

# Legal Services Bill

## Full Regulatory Impact Assessment

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## List of Abbreviations and Acronyms

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ABS	Alternative Business Structures
ADR	Alternative Dispute Resolution
AR	Approved Regulators (professional regulatory bodies)
BME	Black and Minority Ethnic groups
BRE	Better Regulation Executive
CASIA	Complaints Against the Solicitor Independent Adjudication
CCS	Consumer Complaints Service (The Law Society)
CDS	Criminal Defence Service
CLACs	Community Legal Advice Centres
CLANs	Community Legal Advice Networks
CLC	Council for Licensed Conveyancers
CLS	Community Legal Service
CoF	Court of Faculties
DAC	Discipline and Appeals Committee
DCA	Department for Constitutional Affairs
ECHR	European Convention on Human Rights
FSA	Financial Services Authority
FSB	Federation of Small Businesses
HOFA	Head of Finance and Administration
HOLP	Head of Legal Practice
LA	Licensing Authority
LDP	Legal Disciplinary Practice
LPP	Legal Professional Privilege
LSA	Legal Services Authority
LSB	Legal Services Board
LSC	Legal Services Commission

LSCC	Legal Service Complaints Commissioner (also see OLSCC)
LSO	Legal Services Ombudsman (also see OLSO)
LSR	Legal Services Reform
NfP	Not-for-profit organisation
OFT	Office of Fair Trading
OISC	Office of the Immigration Services Commission
OLC	Office for Legal Complaints
OLSCC	Office of the Legal Service Complaints Commissioner
OLSO	Office of the Legal Services Ombudsman
PwC	PricewaterhouseCoopers LLP
RIA	Regulatory Impact Assessment
ROCAS	Reform of Complaints against Solicitors
SBS	Small Business Service

# 1. Purpose and Intended Effect

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This Regulatory Impact Assessment (RIA) sets out the rationale for the reform of the regulation of legal services. The RIA also analyses the likely effect on a range of key stakeholders of the options considered for implementing these reforms.

## **Nature and scope of the legal services market**

- 1.1. The legal services market in England and Wales makes an important contribution to the UK economy. It generated £19 billion (or 1.73%) of the UK's gross domestic product in 2003.<sup>1</sup> This was an increase in real terms of almost 60% since 1995.
- 1.2. In 2003, the volume of UK legal services exported totalled £1.9 billion - three times that of 1995. Total imports of legal services were worth £403m over the same period, showing that the legal services sector is a net exporter to the value of £1.5 billion.<sup>2</sup>
- 1.3. The solicitors' profession has also markedly grown in the recent past. There were 54,734 solicitors in England and Wales with practising certificates in 1990, while in 2004 there were 96,757 solicitors, of whom 75,079 were working in private practices. In addition, the number of solicitors from England and Wales who are located abroad has increased more than nine times between 1990 and 2004, from 355 to nearly 3,400, now located in 71 countries.
- 1.4. In contrast, the number of solicitors' firms fell from 10,120 in 1997 to 9,211 in 2004. Sole practitioners made up 45.3% of solicitors' firms and a further 39.7% had four or fewer partners, but 69.2% of solicitors worked in firms of five partners or more. The number of large practices (those with 26 partners or more) has increased in recent years, and in 1999/2000 these firms generated 50.2% of the total £10.52 billion generated by the profession.
- 1.5. In addition, 3,310 solicitors had rights of audience in the higher courts in April 2005.<sup>3</sup>
- 1.6. The Bar has also witnessed a proportionate increase in numbers in recent years. In 2004 there were 14,364 practising barristers in England and Wales, 11,564 of whom were in independent private practice (251 of whom were not tenants of the 355 chambers) and the rest in employment.<sup>4</sup> This is a large increase from 1990, when there were 6,645 barristers in independent private practice.
- 1.7. Both the Bar and the solicitors' profession are significant employers in the UK, with figures from International Financial Services London showing that the total recorded employment for the solicitors' profession and the Bar (fee earners and administrative

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<sup>1</sup> Data taken from the Office of National Statistics Annual Business Inquiry – <http://www.statistics.gov.uk/abi>

<sup>2</sup> Office of National Statistics – United Kingdom Balance of Payments – The Pink Book 2004 – [http://www.statistics.gov.uk/downloads/theme\\_economy/PinkBook04.pdf](http://www.statistics.gov.uk/downloads/theme_economy/PinkBook04.pdf)

<sup>3</sup> A solicitor usually briefs a barrister on a case in the higher courts. The barrister then presents the case to the court. However, a solicitor may choose to gain higher rights in order to offer a complete service to a client – from initial advice through to case preparation and representation before the courts.

<sup>4</sup> The General Council of the Bar Annual Report 2004 – [http://barcouncil.org.uk/documents/Bar%20Annual%20Report\\_2004\\_WEB.pdf](http://barcouncil.org.uk/documents/Bar%20Annual%20Report_2004_WEB.pdf)

staff) totalled 267,503 in 2003.<sup>5</sup>

1.8. Elsewhere in the legal services sector in 2004, there were:

- nearly 22,000 members of the Institute of Legal Executives. Most legal executives work for solicitors' firms, although a few work independently from solicitors;
- 850 licensed conveyancers in England and Wales, and around 1,300 in training;
- 857 registered trade mark attorneys and 1,500 United Kingdom registered patent attorneys; and
- approximately 900 public notaries in practice, of which around 30 are scrivener notaries, and 815 are general notaries who also practice as solicitors.

1.9. The Not for Profit (NfP) sector is a vital channel for providing access to justice where the need is greatest. This sector encompasses some of the legal services publicly funded by legal aid through the Legal Services Commission (LSC), volunteer services offered by members of the public, and *pro bono* work where lawyers provide their services free of charge.

1.10. There are also a number of NfP organisations providing legal advice, representation and other non-legal services to individuals. These organisations include:

- 468 Citizens Advice Bureaux in England and Wales
- just under 1,000 members of AdviceUK (formerly the Federation of Information and Advice Centres)
- 57 law centres in the Law Centres Federation
- other membership organisations such as trades unions

1.11. The LSC is a key consumer of legal services. It delivers civil and criminal legal and advice services, publicly funded via legal aid, through its Community Legal Service (CLS) and Criminal Defence Service (CDS) schemes.

1.12. In 2003-04 the LSC spent in excess of £2 billion funding legal services and NfP caseworkers who performed legal aid work, amounting to 10.9% of the total turnover of the legal services in the UK, and provided more than 2.6 million acts of assistance through CLS and CDS schemes.

### **The existing arrangements for the regulation of legal services**

1.13. The current regulatory framework for legal services has evolved slowly over time. Today, it is largely a co-regulatory arrangement, with the legal professional bodies exercising regulatory control over their members, subject to varying degrees of oversight by a range of high-level oversight regulators.

1.14. There are currently seven forms of legal service that are subject to statutory

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<sup>5</sup> International Financial Services London, 2005, Legal Services: City Business Series – [http://www.ifsl.org.uk/pdf\\_handler.cfm?file=CBS\\_Legal\\_Services\\_2005&CFID=50659&CFToken=73281930](http://www.ifsl.org.uk/pdf_handler.cfm?file=CBS_Legal_Services_2005&CFID=50659&CFToken=73281930)

regulatory control.<sup>6</sup> The current machinery for regulating legal services is complex. A number of front-line regulators, including legal professional bodies such as the Law Society and Bar Council, have a direct impact on the provision of legal services. Regulation is focused strongly on the nature of the provider rather than the type of service delivered.

- 1.15. In addition to the Approved Regulators (AR), the system involves a number of high-level regulators, including the Secretary of State for Constitutional Affairs, the Master of the Rolls, and the Office of Fair Trading. Important purchasers of legal services such as the Legal Services Commission or local authorities also play a quasi-regulatory role, for example by setting their own entry and quality standards.
- 1.16 But the existing system of profession-led regulation has a number of characteristics, some aspects of which the Government would want to retain where it is appropriate to do so. For example:
  - self-regulatory bodies typically have a greater degree of expertise and technical knowledge about the professions than an external regulatory authority. This information advantage allows the self-regulatory bodies to better guarantee quality of services, monitor compliance, and enforce the necessary codes of conduct. Consequently, costs of information for the formulation and interpretation of quality standards, monitoring, and enforcement can be minimised.
  - self-regulatory bodies may be able to draft and review regulations more quickly and flexibly in order to respond to changes in consumer preferences.
  - the cost of regulation is borne largely by the regulated professions themselves via fees, albeit with at least part of the regulatory cost being passed on to the consumers of legal services.

## **Drivers for reform of the regulatory framework**

### ***The need for a more effective regulatory structure***

- 1.17. The problems associated with the current regulatory framework can be seen in terms of regulatory proliferation, confusion and fragmentation; the propensity of the current structure to create regulatory anomalies and gaps; and the difficulties of interface and co-operation.
- 1.18. **Overlaps** in the current regulatory framework mean that the Secretary of State for Constitutional Affairs has the power to alter rules relating to the qualification or conduct of persons exercising rights of audience or rights to conduct litigation. In addition, all rules of the Law Society require the approval of the Master of the Rolls.
- 1.19. For consumers, the complexities of the current system means that many will not have sufficient information to distinguish between the levels of protection they are afforded under different parts of the regulatory framework and by unregulated providers. This lack of information creates a risk that unregulated service providers

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<sup>6</sup> These are: the right to conduct litigation; the right of audience in the courts; the provision of immigration services; certain probate services; conveyancing; notarial services and acting as a commissioner for oaths. These are described in more detail at Appendix B of the Government's White Paper – The Future of Legal Services: Putting Consumers First. <http://www.dca.gov.uk/legalsys/folwp.pdf>. The Government has proposed to introduce a statutory framework for the regulation of claims management services. Measures to achieve this formed part of the Compensation Act, which Parliament has just passed.

may drive out regulated ones, reducing quality and diminishing choice. It also means that consumers are not protected in a consistent fashion.

- 1.20. It should be noted that almost everyone will need to use legal services at some point, and on the occasions when they do it will often be in highly stressful circumstances (e.g. when moving home, resolving a family dispute, being involved in a court case or carrying out a business transaction).
- 1.21. For some legal services, namely litigation and advocacy, providers can potentially be subject to varying degrees of regulation, or regulatory influence, by a number of bodies including professional bodies, oversight regulators, service or other sectoral regulators (such as the Financial Services Authority), purchasers of legal services (particularly where, as in the case of the Legal Services Commission, they set quality requirements), and insurers.
- 1.22. The existing asymmetry of information in respect of the regulatory standards applied to different providers of legal services may also create significant anomalies between lawyers regulated by different frontline bodies, and between lawyers and non-lawyers, in terms of both consumer protection and regulatory burdens.
- 1.23. **Gaps** in the current arrangements generally mean that an Act of Parliament is needed to provide the protection that consumers need where a new or additional activity needs to be subject to regulatory control (e.g. claims management services). This means it is difficult to put safeguards in place quickly when new problems arise. The current system of regulation is therefore not flexible enough to offer consumers the protection they need and deserve.
- 1.24. Potential **conflicts of interest** also arise in the existing framework, with most of the regulators of legal professionals also performing a representative role, acting as advocates for their members. This raises concerns as, arguably, there is a risk that the regulators' judgements might be unduly influenced by putting the interests of members above those of consumers of legal services and thus undermining public confidence in the legal services sector. Even when this is not the case, the *perception* of undue influence on regulators' considerations may be damaging to the image of the profession. However, largely in response to the recommendations made by Sir David Clementi, the Law Society and the Bar Council have recently announced that they are to establish separate arms to deal with regulation of their respective professions, which will be ring-fenced from representative interests.

