to which partners, directors or employees of the firm. These safeguards should minimise the risk of information protected from disclosure under LPP being exposed.⁶²
- 6.46 There is a risk that in a liberalised regime that facilitates alternative business structures, larger legal firms may seek to “foreclose” competition from smaller firms, reducing the choice available to consumers. However, this behaviour would be subject to vigorous scrutiny from FLRs, who would be bound by the statutory objective of promoting competition, thus mitigating the risk.

Social impacts

- 6.47 As in the LDP model, there is a risk that the anticipated increase in the level of competition in the legal services market may lead to the withdrawal of some inefficient suppliers of legal services from certain areas of the market, in particular, those located on local high streets and in rural areas. This raises the potential of reducing consumer choices and may have an adverse effect on access to justice. However, it is expected that this risk would be more likely to be mitigated in the licensing model by the expected change in the provision of legal services. In particular, reduced regulatory inconsistencies, lowered risk in starting up new legal business afforded by external financing, and the potential to offer legal and associated services under one roof, should all act as draws for potential new owners of ABS firms to enter the legal services market. In the long run this can increase the number of participants in the legal services market, and can potentially make it more competitive.
- 6.48 In particular, since the size of some ABS firms would be larger than LDPs, the scale of gains from economies of scale for these ABS firms should be larger. Thus it is more likely for practitioners from different professions to join up to take advantage of the potential gains, and to continue to offer integrated legal and associated services on high streets and rural areas. In addition, as it is expected that ABS firms would be more likely to continue offering services in these locations via increased usage of technology (see para. 6.40), access to justice should not be diminished.

⁶² Mark and Cowdroy, 2004, noted that the experience in New South Wales suggests that these conflicts in interest do not seem to arise to any greater extent than the issues created in firms under existing business structures where corporate/commercial clients exert enormous pressure on legal practitioners to provide legal advice that is ethically questionable.

Administrative costs

- 6.49 The administrative costs of regulating ABS would be determined by the extent of the regulatory activities for ABS carried out by the ABS regulator. ABS regulators would be expected to levy an ABS licensing fee on ABS firms. This fee would be fair and proportionate to the size of the firm, and would cover the cost of operating the 'licensing' scheme. As this fee is expected to be justified by the benefits ABS firms would enjoy, for example gains in the form of economies of scale, reduction in transaction costs and increased level of freedom in terms of organisational form for business structures in the legal services market, it is not expected that the fee would deter new entrants from setting up ABS firms.
- 6.50 Moreover, it is envisaged that the process of applying for an ABS licence would be no more complicated and administratively burdensome for ABS firms than the existing process for solicitor firms of applying for a practising certificate. For NfP organisations, licences can be obtained as a group, or the fee can be waived on competency grounds to minimise the burden generated from the process of obtaining and maintaining the licences, ensuring that access to justice would be safeguarded.

d. Summary of benefits and costs of each option

6.51 The table below summarises the expected benefits and costs of the options on facilitating alternative business structures in the provision of legal services.

	Benefits	Costs
Option 1 – Do nothing	None.	None.
Option 2 – Facilitate the formation of legal disciplinary practices (LDPs)	<p>Economic</p> <ul style="list-style-type: none"> i. Greater convenience to consumer by allowing one-stop shop of different types of legal services. ii. Competition enhanced by the removal of unduly restrictive professional rules. iii. Fall in start-up costs for potential new suppliers. iv. Opportunity for owners to diversify risks and lower cost of capital. v. Increases access to external financing and inherent flexibility encourage LDPs to innovate and to improve efficiency. vi. Facilitates building up of reputation, leading to increase in quality of legal services and higher protection for consumers. <p>Social</p> <ul style="list-style-type: none"> i. Enhances access to justice via new channels for delivering services. ii. Provides more opportunities for under-represented groups to enter into, and helps increase diversity in, the legal profession. 	<p>Economic</p> <ul style="list-style-type: none"> i. LDP model is more restrictive of business structures than the ‘do nothing’ option (i.e. can only offer legal business), and reduces the scope of competition within the legal services market. ii. Risk of information protected under legal professional privilege being leaked due to unreasonable commercial pressure or conflict of interest. Mitigated by proposed safeguards (e.g. HOLP and HOFA). <p>Social</p> <ul style="list-style-type: none"> i. Greater competition may lead to closure of inefficient suppliers in some locations. They may be replaced by more efficient suppliers, and/or by new delivery methods.

