



THE LAW SOCIETY
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THE PUBLIC INTEREST:

DELIVERING SCOTTISH LEGAL SERVICES

POLICY PAPER ON ALTERNATIVE
BUSINESS STRUCTURES

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EXECUTIVE SUMMARY

Part 1 of the paper provides an introduction and background to the legal services market in Scotland and to alternative business structures: it explains the process that the Council of the Law Society of Scotland (The Council) has followed in considering its policy; it summarises the consultation held and the response to it; and it describes the scope of the policy.

Part 2 of the paper sets out the policy discussion: it explains the objective of the policy and the Council's thinking in relation to that; and it considers a number of models of alternative business structure and what their advantages and disadvantages may be to the public and profession in Scotland. Some responses to the consultation are included by way of illustration.

Part 3 of the paper proposes a framework for the regulation of business structures.

Part 4 of the paper sets out the Council's conclusions and recommendations. For convenience, these are reproduced here:

The Council is determined that the Law Society of Scotland should continue to play a leading role in the delivery of legal services in Scotland. It wishes to ensure that the best possible framework is established for the future delivery of legal services in Scotland.

The Council recognises that the delivery of legal services in Scotland needs to respond to new demands and to developments in the provision of services. It believes it is in the interests of the public in Scotland and of the Scottish legal profession to permit, alongside traditional business models, alternative business structures that could facilitate more modern and competitive delivery of legal services.

The Council does not see any objection of principle to any of the proposed alternative business structures, as long as an appropriate system of regulation is applied to all business structures in Scotland delivering legal services. That regulation must ensure that the core values of the legal profession are protected and that service quality is maintained. The Council believes that the key is to establish a regulatory framework within which a range of business structures can develop.

The Council believes that the Society is the right body to devise the regulatory framework for alternative business structures for the delivery of legal services in Scotland. It has set out in this paper a framework for regulation. The Council intends to work constructively with the Scottish Government and with the professional bodies to develop and implement it. The Council regards the Society as the best body to regulate entities providing legal services in Scotland.

The Council intends, in consultation with the Scottish Government, to set out a timetable for early and energetic progress towards establishing the regulatory framework to allow alternative business structures to develop. Specific business structures could only be permitted once all the practical challenges relating to them had been satisfactorily resolved. The Council believes those business structures which offer fewest practical challenges should be allowed to evolve within the framework more quickly than others.

The Council takes the view that the nature of the economic market affecting the provision of legal services is changing. The introduction of alternative business structures will also have an effect on the market. This changing market will affect access to legal services. The Scottish Government needs to respond to the changing market to protect and promote fair and equal access to justice. The Council would wish to work with the Scottish Government to help achieve that.

The Council believes that it is possible to protect the independence of legal services in Scotland; whatever business structures deliver those services, as long as issues of regulation and legal professional privilege are satisfactorily resolved.

The Council would encourage the Scottish Government to amend or repeal as soon as possible the legislation which impedes or prevents alternative business structures.

The Council will, as soon as legislation permits, seek to amend or repeal those Law Society of Scotland Practice Rules identified which impede or prevent alternative business structures.

The Council intends to work closely with the Scottish Government to develop appropriate legislation setting out in some detail the framework for the future delivery of legal services in Scotland and addressing the issues identified in this paper as needing to be resolved.

PART 1:

INTRODUCTION AND BACKGROUND

THE LEGAL SERVICES MARKET IN SCOTLAND

In Scotland, only solicitors can own law firms and only solicitors can form partnerships with other solicitors. The Council of the Law Society of Scotland (the Council) is responsible for the regulation of solicitors in Scotland. The Faculty of Advocates regulates advocates.

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 solicitors employed by an organisation in non-lawyer ownership who are not permitted to offer services to the public.

The legal sector makes a significant contribution to the Scottish economy. Legal firms have been very successful over the last twenty years and through expansion and diversification, have adapted to meet the demands of their clients. This has been achieved within a strong regulatory framework.

There is a widening gap between high street practice and large-scale practice, reflected in the type and nature of work, profitability and specialisation. Newly qualified solicitors appear increasingly to prefer careers in large commercial practices rather than in a high street partnership.

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, housing, debt and consumer law.)

There are key differences between legal 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 a 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.

There has been an entry into the market of non-regulated or alternatively regulated providers of "legal services". This may increase as demarcation reduces between the types of advice given by traditionally separate professions, as new professions develop (e.g. claims companies, asset management, contract management).

The services sector generally has undergone radical change over the last twenty years. There is a global market in services, made possible by the revolution in technology and communications. New business systems are enabling improved accessibility to networks of customer bases and more efficient and cost-effective means of delivering services. Customers are increasingly adept at shopping around, in a global market, for services that meet their expectations and budget.

ALTERNATIVE BUSINESS STRUCTURE BACKGROUND

In the last few years some have begun to question the ownership and partnership rules of solicitors' firms, suggesting that the legal services market could benefit from allowing alternative business structures (ABSs).

