Oct 07

The Public Interest:

Delivering Scottish Legal Services

A Consultation on Alternative Business Structures

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Discussion paper issued by the Council of the Law Society of Scotland in relation to options for the introduction of alternative business structures

INTRODUCTION

This consultation paper provides background information about the delivery of legal services in Scotland and sets out various options.

In Scotland, only solicitors can own law firms and only solicitors can form partnerships with other solicitors. Recently there have been calls to re-examine the ownership and control rules, suggesting that the legal services market could benefit from allowing alternative business structures (ABSs).

The key issue is to balance consumer choice and the need for legal firms to compete nationally and internationally with continued access to justice, continued access to good quality legal services and the upholding of the core values of the solicitors' profession.

The Scottish Government has asked for the Council of the Law Society of Scotland's (the Council) assistance as it intends to publish a policy statement on this matter. The Society's feedback from this consultation will inform the Council's response to the government.

Purpose of consultation - The Council is committed to contributing to the reform and modernisation of Scotland's legal services market and justice system to meet the needs of all who use them. In focusing on the markets and legal services, it is important to keep the size and nature of the systems in proportion and to acknowledge the pace of change which is unfolding within the legal profession in Scotland. The purpose of this consultation is to allow the Council to be informed about the views of the profession and more widely as to which of the various options represents the best way forward.

Scope of consultation exercise & timetable - This consultation invites responses from both solicitors and non-solicitors. The Council wishes to be in a position to publish proposals for change in early 2008. Comments are invited by **31 January 2008**. All members of the profession and interested stakeholders are invited to comment in accordance with the directions on page 16.

BACKGROUND

The current legal services market in Scotland

- There are 1,247 legal firms in Scotland, of which 46% are sole practitioners. Of the remaining legal firms, partnership numbers range from 2 to 80.
- Of the approximate 10,500 practising certificates that are issued annually, more than a quarter are to in-house solicitors.
- Private practice firms contribute approximately £1.2 billion to the national economy. The profession is increasingly globalised and Scottish solicitors currently work in 44 countries around the world.
- The expansion in the number of universities providing law courses reflects the high demand for LLB places (approx. 1,300 in 2006).
- Public records show that nearly 1.3 million items of work were registered by solicitors in 2005/2006. However, the majority of legal work does not necessarily have a recorded or registered outcome.
- The solicitors branch of the profession can be characterised by a widening gap between high street practice and large-scale practice, reflected in the type and nature of work, profitability and specialisation.
- There is a high degree of variability in the characteristics of the market. Some areas demonstrate high levels of competition (financial services and tax, residential conveyancing, commercial) while others have relatively low levels of competition (family, welfare, debt, housing and consumer law).
- Within some areas of the market there are distinct sub-markets operating. For example, the market for employment law has distinct sectors for employers and employees. There are key differences between these sectors in sources of funding, levels of consumer information and consumer orientation. There are also geographical differences within the market. For example, there appears to be marked variation in the availability of family law practitioners across Scotland.
- There are concerns about the future supply of legal practitioners in specific areas of the market. In particular, there is a shortfall in family law practitioners, in practitioners engaged in welfare, debt and housing work, and in criminal legal aid work. There are clear indications that the number of firms undertaking civil legal aid work is reducing.

Legal Reform in England & Wales

The Legal Services Act is the vehicle by which reform in the legal services market is being taken forward for England and Wales.

The relevant part of the Legal Service Act is Part 5, which deals with the regulation of reserved legal activities and other activities by licensed bodies. The Law Society of England and Wales (LSEW) supports the main proposals of the Legal Services Act, subject to important qualifications concerning the need to ensure: -

"that the system for regulating alternative business structures is workable in practice, and contains effective safeguards to ensure that access to justice is not undermined", and "New business structures - involving partnerships between lawyers and non-lawyers, and the possibility of external ownership of law firms - should be permitted to provide legal services to the public." [i]

The Legal Services Act does not, except in very minor areas, extend to Scotland.

In its approach to alternative business structures, the Legal Services Act proceeds by way of establishing a licensing structure. The Act does not set out forms of alternative business structures that may be possible, nor does it detail how a regulatory regime might operate. At second reading of the Bill the Secretary of State said[ii]:

"Companies and firms will now be permitted to have different types of lawyers and non-lawyers working together on an equal footing and will be able to do so with the benefit of external investment. In the Bill these alternative business structures are termed licensed bodies. The Bill requires any firm or company with non-lawyer owners or managers to be licensed under Part 5 if it wishes to carry out reserved legal activities. It is important to note that the Bill also allows practices with different types of lawyers, but no external managers or owners, to emerge in advance of the Part 5 framework being commenced. These 'legal disciplinary practices' are not alternative business structures under the Bill, and will not be regulated under Part 5…….. The Bill provides a number of important safeguards, which also answer the Joint Committee's concerns about the impact of non-lawyer ownership and management on legal services. These safeguards include: a focus on the work and professional conduct standards of lawyers within alternative business structures, and a duty on non-lawyers to refrain from causing breaches of these standards; requirements for a head of legal practice and head of finance and administration; approval requirements that must be met in relation to external investors; a power for licensing authorities to apply financial penalties, including an appeals procedure and arrangements for recovery of any penalties; the referral of employees and managers to appropriate regulators; arrangements for the disqualification of persons from being involved with alternative business structures; the suspension and revocation of licences; powers of intervention for licensing authorities; and arrangements for the avoidance of regulatory conflict."