### ***The need for more effective competition***

- 1.25. UK competition policy<sup>7</sup> is grounded in the assertion that competitive markets are the most effective vehicles for generating economic growth. Well-functioning markets provide strong incentives for good performance by encouraging firms to improve productivity, reduce costs and innovate, while rewarding consumers with lower prices, higher quality and wider choice. Encouraging efficiency and competition in the domestic market also contributes to UK's international competitiveness.
- 1.26. In March 2001, the Office of Fair Trading (OFT) identified a number of rules of the legal professions that were potentially unduly restrictive, and that may have negative implications for consumers by affecting the quality and price of legal services.<sup>8</sup> The OFT recommended that the legal professional rules should be fully subject to

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<sup>7</sup> HM Treasury, Budget 2005 – Investing in our Future: Fairness and Opportunity for Britain's hard-working families. [http://www.hm-treasury.gov.uk/budget/budget\\_05/budget\\_report/bud\\_bud05\\_report.cfm](http://www.hm-treasury.gov.uk/budget/budget_05/budget_report/bud_bud05_report.cfm)

<sup>8</sup> Office of Fair Trading, March 2001, "Competition in Professions" - <http://www.offt.gov.uk/NR/rdonlyres/B08439C8-C5F6-4946-8AFF-71C050D34F46/oft328.pdf>

competition law and that unjustified restrictions on competition should be removed. Examples of these rules identified by the OFT include:

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

- 1.27. In their report, the OFT recommended that the legal professional rules should be fully subject to competition law and that, in the absence of a clear rationale for the current restrictions, unjustified barriers to competition should be removed.
- 1.28. In a subsequent report, the OFT welcomed the fact that some of the identified restrictions had been removed or were in the process of being removed.<sup>9</sup> However, it pointed out that the remaining rules that the professional bodies had sought to justify continued to be unnecessarily restrictive and hampered the freedom of suppliers to compete in the legal services market.
- 1.29. Markets in which competition is weak not only allow inefficient firms to survive, but can also weaken their incentives to innovate. In the extreme, firms in an uncompetitive environment can use market power to raise prices and restrict output, and hence earn higher profits at their customers' expense.
- 1.30. Free markets will only deliver efficient outcomes if a significant number of consumers have full information about the nature of the goods or services provided, including the price/quality trade-off, to be able to make purchasing judgements.
- 1.31. However, lawyers' customers often lack the detailed knowledge necessary to make an accurate assessment of the value for money of the services they procure, and whether the legal advice and representation they have received can resolve their problems. In addition, the 'credence' nature of legal services means that even after the consumer has received the expert advice, they may still be unable to judge the quality of the advice or representation received.
- 1.32. The problem is exacerbated by the fact that many legal services are purchased infrequently, which means that consumers do not have the opportunity to compare the quality of advice they received against previous purchases. Therefore, the legal services market fails to deliver efficient outcomes, as it does not display the characteristics of a free market.
- 1.33. As mentioned in para. 1.20, it should also be noted that when people do use legal services it will often be in highly stressful circumstances. This set of circumstances can have the following consequences:

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<sup>9</sup> 'Competition in Professions', progress statement, OFT April 2002 <http://www.of.gov.uk/NR/rdonlyres/23B43E4F-2D9C-485C-9F7C-4FF8CAB80FAF/0/oft385.pdf>

- If consumers are unable to distinguish between high quality and low quality suppliers, there is a risk that bad suppliers will drive out good suppliers by offering poor quality services.
  - Many consumers do not have sufficient knowledge to judge whether the legal services being provided by lawyers are necessary or even adequate. When consulted by consumers, lawyers will usually diagnose the legal problem, suggest remedies and implement them. In circumstances where lawyers may have private interests that differ from their customers, there may be incentives for lawyers to over-provide their services (in terms of quantity or quality) above the socially desirable level.
- 1.34. The existence of information asymmetries in the legal services market argues for regulatory intervention in the market. Indeed, self-regulatory bodies, such as the Law Society and the Bar Council, maintain rules on entry, conduct and business structures that attempt to address these market failures.

***The need for more effective and independent complaints handling arrangements***

- 1.35. Under current arrangements, there are separate complaints and discipline systems for each of the legal professions. If consumers are not satisfied with the way a professional body has handled their complaint, they can take the matter to the Office of the Legal Services Ombudsman (OLSO) free of charge.
- 1.36. The majority of complaints are about the standard of service that consumers have received. There are far fewer concerns about how the professional bodies discipline their members when they break the rules.
- 1.37. Problems associated with the handling of complaints against solicitors first came to light in the mid-1980s. Recent research suggests that the consumer's experience has not greatly improved over the intervening period.<sup>10</sup>
- 1.38. The proliferation, fragmentation and overlap in the current regulatory framework are also features of the arrangements in the existing complaints handling arrangements. The following are examples of various anomalies, gaps and overlaps:
- The Legal Services Ombudsman (LSO), the Legal Services Complaints Commissioner (LSCC), the Secretary of State for Constitutional Affairs, the Master of the Rolls, the Court of Faculties, the Financial Services Authority (FSA), the Patent Office and the Immigration Services Commissioner are each responsible for varying degrees of external oversight of complaints handling.
  - Complaints against barristers and solicitors are pursued via different procedures, even where they are providing similar types of service.
  - A consumer seeking a conveyancing service in a high street firm may, within one transaction, deal with a number of individuals – for example, a solicitor, a licensed conveyancer and a legal executive. If a complaint is necessary, there could be several different complaint mechanisms involved.
- 1.39. Consumers also have concerns about the independence of the current complaints handling arrangements for legal services. Currently, professional bodies such as the Law Society and the Bar Council are responsible for regulating the conduct of their

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<sup>10</sup> Details of the findings from a series of opinion surveys conducted since 2004 can be found in the response submitted by Which? to the Government's White Paper: The Future of Legal Services: Putting Consumers First. Their response can be found at: [http://www.which.net/campaigns/other/legalservices/0601legalserviceswp\\_cresp.pdf](http://www.which.net/campaigns/other/legalservices/0601legalserviceswp_cresp.pdf)

members, representing their interests, and handling consumer complaints.

- 1.40. This (at least perceived) lack of independence adds to the feeling held by many consumers that they are at a particular disadvantage in raising a complaint against a lawyer. The absence of significant consumer influence in the complaints handling system is seen to result in a lack of accountability and transparency. As a consequence, the system fails to promote consumer confidence in the legal professions.
- 1.41. In her 2004/5 annual report,<sup>11</sup> the LSO pointed out that despite some improvements in complaints handling made by the Law Society, she was dissatisfied by the Society's own internal quality control of the complaints handling arrangements. In 2004/05, 17,074 complaints were made against the 96,757 solicitors who were practising in England and Wales and fell within the Ombudsman's remit. Of the 1,265 cases that were referred to the Ombudsman, she was satisfied with the quality of handling in 62% of cases.
- 1.42. In the same period, 455 complaints were made against the 14,364 practising barristers. Of the 174 cases that were referred to the Ombudsman, she was satisfied with the quality of handling in 78.7% of the cases (a decreasing number over the last three years). The Ombudsman was satisfied with both turnaround times and the quality of complaint handling by the Bar Council.
- 1.43. The Government welcomes the progress that the Law Society and LSCC are making. The Law Society also established a Consumer Complaints Board on 1 January 2006, with a lay majority, to oversee its handling of complaints. This is another welcomed step.
- 1.44. However, consumers are demanding more when they have complaints about any legal service and therefore change is needed in order to meet these demands. Most importantly, consumers need to be satisfied that complaints are handled independently and without self-interest; that they are handled efficiently, fairly and quickly, and that complaints are used to correct faults in the system.
- 1.45. The Government's White Paper of October 2005<sup>12</sup> identified the main consumer demands with regard to complaints handling as:
  - **Independence:** consumers do not have enough confidence in the current system. They are not convinced that bodies that act as both the team manager and the referee, have the capability to do so effectively.
  - **Timeliness:** where things go wrong, consumers have a right to expect that their complaints will be dealt with quickly and efficiently.
  - **Consistency and clarity:** consumers need to know who to contact when they have a complaint. There should be no overlaps or gaps from the consumer's point of view.
  - **Best practice:** professional bodies largely set their own standards, which may not always be consistent nor always represent best practice. Quality and best practice – within the legal services sector and beyond it – should be identified and driven through the whole system.

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<sup>11</sup> Annual Report of the Legal Services Ombudsman for England and Wales 2004/2005, Law in Order: Your right to expect better, July 2005. <http://www.olscc.gov.uk/pdfs/OLSCAnnualreport2004-2005.pdf>

<sup>12</sup> The Future of Legal Services: Putting Consumers First, October 2005 <http://www.dca.gov.uk/legalsys/folwp.pdf>

## The pathway to reform of the current arrangements

1.46. The Government responded to the OFT's 2001 Report, *Competition in Professions*, with a wide-ranging public consultation exercise.<sup>13</sup> Consumers were clear that their needs were not being met. They felt that legal services lacked sufficient orientation towards the consumer; they did not have confidence in self-regulation alone; and prior experience of poor complaints handling had undermined their confidence in the legal profession.

1.47. The Department for Constitutional Affairs Report that followed in July 2003<sup>14</sup> confirmed the view that:

*“the current framework is out-dated, inflexible, over-complex and insufficiently accountable or transparent”.*

It concluded that a thorough and independent investigation without reservation was needed.

The terms of reference were:

- *to consider what regulatory framework would best promote competition, innovation and the public and consumer interest in an efficient, effective and independent legal sector; and*
- *to recommend a framework which will be independent in representing the public and consumer interest, comprehensive, accountable, consistent, flexible, transparent, and no more restrictive or burdensome than is clearly justified.*

1.48. In July 2003 the Government appointed Sir David Clementi to carry out an independent review of regulation of legal services in England and Wales. As part of his review Sir David published his own consultation paper in March 2004.<sup>15</sup>

1.49. In December 2004, Sir David Clementi published his full report. The report confirmed there was a clear case for reform of the existing **regulatory structure**:<sup>16</sup>

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

1.50. Sir David Clementi also expressed concerns about the need for **more effective competition**. He emphasised the restrictive nature of current business structures in the provision of legal services in his final report:

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<sup>13</sup> For further information see Department for Constitutional Affairs, July 2003, “Competition and Regulation in the Legal Services Market”. <http://www.dca.gov.uk/consult/general/oftreptconc.htm>

<sup>14</sup> *ibid.*

<sup>15</sup> For further information see <http://www.legal-services-review.org.uk/content/consult/review.htm>

<sup>16</sup> For further information see <http://www.legal-services-review.org.uk/content/report/index.htm>

*“... business practices have changed. In particular, the skills necessary to run a modern legal practice have developed; but while those with finance or IT skills may sit on the management committee of a legal firm, they are not permitted to be principals in the business. There is concern also about whether the restrictive practices of the main legal professional bodies can still be justified ...”*

- 1.51. Sir David recommended the facilitation of legal disciplinary practices, which would bring together lawyers from different legal professions, for example solicitors and barristers working together on an equal footing, permitting non-lawyers to be involved in management and ownership of these practices.
- 1.52. Sir David also expressed concerns about the **complaint handling arrangements** in the provision of legal services:

*“There is considerable concern about how consumer complaints are dealt with. The concern arises at a number of levels: at an operating level, there is an issue about the efficiency with which the systems are run; at an oversight level, there is a concern about the overlapping powers of the oversight bodies; and at a level of principle, there is an issue about whether systems for complaints against lawyers, run by lawyers themselves, can achieve consumer confidence. A large number of the responses to the Consultation Paper expressed dissatisfaction with the current arrangements.”*
- 1.53. To increase the independence of the complaint system and to simplify the system for consumers and suppliers of legal services, Sir David recommended the establishment of the new Office for Legal Complaints (OLC). This single, independent body would handle consumer complaints in respect of all members of Approved Regulators (ARs), subject to oversight by the Legal Services Board that he also recommended.
- 1.54. In October 2005 the Government set out its agenda for reforming the regulation and delivery of legal services, in the White Paper *The Future of Legal Services: Putting Consumers First*.<sup>17</sup> The DCA then consulted widely to further develop the proposals outlined in the White Paper.
- 1.55. In response to that consultation, the Government published a draft Legal Services Bill for Parliamentary pre-legislative scrutiny on 25 May 2006.

### **The Government’s objectives in reforming the current arrangements**

- 1.56. The Legal Services Bill develops the proposals set out in the Government’s White Paper and puts consumers at the heart of a new framework for the regulation and delivery of legal services. Key outcomes are to create a new regulatory framework that puts consumers first by:
  - increasing public trust and confidence in the legal sector;
  - ensuring consumer interests are represented effectively;
  - ensuring competition in the legal services market is not unjustifiably restricted;
  - ensuring that appropriate standards of education, training and conduct are

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<sup>17</sup> For further information see ‘The Future of Legal Services: Putting Consumers First’, (October 2005) *op. cit.*

maintained;

- improving redress arrangements to ensure that consumers are given quick and fair redress;
- ensuring that appropriate standards are maintained through effective regulation and disciplinary arrangements;
- ensuring that access to justice is provided and improved; and
- ensuring that the independence of the legal profession from outside influences is maintained.

## **Devolution**

1.57. The Government's proposals have effect in England and Wales only.<sup>18</sup>

## **2. Consultation**

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### **Engagement with stakeholders**

2.1. Throughout the development of its proposals, the Government has held discussions with key stakeholders. These include:

- **Consumer organisations:** such as Which?, Citizens Advice, National Consumer Council, the Federation of Small Businesses, the Equality Commission, Complaints Against Solicitors Independent Adjudication (CASIA), and Reform Of Complaints Against Solicitors (ROCAS).
- **Regulatory bodies:** including the Law Society, the General Council of the Bar, the Institute of Legal Executives, the Institute of Trade Mark Attorneys, the Chartered Institute of Patent Agents, the Council for Licensed Conveyancers, the Court of Faculties, the Council of the Inns of Court, and the Association of Law Costs Draftsmen.
- **Other professional representative bodies:** such as City of London Law Society, Association of Personal Injury Lawyers, Resolution, and Legal Aid Practitioners Group.
- **Others include:** Office of the Legal Services Ombudsman, Office of the Legal Services Complaints Commissioner, British Bankers Association, Legal Action Group, Law Centres Federation, and Amicus.