Proposals include allowing solicitors and non-solicitors to enter into partnership, allowing non-solicitors ownership of, and investment in, law firms and extending the legal services offered by organisations such as banks and supermarkets.

In England, research carried out under the Clementi Review, led the Department of Constitutional Affairs to conclude some changes would benefit the consumer. In October 2007 the Legal Services Act was passed with provision for the introduction of alternative business structures.

At the start of 2007, the Council of the Law Society of Scotland recognised the need to engage the profession further in the alternative business structure debate. With continuing calls for change from some in the legal profession in Scotland and the potential cross-border effect of the Legal Services Act (2007), the Council considered that it was an appropriate time to review its position.

In addition, the Office of Fair Trading (OFT) supported claims by the consumer group Which? that the restrictive nature of the legal services market in Scotland was harming consumer interests. The OFT called on the Scottish Government and the Scottish legal profession to consider how these restrictions might be lifted. The Cabinet Secretary for Justice and Communities supported the need for change and charged the profession with developing detailed proposals that could be put forward for consideration by government.

The Council welcomed this responsibility and has embraced the opportunity to demonstrate its determination that the Society should lead the debate on the future delivery of legal services in Scotland.

In February 2007, the Council brought together a working party to consider alternative business structures. Views of Society members were sought at a members' event in London in June and a conference in Edinburgh in September. Following the conference, the Council felt that a more formal and wider consultation was necessary and so 'The Public Interest: Delivering Scottish Legal Services – A consultation on Alternative Business Structures' was launched in October 2007.

THE CONSULTATION

The consultation was published on 31 October 2007 and comments were invited by 31 January 2008, giving members of the profession and other interested stakeholders 3 months to respond.

Distribution was via the Society's e-bulletin and website with a wider stakeholder group receiving email correspondence. Further promotion was given through The Journal and the media. Various prompts were used during the period of consultation to encourage responses.

In total, 92 responses were received by email and letter. The majority were from legal firms of varying sizes with the remainder coming from a range of legal and non-legal organisations. The consultation document asked 21 questions that focused on 4 specific alternative business structures and the issues that surround them, either separately or collectively. Of the 92 responses received, 59 addressed either all or some of the questions directly and 33 were in the form of free text. Where these responses addressed themes raised by any of the questions, their comments have been included in the analysis.

A number of common themes were identified with an overall support for some change from the status quo. The majority of respondents noted that any change would need to take into account the following:

- That any new structures are regulated effectively
- That the independence of the solicitors' profession is maintained
- That core values are upheld
- That access to justice is not negatively affected
- That appropriate consumer safeguards are in place

The consultation gave further key messages in relation to the following issues:

- **Guarantee Fund and Master Policy** - there was an overall consensus that if alternative business structures were introduced into the legal services market, it would be difficult if not impossible to extend the Guarantee Fund and the Master Policy in their present form to such structures.
- **Resolution of Regulatory Conflict** - the overall view was that it would be necessary to devise an appropriate and rigorous regulatory framework before any changes are implemented.
- **Non-solicitor Partners/External Shareholders**
There was an overall consensus that there should be a "fitness to own" test for non-solicitor partners and external shareholders, although many respondents commented that it would be difficult to formulate. Respondents thought that some kind of charge should be levied on external shareholders. The main reason cited was to meet increased regulation costs.

The consultation responses do not represent a consensus view, or point to any one conclusive course of action. Rather, the focus seems to be on making sure that the quality of legal services provision and the integrity of the solicitor's profession is maintained regardless of the course of action taken. It should be noted that while a wide range of suggestions were made about how this could be achieved, other responses indicated that these fundamental principles could not be upheld if alternative business structures are to be permitted.

A fuller analysis of the consultation responses is available from the Law Reform Department at the Law Society of Scotland.

DEVELOPING POLICY PROPOSALS

The working group for this part of the process included solicitors from different parts of the profession including large firm, small firm, rural and sole practitioners as well as Society staff. In addition to managing the consultation, the remit of the working group also included developing policy proposals.

The options identified in the consultation paper were firstly looked at to determine whether there were any objections in principle. The options were then assessed against the current structures of regulation to determine what changes would be necessary and how such changes could be delivered.

The outcomes from the working group form the basis of this paper. The developing lines of the policy were endorsed by the Council at its meeting of 29 February 2008. This policy paper was approved by the Council at its meeting of 4 April 2008.

SCOPE OF THE POLICY

This policy paper deals with those services provided by solicitors or advocates. It is those services to which this policy refers and any reference in this paper to legal services means services provided by solicitors or advocates.

PART 2:

POLICY DISCUSSION

POLICY OBJECTIVE

The objective of the Council's policy is to ensure that the best possible framework is established for the future delivery of legal services in Scotland.