The projected timetable for implementation of the Act might permit the establishment of licensed bodies by late 2010.

Fundamental principles

The following factors should be borne in mind when considering any changes to the current structures and rules of legal services in Scotland:

Access to justice – means ensuring that those living in Scotland can expect fair and equal access to independent legal advice regardless of ability to pay and location. In resolving the debate on alternative business structures, the Council would want to develop options that contribute to ensuring access to justice across Scotland. Equally, any solution that might deliberately or inadvertently reduce such access would be of concern.

Over the past few years, there have been indications that there may be areas of the country in which legal services are not easily available, and areas of legal practice that cannot be readily accessed. Rural practices report difficulty in attracting staff and family law practices may be withdrawing from legal aid provision. These are anecdotal examples of shifts in the coverage of legal services. The Council has carried out research which indicates that the number of solicitors who are prepared to undertake civil legal aid work is falling and may decline further over the next four years.

Regulation - helps ensure that solicitors provide their services to an agreed standard. If a solicitor falls below the agreed standard then he or she can be subject to sanctions. Given the often complicated nature of legal matters, this is an important consumer safeguard.

The market for legal services requires regulation. It would be incapable of regulating itself if left to free market forces. It is increasingly recognised that regulation of lawyers should be undertaken partly by government agencies and partly by the profession itself under the guise of co-regulation. The Council takes the view that regulation of the profession should mean the requirement that provision of legal services should be regulated. Currently, both the solicitor and the solicitor's firm are regulated.

In many ways, what many people would understand to be legal services are obtainable from sources other than those regulated as providers of such. For instance, advice on claims and contracts, writing wills, drafting powers of attorney and missives. This need for regulation and consumer protection extends to other providers of legal services e.g. claims companies, and is also essential in relation to business structures comprising a combination of lawyers and non-lawyers.

The core values – The Council is especially conscious that change in the business delivery models must be structured to ensure that the core values of the solicitor's profession are maintained and encouraged. These include:

- Independence
- Duty to the court
- Putting the client's interest first
- Avoidance of conflict of interests
- Safeguarding clients' money and property
- Confidentiality and legal professional privilege
- Duty of disclosure to clients

- Integrity
- Support for the rule of law
- Competence, skill and diligence

An **independent** legal profession is one of the cornerstones of any civilised and democratic society and the profession, as officers of the court, should be free from all improper influences, such as pressure from government, the media or big business. The role of the Scottish solicitor is to provide independent assistance in Scots law in such a way that not only meets the needs of the client, but also meets the needs of the administration of justice.

Solicitors must always act in the **best interests of the client** subject to preserving their independence and observing the law, professional rules and the principles of good professional practice. They may not put their personal and financial interest before that of the client and must not act for more than one client where there is a **conflict of interest** between them. They must also **safeguard clients' money** and property that is entrusted to them. Solicitors also have a **duty to disclose** all relevant information to their clients, and if they are unable to do so because of a duty of confidentiality to another client, there is a conflict of interests between the clients.

Client **confidentiality** is fundamental to the client/solicitor relationship and the obligation is not terminated by the passage of time. Solicitors also have a duty to supervise their staff to ensure that they keep client matters confidential. Only clients have the right to insist that what they impart to their legal advisers is **privileged** and protected from disclosure, with certain specified exceptions such as the Proceeds of Crime Act.

Solicitors must behave with honesty and **integrity.**

Solicitors as officers of the court have a duty to uphold the proper administration of justice and the constitutional principle of the **rule of law**.

The issue of core values is developed in the Scottish Solicitors Code of Conduct (see Society's website).

The introduction of alternative business structures, including non-lawyer proprietors and investors whose interests and values may often diverge from these standards, will clearly have implications for the maintenance and observance of the core values.

The Council's view

The Council recognises its responsibility not only to help to ensure that legal services are available to all but also that it should take such steps to ensure that its rules and regulations do not unnecessarily prevent the Scottish legal profession from being able to operate fully in the international market place.

The Council's submissions to the Research Working Group (See Appendix B) indicated serious concerns about the possible consequences of changes to the regulatory regime in this area. Those concerns have not disappeared. However, the Society recognises that both the background against which policy positions are formulated is always changing and also that even a policy articulated as recently as 2004 may benefit from some reconsideration. It goes without saying that the Council

also believes that wider consultation is an important and valuable element in that process.

There is some basis for believing that the landscape in this policy area is changing radically and further changes may take place very quickly in the wake of the Legal Services Act coming into force. In the first place the provisions of the Legal Services Act will be sufficient to allow for alternative business structures. Secondly, the nature and type of those alternative business structures is not restricted and therefore, while we have no real indication of what regimes may be developed to regulate such alternative business structures, we can probably conclude that the market place may very well begin to look radically different in a comparatively short time. Thirdly, there is some evidence of concern within the Scottish legal services community that competitiveness in the international market place may be affected in the event that alternative business structures are available in England and Wales but not in Scotland.

The Council therefore considers that it is now right to facilitate some changes so far as concerns the nature of business structures that may be involved in the provision of legal services.

It is the Council's view that any change by the Scottish Government should be preceded by a regulatory impact assessment, especially as to how changes will affect legal aid, family law, welfare law and consumer protection law.