	Benefits	Costs
<p>Option 3 – Facilitate alternative business structures (ABS) in the provision of legal and other associated non-legal services via a licensing regime (preferred option)</p>	<p>Similar expected benefits as in LDP model (option 2), but expected to be greater due to:</p> <p>Economic</p> <ul style="list-style-type: none"> i. Ability to provide legal and associated business under one roof provides more convenience to consumers, also increases scope of efficiency gains for suppliers. ii. Licensing regime is much less restrictive in the type of business structure ABS firms are allowed to operate under, thus widening the scope of competition. iii. Easier to attract external finance and to share financial risks. iv. Higher incentives for ABS firms to maintain quality of services. <p>Social</p> <ul style="list-style-type: none"> i. Expected increase in number of suppliers leading to more opportunities for under-represented groups ii. More types of legal services to be offered due to increased efficiency and scope of information-sharing across different business areas. iii. Facilitates more opportunities for disputes to be settled via Alternative Dispute Resolution methods, reduce the need of litigation and the demand on valuable court time. 	<p>Economic</p> <ul style="list-style-type: none"> i. Confusions of different regulations amongst ABS regulators and firms. May also increase the risk of regulatory capture. Risk minimised by the statutory requirement of the LSB to seek advice and agreement with other regulators about cross-discipline regulatory decisions. ii. Risk of information protected under legal professional privilege being leaked due to unreasonable commercial pressure or conflict of interest. Mitigated by proposed safeguards (e.g. HOLP and HOFA). iii. Risk that larger legal firms may seek to ‘foreclose’ competition from smaller firms. Risk minimised by FLR’s statutory objective of promoting competition. <p>Social</p> <ul style="list-style-type: none"> i. Greater competition may lead to closure of inefficient suppliers in some locations. They are more likely to be replaced under the licensing model by more efficient suppliers, and/or by new delivery methods.

7. Reforming the complaints handling arrangements in legal services

7.1 The aim of this proposal is to simplify the current arrangements in the complaints handling of legal services encountered by consumers and suppliers, to increase accountability and transparency of the complaints handling system, to improve the way consumer complaints are handled, and to increase consumer confidence in the complaints handling system.

a. Rationale for Government intervention in reforming the complaints handling arrangements in the legal services market

7.2 The proliferation, fragmentation and overlap in the current regulatory framework are also a feature of the arrangements in the complaints handling of legal services encountered. The following are examples of some anomalies, gaps and overlap:

- The Legal Services Ombudsman (LSO), the Legal Services Complaints Commissioner (LSCC), the Secretary of State for Constitutional Affairs, the Master of the Rolls, the Court of Faculties, the Financial Services Authority (FSA), the Patent Office and the Immigration Services Commissioner are all providers of varying degrees of external oversight of complaints handling.
- Complaints against barristers and solicitors are pursued by means of different procedures even where they are providing the same service.
- A consumer seeking a conveyancing service in a high street firm may deal with two individuals – a licensed conveyancer and a member of the Institute of Legal Executives – within one transaction and, if a complaint is involved, three different complaint mechanisms may be relevant.

7.3 There are also concerns about the independence of the current complaints handling arrangements for legal services. Currently professional bodies, such as the Law Society and the Bar Council, are responsible for regulating the conduct of their members and for handling consumer complaints.

7.4 The lack of independence adds to the feeling held by many consumers that they are at a particular disadvantage in raising a complaint against a lawyer. The absence of significant consumer influence in the complaints handling system is perceived to be lacking in accountability and transparency. As a consequence, the system fails to promote consumer confidence in the legal professions.

- 7.5 In her 2004/5 annual report,⁶³ the LSO pointed out that despite some improvements in complaints handling made by the Law Society, she was dissatisfied by the Society's own internal quality control of the complaints handling arrangements. In 2004/05, 17,074 complaints were made against the 96,757 solicitors who were practising in England and Wales that fell within the Ombudsman's remit. Of the 1,265 cases that were referred to the Ombudsman, she was only satisfied with the quality of handling in 62% of the cases.
- 7.6 In the same period, 455 complaints were made against the 14,364 practising barristers. Of the 174 cases that were referred to the Ombudsman, she was satisfied with the quality of handling in 78.7% of the cases (a decreasing number over the last three years). The Ombudsman was satisfied with both turnaround times and the quality of complaint handling by the Bar Council.

b. Options on reforming the complaints handling arrangements in legal services

- 7.7 The following options on reforming the complaints handling arrangements in legal services have been considered:

Option 1 – Do nothing

- 7.8 The current structure to deal with complaints and disciplinary matters in the legal services would be retained. This would mean leaving consumer complaints with the professional bodies subject to oversight by the various bodies. Possible acts of misconduct would continue to be handled by the disciplinary procedures of the professional bodies. Tribunals that are independent of, but are funded by, the professional bodies would continue to hear cases of possible misconduct. This option would not attract any additional costs or create any additional burdens. However the proliferation, fragmentation and overlap featured in the current complaints handling arrangements would remain. In addition, the independence of the complaints system would continue to be questioned, undermining consumer confidence in the legal services market.