### ***Responses to the White Paper***

2.2. The Legal Services Reform White Paper invited comments on the Government's proposals. The Department for Constitutional Affairs received just over 100 responses. The vast majority accepted and supported the Government's proposals

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<sup>18</sup> The Office of the Immigration Services Commissioner (OISC), an existing statutory regulator, will continue to regulate immigration advisers in the UK who are not members of designated professional bodies and pursue those who flout their regulatory scheme. The OISC will remain the responsibility of the Home Secretary. The LSB will take over the OISC's current responsibility, in England and Wales, to monitor the professional bodies' regulation of their members who provide immigration advice. The LSB and OISC will develop a Memorandum of Understanding to set out cooperation between the two organisations, particularly in respect of quality and standards of service for dealing with complaints.

for reform.

- 2.3. Just over half of the responses represented the views of the legal profession, while a quarter were from the consumer organisations or members of the public. The remainder represented other professions, the not-for-profit sector, and other interested parties.
- 2.4. Responses from the larger professional bodies were mixed, but in the main were supportive of the Government's objectives and its main proposals. However, some bodies expressed concerns about the need for careful implementation to ensure, for example, that the Government did not create a large bureaucracy in setting up the Legal Services Board (LSB). Responses consequently raised concerns about the LSB's governance structure maintaining the professions' independence from government, and about the need to limit further the LSB's powers to ensure that it was proportionate and risk-based. They also continued to press the Government to contribute to the cost of reform and were opposed to the profession paying for the full costs. They also raised some concerns about the alternative business structure (ABS) proposals, including issues about access to justice as well as the cost of the reforms.
- 2.5. Responses from the other professional bodies also argued strongly in favour of the Government contributing to the costs of the new arrangements. There were also concerns that the voice of the smaller bodies could be lost in the regulatory framework, and some argued for a professional advisory panel. Other concerns included the added bureaucracy of applying ABS safeguards, a concern that the new Office for Legal Complaints (OLC) should not be essentially the Law Society's Consumer Complaints Services "re-badged", and an argument that the OLC should have the power to delegate complaints handling to those ARs that met minimum service standards. Finally, the smaller bodies wanted to see a central compensation fund established to which all legal service providers would contribute.
- 2.6. The consumer organisations remained extremely supportive of the proposals, as they had been throughout their development. Generally their main concern was that the OLC should have sufficient powers to deal effectively with consumer complaints. The Consumer Advisory Panel, which was established to advise the Government on the implementation of the proposals for legal service reform, has played a key role in the detail and development of these proposals. Membership of the Panel comprises Citizens Advice, Which?, National Consumer Council, Federation of Small Business and the Equal Opportunities Commission (with the OFT assisting).
- 2.7. Responses from the NfP sector were broadly supportive of the prospect of regulation via the ABS framework. Some NfP organisations actively welcome this on the basis that this will provide greater clarity to providers over how regulation applies to them, and more consistent protection for consumers. However, there were also concerns expressed that the new framework will lead to higher costs for charitable organisations and smaller providers, and that there is insufficient recognition of the different objectives of commercial and NfP providers. Some respondents felt that the proposals in the White Paper for LSB discretion did not go far enough in counteracting the threat of greater regulatory burdens, whereas others expressed concerns that these should not mean less scrutiny of NfP practices or the quality of services they offer to consumers.
- 2.8. The Government also received various responses from businesses which were supportive of the ABS proposals and the possible opportunities that those proposals would enable.
- 2.9. The trade union response was broadly supportive of the proposals for the LSB, OLC

and ABS. However, their primary concern was to ensure that the services they provide would not be captured by the definition of legal services and asked for a specific exemption. They also expressed a wish for any individuals affected by the Government's proposals to be dealt with fairly.

## Impact of consultation on the proposals

2.10. Public responses to the Government’s White Paper and the results of its stakeholder engagement have resulted in some amendments to the policy proposals set out in the White Paper. The table below identifies the key changes:

	<b>White Paper reference</b>	<b>Change/addition</b>
<b>LSB - Diversity Objective</b>	The White Paper made references to the general increase in diversity of the legal profession, but did not set it as an objective of the LSB.	The Government considers that the objective of the LSB to “encourage a strong, effective legal profession” should be amended to “encourage a strong, effective and diverse legal profession”.
<b>LSB - Consumer Affairs</b>	The White Paper stated that members of the LSB Board and Consumer Panel would between them have experience of “consumer affairs”.	The Government intends that the legislation should require the Consumer Panel to have a fair degree of members representation of all types of consumers, including sophisticated consumers who are using reserved services in connection with businesses carried on by them.
<b>LSB - duty to consider representations of ARs and representative bodies</b>	The White Paper did not set out a general requirement for the LSB to consult the profession, although it would have consult the Secretary of State for Constitutional Affairs, its Consumer Panel, the OFT and the Senior Judiciary when authorising/deauthorising approved regulators, bringing in unregulated activities under the LSB’s scope, regulating directly, reviewing targets/sanctions or altering the rules of an AR.	The Government intends to place a duty on the LSB to consider the representations of ARs or representative bodies before exercising its powers (e.g. the power to issue a direction). The LSB, once it is established, will have the flexibility to decide the most effective way to consult the profession in exercising its other statutory functions, including the option of setting up a professional panel.
<b>ABS - register for ABS firms</b>	The White Paper did not mention the maintenance of a register of ABS firms.	The Government considers that licensing authorities should be under a duty to maintain a publicly accessible register of their licensed ABS firms. The LSB will be required to make the rules governing the registers.
<b>ABS - removal of HOLP</b>	The White Paper proposed that ABS regulators would have to provide consent before an ABS firm could remove the HOLP.	This requirement will not be set out in the legislation.

<b>Complaints - role of Ombudsmen</b>	The White Paper proposed that complaints about lawyers should be determined by arbiters.	The Government considers that complaints should be determined by ombudsmen rather than arbiters.
<b>Complaints - name of the new complaints handling body</b>	Sir David Clementi referred to the complaints body as the “Office for Legal Complaints”, and the Government adopted this term in public discussion – including in the White Paper.	Provision has been made in the legislation to allow the new complaints-handling body to determine its own trading name (so, as part of the Government’s preferred branding for Alternative Dispute Resolution schemes, the OLC could choose to operate under a title including the term Ombudsman).

### 3. Sectors and Groups Affected

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3.1. The Government has identified that the following sectors and groups will be affected by its proposals:

- consumers of any legal services;
- members of the legal professions that provide reserved legal services (barristers, solicitors, legal executives, licensed conveyancers, notaries, patent agents, and trademark attorneys);
- legal professional and/or regulatory bodies that regulate the provision of reserved legal services (Bar Council, Law Society, Institute for legal Executives, Council for Licensed Conveyancers, Court of Faculty, Chartered Institute of Patent Agents, and the Institute of Trade Mark Attorneys);
- providers of unreserved legal services, including general legal advisors, will writers, employment advisors and claims managers;<sup>19</sup>
- businesses and organisations that currently employ 'in-house' lawyers;
- all NfP organisations that offer legal advice and purchase legal services;
- Government and the Government Legal Service;
- existing oversight regulators (e.g. the OFT);
- potential investors/partners in ABS firms;
- providers of immigration services and the Immigration Services Commissioner; and
- the Offices of the Legal Services Ombudsman and Legal Services Complaints Commissioner.

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<sup>19</sup> The Government has proposed to introduce a statutory framework for the regulation of claims management services. Measures to achieve this form part of the Compensation Act.

## 4. Reforming the Regulatory Framework for Legal Services

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### Options for reform of the regulatory framework

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

#### **Option 1 – Do nothing**

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

#### **Option 2 – A new single regulatory authority**

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

#### **Option 3 – An oversight regulator**

- 4.4. Under this option, a new independent oversight body, the **Legal Services Board (LSB)** would be created. The LSB would assume the roles and responsibilities of the range of the existing oversight regulators, providing consistent and appropriate oversight of Approved Regulators (ARs). These would be existing (or new) professional or other bodies which could seek authorisation from the LSB to act as ARs for the provision of reserved legal services, to perform the day-to-day regulatory functions. In considering applications for authorisation, the LSB would want to ensure that ARs met its statutory requirements (e.g. in having appropriate governance arrangements that provide for a clear split in the exercise of their regulatory and representative functions).
- 4.5. In addition, if the LSB was satisfied that an authorised AR was not exercising its regulatory functions to a high standard, it would have the power to take action, including the right to de-authorise the failing AR. Where no appropriate AR exists, the LSB will have the power to regulate authorised persons directly. Where it is doing so, the LSB will have powers conferred on it to ensure that it can provide effective regulation. In addition, to provide additional consumer protection, the LSB could apply for designation as an enforcer under Part 8 of the Enterprise Act 2002. This would provide the LSB with the power to seek "stop now" orders. In effect this would mean that the LSB would be able to obtain a court order to require practices

or individual practitioners to cease carrying out a specified activity immediately, where that activity breached certain legislation and harmed the collective interests of consumers. This can be used in rare cases of flagrant and particularly damaging abuse.

- 4.6. Additional legal service activities would be brought into, or taken out of, the scope of the LSB's regulatory reach by secondary legislation.
- 4.7. Where appropriate, there would be a statutory requirement for the LSB to consult the OFT, the Secretary of State, the higher judiciary and its Consumer Panel<sup>20</sup> about its regulatory decisions. The LSB would also be able to enter discussions regularly with other statutory regulators, such as the Financial Services Authority (FSA), on regulatory issues.
- 4.8. This is the option preferred by the Government on reforming the regulatory framework for legal services. Through retaining the day-to-day functions of the existing professional bodies, the proposed regulatory framework will be able to utilise the expertise of the legal professional bodies while providing an oversight body that has the powers to ensure that regulation is set according to consumers' interests. The LSB will be less bureaucratic while reducing the potential for additional regulatory burden on both professional bodies and firms, encouraging competition and innovation in the market, and possibly reducing the price of legal services while improving the quality of legal services. Most importantly, the LSB will have the power to ensure that the regulation of the profession is consistent with all the objectives of the Government's reform of the regulatory framework for legal services in England and Wales.

## **Benefits and costs of options of reforming the regulatory framework for legal services**

### **Option 1 – Do nothing**

#### ***Benefits***

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

#### ***Costs***

- 4.10. Through retaining the current regulatory arrangements for legal services, the weaknesses of the system, such as its over-complex and inconsistent arrangements, would remain. Consumers would continue to lack the necessary knowledge to make accurate assessments of the value for money of the services they have purchased and/or whether the legal advice and representation they received can solve their problems. In addition, there is a risk that regulations on conduct and business structures would continue to be set with insufficient regard to protecting and promoting consumer interests or promoting competition, innovation and diversity in the legal profession.
- 4.11. There would be no additional policy costs arising from this option. Using information provided by the legal professional bodies, PricewaterhouseCoopers (PwC), in their independent report on the regulatory reform of legal services,<sup>21</sup> estimate that the

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<sup>20</sup> The Consumer Panel would advise the LSB on the need of consumers of legal services. The members of the Panel would be appointed on merit and would have experience of consumer affairs.

<sup>21</sup> PricewaterhouseCoopers prepared a report for the Department of Constitutional Affairs (DCA) in connection with the DCA's consideration of the financial assessment of the Legal Services Reform. The figures published/stated are exclusive of VAT and are dependent on the assumptions made by PwC and inevitably is subject to a number of uncertainties.

total regulatory costs in 2005-06 were some £97.4 million. Of these costs some £64.9 million relate to regulatory functions, including disciplinary costs.<sup>22</sup> This estimate does not fully capture the opportunity cost of the time spent by high-level regulators (e.g. senior judicial and ministerial time) and therefore understates the total cost of regulation in this respect.

- 4.12. The Law Society's costs represent a substantial proportion of this total at approximately 71%.