The legal profession in Scotland has enormous strengths. Responses to the consultation paper demonstrate the strong and enduring identification of practitioners to the Society's core values. The profession is committed to the interests of justice and to the public interest. Independence, integrity and the highest level of service to the client are fundamental principles. The Scottish solicitor brand is widely recognised and trusted.

The objective of this policy is to ensure that those strengths continue to be accessible and relevant in the modern world. The business structures in which solicitors practice now reflect society, the profession and market conditions of the mid-twentieth century. They are not the conditions pertaining in Scotland now, much less in the decades to come.

The legal profession in Scotland should be in a position to respond to new demands and to seize the opportunities of a global market in services. That is in the best interest of the Scottish profession and the wider Scottish economy.

Comments from the consultation responses

"The key requirement should be to preserve the rule of law and the core values of the legal profession, in both cases to serve the best interests of Scottish society... We do not believe, however, that ring fencing the legal profession from change is the way forward.

"The brand "solicitor", we suggest, is itself embedded in values such as integrity, reliability, value and quality of service."

"We agree with the fundamental principles identified by the Law Society in its [consultation] paper and concur that these principles must lie at the heart of any change that takes place."

The future of the profession needs business structures that, while retaining traditional strengths, also encourage ambition, diversity, career development and entrepreneurship. Any change should ensure that the legal profession in Scotland can continue to flourish and to serve the public interest in the modern world.

The policy is designed to allow law firms in Scotland to deliver competitive and high quality services nationally and internationally within a regulatory structure that upholds the core values of the legal profession, that promotes the interests of justice and that maintains access to justice.

PRINCIPLES UNDERPINNING THE POLICY

Integral to the development of the Council's policy are a number of principles that are fundamental to the legal profession in Scotland and that will continue to guide the Council in taking this policy forward.

These principles are:

- The objectives of any policy must uphold and further the interests of justice and protect and promote the public interest.
- The objectives must support the rule of law and the independence of the legal profession.
- The objectives of any policy must support the core values of the legal profession, including confidentiality and legal professional privilege.
- The Scottish legal profession should be able to operate as effectively as possible in an increasingly competitive global market.
- The public in Scotland should be able to benefit from the competitive provision of services by the legal profession.
- Changes to the way such services are delivered should, where possible, enhance the public's access to independent and affordable legal services.
- There should be appropriate regulation of the delivery of such services to ensure that the public is protected and that quality is maintained.
- Changes to the way such services in Scotland are delivered and regulated should reflect the distinctive nature of the Scottish legal tradition and market.

BUSINESS STRUCTURE OPTIONS

Discussion of alternative business structures in the legal profession has been largely dominated by the approach taken by the Clementi Report which set out recommendations focusing on certain types of structure.

The Council's consultation paper followed this approach and sought views on the advantages and disadvantages of moving to introduce specific new structures. A consideration of a number of different models follows. These models are: the traditional business model; the legal disciplinary practice (LDP); the multi-disciplinary practice (MDP); and models involving external capital.

It is worth noting at this stage, however, that the Council, in the course of the consideration of alternative business structures, has come to the view that many of the issues involved are common to these different structures and that the models-based approach can impose artificial constraints on policy development.

The Council found it more helpful to work from the premise of what the profession and public interest in Scotland require of the delivery of legal services. This has led the Council to devise a policy that does not focus on specific models, but that proposes a regulatory framework within which legal businesses have freedom to develop the structure they consider allows them to deliver services most effectively. This is set out in detail later in this paper.

Traditional business model

The only forms of business structure permitted to solicitors in Scotland who wish to offer legal services to the public are to operate as a sole practitioner (which may be done as a company) or to form a partnership or an incorporated practice with other solicitors (or with registered foreign lawyers in multi-national practices).

Restrictions on business structures for solicitors in Scotland can be summarised as:

- Restrictions on solicitors forming partnerships or incorporated practices with non-solicitors (apart from registered foreign lawyers in multi-national practices.)
- Restrictions on solicitors and other regulated professionals or other non-professionals forming partnerships to provide the public with a range of services including legal services.
- Restrictions on non-lawyers owning a law firm.
- Restrictions on solicitors employed by non-solicitors acting for the public, including businesses which are not associated companies of their own employer.

These restrictions were restated 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 then passed in accordance with the Solicitors (Scotland) Act 1980, and with the approval of the Secretary of State for Scotland.

The traditional solicitors' partnership model has served Scotland well in many respects. It delivers a wide variety of legal services to many thousands of clients each year. It is estimated that private practice firms contribute well over £1.2 billion annually to the economy. The traditional model has protected the core values of the profession and the interests of justice. Responses to the consultation show that many within the profession think that this is the best way to continue providing legal services.

Improvements have been made over the years to the traditional solicitors' partnership, including the ability to limit liability as a company or LLP but the model has remained fundamentally unchanged.

Over the same period a number of new trends relevant to the legal services market, referred to in Part 1 of this paper, have become evident. This is the context within which any policy must be considered.