Option 2 – A single point of entry for all complaints against legal practitioners (the 'post box' option)

- 7.9 Under this option, a single point of entry for all consumer complaints would be established, with complaints being passed down to the FLRs to deal with them. Complaints would be sifted into different categories or type of complaints. This point of entry would essentially be a '**post box**' for all complaints.

⁶³ Legal Services Ombudsman, 2005.

Option 3 – A new complaints handling body

- 7.10 Under this option, **the Office for Legal Complaints (OLC)** would take over the role of the FLRs in handling consumer complaints. The OLC would be a single body, completely independent from the FLRs. The Office of the Legal Services Ombudsman and the Office of the Legal Services Complaints Commissioner would be assumed by the OLC.
- 7.11 The OLC would form part of the new regulatory framework involving the LSB and would be accountable to the LSB for its overall operation. This would ensure that the LSB had proper oversight of the entire regulated legal services sector. However, the LSB would have no authority to examine individual complaints.
- 7.12 Legal service providers would be required to maintain ‘in-house’ complaints handling procedures, which met standards set by the FLRs, to deal with complaints made by consumers in the first instance. The OLC would handle all complaints made against providers that could not be resolved at local level. These complaints would be passed directly to the OLC.
- 7.13 The OLC would refer potential issues of misconduct to the FLRs. The OLC would have the ability to require a FLR to inform the OLC of its decision on conduct matters.
- 7.14 In addition, the OLC would be empowered to provide redress, up to a limit of £20,000, to consumers in most circumstances. It would refer the complaints to other statutory regulators (or their redress body) concerned. The existing disciplinary arrangements with regard to acts of misconduct would be largely unchanged and would continue to be handled by the disciplinary procedures of the FLRs, although there would be LSB oversight.
- 7.15 This is the Government’s preferred option on reforming the complaint handling arrangements in legal services.

c. Benefits and costs of options on reforming the complaints handling arrangements in legal services

Option 1 – Do nothing

Benefits

- 7.16 There would be no additional economic or social benefits arising from this option.

Costs

- 7.17 There would be no additional economic or social costs arising from this option. However the proliferation, fragmentation and overlap featured in the current complaints handling arrangements would remain. In addition, complaints handling by certain professional bodies would remain unsatisfactory, and the independence of the complaint system would continue to be questioned, undermining consumer confidence in the legal services market.

Administrative costs

- 7.18 There would be no additional administrative costs arising from this option. Based on information provided by the legal professional bodies and others, the current complaints and disciplinary systems cost approximately £35 million to run annually.⁶⁴

Option 2 – A single point of entry for all complaints against legal practitioners (the ‘post box’ option)

Benefits

Economic impacts

- 7.19 This option provides a single system with one point of entry for all consumer complaints, making the system simpler for consumers. This would potentially help to accommodate alternative business structures. Inefficiency in the complaints handling system caused by consumer complaints being directed to the incorrect regulator would also be minimised.

Social impacts

- 7.20 There would be no additional social benefits arising from this option.

Costs

Economic impacts

- 7.21 A body with a ‘post box’ role for consumer complaints would put an additional operational cost burden on suppliers. This burden is likely to be transferred to consumers, leading to higher prices. The fact that this body has no power to deal with the substance of complaints would mean that the higher prices consumers would be paying would bring little, if any, benefit such as better complaints handling, to them.
- 7.22 Moreover, the complaint system would remain in the control of the legal profession, and as such could continue to fail to improve consumer confidence in the legal services industry and would not aid the regulatory framework in achieving its objectives.

⁶⁴ Clementi, 2004b.

- 7.23 As the central complaint office would be unable to award redress, there would be less incentive for suppliers to improve service quality – not least because they would no longer need to worry about the costs and consequences of complaints lodged against them.

Social impacts

- 7.24 There would be no additional social costs arising from this option.

Administrative costs

- 7.25 DCA currently does not possess an accurate estimate of the operational and transitional costs of a central complaint office that only has a ‘post-box’ function. However, the nature of the role it is expected to perform would mean that these costs are expected to be small compared to the OLC model.