## **Option 2 – A new single regulatory authority**

### ***Benefits***

#### Economic benefits

- 4.13. As all regulatory functions would be vested in and carried out by the LSA, whose objective would be to promote consumer interests, the emphasis on service-driven regulation should reduce the risks of regulations on entry to the professions and conduct and business structures being set more strictly than necessary. This in turn should help promote competition and innovation in the legal services market. Provided that the LSA was an effective organisation in ensuring that regulation was in the consumer interest rather than that of providers, prices for legal services could fall and the market expand, to the benefit of consumers.
- 4.14. The creation of a single and independent regulator that removed the self-regulatory elements within the regulatory framework and had significant non-legal/consumer influence should lead to greater accountability by reducing conflicts of interest between the regulatory and representative functions of the professional bodies. This would also improve the transparency of regulatory procedures and increase regulatory certainty. This in turn should increase consumer confidence in the professions, potentially leading to an increase in the demand for legal services.
- 4.15. A single regulator would be likely to lead to the harmonisation of regulation and the reduction of regulatory inconsistencies for the legal sector. The resulting reduction of regulatory burden stemming from the duplication of regulatory functions<sup>23</sup> and increased efficiencies could lower compliance costs for existing suppliers. This could encourage new entrants into the sector, increasing competition and innovation. The harmonisation of regulation should also prevent suppliers from taking advantage of the operation of different regulators covering the same services by choosing the one most convenient for them. This would reduce the risk of regulations being weakened and consumer protection endangered. As a result, the quality of legal services should improve, to the benefit of consumers.
- 4.16. The LSA's having the power to set and impose directly professional rules, standards of services and rules of conduct consistently across the legal professions, would mitigate the risk of regulatory capture<sup>24</sup>. This would ensure that decisions regarding regulatory issues were taken independently and would facilitate consumer input into the decision-making process, thus protecting consumer interests.
- 4.17. A single regulator should facilitate more consistency in training and entry standards,

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PwC's independent report is published on DCA's website and can be found at:

<http://www.dca.gov.uk/legalsys/lrreform.htm>

<sup>22</sup> This includes enforcement, rule making, monitoring, rule-making activities and setting entry standards, but excludes complaints handling and disciplinary costs.

<sup>23</sup> See Section 1, Rationale for Government Intervention to Reform the Regulatory Framework

<sup>24</sup> Regulatory capture occurs when regulators advocate the interests of the suppliers that they regulate rather than the consumer.

permitting common training between different legal service providers and making it easier to transfer between them. This should lower the barriers to entry to the legal services market for potential new entrants, and promote diversity and competition among providers.

- 4.18. A single regulator should provide a clear forum for dealing with any conflicts in the objectives within the regulatory regime. It is better that resolution of such conflict rests within one accountable body, rather than in separate bodies with different vested interests.
- 4.19. A single regulator should permit greater flexibility in the system. The emergence of new services that required regulation would not require the setting up of new bodies to regulate them in the future. This would reduce the emergence of regulatory anomalies and gaps. A single regulator would also make it easier to regulate Alternative Business Structures firms (ABS), through the simplification and concentration of regulatory powers in one body.

#### Social benefits

- 4.20. A single regulator would be likely to lead to greater consistency, providing a single coherent system of authorisation, supervision and investigation, which would demonstrate transparency and accountability to the consumer. In addition, clearer lines of responsibility and greater accountability for the objectives of the regulatory system would lead to greater consumer confidence and awareness of consumer rights.
- 4.21. The shift away from a professionally-driven approach to one that was more service-driven might be accompanied by a more consumer-driven approach, one that emphasised the need to satisfy consumer interests rather than sustaining the standing of the professional provider. This should improve customer relations and society's perception of legal service providers.

#### **Costs**

##### Economic costs

- 4.22. There would be a substantial risk that, through increasing workload after its creation and with a lack of sound management, the LSA could become an overly bureaucratic and inefficient organisation, with consequent problems of cost and unwieldy procedures. In addition, it is possible that regulatory expertise would be lost during the transitional period, through the abolition of the professional bodies' regulatory powers. Moreover, with all regulatory functions being performed by the LSA, the potential for competition between the professional bodies in the provision of representative and regulatory services would be removed.
- 4.23. There is a risk that the creation of the LSA would produce additional regulatory burdens on the professions (compared to the other options), incurring significant additional compliance costs for existing and potential new suppliers. This might result in existing suppliers transferring the additional costs to consumers, leading to price increases without any corresponding increase in quality. Moreover, there is a risk that these costs would fall disproportionately on legal practitioners in rural areas and small practices, and potentially be passed onto their customers, as there would be fewer practitioners in these practices to shoulder the additional cost burdens. The additional costs might also result in a rise in entry costs sufficient to deter potential new entrants to the legal services market, stifling competition and reducing the incentives for existing suppliers to innovate.

- 4.24. Establishing an independent LSA with all regulatory powers vested in it would make it less likely that the expertise of the professional bodies for setting the levels of entry standards and training, formulating professional rules, monitoring compliance and enforcing the necessary codes of conduct would be utilised. It would be less likely that the professions would be willing to give up time freely to support the regulatory system; consequently, the cost of information for the formulation and interpretation of quality standards might rise.
- 4.25. Without the expertise of the professions, there would be a greater risk of the regulatory framework being set up inappropriately, to the detriment of consumers and the professions. Furthermore, the removal of regulatory functions from the professions might lessen the feeling of responsibility professionals have for the quality standards of their professions and would thus increase monitoring and enforcement costs.
- 4.26. Although the LSA would be independent from Government and fully funded by the professions, the fact that all regulatory powers would be vested in it might increase scepticism about the independence of the legal professions from outside influence. It has been argued that the resulting detrimental effect on confidence in the UK legal professions might deter foreign consumers of legal services from using the UK (and London in particular) as a centre for international and commercial litigation and arbitration. Figures show that up to 4,000 international disputes a year are dealt with in London, and more than 90% of disputes handled by international law firms in London involve at least one foreign party with the amounts in dispute totalling over US \$40 billion in 2002.<sup>25</sup>
- 4.27. Using the information provided by the professional bodies, the operating cost for the LSA, including disciplinary functions was estimated in PwC's Final Report<sup>26</sup> to be £66.4 million annually. This represents a total estimated net additional annual ongoing cost of £1.5 million greater than the current cost of separate legal regulation (i.e. the "Do Nothing" option).
- 4.28. Using broad assumptions, the PwC report estimates that the transition costs associated with the establishment of the LSA represent £55.3 million, spread over three years either side of the LSA inheriting its powers and duties.

Option	Annual Running Costs	Transition Costs (two years before vesting)	Transition Costs (one year before vesting)	Transition costs (one year after vesting)
	£'000	£'000	£'000	£'000
<b>Do nothing</b>	64,900	n/a	n/a	n/a
<b>With Legal Services Authority</b>	66,400	11,550	16,740	27,000

*Costs in 2005-06 prices.*

#### Social costs

- 4.29. Aside from the social costs referred to under the economic costs section there would

<sup>25</sup> International Financial Services London, (March 2005), *Legal Services: City Business Series*. *op. cit*

<sup>26</sup> PwC's independent report is published on DCA's website and can be found at: <http://www.dca.gov.uk/legalsys/lrreform.htm>

be no additional social costs arising from this option.

### **Option 3 - An oversight regulator**

#### ***Benefits***

##### Economic benefits

- 4.30. By providing a single point of consistent oversight regulation, the establishment of the LSB would lead to a reduction of inconsistencies in the current regulatory framework in the form of regulatory proliferation, confusion, fragmentation and anomalies for the legal sector. The process of altering professional rules as a response to changes in market condition would also be streamlined. This should result in a reduction in regulatory burden for existing suppliers and an increase in efficiency. Consequently, new entrants would be attracted to the legal services market, increasing competition and driving innovation within the sector.
- 4.31. The flexibility of the system would allow the LSB to authorise new and current ARs to regulate their members in the provision of a range of existing legal services and newly reserved areas of legal services, and would also help facilitate Alternative Business Structures (ABS) and consequently encourage competition and innovation in the market.
- 4.32. In addition, this flexibility should also increase competition for the regulation of the ABS firms, leading to efficiency drives among the ABS regulators and reducing regulatory burdens for ABS firms. Moreover, this flexibility should ensure that consumers were appropriately protected, especially with the legal services market developing rapidly and new forms of legal services emerging.
- 4.33. The LSB would have a statutory objective to protect and promote consumer interest, promote competition in the provision of legal services and encourage an independent, strong, diverse and effective legal profession. The objectives will ensure that regulation is applied in a manner that is ultimately beneficial to consumers.
- 4.34. A regulatory framework that gave responsibility for the regulatory functions to ARs with an LSB providing consistent oversight would mean that the expert knowledge of the legal professions in setting entry standards and training, formulating professional rules, monitoring compliance and enforcing the necessary codes of conduct would be retained. The risk of losing regulatory expertise during any transitional period should also be reduced. Leaving the day-to-day regulations as far as possible to the ARs would also be more likely to increase the commitment of suppliers to high standards, reducing the risk of rising monitoring and enforcement costs.
- 4.35. The duty of the LSB to consult with the Office of Fair Trading (OFT) when authorising new ARs, or adding to or removing from the list of reserved legal services, will ensure that competition issues are fully considered by the LSB and OFT. In addition, the LSB would be under a duty to respond to any competition issues that the OFT brought to its attention. This would reduce the risk of competition being stifled by anti-competitive practices, maintaining the benefits of innovation and diversity within the market.

##### Social benefits

- 4.36. If the oversight body was not created and the professional regulatory bodies were only required to separate their regulatory and representative functions, as the Law Society has suggested, there would still remain a number of deficiencies in the

regulatory framework which these arrangements would not address. More specifically, the LSB would eliminate the inconsistencies in the existing regulatory framework and, by acting as an independent oversight regulator, would be able to identify best practices to meet the objectives of reforming the regulatory framework.

- 4.37. Through the creation of an oversight regulator, the regulatory framework would provide consumers with better protection. This is because an oversight body would monitor the legal services sector and ensure that regulatory gaps were identified and tackled before consumers were put at risk. The LSB would be responsible for authorising and regulating the ABS regulators who would license businesses to provide legal and non-legal services to consumers. We expect that ABS would encourage competition and innovation in the provision of legal services.
- 4.38. The separation of the regulatory and representative functions of the professional bodies would not on its own contribute to increasing consumer confidence. The LSB would be independent from the Government and the profession, and would therefore focus on promoting consumer interests and its statutory objectives. Such a system would help to increase consumer confidence in the system and improve the professional standing of providers.
- 4.39. Once the LSB has been established and its powers brought into effect, it will set out criteria which the ARs will need to meet when separating their regulatory and representative functions. If the ARs fail to meet these criteria then the LSB has the power of direction to intervene in order to correct failures.
- 4.40. The LSB would be a smaller, less bureaucratic and more efficient organisation than the LSA model. As such it would have a greater ability to adjust flexibly to future changes in the legal services market, and to make the appropriate regulatory response. This should aid future development in the market, in particular the possible expansion of the role of ABS firms in the provision of legal services. Further, this could also bring positive benefits in terms of increasing access to justice, especially to the most vulnerable sections of society, such as those consumers restricted in their geographical access to legal services and those with special needs. In addition, the LSB will be under a statutory duty to improve access to justice.
- 4.41. In accordance with the objectives of the new regulatory framework, the LSB will operate openly and transparently so that consumers could understand its decisions and hold it to account. The LSB would consult with consumers and would establish and maintain a Consumer Panel, further demonstrating its dedication to consumer interests. We expect that this feature of the LSB would instil greater confidence in consumers.
- 4.42. The clear separation of regulatory and representative functions, which the LSB would require ARs to have in place, in conjunction with an oversight regulator, would lead to greater accountability, transparency and regulatory certainty. Consumers can be assured that the people who are regulating and disciplining regulated persons are not the same people who represent the interests of the legal profession. The LSB's retention of the right to carry out regulatory functions directly, should an AR fail, would provide an incentive for ARs to regulate their professions with consideration for consumers' interests and consistent with the LSB's objectives.
- 4.43. Under the LSB option, the front-line regulatory powers would be exercised at AR level, subject to regulatory competencies and governance arrangements. The fact that day-to-day regulatory functions would be performed by ARs themselves would support the principle that the legal profession should be independent of Government, and would demonstrate it more clearly than the LSA model. This should mitigate any

potential impact on UK legal services' international standing. In particular, this should reduce the risk of withdrawal of foreign purchasers and supplier of legal services from the UK legal services market, and the likelihood of English lawyers being prohibited from carrying out legal work within foreign jurisdictions post-reform, compared to the LSA option.