OPTIONS AND QUESTIONS

Preliminary issues

Opting for the status quo – The Council believes that "no change" in the area of alternative business structures is not an acceptable option.

A stepped or gradual change - In identifying options, we think it is necessary to consider not only the areas and possible models for change but the possibilities of staging the various changes over a period of time. The Joint Committee of Parliament in its report on the Legal Services Act[iii] identified a stepped approach and the Council suggests that such an approach is worth considering so far as Scotland is concerned.

The Council is also aware that there are areas in which change can be achieved relatively quickly. For example:

a) Movement between solicitor and advocate branches of the profession. The Council suggests that steps be taken to ease transfer between the profession of solicitor and that of advocate. In particular, we think that it is worthwhile investigating the rules which may impede transfer from the Faculty of Advocates to the solicitor profession. At present, an advocate transferring to the solicitor branch does not have rights of audience and would require to requalify as a solicitor advocate.

b) Intra-UK transfers – The Council suggests that the rules in relation to intra-UK transfers might be reviewed to determine whether there are opportunities to align the processes with those that currently apply in the case of transfers between EU member states, including Article 25 of the Services Directive.

The need for change does not flow simply from factors external to the profession. The Council is acutely aware of a significant number of voices in the profession calling for a change in the rules.

There are good reasons why some change must be made and why the debate should be about how we can modernise in such a way as to protect the interests of consumers and the integrity of the profession in Scotland. There needs to be an awareness of the effects on competition and a recognition of the possible problems to which attention has been drawn, but more particularly of the risks which a failure to modernise might draw in its wake. Those risks importantly include the risk of a flight of business from Scotland and the incursion into the Scottish market of other possibly unregulated providers. The effect of that would be to see services being provided without the protections and guarantees which public policy has to date required from the solicitor profession.

Legal Disciplinary Partnerships (LDPs)

In this option, the Legal Disciplinary Partnership would allow solicitors, advocates and registered foreign lawyers (including barristers) to practise as partners in the same firm or members in the same incorporated practice. Within this model there are various permutations e.g. solicitors and registered foreign lawyers without advocates or all three professions together. Regulation would be by the Society.

Obviously the Faculty of Advocates has a material interest in this particular debate. It might also be suggested that the growth of the solicitor advocate sector coupled with a relaxation in movement restrictions between the Faculty and the solicitor branch of the profession may make the restrictions easier to justify. The suggested easing of movement between the advocate and solicitor branches may also assist here.

There are a number of arguments in favour of change that would allow solicitors and advocates to practise together in Scotland. These include facilitating greater consumer choice, as may already be the case where solicitor advocates are present in firms and enhancing the quality of written and oral pleading available to clients by bringing in specialist pleaders to do court work. LDPs would also avoid the need for clients to have to instruct both a solicitor and an advocate.

There are arguments against LDPs, including the effect on the availability of an independent referral bar if there was extensive depletion of the Faculty as a centre of excellence. That might have the effect of depriving clients in rural or isolated areas of access to some of the most able and experienced practitioners at the Bar. There is also the suggestion that such a change is unnecessary given that solicitor advocates already exist in growing numbers in many firms and can provide direct access to the Court of Session and the High Court without having to instruct an advocate. It could also be argued that advocates who wish to join a solicitors' practice are free to resign from the Faculty and seek restoration to the Roll of Solicitors (or admission as solicitors if not previously admitted), and easing of transfer rules would facilitate such moves.

The Council recognises that a change even as apparently straightforward as allowing advocates and solicitors to form LDPs does raise important issues including issues of principle. We will have to ensure that access to justice in its broadest sense is not adversely affected if advocates are to be allowed to practise as part of a solicitors' firm. But equally, we have to be sure that there is a continued justification for requiring clients to have to instruct a firm of solicitors if they wish to instruct an advocate for a matter in the Court of Session or the High Court. It might be that consumer choice is already adequately provided for by the choice between an advocate and a solicitor advocate, especially if there is an easier transfer process between the Bar and the solicitor profession.

Questions for consideration: -

1. **Do you think the legal services market would benefit from a move towards a LDP model?**

2. **Is there any justification for requiring clients to have to instruct a firm of solicitors if they wish to instruct an advocate for a matter in the Court of Session or the High Court?**

3. **Is consumer choice already adequately provided for by the choice between an advocate and a solicitor advocate?**

Multi-Disciplinary Partnerships (MDPs)

There are a number of permutations within MDPs including the LDP model. Other option would involve solicitors and: -

- other professionals who are already subject to regulatory control (e.g. accountants and ICAS)
- other persons who may or may not be members of professions

- in either a partnership or an incorporated practice providing a range of services including legal services.

Legal practices offering a range of cross-discipline services already exist but require to be owned exclusively by Scottish qualified solicitors and registered foreign lawyers. Many firms of solicitors in Scotland employ people with other qualifications to provide services such as accountancy, factoring and property valuation. The MDP option would allow those others the opportunity to become full equity partners of the practice, or members in the case of an incorporated practice. The Society's Fee Sharing Rules already allow solicitors' firms to remunerate employees with a proportion of the firm's profits, but they cannot own a share of the equity.