Option 3 – A new complaints handling body

Benefits

Economic impacts

- 7.26 A complaint system that is independent of the legal profession would improve consumer confidence in the legal services industry and should aid the regulatory framework in achieving its objectives. In conjunction with the statutory requirement for the FLRs to separate their regulatory and representative functions under the LSB model, it would remove consumers’ concerns that systems for complaints against lawyers, run by lawyers themselves, fail to look after their interests. Consequently, consumers with valid reasons to complain, who have been reluctant to do so, should be more confident and inclined to do so, forcing suppliers to improve the service quality of legal services.
- 7.27 A single complaints body would bring greater consistency and clarity to the complaints handling process. The clearer channels for complaints handling would lead to a more efficient and effective complaint mechanism. Coupled with potential scope for economies of scale, this should lead to time and overhead savings for FLRs and suppliers of legal services.
- 7.28 The OLC would provide a single system with one point of entry for all consumer complaints, making the system simpler for consumers, and help to accommodate alternative business structures. Inefficiency in the complaints handling system caused by consumer complaints being directed to the incorrect regulator would also be minimised.

- 7.29 Since the OLC is expected to be more effective in handling complaints, and as consumers with valid reasons to complain would do so given their increased confidence in the system, it is more likely that suppliers that provide poor quality services would be complained against and be sanctioned by the OLC. Consequently, the compliance costs for these suppliers are likely to rise, for example in the form of paying financial redresses or extra investment in their 'in-house' complaints handling facilities. However, this possibility should act as incentives for these suppliers to raise the quality of their services, or to improve their complaints handling facilities so that complaints can be satisfactorily resolved in house, to the benefits of consumers.
- 7.30 The ability of the OLC to award redress of up to £20,000, which is greater than the current CCS limit, should give consumers with valid reasons to complain an increased incentive to do so by going to the OLC rather than seeking redress through the courts. Such a redress mechanism would also have a further benefit, to the profession, to the extent that consumers would have more confidence in purchasing legal services. The ability of the OLC to award an increased maximum level redress should also provide suppliers with an increased incentive to improve the service quality of legal services in order to reduce the likelihood of having complaints lodged against them.
- 7.31 The way the OLC would be funded, in part by a general levy on the profession, and in part as a payment from those against whom complaints are made (i.e. polluter pays), should provide suppliers with another incentive to improve service quality of legal services in order to reduce the likelihood of having complaints lodged against them, potentially to the detriment of their reputations.

Social impacts

- 7.32 There would be no additional social benefits arising from this option.

Costs

Economic impacts

- 7.33 There is a possibility that increased consumer confidence in the complaint system, simplification of the complaint procedures and the greater transparency of the disciplinary systems may lead to more consumers who have valid reasons to complain doing so. The resulting increase in complaint cases may increase the workload for suppliers of sub-standard legal services, as the OLC would now be more likely to follow-up a higher proportion of the complaints received. However, this

has to be balanced by the fact that firms required by the OLC to compensate for the poor service provided would have incentives to improve the quality of their services, leading to fewer complaints being lodged against them. This would reduce the likelihood of the cost involved in handling complaints being incurred in the first place.

7.34 The introduction of the OLC may mean that legal professionals are overly cautious and avoid taking on cases which are more complex or 'difficult' and could leave the supplier more susceptible to complaints, thus incurring extra cost to them. This may lead to some suppliers withdrawing from these particular markets, reducing competition, or worse still, abandoning the market all together. As a result, consumers may be unable to find a supplier that is willing to provide them with the services they demand. However, the likelihood of this happening is reduced by the proposal that the amount of redress the OLC can award would be limited to £20,000.

7.35 A complaint that involves legal and non-legal professions in the ABS firm may lead to confusion amongst the FLRs, the OLC and the regulatory bodies of the non-legal professions as to how the complaint should be handled. The lack of consistency amongst the complaint handling bodies may lead to increases in their operational the compliance costs for the ABS firms. However, by having the authority to enter into discussions with other statutory regulators, the LSB would have the opportunity to ensure that the handling of the complaint will be consistent across the professions involved.

Social impacts

7.36 There would be no additional social costs arising from this option.

Administrative costs

7.37 Using information provided by the legal professional bodies, the costs of this option are estimated to be approximately £29 million annually in Sir David's Final Report, of which around £23 million is accounted for by the OLC. The key drivers of the difference in costs compared to the 'do nothing' option (£6 million savings annually) are the savings generated through the rationalisation of numerous complaints functions into one body, and savings in indirect costs.⁶⁵

7.38 The cost is estimated on the assumption that the OLC would require staffing of 360 with a nine-member board. It is also assumed that the LSO and LSCC would no longer be required under this model but parts of their roles have been included in the cost of the complaints body, represented by senior advisory time.

⁶⁵ Clementi, 2004b.