## **Costs**

### Economic costs

- 4.44. Under the LSB option, the legal professions would be subject to regulations set by the approved regulators. These regulations, and other regulatory arrangements, would require the approval of the LSB before coming into force. In addition, if, in the future, the LSB decided to widen the regulatory net to include previously unregulated professions, then regulatory costs associated with the new area would fall on practitioners in those professions. Although there is a risk that these costs could be passed onto consumers, this should be minimal, as increased competition among suppliers would provide an incentive for suppliers to identify cost-saving strategies to keep prices relatively low.
- 4.45. The LSB's ability to adapt to changes in the legal services market (including the possibility to widen its regulatory net) would not be without significant benefits. Oversight regulation conducted by the LSB would drive efficiency in the market while protecting consumer interests. The result of this would be a consistent level of high-quality provision across all professions within legal services.
- 4.46. ARs might use their knowledge of the current market conditions of the legal services' market to formulate regulations that put the interests of the professions above those of consumers. However, there would be safeguards to substantially reduce the incentives of bodies to set regulations in a way that harmed consumers. These would include the ability of the LSB to impose financial penalties on approved regulators. This should serve to deter ARs from acting in a manner contrary to the regulatory objectives of the LSB. In addition, the LSB also has the power to approve rules, to direct that rules be called in or amended, and to impose sanctions, with de-authorisation of the AR as a last resort.
- 4.47. In using these safeguards, the LSB would be required to act proportionately, exercising its powers consistently with the need to ensure effective regulation.
- 4.48. In their independent report on the costs of the Government's proposed arrangements,<sup>27</sup> PwC identified the ongoing annual running costs of the regulatory system (including disciplinary costs) under the LSB model to be around £67.3 million. The key driver for the difference in costs compared to the 'do nothing' option (which is estimated to cost £64.9 million) is the additional annual running costs of a Legal Services Board, estimated at £3.6 million (as per PwC's base-case scenario).
- 4.49. This represents a total estimated net additional annual cost of £2.4 million greater than the current costs of separate legal regulation (i.e. the "Do Nothing" option).
- 4.50. The cost of the LSB option would also be around £900,000 per year more than the LSA. Despite the much lower annual running costs of the LSB oversight regulator (£3.6 million as an 'oversight' regulator against £66.4 million for the LSA as 'sole' regulator), PwC estimated that under the LSB option, £63.6 million of the costs will remain with approved regulators. This is because the powers and duties of day-to-day regulation would be delegated down from the LSB and therefore the ARs will

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<sup>27</sup> PwC's independent report is published on DCA's website and can be found at: <http://www.dca.gov.uk/legalsys/lisreform.htm>

continue to incur costs (e.g. staff and accommodation costs) in largely the same way as they do under the current system.

- 4.51. The Government is content that the small increase in regulatory costs can be justified by the potential benefits accruing to consumers and the legal service sector as a whole from the introduction of an oversight regulator (as discussed above). This increase in regulatory costs should be seen in conjunction with the decrease in costs attributable to bodies involved in the regulatory framework from the creation of a single, independent complaints handling body (see 6.34 onwards).
- 4.52. PwC's base case cost was estimated on the assumption that the LSB would have a 39 core staff members, with a 9-member board and a 10-person Consumer Panel in an out-of-London location. The estimate assumed that the underlying nature of the regulatory activities, within the remit of the LSB's framework, would not be substantially different from those performed under the current regulatory framework.
- 4.53. The main driver for the LSB's estimated annual running cost of £3.6 million is direct staff costs of £1.9 million.
- 4.54. PwC estimated transitional costs of £2.3 million for the LSB, which would be spread over approximately three years either side of vesting powers in the new oversight regulator. The largest transition cost of £900,000 related to new premises costs (rent, rates and insurance). The majority of transition costs (£1.6 million) would fall in the year before vesting powers in the LSB.

<b>Option</b>	<b>Annual Running Costs</b>	<b>Transition Costs (two years before vesting)</b>	<b>Transition Costs (one year before vesting)</b>	<b>Transition costs (one year after vesting)</b>
	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>
<b>Do nothing</b>	64,900	n/a	n/a	n/a
<b>With a Legal Services Authority</b>	66,400	11,550	16,740	27,000
<b>With a Legal Services Board</b>	67,250	200	1,580	500

*Costs in 2005-06 prices.*

- 4.55. PwC's report also identified £1 million of additional "implementation costs" from setting up a task force for detailed organisation design for the LSB and an independent complaints handling body (i.e. the OLC). These costs were estimated to fall in the year before powers and duties would be vested in the new bodies.
- 4.56. PwC also costed alternative scenarios over and above their base case. This included costing for an incremental increase in the level of activity and locating the LSB in the North of England or London. A combination of these variables could result in the annual ongoing running costs of the LSB rising to £5.6 million (base-case plus incremental level of activity and located in London). Under this alternative

scenario, transition costs could also rise by approximately £600,000.

#### Social costs

- 4.57. An over-arching regulatory body could dilute personal ethical responsibilities and regulatory accountability of individual solicitors. The removal of self-regulation could also de-moralise legal practitioners increasing the risk of lowering quality standards to the detriment of consumer interests. However, through the ARs retaining the responsibility for ethical and regulatory accountability, this should be prevented.

## 5. Facilitating Alternative Business Structures (ABS) in the Provision of Legal Services

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

### **Option 1 – Do nothing**

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

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

5.3. Under this option, lawyers from different legal professional bodies would be permitted to form legal disciplinary practices (LDPs). Non-lawyers would be permitted to be managers of LDPs, with roles to enhance the provision of legal services, but not to provide other non-legal services to the public. Outside ownership would be permitted, provided that owners are cleared by the regulatory authorities as “fit to own” the LDP.

5.4. In the regulation of LDPs, an Approved Regulator (AR) would apply to the LSB for authorisation to regulate the designated types of LDPs. To obtain the authorisation from the LSB, the AR would need to demonstrate its competence in the legal areas it wants to regulate and to satisfy the LSB of its governance and administrative arrangements. A prospective LDP would apply for a licence to be regulated by an AR, the granting of which depends on whether the specified legal service areas proposed by the applicant fall within the terms of the authorisation granted by the LSB to the AR, and on whether the applicant meets the relevant safeguard tests. In particular, the prospective LDP must nominate:

- a Head of Legal Practice (HoLP); a qualified lawyer subject to approval by the Regulator as a suitable candidate for the function of ensuring compliance in relation to the legal areas in which the ABS will practice.
- a Head of Finance and Administration (HoFA), approved by the Regulator as a suitable candidate for the function of ensuring compliance in relation to practice management, particularly the handling of clients’ monies.

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

- 5.5. Under this option, it would be possible for different lawyers and providers of non-legal services to obtain licences to establish ABS firms<sup>28</sup> that contained multiple disciplines, with external financing, subject to the approval of a licensing authority (LA). Under the proposed arrangement, ARs could seek authorisation from the LSB to license and regulate ABS firms. Applications would need to set out precisely the activities that the prospective licensing authority was seeking to license, the governance arrangements it had in place, and its competence to regulate the activities it proposed to license. If one of the activities the licensing authority was seeking to license involved an area outside the legal profession (e.g. financial services), the LSB would also have to consult with regulators of other regulated services (e.g. the FSA) before giving its authorisation.
- 5.6. In addition, ABS firms would have to meet the standards set by the LAs. ABS firms could be 100% financed externally at the outset, but the LA would be required to ensure that they acquired appropriate indemnity insurance cover. External investors in ABS firms would also have to pass a robust 'fitness to own' test set by the AR before being permitted to invest in the firm. This test would be triggered by an amount prescribed in statute and subject to any supplementary requirements imposed by the rules of LAs.
- 5.7. A prospective ABS would also have to nominate a HOLP and a HOFA as at paragraph 5.4.
- 5.8. Legislation would require the LSB to monitor the provision of legal services across different sectors and geographically, and use the results to inform its regulatory decisions. This would include the authorisation and imposition of any conditions upon ABS regulators in accordance with the LSB's objectives. Furthermore, the LSB would be able to take appropriate action against licensing authorities if they breached the terms of their designations, and licensing authorities would be able to take action against ABS firms if they breached the terms of their licences.
- 5.9. This is the Government's preferred option on facilitating ABS in the provision of legal services. The ABS licensing regime would be much less restrictive than the LDP option, allowing firms to offer both legal and non-legal services. ABS firms that contained a mixture of lawyers and non-lawyers could lead to the sharing of good management practice, technological innovation and efficiencies across the market enhancing competition among firms and potentially reducing the price of legal services. In addition, access to external finance would enable firms to spread start-up risks, get greater access to equity to expand their business, diversify, and improve the efficiency of their service provision, all to the benefit of customers.

### **Benefits and Costs of facilitating Alternative Business Structures for the Provision of Legal Services**

#### **Option 1- Do nothing**

##### ***Benefits***

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

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<sup>28</sup> In this context, 'ABS firm' is a generic term for all types of legal business entities (e.g. commercial, NFP) that might be considered for ABS.

## **Costs**

- 5.11. The current unjustified restrictions on business structures in the legal services market would remain. The inflexibility of the arrangements would continue to stifle competition in the market, to the detriment of legal services providers and consumers. In addition, the lack of incentives for providers to improve productivity, reduce costs and innovate while rewarding consumers with low prices, higher quality and wider choice will continue to persist. The retention of the current restrictions would also have an impact on the UK's international competitiveness as English law firms are unable to adapt to the ever-growing global changes in technology, innovation and consumer-oriented focus.

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

### ***Benefits***

#### Economic benefits

- 5.12. Enabling a wider range of business structures in legal services should benefit consumers and suppliers by allowing the legal services market to work better. This is because competition between existing suppliers, and potential competition from new suppliers and from new forms of supply, would be less restricted as a result of the removal of the current restrictions on partnerships between legal practitioners. In particular, allowing new capital from outside the legal service industry should increase capacity and exert a downward pressure on prices<sup>29</sup> via increased competition.
- 5.13. In addition, allowing the formation of LDPs would increase the scope of sharing the risks of starting a new firm among new entrants to the legal services market, leading to a decrease in financing costs. This would lower the barriers to entry for potential new entrants, potentially increasing the number of suppliers in the market, stimulating more competition and encouraging innovation, leading to an increase in the quality of the services.
- 5.14. Creating integrated legal practices would bring greater convenience to consumers by allowing a one-stop shop for different types of legal services e.g. car insurance and accident claim services. In addition, integrated legal practices would provide opportunities for LDPs to gain from economies of scale (economies of scope and/or economies of specialisation). If so, it is envisaged that the cost of these legal services would fall as consumers would now have the opportunity to purchase services from a single LDP, if they preferred, rather than having to purchase from a number of suppliers. The degree of the reduction in costs, however, would depend on the level of competition in the legal services market.
- 5.15. Allowing external investment in LDPs would give these firms access to a wider pool of capital, for example via share issue, that could be used for new investment such as upgrading infrastructure and greater innovation in the provision of legal services in more consumer-friendly ways. This should then generate scope for further efficiency gains.<sup>30</sup> Additionally, the increased access to external financing and the inherent flexibility of LDPs would give more opportunities for owners to invest in

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<sup>29</sup> It has been noted that a combination of technology, regulatory changes and the removal of the ban on advertising have resulted in reductions in the prices of conveyancing services. See Stephen, F. H., Love, J. H. & Paterson, A. A., (November 1994), *Deregulation of conveyancing markets in England and Wales*, Fiscal Studies, 15, pp. 102-118

<sup>30</sup> It has been argued that permitting external financing of law firms would be key to the introduction of more information technology to reduce the costs of personal legal services that involve relatively small but numerous transactions of a similar nature, and that under the current rules similar transformation would be unlikely to take place. See Dow, J and Lapuerta, C, (2005), *The benefits of multiple ownership models in law services*. [<http://www.dca.gov.uk/legalsys/lsreform.htm#cr>]

expanding their businesses to take advantage of any changes in legal services market, and help to maintain or increase the international competitiveness of the UK legal service sector.<sup>31</sup>

- 5.16. External owners of LDPs might seek to float a stake in the stock market, which could then improve efficiency by sending a market signal concerning the future prospects of the firm. Prospective recruits and investors could find this valuable in choosing among alternative employers and investments, and the LDP could also find this useful for evaluating its own performance.<sup>32</sup>
- 5.17. In addition, the reduction of the need for partnership equity in LDPs would lower the barriers to entry for potential new entrants<sup>33</sup>, potentially increasing the number of suppliers in the market, help stimulate greater competition and encourage innovation. It would also allow owners and partners of LDPs to diversify their risks, lowering the cost of capital, and facilitating their withdrawals from the legal services market by making their interests more liquid.<sup>34</sup>
- 5.18. External financiers of LDPs might want to build on the reputation of newly-established LDPs by developing brands and by ensuring that the quality of services offered satisfy consumer demand.<sup>35</sup> Once a reputation had been established, an LDP would have a strong incentive to maintain the quality of service so that business would not be lost. As a result, its owners might demand stricter operational discipline such as a higher level of internal controls with checks and balances in connection with consumers' monies (in particular if the LDP becomes a public limited company) to protect the reputation, which could potentially lead to an increase in efficiency. This should also lessen the likelihood of harm done to consumers due to conflict of interests.<sup>36</sup>