There are several ways in which a MDP might operate. One example might be a partnership in which lawyers would remain a significant majority of the partners and non-lawyers would require to:

- have certain minimum professional qualifications
- sign a personal undertaking to accept joint and several liability under the Guarantee Fund
- be bound by the Society's Practice Rules
- follow the Society's Code of Conduct and Practice Guidelines
- apply annually for a Practising Certificate
- not hold themselves out personally as solicitors

In the Council's view the Society should remain the regulator for such practices.

The arguments in favour of MDPs include allowing firms to offer full professional development to staff with other qualifications. In addition, from the client perspective, a MDP could possibly offer clients a one-stop shop for a range of different services.

The arguments against include the question of independence (to give advice without fear or favour), as there could well be greater commercial or other pressures on solicitors in aa MDP, which could compromise a solicitor's duty of independence. There can be little doubt that a change of this magnitude would bring challenges to the way the profession works.

The Society recognises that there could well be economic advantages in MDPs although it is concerned that the concept might not be wholly compatible with the core values of the profession. However, if means could be devised to establish MDPs without compromising those protections, the Society has indicated that it would be more in favour of MDPs. Introducing MDPs would require the Society to take on the role of regulating such bodies.

The actual effect of MDPs on the provision of legal services across Scotland and especially in rural areas is unknown. If MDPs result in greater concentration of legal service provision within urban areas, rural communities could be less well served than they may be at present. The key issue will be the need to resolve any potential conflicts between different regulatory codes. Large MDPs could draw more profitable work away from smaller rural practices, leading to a restriction of access to justice given the relative remoteness of a considerable proportion of the Scottish population. However, the delivery of some legal services by electronic means and the development of an online market place might mean that such concerns become less substantial for certain services (e.g. will writing) over the next decade.

The issues surrounding MDPs call into question the continuation of the Guarantee Fund, especially if it has no cap on liability and may be called upon in circumstances where a non-solicitor principal is involved. The MDP debate brings these matters to the fore. The Guarantee Fund, which is funded entirely by the profession, is used to reimburse clients who have suffered monetary loss as a result of dishonesty of a solicitor or their staff.

Questions for consideration:-

4. **Do you think the legal services market would benefit from a move towards a MDP model?**

5. **Would the advent of MDPs be an adequate response to the demands for change from the profession and from other stakeholders?**

6. **What effect, if any would allowing non-solicitor partners have on the core values of the solicitors' profession?**

7. **What would the impact if any be on the Guarantee Fund and/or the Master Policy?**

8. **What would the effect of the creation of MDPs be on access to justice?**

9. **How would conflict between different regulatory codes be resolved?**

Shareholding option

This option allows non-solicitors to hold shares in an incorporated solicitors' practice without being able to become directors of the practice. The option distinguishes between ownership and control. It would be restricted to an incorporated practice. Both the LDP and the MDP options could be introduced using a model in which ownership is external to the practice. Again, there are variations within that shareholding option.

The arguments in favour of allowing non-solicitors to hold shares in an incorporated practice include firms being allowed to reward any member of staff with a shareholding in the practice, along the lines successfully operated by a number of other companies. This option would allow partners to retire while still owning an interest in the practice even after coming off the Roll of Solicitors, and would allow their successors greater flexibility in deciding how retiring partners are paid out. This option would also allow larger firms to have a share flotation and would take account of the desire some large firms have expressed for access to external investment capital. Control would continue to be exercised by solicitors responsible to the Law Society of Scotland as the regulatory body.

Arguments against allowing non-solicitors to hold shares in a law practice include that unless restrictions were placed on the number of shares which could be owned by any single shareholder and the definition of "control" was made explicit to ensure that qualified majorities decided the essential issues, it could become impossible to ensure that real control of the practice remained with the solicitors. Correspondingly, without the need for a professional qualification to be a shareholder, establishing objective criteria allowing non-solicitors to satisfy a "fitness to own" test may be difficult. Even if such a "fitness to own" test could be implemented, the resource implications on the Society as a regulator would be considerable, particularly for flotation on the stock market; at the least, some different approaches to practising certificate levels would have to be considered. Finally, the demand to generate profits for shareholders could compromise the independence of the solicitors in the practice and their compliance with the Code of Conduct, particularly the conflict between the interests of the clients and the interests of the shareholders.

For the shareholding model, such bodies would automatically be subject to other regulatory regimes such as The Companies Act and the rules of the London Stock Exchange (if publicly listed).

Questions for consideration:-

10. Do you think the legal services market would benefit from a move towards a shareholding model?

11. How would it be possible to ensure that control of a solicitors' practice with non-solicitor shareholders could remain with the solicitor directors?

12. Should any limit be imposed on the proportion of shares which could be owned by any single external shareholder?

13. Should any minimum proportion of shares still require to be owned by solicitors or registered foreign lawyers?

14. **What, if any, requirements should there be for non-solicitors to satisfy by way of "fitness to own"?**

15. **What, if any, charge should be levied by the Society on external shareholders and should that be a one-off or annual charge?**

Non-lawyer ownership and control option

This option allows non-solicitors to own and control legal practices. It would allow an organisation to employ solicitors and provide legal services to the public. Such organisations already exist in providing services outwith the reserved areas. This model is commonly referred to as Tesco Law.