- 7.39 In addition to the operating costs, Sir David Clementi also considered the costs associated from transferring from the existing regulatory framework to the future recommended regulatory model. These included transition costs relating to people, facilities, technology, and set up. Whilst Sir David considered that these transition costs were beyond the scope of his review, he nevertheless made some indicative assessments of these costs. Sir David engaged Ernst & Young to carry out some work to help him estimate the level of these costs. Ernst & Young based their work on a number of key assumptions made by Sir David Clementi's review team which were detailed in their report on transition costs as well as a caveat.⁶⁶ The outcome of this assessment suggested that costs would be in the region of slightly over £9 million for the OLC.
- 7.40 Since the structure of the OLC may differ from the model that estimates were made on, there is a risk that the aggregate additional costs establishing the OLC would differ from the quoted figures above.
- 7.41 Detailed analysis of the estimated operation and transitional costs of the OLC model will be carried out during further development of the Regulatory Impact Assessment.

d. Summary of benefits and costs of each option

- 7.42 The table below summarises the estimated operating and transitional costs of the options on reforming the complaints handling arrangements in legal services.

	Estimated operating costs per annum (£m)	Estimated additional operating costs per annum (£m) (compared to option 1)	Indicative transitional costs (£m)
Option 1 – Do nothing	35	–	–
Option 2 – ‘post box’	N/a	N/a	–
Option 3 – OLC (preferred option)	29	6	9

⁶⁶ Clementi, 2004b.

7.43 The table below summarises the expected benefits and costs of the options on reforming the complaints handling arrangements in legal services.

	Benefits	Costs
Option 1 – Do nothing	None.	None.
Option 2 – The ‘post box’ option	<p>Economic</p> <ul style="list-style-type: none"> i. Single point entry for all service complaints simplifies complaints handling arrangements for consumers. ii. Reduces inefficiency in complaints handling system by ensuring complaints being directed to the correct FLR. <p>Social</p> <p>None.</p>	<p>Economic</p> <ul style="list-style-type: none"> i. Lacks power to deal with the substance of complaints. ii. Fails to improve consumer confidence in the legal services industry. iii. Provides few incentive for suppliers to improve quality of services. iv. Adds operational burdens on suppliers without corresponding benefits to consumers. <p>Social</p> <p>None.</p>

	Benefits	Costs
<p>Option 3 – A new complaints handling body, the Office for Legal Complaints (OLC) (preferred option)</p>	<p>In addition to the benefits of option 2, the OLC model will provide:</p> <p>Economic</p> <ul style="list-style-type: none"> i. Independence for the complaints handling system, thus inducing consumer confidence in the legal services industry. ii. Greater consistency and clarity to complaints handling process, leading to a more efficient and effective complaint mechanism, thus inducing savings for FLRs and suppliers. iii. Incentives for suppliers to improve quality of services to protect reputations of suppliers, thus reducing the likelihood of complaints lodge against them, potentially reducing administrative burdens. <p>Social</p> <ul style="list-style-type: none"> i. Increased consumer confidence. 	<p>Economic</p> <ul style="list-style-type: none"> i. Increased workload to handle complaints for sub-standard suppliers, though this acts as an incentive for them to improve standards of service. ii. Legal professionals may become overly risk-averse and avoid taking more complex and difficult legal cases. iii. Confusion amongst FLRs, the OLC and other statutory regulators as to how complaints should be handled. The authority the LSB has to discuss with other statutory regulators will ensure the handling of complaints will be consistent across the professions involved. <p>Social</p> <p>None.</p>

8. Conclusion

a. Options preferred by the Government

- 8.1 To simplify the current regulatory framework for legal services, the Government proposes the creation of the Legal Services Board (LSB) that will provide a single point of oversight in the new system. The LSB will have regulatory power vested in it. It will authorise the FLRs to conduct day-to-day regulatory functions if it is satisfied with their competence and governance arrangements. FLRs will have to satisfy the LSB that they have separated their regulatory and representative functions. The LSB will also have statutory powers to intervene if the FLRs are judged to be failing in their duties. Moreover, the LSB will set up and maintain a Consumer Panel to ensure that it is in touch with the views and demands of different consumers. The LSB will also be able to propose to the Secretary of State any additional legal service activities that should be brought into, or taken out of, the scope of the LSB's regulatory reach by secondary legislation.
- 8.2 The proposal will also enable the facilitation of alternative business structures (ABS) in the provision of legal services. Lawyers and providers of associated non-legal services could come together, with external financing, to provide legal and associated services via a licensing regime. This would be subject to the approval of a FLR that has obtained an authorisation from the LSB to regulate that form of ABS. In addition, the ABS firm must meet the standards by the FLR. In particular, it would be required to satisfy the LSB's compensation fund and indemnity insurance requirements. Moreover, a prospective ABS must nominate a Head of Legal Practice (HOLP) and a Head of Finance and Administration (HOFA) to ensure that the conduct of legal business and practice management is in accordance with regulatory rules. External investors of the ABS firm must also pass a robust 'fit to own' test set by the FLR before being permitted to invest in the firm.
- 8.3 The Government proposes the establishment of a new Office for Legal Complaints (OLC) to provide independence in complaints handling. It will be the single point of entry for all complaints. It will handle all complaints made against providers of legal services that cannot be resolved at the local level, and will be empowered to provide redress to consumers. It will set standards for complaints handling and identify best practice. It will be accountable to the LSB for its overall operation, to ensure that the