Some consultation responses express concerns that unless more flexible business structures are permitted it will make it harder for Scottish law firms to flourish and offer a competitive product in a modern environment. If the Scottish legal profession cannot respond to new demands it risks the accelerated entry into the market of other, possibly unregulated, providers.

At a time when the Legal Services Act will permit alternative business structures in England and Wales, a failure to modernise the delivery of Scottish legal services risks a flight of business from Scotland. Some fear that if there is significantly greater freedom to operate effectively in England and Wales, a move away from Scotland of more talented young lawyers could result.

The current statutory restrictions are as unacceptable to many within the legal profession in Scotland as they are to the Scottish Government and the Office of Fair Trading.

Comments from the consultation responses

"If solicitor providers are unable to compete effectively against other players in the broader

"legal services" market this would damage both the relevance and the reputation of solicitors within the sector."

"...we believe that the current position of the Legal Market in Scotland cannot be sustained without change, particularly having regard to the impact of the Clementi proposals in England and Wales."

"...we would submit that the fundamental principle is that any collection of solicitors should be free to operate utilising whichever business vehicle they consider appropriate to their personal circumstances... a solicitor or solicitors should be entitled to operate using the vehicle of a traditional partnership, limited liability partnership, limited liability company or indeed any other form of corporation which they deem appropriate."

"This whole exercise is a review of unnecessary existing limits with a view to trying to provide better flexibility in the delivery of services."

"In reality the legal services market has already moved towards a non-lawyer ownership and control model in all except the restricted areas."

Permitting law firms to operate within different structures would offer solicitors a choice about how they conduct their business. It is expected that many would choose to continue operating in traditional solicitors' practices. Changes to legislation must not prevent them from doing so, but could offer others the freedom to develop in the way they believe best suits the needs of their businesses and their clients.

Legal Disciplinary Practices (LDPs)

As stated above, current statutory restrictions prevent solicitors forming partnerships or incorporated practices with non-solicitors (except with registered foreign lawyers in multi-national practices). In particular, solicitors may not form an incorporated practice together with Advocates.

Faculty of Advocates' Rules prohibit advocates from practising other than as self-employed sole practitioners. For the most part, clients can only access an advocate through a solicitor. Solicitors select advocates on behalf of clients from the independent referral bar.

A Legal Disciplinary Practice (LDP) would allow solicitors, advocates and registered foreign lawyers to practise as partners in the same firm or as members in the same incorporated practice.

Allowing solicitors and advocates to form LDPs could have the following advantages:

- It would permit direct access by clients to advocates and so avoid the need for clients to have to instruct a solicitor and an advocate separately. This could reduce costs to the client and make legal services in Scotland more competitive.
- It would offer more choice to solicitors and advocates about how to deliver their services most effectively and how to share profits between them.
- It would allow member of the different legal professions to share overhead costs which could result in lower legal costs for clients.
- It may enhance the quality of service by facilitating transfer of skills and knowledge between solicitors and advocates.
- The core values of the branches of the legal profession are virtually identical and would not be put at risk by permitting LDPs.

On the other hand, the following points should also be noted:

- The Council recognises the distinctive nature of the Faculty of Advocates as an independent referral bar. Faculty members provide high quality advocacy services to the Scottish public and uphold the standards which the public office of advocate demands.
- It has been suggested that LDPs are unnecessary because solicitor advocates already exist in growing numbers in many firms and can provide direct access to advocacy services without having to instruct a separate solicitor.

A variation of the LDP model is the LDP including some non-lawyer owners with direct control or significant influence on the legal practice. These are non-lawyers who have an equity stake in the practice and influence the operation of the practice but do not provide services to the public. They could include a chief executive, director of finance, IT or human resources, for example, who may or may not be members of a professional body.

At present a number of solicitors' firms in Scotland employ non-legal professionals who maximise the service potential of many firms. Under present arrangements they cannot have any degree of ownership of the business. This reflects business practices of the past and does not match the needs of a competitive service industry.

Permitting legal practices to extend the option of an equity stake could allow them to attract and retain more easily expertise in fields such as IT and human resources needed to transform legal service businesses in Scotland for a competitive international market. Appropriate regulation would be essential to ensure that only fit and proper persons had significant influence on or control of a legal practice.

Comments from the consultation responses

"[We] would welcome the opportunity to integrate non lawyer professionals more fully into partnership to share the incentive and responsibilities of ownership."

"By allowing non-solicitor partners, the efficiency of legal practices and the range of services offered could well be enhanced. For example, a Solicitors' practice could assume as a partner a person with extensive business experience who could act as Chief Executive. It may be necessary to enhance the position of the Chief Executive to partnership status as a means of attracting persons of the right quality to the profession."

"...our view is that the introduction of LDPs, which would of necessity be optional rather than compulsory, would ...provide the Profession with an additional element of flexibility which would in general terms be welcomed."