This is the option that is set out in the Legal Services Act. The Act affects England and Wales only, but there are commercial pressures to bring some equivalent entities into operation in Scotland. The Act contemplates a "fitness to own" test without detailing any criteria that would be applied. There are significant issues in relation to client confidentiality, legal professional privilege, client protections and complaints handling which are as yet unresolved. With this option, it would be difficult to describe the entity as a firm of solicitors. It would be an organisation employing solicitors and providing legal services to customers. In many ways this option could be achieved by abolishing the reserved areas completely, allowing any type of business to provide conveyancing, litigation or executry services provided it did not trade as "solicitors".

There could be various permutations as to how these entities might operate. One variation might be for such organisations to set up separate companies to deliver legal services. Whilst these companies could be regulated by the Society under the current regime, the Society could not, in general, regulate entities that were owned and controlled by non-lawyers.

An individual solicitor employed by such organisations would be entitled to remain a solicitor and member of the Law Society of Scotland but would not be obliged to do so.

Some of the arguments in favour of non-lawyer ownership and control are focused on consumer interest. These include benefits from economies of scale, enhanced competition, wider choice and the abolition of restrictive practices.

For existing firms wishing to expand, there may be greater opportunities to access capital. With relaxation of control on structures in England and Wales, assuming the Legal Services Act is implemented in its present form, opportunities may open up that could be denied to Scottish firms in the absence of similar relaxation.

Arguments against opening up both ownership and control of law firms to non-solicitors include the potential loss of existing consumer safeguards such as the Guarantee Fund and Master Policy (a professional indemnity scheme for solicitors). Added to which, such entities would not be bound by the current Code of Conduct.

It may also be difficult to develop a "fitness to own" test that is sufficiently rigorous and broad enough to cover all potential non-solicitor owners.

The thrust of EU directives and United Kingdom legislation on prevention and detection of money laundering and recovery of proceeds of crime has been to impose substantial requirements on professionals such as solicitors to monitor the probity of clients and their transactions. That policy is in the public interest and could be undermined by allowing non-solicitor ownership and control of law firms.

Concentrating the supply of legal services into a small number of large suppliers could have implications for access to justice. This would have more of an impact where legal resources are already limited, such as rural areas.

Questions for consideration: -

16. Do you think the legal services market would benefit from a move towards a non-lawyer ownership and control model?

17. How do we ensure that the Solicitors' Code of Conduct takes priority over the interests of shareholders?

18. Would the abolition of the reserved areas provide the competition demanded by consumers while retaining the integrity of the solicitor profession?

19. Should legal professional privilege be available to the customers of practices where the owners and operators of the firm are not solicitors?

INVITATION TO COMMENT

How to respond

The Council would like to receive written responses to this consultation paper by 31 January 2008. The questions are set out for convenience at this point:-

1. Do you think the legal services market would benefit from a move towards a LDP model?

2. Is there any justification for requiring clients to have to instruct a firm of solicitors if they wish to instruct an advocate for a matter in the Court of Session or the High Court?

3. Is consumer choice already adequately provided for by the choice between an advocate and a solicitor advocate?

4. Do you think the legal services market would benefit from a move towards a MDP model?

5. Would the advent of MDPs be an adequate response to the demands for change from the profession and from other stakeholders?

6. What effect, if any, would allowing non-solicitor partners have on the core values of the solicitors' profession?

7. What would the impact if any be on the Guarantee Fund and/or the Master Policy?

8. What would the effect of the creation of MDPs be on access to justice?

9. How would conflict between different regulatory codes be resolved?

10. Do you think the legal services market would benefit from a move towards a shareholding model?

11. How would it be possible to ensure that control of a solicitors' practice with non-solicitor shareholders could remain with the solicitor directors?

12. Should any limit be imposed on the proportion of shares which could be owned by any single external shareholder?

13. Should any minimum proportion of shares still require to be owned by solicitors or registered foreign lawyers?

14. What, if any, requirements should there be for non-solicitors to satisfy by way of "fitness to own"?

15. What, if any, charge should be levied by the Society on external shareholders and should that be a one-off or annual charge?

16. Do you think the legal services market would benefit from a move towards a non-lawyer ownership and control model?

17. How do we ensure that the Solicitors' Code of Conduct takes priority over the interests of shareholders?

18. Would the abolition of the reserved areas provide the competition demanded by consumers while retaining the integrity of the solicitor profession?

19. Should legal professional privilege be available to the customers of practices where the owners and operators of the firm are not solicitors?

Additional Questions

20. What, if any, requirements should be in place to protect solicitors' independence?

21. What advantages or disadvantages do you see in a gradual or stepped introduction of alternative business structures?

If there are any areas of the debate that you feel have not been covered, please let us know.

Please mark all correspondences with "ABS Consultation" and email your response to ABSConsultation@lawscot.org.uk or send it by post or fax to the ABS Consultation Team on 0131 225 4243.

The responses to the consultation will go towards helping the Council of the Law Society of Scotland form a policy document. All respondents will be notified in due course when the policy document is put on the website.

We thank you for your participation.

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APPENDICES

Appendix A
Fundamental principles - The necessity for compliance with law including in particular Community obligations.