LSB has proper oversight of the entire regulated legal service sector.

b. Summary of expected benefits and costs

8.4 The table below summarises the expected benefits and costs of the options proposed by the Government.

	Benefits	Costs
An oversight regulator (LSB)	<p>Economic</p> <ul style="list-style-type: none"> i. Consolidation of regulatory roles and responsibilities of the multiple oversight regulators to a single point of consistent regulatory oversight. ii. As a relatively small oversight regulator, LSB will be less bureaucratic and more efficient. iii. Simplification of current regulatory framework by reducing regulatory proliferation, fragmentation and inconsistencies. May lead to lower compliance costs for suppliers. iv. Risk of additional regulatory burdens reduced. v. Reduces the likelihood of regulatory anomalies and gaps, offering greater protection to consumers. vi. No self-regulatory element within the framework, ensuring that regulatory decisions are made in consumers' interest. vii. Reduces the risk of regulations being set to the detriment of competition and innovation. viii. Less likely to lose regulatory expertise during transitional period. ix. Increases the independence of regulatory decisions. 	<p>Economic</p> <ul style="list-style-type: none"> i. Risk of adding regulatory burdens on those suppliers of currently unregulated legal services, if these services are brought into the LSB's regulatory net. ii. Risk of the professions formulating regulations that put the professions' interests above those of consumers. Risk minimised by LSB's ability to 'call-in' rules and to impose sanction to ensure that regulations will not be set in such a way that would harm consumers.

	Benefits	Costs
<p>An oversight regulator (LSB) (cont.)</p>	<p>Economic</p> <ul style="list-style-type: none"> x. Increases consumer confidence via greater accountability, transparency and regulatory certainty. xi. Greater flexibility in the regulatory system, especially with regard to regulation of ABS firms. <p>Social</p> <ul style="list-style-type: none"> i. Principle of the legal profession being independent of government will be demonstrated more clearly than if the regulatory role were removed from the professional bodies entirely. ii. Greater ability to adjust to future changes in the legal services market and to make the appropriate regulatory response. This will aid the future development in the market, bringing positive benefits in terms of increasing access to justice and diversity within the legal professions. 	<p>Social</p> <p>None.</p>

	Benefits	Costs
<p>Facilitate alternative business structures (ABS) in the provision of legal and associated non-legal services via a licensing regime</p>	<p>Economic</p> <ul style="list-style-type: none"> i. Greater convenience to consumer by allowing one-stop shops of different types of legal and associated non-legal services. ii. Ability to provide legal and associated business under on roof increases scope of efficiency gains for suppliers. iii. Competition enhanced by the removal of unduly restrictive professional rules. iv. Licensing regime is much less restrictive in the type of business structure ABS firms are allowed to operate under, thus widening the scope of competition. v. Fall in start-up costs for potential new suppliers. vi. Opportunity for owners to diversify risks and lower cost of capital. vii. Increases access to external financing and inherent flexibility encourage ABSs to innovate and to improve efficiency. viii. Facilitates building up of reputation, leading to increase in quality of legal services and higher protection for consumers. ix. Higher incentives for ABS firms to maintain quality services. 	<p>Economic</p> <ul style="list-style-type: none"> i. Confusion of different regulations amongst ABS regulators and firms. May also increase the risk of regulatory capture. Risk minimised by the statutory requirement of the LSB to seek advice and agreement with other regulators about cross-discipline regulatory decisions. ii. Risk of information protected under legal professional privilege being leaked due to unreasonable commercial pressure or conflict of interest. Mitigated by proposed safeguards (e.g. HOLP and HOFA). iii. Risk that larger legal firms may seek to ‘foreclose’ competition from smaller firms. Risk minimised by FLR’s statutory objective of promoting competition.

	Benefits	Costs
<p>Facilitate alternative business structures (ABS) in the provision of legal and associated non-legal services via a licensing regime</p>	<p>Social</p> <ul style="list-style-type: none"> i. Enhances access to justice via new channels for delivering services. ii. Provides more opportunities for under-represented groups to enter into, and helps increase diversity in, the legal profession. iii. More types of legal services to be offered due to increased efficiency and scope of information-sharing across different business areas. iv. Facilitates more opportunities for disputes to be settled via Alternative Dispute Resolution methods, reducing the need of litigation and the demand on valuable court time. 	<p>Social</p> <ul style="list-style-type: none"> i. Greater competition may lead to closure of inefficient suppliers in some locations. They are more likely to be replaced under the licensing model by more efficient suppliers, and/or by new delivery methods.