Multi-Disciplinary Practices (MDPs)

The restrictions that prevent LDPs also prohibit multi-disciplinary practices. MDPs would allow solicitors and other regulated professionals such as accountants, architects or surveyors and other persons who may or may not be members of professions to form a partnership or an incorporated practice providing clients with a range of services including legal services.

Comments from the consultation responses

"Effective skill transfer is core to all successful and sustainable advisory businesses and being in business together creates a systemic incentive to develop talent and so consistently improve the quality of service being provided."

"It is possible, for example, that a grouping of different professionals might lead to the retention of more than one practice in some rural areas thus offering choice as well as increased accessibility to legal services."

"It [MDPs] could open up options for clients, allow for an increase in firms that can offer a "one stop shop" for clients and thereby potentially saving cost and may provide an option for small towns where professionals can share running costs and therefore find it more economical for practice in rural locations."

"We believe that MDPs could be commercially attractive to both professionals and consumers, although there are significant issues of detail that would need to be resolved prior to the implementation of a new multi-disciplinary model."

The formation of MDPs could have the following advantages:

- It would allow firms to offer clients a one-stop shop for a range of different services. This could be attractive to clients and more cost-effective for the firms.
- Legal practices already offer cross-disciplinary services. Non-solicitors can be involved in management and can share profits but cannot become principals. MDPs would allow greater financial and personal commitment from the non-solicitors and allow firms to offer fuller career development to them.
- The possibility to create a practice with other professionals offering a range of services including legal services may help to sustain legal practices in small communities, where otherwise a solicitor's practice would not be viable.

Some disadvantages of MDPs could be:

- A potential risk to the core values of the legal profession. There could be greater commercial or other pressures on solicitors in an MDP which could compromise a solicitor's duty to give independent advice, without fear or favour. It has to be noted, however, that solicitors face a range of pressures within traditional practices or as employed lawyers which they are generally able to overcome because of their training and commitment to the ethos embodied in the core values. It cannot be assumed that pressures within an MDP would create greater risks, but appropriate regulation would be essential to guard against damage.
- The issue of conflict between different regulatory codes is a significant challenge to the development of MDPs. The Society does not believe an entity could be allowed to operate where individual principals within it were subject to conflicting codes of conduct. A solution would need to be found to any such conflicts before members of different professions could form an MDP.
- Legal professional privilege may not in the current legal environment be available across professions within an MDP. This is a significant issue which the Society believes must be resolved satisfactorily, possibly through legislation, to allow MDPs to develop. Proper systems would be needed to ensure that a solicitor or advocate would be able to protect from disclosure within a practice communications with a client.
- MDPs could result in a greater concentration of legal service provision within urban areas, with large MDPs drawing work away from smaller practices in small towns and rural areas. On the other hand, the ability to work within a diverse partnership may help sustain legal practices in small and remote communities that are already under threat for other reasons. The electronic delivery of some services provided by solicitors and the development of an online market place will increasingly make the issue of geographic location less relevant. Online services cannot, of course, substitute in all cases; there will still be a need for legal representation in court and for one-to-one communication with clients.
- The Council would expect that the introduction of MDPs would have consequences for the operation of the Guarantee Fund and Master Policy. Responses to the consultation made clear, however, that many question the sustainability of these schemes irrespective of the introduction of alternative business structures. Clear provisions as to how the Guarantee Fund and Master Policy or equivalent forms of client protection would operate would need to be developed before MDPs could be permitted.

Structures involving external capital

There are currently restrictions on non-solicitors owning or controlling legal practices. External ownership or control of legal practices could take the following forms:

- Shareholding by any person who is not a director of the practice, including holding of sufficient shares to give an investor an influencing or controlling interest in the practice.
- Ownership by non-lawyers of a legal practice, including allowing organisations to employ solicitors or advocates to provide legal services to the public.

Comments from the consultation responses

"The requirements of legal firms to operate for major business clients are very different from what they were even ten years ago. Very substantial investment in technology, disaster recovery, business continuity, finance and human resources is now required. ...External capital is required simply to allow Scottish firms to compete...Expansion by Scottish firms into international markets, on any scale, will remain more or less impossible unless a shareholding model is permitted."

"External owners that understand the importance of professional values, customer care and regulatory compliance to an organisation's brand and its value will inherently be aligned to supporting professional values and ethics. Such owners should be welcomed irrespective of levels of executive control and concentration of ownership."

"The Financial Services sector is a large employer of in-house lawyers, where the application of their professional ethics can be seen to work successfully in a commercial environment."

The introduction of external capital could have the following advantages:

- Firms may have access to external investment capital, enabling them to expand and compete more effectively against global competition. It is understood that a range of firms in Scotland wish to attract external investment.
- It could improve the governance and compliance regime at the level of the organisation by reinforcing individual adherence to core values with loyalty to brand reputation.
- Firms could reward staff, including retired staff, with a shareholding in, and a continued interest in the success of, the practice.
- Ownership by large companies could result in economies of scale, access to existing customer bases and enhanced competition with reduced costs, easier access and wider choice for the consumer.
- It may give Scottish practices similar opportunities to those the Legal Services Act will offer in England and Wales.