The Community obligations of the United Kingdom

The core values set out in the Report of the Law Society of Scotland Working Party on Multi Disciplinary Practices in 1999 were: -

- independence (to give advice without fear or favour);
- conflict of interest (not to act in a conflict of interest situation);
- confidentiality (to treat all discussions with the highest confidence; and
- privilege (the client's right to sanctity of discussion)

The Services Directive (2006/123/EC) (at Article 25)[3] recognises that the safeguarding of these values is capable of providing an objective justification for a ban on MDPs and explicitly places on any member state that does decide to permit MDPs a positive obligation to ensure that the values are protected.

"Multidisciplinary activities
1. Member States shall ensure that providers are not made subject to requirements which oblige them to exercise a given specific activity exclusively or which restrict the exercise jointly or in partnership of different activities. However, the following providers may be made subject to such
requirements:
(a) the regulated professions, in so far as is justified in order to guarantee compliance with the rules governing professional ethics and conduct, which vary according to the specific nature of each profession, and is necessary in order to ensure their independence and impartiality;
....
2. Where multidisciplinary activities between providers referred to in points (a) and (b) of paragraph 1 are authorised, Member States shall ensure the following:
(a) that conflicts of interest and incompatibilities between certain activities are prevented;
(b) that the independence and impartiality required for certain activities is secured;
(c) that the rules governing professional ethics and conduct for different activities are compatible with one another, especially as regards matters of professional secrecy.
3. In the report referred to in Article 39(1), Member States shall indicate which providers are subject to the requirements laid down in paragraph 1 of this Article, the content of those requirements and the reasons for which they consider them to be justified."

These provisions of the Services Directive are derived from EC case law and indirectly form part of law in the United Kingdom, not only as regards competition but also in regard to the exercise of the statutory power to approve rules made by the Law Society of Scotland and generally.

The law of legal professional privilege, one of the core values, has been applied and clarified since the publication of the Clementi Report in July 2005 by the adoption of the Third Money Laundering Directive (on 26 October 2005) and its implementation in parts of the Proceeds of Crime Act 2002 (as amended) and the judgment of the

Court of First Instance CFI judgment of 17 September 2007 in cases T-253 and T-125 AKZO Chemicals, delivered on 17 September 2007 (affirming AM&S)

The Third Money Laundering Directive (2005/60/EC) permits the following relaxation of the strict money laundering suspicion reporting requirement:-

"*Article 23*

2. Member States shall not be obliged to apply the obligations laid down in Article 22(1) *[the reporting obligations*] to notaries, independent legal professionals, auditors, external accountants and tax advisors with regard to information they receive from or obtain on one of their clients, in the course of ascertaining the legal position for their client or performing their task of defending or representing that client in, or concerning judicial proceedings, including advice on instituting or avoiding proceedings, whether such information is received or obtained before, during or after such proceedings."

The scope of the permitted relaxation of reporting requirements to take account of legal privilege is limited to situations where the legal services providers in question are "notaries, independent legal professionals, auditors, external accountants and tax advisors" AKZO explains the significance of this.

Under the Proceeds of Crime Act 2002 at section 330 subsection 7B (added in 2006) the requirements for a communication to be privileged include that the professional involved in the communication is "employed by, or is in partnership with, a professional legal adviser or a relevant professional adviser to provide the adviser with assistance or support," and "relevant professional adviser" is defined at section 330 subsection 14 (added along with subsection 7B) as follows:-

" a relevant professional adviser" is an accountant, auditor or member of a relevant professional body which is established for accountants, auditors of tax advisers (as the case may be) and which makes provision for-

(a) testing the competence of those seeking admission to such a body as a condition for such admission; and

(b) imposing and maintaining professional and ethical standards for non-compliance with those standards.

Appendix B
The recommendations of the Research Working Group on the Legal Services Market in Scotland

In March 2004 the Scottish Executive had established a Research Working Group on the legal services market in Scotland ("the working group") "to draw together and analyse the evidence base on the Scottish legal services market." The Executive Summary notes that "This work was driven by a desire on the part of Scottish Ministers that legal services in Scotland should be regulated in the interests of consumers, by developments at European Commission level (reviewing competition in the liberal professions) and by developments in England and Wales (a report by the Office of Fair Trading in 2001 which led to the independent review of the regulatory framework by Sir David Clementi and latterly to the publication by the

Department for Constitutional Affairs of a White Paper "The Future of Legal Services: Putting Consumers First" in October 2005)."

It was not the function of the Working Group to develop policy options. The Group agreed research aims "to identify, describe and analyse the different legal services markets operating in Scotland; to identify restrictions, whether deriving from statute, professional rules or custom and practice, which might have the effect of preventing, limiting or distorting competition in the different Scottish markets; and to identify access to justice, public interest and consumer protection factors that might justify such restrictions and to evaluate whether the restrictions were proportionate to their purpose." However "the Group also undertook to examine the evidence on alternative systems and structures across comparable jurisdictions including alternative business structures and the availability of rights of audience and rights to conduct litigation."

The working group noted in the executive summary to its report in relation to alternative business structures:

"(ix) Restrictions on business structures

25. A range of restrictions existed which prevented the use of alternative business structures for the provision of legal services. These included a restriction on partnerships between advocates; restrictions which had the effect that non-lawyers could not own law firms and that solicitors employed by an organisation in non-lawyer ownership could not offer services to the public; restrictions which meant that different branches of the legal profession could not work together in legal disciplinary practices (LDPs); and restrictions which meant that lawyers could not combine with members of other professions to form multi-disciplinary practices (MDPs).