### Social benefits

- 5.19. We expect that innovations in the legal services market, driven by the expected increase in the level of competition in the market, could lead to the introduction of new customer service techniques and new channels for delivering services. As a result, less mobile consumers and those living in rural areas could find it easier to purchase legal services, enhancing access to justice.
- 5.20. One example of how embracing new technologies and marketing ideas can benefit legal service providers and consumers alike is the model used by firms such as Shop4Law.<sup>37</sup> Shop4Law uses an internet-based programme through which consumers identify their personal needs and are matched with individual legal service providers. For solicitors, Shop4Law is an innovative way to promote themselves and develop their businesses in a cost effective way. For consumers, the website provides a convenient and user-friendly way of finding a solicitor who is

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<sup>31</sup> It has been argued that the strong competitive position of English law firms is likely to be maintained *only* if the legal profession is adaptable. See Brealey, R A and Franks, J R, (2005), *The organisational structure of legal firms; a discussion of the recommendations of the 2004 Review of the Regulatory Framework for Legal Services in England and Wales*. [<http://www.dca.gov.uk/legalsys/lrreform.htm#cr>]

<sup>32</sup> See Dow, J and Lapuerta, C, (2005), *op. cit.*

<sup>33</sup> It has been suggested that the illiquidity of partnership equity places the law firm at some competitive disadvantage in recruiting. Brealey, R A and Franks, J R (2005). *op. cit.*

<sup>34</sup> Dow, J and Lapuerta, C, (2005) and Brealey, R A and Franks, J R, (2005), *op. cit.*

<sup>35</sup> Data provided by The Law Society, shows that claims of 'dishonest practice' are disproportionately generated by smaller law firms (as measured by number of partners) which tend to have less incentives to build up reputation compared to their larger counterparts. Grout, P A, (2005), *The Clementi Report: Potential risks of external ownership and regulatory response – A report to the Department for Constitutional Affairs*. [<http://www.dca.gov.uk/legalsys/lrreform.htm#cr>]

<sup>36</sup> Blanes i Vidal, Jordi, Ian Jewitt and Clare Leaver, 2005, *Legal Disciplinary Practices: A Discussion of the Clementi Proposals* - <http://www.dca.gov.uk/legalsys/blanes-i-vidal-leaver-jewitt.pdf>

<sup>37</sup> <http://www.shop4law.co.uk/>

most closely aligned to their preferences (be they location, experience, cost or speed of service).

- 5.21. The reduction of the need for partnership equity in LDPs is expected to provide more opportunities to a wider range of individuals, such as female legal professionals<sup>38</sup> and those from lower income groups<sup>39</sup> who might have the required competence but not the capital or time to progress within existing legal partnership arrangements. It should also make it easier for LDPs to hire and retain high-quality para-legal and managerial staff.
- 5.22. The potential increase in the number of suppliers in the legal services market could also potentially increase the number of training opportunities for law students, including those from under-represented groups. In particular, it has been pointed out that the increased flexibility provided by LDPs would improve the representation of women and their retention at the Bar.<sup>40</sup> This could also help to further increase diversity in the legal professions.

## **Costs**

### Economic costs

- 5.23. Although constrained by the existing regulatory framework, many in the legal profession have sought to extend the range of legal and non-legal services that they can deliver. For example, a number of legal practices currently offer financial services as part of an all-round service to their customers. Under this option, LDPs would be restricted to the provision of legal services only, which could be more restrictive than the current system where legal practices can offer a wide range of unregulated (non-legal) services such as general business advice and estate agency services, as well as other regulated services such as financial advice. This would reduce the incentives for prospective owners to establish a new LDP, reducing the potential scope of competition within the legal services market, to the detriment of consumers of legal services.
- 5.24. Concerns have been expressed that the introduction of outside ownership of LDPs may lead to the leaking of clients' confidential information protected from disclosure under legal professional privilege (LPP) due to unreasonable commercial pressure or conflicts of interest<sup>41</sup>, thus compromising the interests of consumers. However, it has been argued that the potential harm from conflicts of interest caused to consumers is often induced by the inability of owners to perfectly control managers, rather than by their excessive ability to do so.<sup>42</sup> In addition, it is expected that the proposed safeguards in place, such as the fitness-to-own test and the incorporation of a HOLP and a HOFA in the LDP, would minimise this risk.<sup>43</sup> Furthermore, commercial considerations should also play an important role in protecting confidential information.

### Social costs

- 5.25. There is a risk that the anticipated increase in the level of competition in the legal services market could lead to the withdrawal of some inefficient suppliers of legal

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<sup>38</sup> See 5.47

<sup>39</sup> Office of Fair Trading, (2001), *op. cit.*

<sup>40</sup> Blanes i Vidal, J, Jewitt, I and Leaver, C, (2005), *op. cit.*

<sup>41</sup> It has been pointed out that conflicts of interests are the other side of the coin to synergies, and if most operations of the LDP were ring-fenced, then opportunities for synergies in the LDP would be limited. The resulting gains from economies of scale are correspondingly lower. Brealey, R A & Franks, J R, (2005), *op. cit.*

<sup>42</sup> Blanes i Vidal, J, Jewitt, I and Leaver, C, (2005), *op. cit.*

<sup>43</sup> It has been argued that conflicts of interest already exist in law firms and that the resulting problems would be better dealt with by regulation rather than by severe restrictions on outside ownership. See Brealey, R A & Franks, J R, (2005), *op. cit.*

services from certain areas of the market. In particular, inefficient suppliers on local high streets and in rural areas may be forced to close down under the pressure of greater competition from lower cost providers. This raises the potential risk of reducing consumer choices and could have an adverse effect on access to justice. This risk should be mitigated by the expected changes in the provision of legal services.

- 5.26. Different legal practitioners would have the opportunity to form integrated legal practices and be more efficient by taking advantage of the potential gains from economies of scale, thus ensuring that they could continue offering legal services (see para. 5.30). In addition, new innovations in the legal services market, driven by greater competition, could lead to new ways of legal services being delivered to consumers in rural areas, thus ensuring that their access to justice would not be diminished (see para. 5.46).

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

#### ***Benefits***

##### Economic benefits

- 5.27. We expect that all the economic benefits listed under the LDP model would apply equally under this licensing model (see para. 5.12–5.18). However, we expect that the scale of these benefits would be greater under the ABS licensing model in some respects.
- 5.28. Firstly, the business structures facilitated under the licensing regime would be much less restrictive compared to the LDP model, by allowing the ABS firms to be multi-disciplinary practices, offering both legal and non-legal services.<sup>44</sup> The licensing regime would also be less restrictive compared to the ‘do nothing’ option, as it would allow ABS firms to offer reserved and unreserved legal and non-legal services.<sup>45</sup> This could expand the scope of competition within the legal services market.
- 5.29. Secondly, ABS firms might find it easier to attract external financing than LDPs, due to their ability to accommodate legal and non-legal business areas, thus allowing them to offer more service packages, which would be more attractive to investors. In addition, the risks of starting a new ABS firm would not be restricted to legal practitioners. Reduced risk for new entrants could lead to higher levels of competition than under the LDP model.
- 5.30. Thirdly, gains from facilitating integrated practices could be greater, as consumers could benefit from the convenience of purchasing legal as well as non-legal services under one roof. The scale of the gains from economies of scale could also be larger, since some ABS firms could be larger than LDPs thanks to their ability to accommodate practitioners from a wider range of services.<sup>46</sup>

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<sup>44</sup> It is interesting to note that enactment of the Legal Profession (Incorporated Legal Practices) Act 2000 in New South Wales, Australia, has facilitated the establishment of legal practices with alternative business structures, known as Incorporated Legal Practices (ILPs). In 2005, approximately 60 of the 452 ILPs in New South Wales are multi-disciplinary. Mark, S A and Cowdroy, G, (2004), ‘Incorporated legal practices - A new era in the provision of legal services in the state of New South Wales’ *Penn State International Law Review*, 22.

<sup>45</sup> In New South Wales in 2005, approximately 20% of ILPs provide accountancy and / or financial planning services as well as legal services. The data suggests that the most common areas of practice for ILPs are commercial / corporate advisory work, financial services and conveyancing. Over 10% of the legal profession in New South Wales now work in an ILP and this number is steadily increasing.

<sup>46</sup> Davies, S W, (2005), *The economic implications of partnership restrictions in the legal services sector and their possible removal*. [<http://www.dca.gov.au/legalsys/lrsreform.htm#cr>]

- 5.31. Fourthly, the incentives to maintain high quality would be higher for ABS firms compared to LDPs, as more areas of service would be at risk from a bad reputation.<sup>47</sup> Owners of ABS firms might also demand even stricter operational discipline<sup>48</sup> to ensure that the hard-earned reputation was maintained.<sup>49</sup>
- 5.32. Moreover, ABS firms that contained practitioners from different services would allow the sharing of good practice and of innovation and technological advances across the professions. This should lead to increases in efficiency and better quality of services. The greater scope for flexibility of services that these firms would provide should also allow them to respond rapidly to changing consumer demand by offering new combinations of legal and non-legal service packages.
- 5.33. The facilitation of ABSs would also enable firms to expand the scope of their business and broaden their capacity to compete in international markets. Under the existing restrictions providers can face constraints on the amount of debt equity they can raise to aid the expansion of their business. Under ABS, legal service providers would have access to a wider range of finance to invest in large-scale capital projects that increase efficiency.

#### Social benefits

- 5.34. We expect that the social benefits listed under the LDP model would apply equally under the ABS licensing model (see para. 5.19–5.22). However, we also expect that the scale of these benefits would be greater under this model in some respects.
- 5.35. By facilitating a greater number of new suppliers in the legal services market, the ABS licensing model could also provide more opportunities than under the LDP model for under-represented groups to enter into and to progress within the legal professions. This could help to further increase diversity in the legal professions. In addition, there should also be more training opportunities for law students compared to under the LDP model. This would have significant benefits for trainees in BME groups, whom statistics have identified as having greater restrictions to training facilities than their non-BME counterparts.<sup>50</sup>
- 5.36. The potentially larger gains from economies of scale by ABS firms should mean that ABS firms would be more likely than LDP firms to centralise their back-office operations, potentially minimising costs. This raises the possibility of providing legal services in areas where they did not exist before, e.g. in rural areas. These could now become financially viable and attractive to owners of ABS firms. Through longer opening hours, increased usage of technology and advanced customer care skills, ABS firms would be able to offer consumers improved access to a wide range of legal services, thus enhancing access to justice.
- 5.37. In addition, increased efficiency and the larger scope of information-sharing with other business areas within the ABS firm could lead to suppliers becoming willing to offer more types of legal services that are less financially viable under the existing restrictive business structures.

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<sup>47</sup> This is especially true for large corporations, where one scandal can harm an entire corporation's reputation and business. Moreover, the stakes of large corporations in protecting their reputations can prompt service quality that exceeds minimum acceptable levels.

<sup>48</sup> It has been noted that a number of large national legal firms in New South Wales are seriously considering ABS because of the improved management and structural options it affords them, but are waiting for legislation to be enacted in all states.

<sup>49</sup> Data from New South Wales suggests that practitioners working in ILPs are slightly less likely to be the subject of a consumer complaint than practitioners working in traditionally structured firms. This may be due to the requirement of ILPs to implement appropriate management systems.

<sup>50</sup> The Law Society, Strategic Research Unit (2005) *Trends in the solicitors' profession: Annual statistical report 2005*. Also see Diversity Impact Assessment.

- 5.38. As civil disputes often involve multi-disciplinary issues, the ABS proposals could act as a catalyst for the creation of one-stop shops with integrated legal and non-legal professionals. This could result in an increase in providers who offer a more comprehensive services for consumers, leading to a situation where the parties involved would be better able to make more informed decisions as to how disputes would be best settled. For example, providers might use Alternative Dispute Resolution (ADR) methods, thus reducing the need for the parties involved to incur substantial costs, unwanted stress and uncertainty of litigation. This would also help reduce the demand on valuable court time.