Some disadvantages of permitting the introduction of external capital could be:

- There are concerns that external owners could use their influence and control to pressure solicitors to act in illegal or improper ways. This could have implications for obligations in respect of money laundering or Proceeds of Crime Act monitoring and other co-regulatory regimes. Potential risks could be greater where there is a concentration of ownership of an entity. Existing business structures, however, do not prevent solicitors succumbing to a range of influences. Appropriate regulation would be essential to guard against corruption and to ensure that only fit and proper persons had significant influence on or control of an entity.
- There could be a potential risk to the core values of the legal profession. The demand to generate profits for the shareholders could compromise the independence of solicitors in the practice and their compliance with the Code of Conduct and practice rules, particularly the conflict between the interests of the clients and the interests of shareholders. It has to be noted, however, that solicitors face a range of pressures within traditional practices or as employed lawyers which they are expected to overcome as trained professionals who are committed to the ethos embodied in the profession's core values. It cannot be assumed that pressures within an externally owned business would create greater risks, but appropriate regulation would be essential to guard against damage.
- Concentrating the supply of legal services into a small number of large suppliers could be a consequence of permitting external ownership and could have implications for access to justice. However, it has been noted that firstly, there is already a trend towards larger urban practices and this is likely to continue irrespective of permitting new structures and secondly, access to justice may be served if clients find they can obtain legal services from a local retailer from whom they already buy other goods or services.
- It could lead to incentives to focus on certain legal services. This, however, is already happening under traditional business models. It would be important for the Scottish Government to address any impact on access to justice in some areas of law, whatever the reason for it.
- Clear provision as to how the Guarantee Fund and Master Policy or equivalent forms of client protection would operate in the case of external ownership or control would need to be developed.

Permitting the introduction of external capital may mean that practitioners wishing to create a joint-entity use this model in preference to an MDP. They could create and finance a holding company to employ themselves. This would be likely to offer the same advantages as an MDP, but with the protection of limited liability. In this case or in any other form of externally owned MDP, the issues outlined in the section of the paper dealing with MDPs, relating to legal professional privilege and conflicting professional codes of conduct of individual practitioners would need to be resolved before such structures were permitted.

CONCLUSIONS IN RELATION TO BUSINESS STRUCTURE OPTIONS

The Council believes that the legal profession in Scotland should be able to offer its services through structures which best meet the demands of modern society and a global economy. Practitioners should be free to retain the traditional business model but that should not be their only choice.

It has become apparent that the different business structure options considered, or variations of them, may offer advantages that would benefit the delivery of legal services in Scotland. The models considered differ and offer different advantages and disadvantages. However, it has also become evident that the fundamental issue is how to provide modern business methods for the delivery of legal services in Scotland which are safe, effective and of benefit to the public and the profession.

It is the overwhelming view of the responses to the consultation that change must be accompanied by appropriate regulation to protect the core values of the Scottish legal profession and to ensure that there is a fair and equal playing field for all legal service providers in Scotland. There is also a strong view that the Society and its Code of Conduct are fundamental to any system of appropriate regulation.

The focus then becomes not how to construct business models or which models to permit but how to devise a regulatory system that allows the profession in Scotland continue to flourish. The aim must be to establish a regulatory framework within which Scottish legal practices have freedom to design the business model which best suits them and which allows them to respond to new demands over time.

Comments from the consultation responses

“The regulatory framework ... must safeguard ethical standards and consumer interests.”

“A combination of clear values/ethical standards/principles, and a strong and proactive regulator to enforce them, provides the protection necessary to maintain the integrity of the independent advice given to clients.”

“Ensure Solicitors’ Code has priority.”

“Any move to non lawyer ownership and control models will obviously be a radical change to the legal services market. There is no reason, however, to consider such a move detrimental provided appropriate regulations are required for the purposes of consumer protection.”

The Council believes that alternative business structures should be permitted subject to an appropriate system of regulation being in place and once the necessary legislative and regulatory changes have been implemented.

Thinking has moved from having a regulatory model for each business structure (LDP, MDP and the external ownership/control) to identifying a single regulatory model that can accommodate all business structures. Such an approach is not incompatible with a phased or gradual introduction.

The Council wants to move ahead quickly to devise the framework within which the profession can develop a range of business structures, but it recognises that it may not be possible to move in one step to permitting any form of business structure.