26. The advantages and disadvantages of alternative business structures were explored by the working group, taking account of the interests of the users of legal services and the implications of change for existing regulatory arrangements. The issue of alternative business structures appeared to be likely to stay on the agenda and policy development work would be required to establish the extent to which they suited Scottish circumstances and how they might best be regulated if they were to become a reality in Scotland."

Appendix C
Society's responses to the Research Working Group

On restrictions on third party ownership etc: –
"8.28 The Law Society of Scotland could see no circumstances in which the ownership and control of law firms by non-lawyers could be permitted, without surrendering the prime objectives of maintaining independence and public protection. The Society foresaw grave risks to maintaining the rule of law if non-lawyers were to have either ownership or control of law firms. The Society considered furthermore that the risk to clients and the difficulties of regulating such firms would be insurmountable, particularly with regard to potential conflict between the commercial interests of the owners and the professional duty of solicitors working in the firm to serve the interests of the client.

On restrictions on LDPs: –
8.36 The Law Society of Scotland was concerned about the prospect of LDPs with non-lawyer ownership and was strongly opposed to the idea unless satisfactory arrangements for the regulation of non-lawyer proprietors could be identified. The Society was concerned that the ownership of legal disciplinary practices might fall into in the hands of non-lawyers involved in organised crime, money laundering or drug running. With regard to the proposals made by Sir David Clementi in his final report, the Society did not believe that the case had been made out on an empirical basis which demonstrated consumer demand for legal disciplinary practices. In the Society's view a satisfactory explanation had not been given of the arrangements for the regulation of such practices; and the fitness to own test would require to be sufficiently rigorous to prevent solicitor firms becoming prey to organised crime. Exposure of the Society's Master Policy, the Guarantee Fund and the complaints system to non-solicitors might have substantial implications for the continuity of such valuable public protections.

On restrictions on MDPs –
"8.68 The Law Society of Scotland Working Party on MDPs measured MDPs against the four core values of the solicitor profession. As regards **independence** (to give advice without fear or favour), the Working Party concluded that there could well be greater commercial or other pressures on solicitors in an MDP, which could threaten a solicitor's duty not to allow their independence to be impaired. Strict rules apply to solicitors on **conflict of interest** (not to act in a conflict of interest situation) and the concept of "Chinese walls" was not operated. Though it would be possible in theory to impose the Society's rules on all other persons in an MDP, the working party thought it would be difficult to achieve and to regulate compliance. On **confidentiality** (to treat all discussions with the highest confidence), any Chinese walls would have to separate one department from another within an MDP clearly and decisively, which would raise questions about the operational viability of MDPs. On **privilege** (the client's right to sanctity of discussion) the Society did not favour a restriction of the doctrine of legal professional privilege in view of its importance to the rule of law.

8.69 The Society was concerned that the economic advantages of MDPs were incompatible with the four core values. If means could be devised to establish MDPs without compromising those protections, the Society had indicated that it would be prepared to reconsider its view. The Society could not however see how MDPs could operate without compromising those principles, short of requiring all other MDPs to become subject to the rules of the Society.

The Society had been concerned about the effect that MDPs might have on the provision of legal services across Scotland and especially in rural areas. If MDPs resulted in greater concentration of legal service provision within urban areas, rural communities could in its view be less well served than they were at present. Large MDPs might draw more profitable work away from smaller rural practices which would be a concern, given the relative remoteness from larger towns and cities of a considerable proportion of the Scottish population. It was necessary to weigh in the balance however that the delivery of legal services by electronic means and the development of an online market place might mean that such concerns became less substantial over the next decade."

Appendix D
Process for reform in England and Wales

In a report published in July 2003[1] the UK government expressed its support for the principle of enabling legal services to be provided through alternative business structures. It said " *The Government supports in principle enabling legal services to be provided through alternative business structures. Such new structures would provide an opportunity for increased investment and therefore enhanced development and innovation, for improved efficiency and lower costs.... The Government accepts in principle that new business entities such as multi-disciplinary partnerships and corporate bodies should be allowed to provide legal services.*"

The ensuing Inquiry chaired by Sir David Clementi[1] made certain recommendations in relation to the possibility of alternative business structures. In particular the Clementi report recommended:

"101. Legal Disciplinary Practices [LDPs] are law practices which permit lawyers from different professional bodies to practice together as equals. I conclude that non-lawyers should be permitted to be Managers of such practices, subject to the principle that lawyers should be in a majority by number in the management group. The non-lawyers would be there to enhance the services of the law practice, not to provide other services to the public.

102. Outside ownership of LDPs should be permitted. Such ownership should be subject to a 'fit to own' test; but the main focus of the regulatory authorities should be upon the identity of the management team, in particular the Head of Legal Practice and the Head of Finance and Administration, and the management systems that they employ, in short on who manages the practice and how. Within England and Wales outside ownership is already permitted in respect of certain types of legal practices which provide conveyancing services; it is proposed that, subject to proper safeguards to be set by the Legal Services Board, it should now be permitted in other areas of the legal services market.

103. In the regulation of LDPs it is proposed that the focus of the regulatory system should be upon the economic unit, rather than the individual lawyer. The principle to be applied is that of 'lead regulation by reference to economic unit, residual regulation by reference to professional qualification'. Recognised front-line bodies would apply to the LSB for authorisation to regulate designated types of LDPs; and the LSB would determine each application against the recognised body's competence in particular legal service areas and the governance and administrative arrangements that the recognised body had in place.