	Benefits	Costs
A new complaints handling body, the Office for Legal Complaints (OLC)	Economic <ul style="list-style-type: none"> i. Independence for the complaints handling system, thus increasing consumer confidence in the legal services industry. ii. Single point of entry for all service complaints simplifies complaint handling arrangements for consumers. iii. Greater consistency and clarity in the complaints handling process, leading to a more efficient and effective complaint mechanism, thus induce savings for FLRs and suppliers. iv. Reduces inefficiency in complaints handling system by ensuring complaints are directed to the correct FLR. v. Incentives for suppliers to improve quality of services to protect reputations of suppliers, thus reducing the likelihood of complaints lodge against them, potentially reducing administrative burdens. 	Economic <ul style="list-style-type: none"> i. Increased workload to handle complaints for sub-standard suppliers, though this acts as an incentive for them to improve standards of service. ii. Legal professionals may become overly risk-averse and avoid taking more complex and difficult legal cases. iii. Confusion amongst FLRs, the OLC and other statutory regulators as to how complaints should be handled. The authority the LSB has to discuss with other statutory regulators will ensure the handling of complaints will be consistent across the professions involved.
	Social <ul style="list-style-type: none"> i. Increased consumer confidence. 	Social <p>None.</p>

8.5 The table below summarises the operating and transitional costs of the options proposed by the Government.

	Estimated operating costs per annum (£m)	Estimated additional operating costs per annum (£m)(compared to 'do nothing' option 1)	Indicative transitional costs (£m)
Legal Services Board (LSB)	50.5	+4.5	4
Office for Legal Complaints (OLC)	29	-6	9

9. Small Firms Impact Test

- 9.1 The Law Society's database shows there were 9,211 private solicitors' firms in 2004, with 75,079 solicitors with practising certificates working in these firms. Sole practitioners made up 45.3% of all solicitors' firms (4,176), while 98.5% of all firms (9,069) had no more than 25 partners. However, the data excludes information on non-admitted fee earners, as well as the number of administrative and support staff employed by solicitors' firms.
- 9.2 There are also 11,564 barristers in independent private practice, of whom 251 are not tenants in chambers.
- 9.3 As discussed earlier, there is a risk that an LSA that has to carry out all regulatory functions would produce additional regulatory burdens on the professions, thus incurring significant additional compliance costs for existing and potential new suppliers. In particular, these costs may fall disproportionately on small legal practices.
- 9.4 Under the Government-preferred option, the LSB would act as an oversight regulator, whilst delegating day-to-day regulatory functions to FLRs. As such, the LSB is not expected to impose any additional compliance costs on small legal practices. Moreover, since the establishment of the LSB would lead to a reduction of inconsistencies in the current regulatory framework, the LSB model should result in a reduction in regulatory burden for small legal firms. However, there is a possibility that new regulatory costs would fall onto small practitioners of currently unregulated professions, if the LSB decides to bring them into its regulatory net.
- 9.5 Both the LDP and the 'licensing' models are expected to provide benefits to small firms that act as consumers of legal and associated services, in that both models allow the provision of one-stop shops for these services to consumers, bringing to them greater convenience.
- 9.6 There is a risk that the anticipated increase in the level of competition facilitated by both LDP and 'licensing' models may lead to closure of small, inefficient legal suppliers in some locations. However, this risk would be mitigated by the possibility provided by both models that practitioners from different professions are allowed to join up to ensure that it is economically viable for them to continue to provide legal and associated services, and to gain from efficiency savings.⁶⁷

⁶⁷ Mark and Cowdroy, 2004, use data from the Law Society of New South Wales, Australia, to indicate that amongst the 452 Incorporated Legal Practices (ILPs) in the state which have business structures broadly similar to those proposed in the 'licensing' regime, the vast majority of these were previously sole practitioners or small partnerships.

- 9.7 The Law Society, which represents all solicitors in England and Wales, including those of small firms, has expressed its broad support for the Government proposals. In particular, the Society's ex-President has publicly said that the proposals '*will create a dynamic legal market offering a better deal for consumers and fresh opportunities for solicitors.*'⁶⁸
- 9.8 The Federation of Small Businesses (FSB) has expressed its broad support for the Government proposals. In particular, the FSB is very interested in the one-stop shop option that the licensing regime of alternative business structures in the provision of legal services provides.
- 9.9 DCA officials will continue to seek views from small legal firms and their representatives. The Department will also continue to engage closely with the Small Business Service during further development of the Regulatory Impact Assessment.