The responses to the consultation indicate that the Scottish public’s access to justice is of great importance to the Society’s members. While it has been a key consideration in the process of arriving at the recommendations detailed in this paper, the Council would stress that the intention was to create a policy on alternative business structures, not to create a policy specifically to address access to justice issues. The effect of alternative business structures on access to justice cannot be accurately predicted. While some responses suggested that it could have a positive impact, some envisaged a reduction in access to justice and many thought it would have no significant impact at all. Even if the introduction of alternative business structures were to have a positive impact on access to justice, it would still only be part of the solution.

There is an argument that other considerations, such as legal aid funding, are more relevant in this respect.

The Council takes the view that the Scottish Government is the body with the power to promote fair and equal access to legal services in Scotland and needs to be ready to respond to changes in the market to ensure that access. The Council would urge the Scottish Government, whatever the impact of alternative business structures, to consider how access to justice can be achieved.

PART 3:

REGULATION

The market for legal services requires regulation. Legal services impact on some of the most important aspects of people's lives. Legal matters can be complex and involve a range of ethical considerations. Regulation helps ensure that solicitors or advocates provide their services to an agreed standard and, if not, can be subject to sanction. A free market could not offer the consumer safeguards required. Firms of solicitors in Scotland are currently regulated by the Law Society of Scotland.

The Council believes that regulation is the key issue in relation to alternative business structures. There should be appropriate regulation of the delivery of services provided by solicitors and advocates in Scotland, whatever business structure delivers those services, to ensure that the core values of the legal profession are protected and that service quality is maintained.

The Council believes that the Society needs to have a significant and continuing role in developing and implementing a regulatory system that will allow alternative business structures to develop.

There are a number of issues to be addressed in devising a regulatory regime.

Fundamental will be the need to regulate the delivery of services provided by solicitors and advocates at the level of the entity or organisation. In other service industries, such as financial services, this is generally accepted as an effective and proportionate method of regulation.

Practitioners within the entity offering services to the public must also be regulated as individuals. This could give rise to conflict between different professional regulatory codes and a method of dealing with conflict must form part of a regulatory regime.

Any person with control or significant influence over the operation of an entity offering legal services must also be subject to regulation as an individual. There is a need to devise a system to ensure structures involving external ownership are controlled or subject to significant influence only by fit and proper persons and that they comply with an appropriate code of conduct that protects solicitors' independence.

The Council believes that it is imperative that the client's legal professional privilege is protected. It would be necessary to ensure this was secure in an MDP or externally owned model before these structures could be permitted.

It needs to be clear who is to regulate, particularly where different professions or where individuals without a profession are involved. The Scottish Government has made clear that it does not intend to establish an equivalent of the Legal Services Board that will oversee the regulation of alternative business structures in England and Wales. The different nature of the independent Scottish legal profession and market and the fact that the Scottish Legal Complaints Commission has already been established would make the creation of such an entity a disproportionate response.

The Council takes the view that the Society is the most appropriate body to regulate entities delivering legal services in Scotland. The Society is the only body in Scotland with relevant experience of regulation of all areas of legal practice. Its capacity, however, would need to be enhanced to take on additional functions.

It would need to take into account the following -

- An appropriate system for operating the Guarantee Fund and Master Policy or to provide equivalent forms of financial cover.
- The role of the Scottish Legal Complaints Commission in relation to alternative business structures.
- The system of regulation must be proportionate to the risks likely to arise in the business model, and should be simple, cost effective, transparent and accountable.

PROPOSED REGULATORY FRAMEWORK

The Council proposes a framework of regulation for alternative business structures comprising the following key elements. This does not pretend to solve all the issues, but is proposed as a realistic platform for working with the Scottish Government and other professional bodies to find solutions:

Key elements of proposed regulatory framework

- All business structures offering services provided by solicitors or advocates must be regulated at the level of the entity.
- The entity must be licensed by a regulator approved by the Scottish Government. The Council believes that the best regulator for legal services in Scotland is the Society.
- The entity must be regulated and subject to a set of Firm's Principles which would include the core values. The Firm's Principles would include a requirement to deal with the regulator in an open and co-operative way and to be licensed by the regulator.
- A clear definition of 'Firm Principles' would be required which would form the basis of the licence from the regulator. These would need to be approved by the Government at the time of approval of the regulator itself.
- All activity of the entity must comply with the licensing terms of the chosen regulator.
- A business that does not want its entire organisation subject to such regulation would operate through a subsidiary. This subsidiary would be the entity to be regulated.
- Individual practitioners would be additionally regulated to ensure personal ethical behaviour by their relevant professional body. Professional bodies will, therefore, only regulate individuals within their own profession.
- Owners with Direct Control or Significant Influence [or 'Individuals with a Controlled Function'] would be subject to and would be required to remain able to meet a 'fit and proper' test, e.g. honesty, integrity, competency, financial probity and an acceptance of the 'Firm Principles' as the basis upon which the entity will be organised and will deliver its services. Included in this definition would be partners or directors, whether or not they have extant practising certificates or whether they are in that capacity as a representative of a fund or other body that has ownership in the firm.
- Owners with no Direct Control or Significant Influence, i.e. a private equity fund or an individual that owns a stake in the firm, would not be subject to a fit and proper test. There would seem to be no need for them to meet such a test, as they are similar to shareholders in FSA regulated banks.
- Once they had passed a 'fit and proper' test, Owners with Direct Control or Significant Interest [Individuals with a Controlled Function] would be subject to a set of Individual Principles that would include the core values.
- Each entity would need to have, as part of its licence conditions, a Firm's Practice Officer or Committee. That Officer or Committee would act as a gatekeeper and would be required to report to the regulator on the compliance of the entity, and disclose any non-compliance, with its licence terms.
- The Practice Officer or Committee would also be required to report to the regulator in respect of Owners with Direct Control or Significant Influence [Individuals with a Controlled Function]. The Officer or Committee would be required to report on their decisions collectively and on the continued ability of individuals to meet a "fit and proper" test.
- The Practice Officer or Committee would need a power of veto entrenched within the entity's constitution to ensure that the firm's activities and proposed activities complied with the core values. Those carrying out the function of gatekeeper must hold individual practising certificates from the regulator that is licensing the entity.
- Only those within the firm who have practising certificates, or who are accountable to those who do (such as paralegals or tax advisers), would be permitted to deliver legal services to clients. Such individuals, regardless of their status within the firm would be subject to the core values.