104. Multi-Disciplinary Practices are practices which bring together lawyers and other professionals to provide legal and other services to third parties. Legal work might be only a minority of the work done by the practice. There are considerable issues around such practices, in particular that of regulatory reach; and the fact that a regulator, such as the Legal Services Board, would have no jurisdiction over activities outside the legal sector. The proposal of this review is that attention should focus on the setting up of a new regulatory system for lawyers with the LSB at its centre, and the authorisation of LDPs. This would represent a major step towards MDPs, if at some subsequent juncture the regulatory authorities considered that sufficient safeguards could be put in place."

Appendix E
The current legal framework in Scotland

Under current arrangements, the Council of the Law Society of Scotland is responsible for the regulation of solicitors in Scotland. The Council is under a statutory obligation in terms of section 1 of the Solicitors (Scotland) Act 1980 to "promote the interests of the solicitor's profession and the interests of the public in relation to that profession".

The capacity to legislate on the regulation of the legal professions in Scotland was devolved to Scottish ministers and the Scottish Parliament by the Scotland Act 1998. Accordingly, the Scotland Act expressly excepts matters relative to the regulation of the professions of solicitor and advocate in Scotland from the general reservation of the regulation of competition to the United Kingdom Parliament and ministers of the Crown.

Restrictions on alternative business structures for the legal profession in Scotland are presently found in:-

- restrictions on non-lawyers owning a law firm and on employed solicitors acting for third parties
- restrictions on legal disciplinary partnerships, and
- restrictions on multi disciplinary practice
- The Working Group – see below – set out comments on those restrictions and the rationale for each.

These restrictions were brought into effect following the Law Reform (Miscellaneous Provisions)(Scotland) Act 1990, The Solicitors (Scotland)(Multidisciplinary Practice) Practice Rules 1991 and the Solicitors (Scotland) Practice Rules 1991 on fee sharing were enacted in accordance with the Solicitors (Scotland) Act 1980 s.34(3A) which required the approval of the then Secretary of State after consultation with the Director General of Fair Trading before the rules were submitted to the Lord President for approval.

Appendix F
Legislative or regulatory changes required for -

LDP - The Society's Fee Sharing Rules (Solicitors (Scotland) Practice Rules 1991) allow solicitors to share fees and/or profits with lawyers in other jurisdictions (whether Registered or not) and with advocates but the MDP Rules (also from 1991) prohibit solicitors from forming a "legal relationship" (defined as a partnership; joint venture or membership or directorship of a corporate body) with non-solicitors except Registered Foreign Lawyers in a Multi-National Practice (which might include Barristers).

There is therefore no current barrier to a LDP including English barristers who have registered as foreign lawyers, and only Section 26 of the 1980 Act prevents a Legal Disciplinary Partnership with an advocate although Section 34 also prevents such a practice operating as an incorporated practice. In addition the Faculty of Advocates Rules currently prohibit advocates from practising other than as a self-employed sole practitioner. Advocates who were previously admitted as solicitors in Scotland can resign from the Faculty and seek restoration to the Roll of Solicitors, but thereafter

would require to seek rights of audience to appear in the Court of Session or High Court unless they have already been awarded the rank and dignity of Queen's Counsel.

MDP - Section 26 of the 1980 Act would require to be amended.
To secure such a change the Solicitors (Scotland) Act 1980 would require amendment. The Society's Rules would not need to be amended as both the Fee Sharing and MDP Rules include power to grant a waiver. In addition since Society approval for each application would be required it would be possible to secure proper regulation; the Society would be able to implement a "fit and proper person" test similar to that required to be admitted as a solicitor. The personal undertaking given by the non-solicitors would give the Society the right to consider issues of conduct of non-lawyer employees and therefore provide greater accountability than at present in matters of conduct.

Shareholding - Amendment to Sections 26, 34 and 60A of the Solicitors (Scotland) Act 1980 would be required as well as amendments to the Society's MDPs Rules and Fee Sharing Rules.

Non-legal ownership - For this option to be implemented Section 26 of the Solicitors (Scotland) Act 1980 would have to be repealed, and Sections 34 and 60A would have to be amended.

End notes: -

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[i] Briefing paper – House of lords – 6th Dec 2006 LSEW
[ii] 6th Dec 2006 – col 1165/1166
[iii] Directive 2006/123/EC Art25(2)

States shall ensure the following:

26.1 that conflicts of interest and incompatibilities between certain activities are prevented;
26.2 that the independence and impartiality required for certain activities is secured;
26.3 that the rules governing professional ethics and conduct for different activities are compatible with one another, especially as regards matters of professional secrecy:
26.4 In the report referred to in Article 39(1), Member States shall indicate which providers are subject to the requirements laid down in paragraph 1 of this Article, the content of those requirements and the reasons for which they consider them to be justified."

Comment - The requirement of objective justification is not new. It comes from EC case law. What is new is the consumer protection dimension of Article 25 (2). It means that if a member state permits multi-disciplinary practices in the regulated professions but fails to ensure the prescriptions in paragraphs 26.1, 26.2 and 26.3 above, the Member State concerned is in violation of a Community obligation.