⁶⁸ Law Society, 2005b.

10. Competition assessment

- 10.1 The Department has completed the competition filter test and, based on the following findings, concluded that a simple competition assessment is required.
- 10.2 The market for legal services overall appears to be far from concentrated. The largest law firm by turnover had a market share of 4.9% in 2004. In the same year, the largest three law firms by turnover had a combined market share of 12.9%.⁶⁹
- 10.3 The proposed LSB would act as an oversight regulator, delegating day-to-day regulatory functions to FLRs. As such, it is not anticipated that any additional regulatory costs would not fall disproportionately on smaller firms. However, additional regulatory costs would fall onto practitioners of currently unregulated professions, if the LSB decides to bring them into its regulatory net.
- 10.4 Moreover, as the OLC would be funded in part as a payment from those firms against whom complaints are made (i.e. polluter pays), regulatory costs would fall more heavily on those who provide poor quality legal services.
- 10.5 Under the 'licensing' model, set-up costs should be lowered for new entrants to the legal services market, as access to external financing increases the scope of sharing the risks of starting a new firm. Moreover, as current legal firms that wish to become ABS firms have to be subject to the same set of regulations as new ABS firms, it is not foreseen that new entrants would have to meet higher ongoing regulatory costs.
- 10.6 The legal sector is traditionally not characterised by rapid technological change. However, allowing external investment in ABS firms would give them access to new capital that can be used for new investment such as upgrading infrastructure and generating fresh methods of delivering legal services, often involving the use of technology.
- 10.7 As the proposals aim to stimulate greater competition, innovation and consumer choice in the legal services market, they are expected to have an effect on market structure. Reduced regulatory inconsistencies, lowered risk in starting up new legal business afforded by external financing, and the potential to offer legal and associated services under one roof would all act as draws for potential new owners of ABS firms to enter the legal services market. In the long run this can increase the number of participants in the legal services market, and can potentially make it more competitive. There is also a possibility that existing legal and non-legal firms may merge to take advantage of the gains from economies of scale, increasing their sizes.

⁶⁹ Legal Business, 2004.

- 10.8 It is not anticipated that the new regulatory framework would restrict the ability of legal firms to choose the price, quality or location of their services. However, the range of the services these firms want to provide may be affected by the fact that the services they want to offer may be brought by the LSB into its regulatory net, thus requiring the FLRs' approvals in order to provide the said services.
- 10.9 The Department aims to use the responses gathered after further engagements with stakeholders to inform the development of any further competition assessment, and will continue to work closely with the OFT on these issues.

11. Enforcement, sanctions and monitoring

- 11.1 Under the existing arrangements, enforcement of regulations, sanctions and monitoring of compliance are carried out by the front line legal professional bodies, such as the Law Society and the Bar Council. Complaints to the professions are handled by the complaints handling arms of the various front line bodies.
- 11.2 In the LSA model, all enforcement, monitoring and sanctioning responsibilities would be transferred to the LSA. In the LSB model, the day-to-day enforcement, monitoring and sanctioning functions would be delegated to the FLRs and ABS regulators, subject to them satisfying the LSB with regard to their competence and governance arrangements. However, the LSB would be able to impose a sliding scale of sanctions if they are found to have failed.
- 11.3 For reforming the complaints handling arrangements in legal services, the 'post-office' model would provide a single point of entry for all complaints to be directed to. Complaints would then be passed down to the front-line professional bodies to be dealt with. In the OLC model, the OLC would be empowered to provide redress in most circumstances,⁷⁰ including compensation for poor service, distress, and loss from negligence.
- 11.4 The enforcement, sanctioning and monitoring processes will continue to be developed as appropriate along with the proposals outlined in the Assessment.

⁷⁰ The OLC may also refer the complaints to other statutory regulators (or their redress body) concerned.

12. Compensatory simplification measures

- 12.1 The proposals are to be seen as simplification measures in their own right. The new regulatory framework is designed to provide a clear and consistent regulatory oversight via the abolition of all regulatory roles and responsibilities of seven existing oversight regulators and the creation of an oversight body to provide a single point of oversight. This would eliminate the problems of the current framework, in terms of regulatory proliferation, confusion and fragmentation; the propensity of the current structure to create regulatory anomalies and gaps; and difficulties of interface and co-operation, thus increasing transparency, consistency and accountability.
- 12.2 Moreover, the removal of the restrictive nature of current business structures in legal services would facilitate more competition and innovation in the provision of legal services and offer more choice to consumers. It would also open up more opportunities for existing and potential new suppliers to offer new types of legal services.
- 12.3 In addition, the establishment of a single complaints handling body would simplify the complaint systems for consumers to use and also increase the efficiency with which the systems are run.

Appendix E

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