Conflicts between different professional regulatory codes

This is seen as a significant challenge and can be expected to make the model of the MDP one of the most difficult business structures to achieve. The Council would propose working with other professional bodies to achieve convergence of codes where possible.

Where it is not possible to avoid conflict between what the entity must do under its licence and what an individual practitioner must do under a practising certificate then the organisation cannot engage the practitioner until the conflicting regulatory regimes have been harmonised.

Indemnity insurance and fidelity cover

All activities of a business structure must have appropriate indemnity insurance and fidelity cover, at a level approved by their licensing regulator, which must be not less than a statutory minimum level. The minimum terms of the protection afforded must be made explicit to clients in all transactions.

LEGISLATIVE AND REGULATORY CHANGES REQUIRED

A number of changes to legislation, particularly to the Solicitors (Scotland) Act 1980 and to the Rules of the Law Society of Scotland will be necessary if alternative business structures are to be permitted.

The Council would expect that as well as repealing or amending existing legislation, the Scottish Government would need to introduce legislation setting out in some detail the framework for the future delivery of legal services in Scotland. It would also have to address the issues identified in this paper as needing to be resolved before alternative business structures can be permitted. The Council would intend to work closely with the Scottish Government to develop appropriate legislation.

PART 4:

CONCLUSION AND RECOMMENDATIONS

The Council is determined that the Law Society of Scotland should continue to play a leading role in the delivery of legal services in Scotland. It wishes to ensure that the best possible framework is established for the future delivery of legal services in Scotland.

The Council recognises that the delivery of legal services in Scotland needs to continue to respond to new demands and to developments in the provision of services. It believes it is in the interests of the public in Scotland and of the Scottish legal profession to permit, alongside traditional business models, alternative business structures that could facilitate more modern and competitive delivery of legal services.

The Council does not see any objection of principle to any of the proposed alternative business structures, as long as an appropriate system of regulation is applied to all business structures in Scotland delivering legal services. That regulation must ensure that the core values of the legal profession are protected and that service quality is maintained. The Council believes that the key is to establish a regulatory framework within which a range of business structures can develop.

The Council believes that the Society should determine and manage the regulation of alternative business structures for Scottish legal services. It has set out in this paper a foundation on which to build. The Council will work constructively with the Scottish Government and with the professional bodies to develop and implement it.

The Council intends, in consultation with the Scottish Government, to set out a timetable for early and energetic progress towards establishing the regulatory framework to allow alternative business structures to develop. Specific business structures could only be permitted once all the practical challenges facing them had been satisfactorily resolved. The Council believes those business structures which offer fewest practical challenges should be allowed to evolve within the framework more quickly than others.

The Council believes that the nature of the economic market affecting the provision of legal services is changing. The introduction of alternative business structures will affect the market. This changing market will affect access to legal services. The Scottish Government needs to respond to the changing market to protect and promote fair and equal access to justice. The Council would wish to work with the Scottish Government to help achieve that.

The Council believes that a high quality and independent legal service in Scotland, can be delivered by several types of business structures, as long as the delivery of the service is regulated it is regulated effectively and legal professional privilege is safeguarded.

The Council would encourage the Scottish Government to amend or repeal the legislation which impedes or prevents alternative business structures as soon as possible.

The Council will, as soon as legislation permits, seek to amend or repeal those Law Society of Scotland Practice Rules identified which impede or prevent alternative business structures.

The Council intends to work closely with the Scottish Government to develop appropriate legislation setting out in some detail the framework for the future delivery of legal services in Scotland and addressing the issues identified in this paper as needing to be resolved.



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