## **Costs**

### Economic costs

- 5.39. Allowing alternative business structures could cause confusion within the ABS firms that had to satisfy different regulations set by different regulators, where the ABS firm provided services subject to control by more than one regulator. This would raise the firm's compliance costs and the operational costs for the different regulators, as more resources might have to be employed to ensure that regulations set by various regulators did not contradict each other. More importantly, the possibility of confusion among the regulators might increase the risk of certain parts of ABS firms' businesses not being properly regulated, to the detriment of consumers. Potential conflicts arising out of the rules of different regulators might also increase the risk of regulatory capture.
- 5.40. However, the LSB would agree to license combinations of services only where it was satisfied with the LA's regulatory arrangements (e.g. having agreements in place with other regulators concerned). It could also minimise this risk by entering into regular discussions with other regulators, such as the FSA, on regulatory issues. In addition, the statutory requirement for the LSB to consult the OFT, the higher judiciary and its Consumer Panel about its regulatory decisions should reduce any confusion of regulations across services.
- 5.41. Where a conflict of rules arose, it would be the responsibility of the licensing authority to resolve it. Where this proved impossible, the case would then be referred to the LSB to give direction as to how the conflict could be resolved in accordance with its objectives.
- 5.42. There is a concern, similar to that associated with the LDP model, that the introduction of outside ownership and providers of non-legal services in ABS firms could lead to the disclosure of clients' confidential information, due to conflicts of interest or professional duty to disclose information (e.g. auditors), compromising the interest of consumers. LAs would not issue licences for combinations of services that cause insuperable difficulties in this area and, where combinations are possible, would apply conditions aimed at minimising risks and resolving conflicts of interest. These will be among the responsibilities of the Head of Legal Practice.
- 5.43. In addition, the LSB would also require firms to have in place a system by which they could satisfy the conditions of LPP. The protection of LPP would extend to all services provided directly by qualified lawyers or under their supervision and would prevent the need for 'ring-fencing' within ABS firms in order to preserve confidential client information, enabling them to compete on an equal footing with conventional law firms. ABS firms would be required to make clear to all potential clients the extent to which LPP applied and in relation to which partners, directors or employees of the firm. These safeguards should minimise the risk of a client's confidential

information being exposed.<sup>51</sup>

- 5.44. Under this option, all non-lawyers who owned more than a set proportion of a firm (usually 10%) would be required to pass a robust 'fitness to own' test before being allowed to invest in the ABS firm. To reinforce this, the licensing authorities would have powers to divest owners of their shares in an ABS firm where there was evidence that they were unfit, for example, through criminal convictions or a failure to comply with licensing rules. Divestiture powers would apply to both passive investors and owner-managers, and would be subject to warning and review/appeal procedures. This power would not only serve to protect consumers, but would also provide an incentive for external investors to behave in a manner consistent with the criteria laid out in the fitness to own test.
- 5.45. There is a risk that in a liberalised regime that facilitated Alternative Business Structures, larger legal firms might seek to "foreclose" competition from smaller firms, reducing the choice available to consumers.<sup>52</sup> This could have serious implications for consumers in rural areas if those larger legal firms did not consider it profitable to spread their service provision to those areas.
- 5.46. However, we envisage that ABS could potentially increase rural access to legal services, through utilising the existing infrastructure of firms. For example, banks and building societies could use their high street offices and internet delivery systems to provide legal services in those areas, avoiding high set-up costs.
- 5.47. The Government recognises the risk of diminished access in rural areas. The LSB and ABS regulators would be under a duty to ensure that the statutory objective of access to justice was achieved, especially for those with a geographical disadvantage and those with special needs. As a result of this duty, the distribution of service provision would be closely scrutinised by the LAs, who would be bound by the statutory objective of promoting competition, thus mitigating the risk.
- 5.48. Due to the increased competition introduced by the ABS proposals, there is a possibility that inefficient firms might be driven out of business if they could not adapt to participate in the newly competitive legal services market. This might affect mainly smaller firms who cannot evolve with the market, disproportionately affecting BME solicitors and women. However, women should benefit from the move away from the traditional partnership structures towards more flexible structures that the ABS proposals should promote. They will benefit from the greater range of employment opportunities with high responsibility within legal and non-legal entities, thus facilitating their ability to demonstrate their capability in ways that are not widely acceptable in the existing societal structure which is predominantly patriarchal.<sup>53</sup> The impact these proposals may have on BME groups and on women solicitors is discussed in detail in the Diversity Impact Assessment.
- 5.49. Under the licensing scheme, firms currently operating under business arrangements that would fall within the regulatory net of ABS licensing might be at a competitive disadvantage because of the regulatory burden of the licensing fees. However, where the organisation was a NfP one, the LSB and licensing authorities would have the discretion not only to set lower fees, but also to waive or alter any or all of the licensing conditions according to the nature of the entities they regulated.

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<sup>51</sup> The experience in New South Wales suggests that these conflicts in interest do not seem to arise to any greater extent than the issues created in firms under existing business structures where corporate/commercial clients exert enormous pressure on legal practitioners to provide legal advice that is ethically questionable.

<sup>52</sup> See Small Firms Impact Test

<sup>53</sup> Landers, Rebitzer and Taylor (1996) *cited* Blanes i Vidal, J, Jewitt, I and Leaver, C, (2005) offer compelling evidence that the existing business structures are particularly unsuitable for the progression of women solicitors.

- 5.50. Requirements could be waived according to criteria based on rules, for particular categories of body, as well as on a case-by-case basis. In determining whether to waive licensing rules, licensing authorities would be expected to have regard to the risk status of NfP providers, which in many cases would be low, as well as to the potential impact on access to justice if greater regulatory burdens were imposed.
- 5.51. For existing firms other than NfP providers who currently operate under an ABS structure, for example, certain CLC Recognised Bodies, and Trade Mark/Patent firms, there would be a transitional period to enable approved regulators to adapt their existing arrangements in order to apply for licensing authority designation, and to issue any appropriate licences. This issue is discussed further in the Competition Assessment.
- 5.52. For organisations such as trade unions, the full ABS licensing requirements could impede their ability to provide services to their members. Because unions are owned by their members, the “fitness to own” test would be inappropriate, and their widely distributed organisation means that the HoLP and HoFA rules could not be readily carried out. In addition, the limitation on unions providing services only to members, and control via the rule-book and specific trade union legislation, mean that those roles should not be needed. Therefore, although trade unions would be required to obtain ABS licences, they would be subject to conditional waivers, with licensing authorities retaining the discretion either to impose conditions on individual unions short of the full licensing framework or, if the need arose, to create a body of licensing rules applicable to all the unions that they covered.
- 5.53. The administrative costs of regulating ABS would be determined by the extent of the regulatory activities in question. Licensing authorities would be expected to levy a licensing fee on ABS firms. This fee would be fair and proportionate to the size of the firm, and would cover the cost of operating the licensing scheme. As this fee is expected to be justified by the benefits ABS firms would gain in being permitted to form new business structures (for example gains in the form of economies of scale, reduction in transaction costs and increased level of freedom in terms of organisational form), we do not expect it to deter new entrants from setting up ABS firms.
- 5.54. Moreover, we envisage that the process of applying for an ABS licence would be no more complicated and administratively burdensome for ABS firms than the existing process for solicitors of applying for a practising certificate. For NfP organisations, licences could be obtained as a group, or the fee could be waived, to minimise the burden generated from the process of obtaining and maintaining the licences, ensuring that access to justice would be safeguarded.

### Social costs

- 5.55. As in the LDP model, there is a risk that the anticipated increase in the level of competition in the legal services market could lead to the withdrawal of some inefficient suppliers of legal services from certain areas of the market, in particular, those located on local high streets and in rural areas. This could reduce consumer choice and might have an adverse effect on access to justice. However, we expect that this risk would be more likely to be mitigated in the ABS licensing model by the expected changes in the provision of legal services. Through lifting the restrictions on access to external finance and partnerships between lawyers and non-lawyers, there would be greater potential for widespread expansion, efficiency gains and technological innovation in the provision of integrated services.

- 5.56. Compared to the LDP option, the ABS licensing regime would be better placed to encourage service provision in rural areas. The lower risk in starting up new legal business that is afforded by external finance, and the potential to offer legal and non-legal services under one roof, would provide an incentive for suppliers to provide legal services in areas and locations which were previously regarded as unprofitable.
- 5.57. In particular, since there is potential for the size of some ABS firms to be larger than LDPs (due to the greater variety of permitted services), the scale of gains from economies of scale for these ABS firms would also be larger. Thus it is more likely that practitioners from different professions will be able to join up to take advantage of the potential gains, and to continue to offer integrated legal and associated services on high streets and rural areas. In addition, as we expect that ABS firms would be more likely to continue offering services in these locations via increased usage of technology, access to justice should not be diminished.
- 5.58. Through lifting the restrictions on partnerships between lawyers and non-lawyers in the provision of legal and non-legal services, consumers could be at risk from the practice of 'tying-in'<sup>54</sup>. This risk would be further increased if there were a majority of non-lawyer owners in the ownership structure exerting commercial pressure on practitioners. In order to reduce this risk, every ABS firm would have to identify a HoLP who would ensure that it adhered to the licensing authority's rules. In addition, licensing authorities would also have discretion to decide whether the services provided by some ABS firms required a certain level of lawyer control to prevent practices that were not in the interest of the consumer.

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<sup>54</sup> Blanes i Vidal, J, Jewitt, I and Leaver, C, (2005), *op. cit.*, identify two types of tying-in. Contractual tying-in occurs where non-advocacy and advocacy services are bundled together so that a customer cannot purchase one without the other. This also relates to 'buy one, get one free' offers. *De Facto* tying-in relates to the *switching costs* of clients switching from one supplier to another. These costs may include transferring files and giving new instructions. Depending on how high these switching costs are, providers may fail to refer clients to other suppliers when faced by lack of expertise or conflicts of interest. Both these forms of tying-in are illegal under the Competition Act 1998.

## 6. Reforming the Complaints Handling Arrangements in Legal Services

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- 6.1. The aim of this proposal is to simplify and improve the current arrangements in the way that consumer complaints are handled. The proposals should lead to a more accountable and transparent complaints handling system, and should improve consumer confidence in the complaints handling system.
- 6.2. The following options on reforming the complaints handling arrangements in legal services have been considered:

### **Option 1 – Do nothing**

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

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

- 6.4. Under this option, a single point of entry for all consumer complaints would be established for complaints that remained unresolved at the ‘in-house’ level. Complaints would be sifted into different categories or type of complaints and would then be passed down to the ARs to deal with them. This point of entry would essentially be a ‘post-box’ for all complaints and the complaints handling system would remain in the control of the legal profession.

### **Option 3 – A new complaint handling body**

- 6.5. Under this option, the **Office for Legal Complaints (OLC)** would take over the role of the ARs in handling consumer complaints. The OLC would be a single body, completely independent from the ARs. The Office of the Legal Services Ombudsman and the Office of the Legal Services Complaints Commissioner would be abolished.
- 6.6. The OLC would form part of the new regulatory framework including the LSB and would be accountable to the LSB for its overall operation. This would ensure that the LSB had proper oversight of the entire regulated legal services sector. However, the LSB would have no authority to examine individual complaints.
- 6.7. Legal service providers would be required to maintain ‘in-house’ complaints handling procedures, which would have to satisfy any requirements set by the LSB, to deal with complaints made by consumers in the first instance. The OLC would handle all

complaints made against the providers that could not be resolved at the local level. These complaints would be passed directly to the OLC. The OLC would refer potential issues of misconduct to ARs. It would be able to require an AR to inform it of the action the AR took on conduct matters.

- 6.8. In addition, the OLC would be empowered to provide redress to consumers where appropriate, up to a limit of £20,000. It could also refer complaints to other statutory regulators or their redress bodies. The existing disciplinary arrangements with regard to misconduct would be largely unchanged and would continue to be handled by the disciplinary procedures of the ARs, although there would be LSB oversight.
- 6.9. This is the Government's preferred option on reforming the complaints handling arrangements in legal services. The OLC would be independent of the legal profession, which would help to improve consumer confidence in the legal services market, and should aid the regulatory framework in achieving its objectives. The OLC would provide a single system with one point of entry for all consumer complaints, making the system simpler for consumers and helping to accommodate alternative business structures. In addition, the fact that the OLC would have powers to deal directly with complaints, as well as having the ability to provide redress of up to £20,000, would provide legal services providers with an incentive to act in an ethical and accountable manner to avoid complaints being lodged against them and also to provide consumers with adequate compensation, where necessary.

### **The Benefits and Costs of reforming the Complaints-handling arrangements for Legal Services**

#### **Option 1 – Do nothing**

##### ***Benefits***

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

##### ***Costs***

- 6.11. There would be no additional economic or social costs arising from this option. However, there is a risk that the proliferation, fragmentation and overlap featured in the current complaints handling arrangements would remain. In addition, complaint handling by certain professional bodies might remain unsatisfactory, and the independence of the complaint system would continue to be questioned, undermining consumer confidence in the legal services market.
- 6.12. There would be no additional policy costs arising from this option. Using information provided by the legal professional bodies, PwC, in their independent report on the regulatory reform of legal services<sup>55</sup>, estimated that the total regulatory cost in 2005-06 was £97.4 million. Of this, £32.5 million related to complaints handling.
- 6.13. The Law Society's costs represent a substantial proportion of this total at approximately 88%.

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

##### ***Benefits***

##### **Economic benefits**

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<sup>55</sup> PwC's independent report is published on DCA's website and can be found at: <http://www.dca.gov.uk/legalsys/lrreform.htm>

- 6.14. This option would provide a single system with one point of entry for all consumer complaints, making the system simpler for consumers to use. This would also minimise the inefficiencies caused by consumer complaints being directed to the incorrect regulator.

#### Social benefits

- 6.15. The simplification of the complaints handling system would increase public understanding of the system and therefore encourage those consumers who had a valid reason to complain, to do so. This might help to restore some consumer confidence in the complaints handling system.

#### **Costs**

##### Economic costs

- 6.16. A body with a 'post-box' role for consumer complaints would put an additional operational cost burden on suppliers, through the cost of creating and running the new body. This burden would probably be transferred to consumers, leading to higher prices. The fact that this body would have no power to deal with the substance of complaints would mean that the higher prices consumers would be paying would bring virtually no additional benefit to the complaints handling process.

##### Social costs

- 6.17. Under this 'post-box' complaints system, substantive complaints handling functions including adjudication would remain in the control of the legal profession, so there would continue to be some concerns over the system's independence. This option might fail to improve consumer confidence in the legal services industry and would fail to aid the regulatory framework in meeting its objectives such as protecting and promoting consumers' interests.
- 6.18. As the 'post-box' complaint office would be unable to award redress, there would be less incentive for suppliers to improve service quality. This complaint office will essentially act as a 'complaints distribution centre'.
- 6.19. Using the information provided by the legal professional bodies, the operating cost for the 'post-box' option, were estimated in PwC's final report to be £32.9 million annually.<sup>56</sup> This represents a total estimated net annual cost of £400,000 more than the current costs for complaints handling (i.e. the "Do Nothing" option).
- 6.20. Using broad assumptions, the PwC report estimated that the transition costs associated with the establishment of the 'post-box' option were £500,000, spread over one year.
- 6.21. The relatively small increase in costs under the 'post-box' option reflects the small change in the way complaints handling is arranged under this option.

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<sup>56</sup> *ibid*

Option	Annual Running Costs	Transition Costs (two years before vesting)	Transition Costs (one year before vesting)	Transition costs (one year after vesting)
	£'000	£'000	£'000	£'000
<b>Do nothing</b>	32,520	n/a	n/a	n/a
<b>Postbox</b>	32,920	-	-	500

*Costs in 2005-06 prices.*

### **Option 3 – A new complaint handling body**

#### ***Benefits***

##### Economic benefits

- 6.22. A single complaint body would bring greater consistency and clarity to the complaints handling process. With one point of entry for all consumer complaints, the system would be simpler and would also help to accommodate Alternative Business Structures (ABS) by identifying the most efficient route for resolution when the complaint had not been successfully resolved via 'in-house' procedures. The clearer channels for complaints handling would lead to a more efficient and effective complaint mechanism. Coupled with potential scope for economies of scale, through the amalgamation of several systems into one, this should lead to time and overhead savings for ARs and suppliers of legal services.
- 6.23. The ability of the OLC to award redress of up to £20,000 in a manner that was fair and consistent to both consumers and providers should give consumers with valid reasons to complain an incentive to do so. Such a redress mechanism would have a further benefit to the profession to the extent that consumers would have more confidence in purchasing legal services. The ability of the OLC to award redress should also provide suppliers with an incentive to act in an ethical and accountable manner, and overall, improve the service quality of legal services.
- 6.24. The OLC would be funded in part by means of a general levy on all authorised bodies and in part through case fees (the 'polluter-pays' principle). The case fee would provide an incentive for providers to resolve complaints through in-house arrangements, to avoid the cost of the complaint reaching the OLC. However, it seems only fair that the OLC should have the ability to waive all or part of the case fee in circumstances where it considered that the legal service provider had made considerable efforts to resolve a complaint in house, and/or where it considers that a consumer had acted unreasonably. This would ensure that providers who took all reasonable steps to resolve complaints through their in-house systems would not be penalised unnecessarily.

##### Social benefits

- 6.25. A complaint system that was independent of the legal profession will improve consumer confidence in the legal services industry. Consequently, consumers with valid reasons to complain should be more confident and inclined to do so, encouraging suppliers to improve the quality of their legal services and therefore

reduce the number of complaints lodged against them.

- 6.26. The powers that the OLC would have to share information about complaints with consumers could empower consumers to make better-informed decisions about choosing their legal service provider thus improving consumer confidence in the legal services market. They would be confident that complaints would be dealt with transparently and independently. Such information would help consumers make better-informed decisions about purchasing legal services, helping to address the existing information asymmetries in the market and improve standards of quality and eventually, through increased competitiveness, reduce prices and improve access to justice.
- 6.27. Through establishing an independent and impartial complaint system, the OLC would provide a clear forum for dealing with complaints in a way that was consistent with the objectives of legal services reform. This would mainly involve protecting and promoting consumer interests; providing an incentive for individual practitioners to meet appropriate quality standards; and increasing public understanding of citizens' legal rights.
- 6.28. By leaving ARs with the power to discipline their own members, the reform of complaints handling arrangements would recognise that consumers are far more content with this aspect of their performance to date.

## **Costs**

### Economic costs

- 6.29. Increased consumer confidence in the complaint handling system, simplification of the complaint procedures, an increase in the redress amount and the greater transparency of the disciplinary systems, could when taken together, lead to a rise in complaints, both genuine and spurious ones. The potential increase in complaint cases could increase the workload for suppliers of substandard legal services, as the OLC would now be more likely to follow-up a higher proportion of the complaints received. However, this cost has to be balanced by the fact that firms required by the OLC to compensate for poor service would have further incentives to improve the quality of their services, leading to fewer complaints being lodged against them. This would help reduce the likelihood of the cost involved in handling complaints being incurred in the first place.
- 6.30. Since the OLC should be more effective in handling complaints, there could be an increase in the numbers of legitimate complaints made, so it is more likely that suppliers who provide poor quality services would be complained against to the OLC. Consequently, the compliance costs for these suppliers would rise, for example in the form of paying financial redresses or extra investment in their 'in-house' complaints handling facilities. However, this risk should act as incentives for these suppliers to raise the quality of their services, or to improve their complaints handling facilities so that complaints can be satisfactorily resolved in-house, to the benefit of consumers.
- 6.31. It has been suggested that the introduction of the OLC might make legal professionals overly cautious, so that they might seek to avoid taking on more complex or 'difficult' cases, and could leave them more susceptible to complaints, thus incurring extra costs. This might lead to some suppliers withdrawing from some types of work, reducing competition, or worse still, abandoning them all together. As a result, consumers might be unable to find a supplier who was willing to provide them with the services they needed. However, this risk would be reduced by the proposal that the amount of redress the OLC can award would be limited to £20,000

and that it will have the power to waive fees for spurious complaints. Further, the risk of legal providers taking an overly cautious approach already exists under the current system and there is no empirical evidence that it has driven some lawyers to avoid these cases. The ‘cab-rank’ principle<sup>57</sup> also ensures that some lawyers are not allowed to select their clients by personal preference.

- 6.32. The cost of generating more complaints might not necessarily result in additional cost to particular sectors of the legal services market. In working out its funding mechanism, the OLC would consult with the profession to ensure that the costs of complaints handling were divided fairly. It would be open to the OLC, for example, to ensure that the cost per complaint was lower in areas where providers were inherently more likely to generate complaints. For example, criminal barristers generate high levels of complaints because their clients often view it as another quasi-appeal route; but these complaints are not especially likely to be upheld. The OLC would consult on its annual budget, and as it would be bound by the regulatory objectives, it would want to take steps to mitigate any risk that providers would shy away from particular areas of the law.
- 6.33. In their report on the costs of the Government’s proposed arrangements, PwC identified the ongoing annual running cost of complaints handling system under the OLC option to be around £20.6 million.<sup>58</sup> This figure comprises £16.8 million for the OLC’s running costs and approximately £3.8 million in unavoidable overhead costs currently allocated to regulators’ complaints handling functions.
- 6.34. The key driver for the difference in cost compared to the ‘do nothing’ option (which costs £32.5 million) is the savings made against annual running costs from the rationalisation of the complaints handling system, which are estimated at £28.7 million, and the ongoing annual running costs of the new OLC, estimated at £16.8 million (for their base-case scenario).
- 6.35. This represents a total estimated net annual cost of £12 million less than the current costs of separate complaints handling (i.e. the “Do Nothing” option).
- 6.36. The OLC would also be around £12.3 million per year cheaper than the post-box option. This is because, under the ‘post-box’ option, complaints handling would continue to be done by the individual regulators, and thus would not benefit from the rationalisation of the current complaints handling framework.
- 6.37. This base case cost was estimated on the assumption that the OLC would have a core staff of 319 staff, with a 7-member board, based in the West Midlands. The estimate assumed that the underlying nature and volume of complaints under the new OLC would not be substantially different from those received under the current regulatory framework.
- 6.38. PwC estimated one-off transition costs of £23.6 million for the OLC, which would be spread over approximately two years either side of vesting powers and duties in the new single complaints body. The Government is satisfied that these costs would be justified by the benefits of a single, independent complaints-handling body as outlined above. Furthermore, these one-off transition costs should be seen in the context of the estimated £12 million annual decrease in operating costs under the OLC option.

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<sup>57</sup> The “cab rank” rule dictates that every member of the Bar is obliged, without fear or favour, to represent clients who offer themselves, regardless of how unpopular they may be in the community or elsewhere.

<sup>58</sup> PwC’s independent report is published on DCA’s website and can be found at: <http://www.dca.gov.uk/legalsys/lsreform.htm>

<b>Option</b>	<b>Annual Running Costs</b>	<b>Transition Costs (two years before vesting)</b>	<b>Transition Costs (one year before vesting)</b>	<b>Transition costs (one year after vesting)</b>
	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>
<b>Do nothing</b>	32,520	n/a	n/a	N/a
<b>Postbox</b>	32,920	-	-	500
<b>With an Office for Legal Complaints</b>	20,590	140	12,280	11,140

*Costs in 2005-06 prices.*

- 6.39. PwC's report also identified £1 million of additional "implementation costs" for setting up a task force for detailed organisation design for the OLC and an oversight regulator (i.e. the LSB). These costs were expected to fall in the year before powers and duties are vested in the new bodies.
- 6.40. PwC also estimated costs under alternative scenarios over their base case. This included costing for an incremental increase in resources required to accommodate an increase in the volume of complaints handled by the OLC. PwC considered an increase of 25%. Under PwC's analysis the annual ongoing running costs of the OLC operating at this incremental level of activity could rise by approximately £4.2 million to £21.0 million (base-case plus incremental level of activity, for a single-site option located in the West Midlands).
- 6.41. Under this alternative scenario, transition costs could also rise by approximately between £3.5 million and £6.6 million (dependent on the nature of the increase in complaints) to between £27.1 million and £30.1 million.
- 6.42. PwC considered the prospect of an increase in the level of complaints handling post-establishment of the OLC. By way of example they identified a number of possible scenarios. It is difficult to predict the potential increase in complaints, although one figure of 25%, which PwC identified, appears from our own review to be broadly in the range experienced in some other sectors.<sup>59</sup> However, the circumstances in those sectors are very different to those in the legal sector and the Government considers it difficult to make any meaningful assessment about any potential increase in complaints handling as a result of the establishment of the OLC on the basis of data currently available.
- 6.43. One important factor, which is not evident in the majority of comparative bodies, is the potential for the OLC to levy a case handling fee in respect of any complaint it receives. We consider this should act as a strong incentive to reduce the prospect of considerably higher levels of complaints being made to the OLC. Further, approved regulators will be charged by the LSB with ensuring the persons they regulate have appropriate and effective in-house complaints handling arrangements in place and

<sup>59</sup> Other sectors reviewed include: finance, energy, postal services and the communications industries; their regulatory bodies are Financial Ombudsman Service (FOS), Energywatch, Postwatch and Ofcom, respectively.

the LSB will take regulatory action against them should this not be the case.

- 6.44. Any increase in other sectors have generally occurred some two to three years after establishment of the new complaints handling bodies, and if this did prove to be the case in terms of legal services complaints such a delay would enable the OLC take a flexible approach to the structuring of its organisation and processes in order to absorb any such impact. Data from other complaints handling bodies consistently show decreasing unit costs with increasing complaint volumes possibly due to a combination of parallel reforms regarding processes, organisational design and operational structures. It is also possible that any increases in complaints handling could either be absorbed within the efficiencies which PwC consider the new arrangements will provide, or by fine tuning the fees that may be levied by the OLC under the "polluter pays" regime.
- 6.45. The Government commissioned PwC to provide independent financial analysis to support the draft Legal Services Bill. In order to do this PwC needed to make a number of assumptions on the potential structure and operational capacity of the new bodies. PwC consulted with approved regulators, officials at the DCA and other interested parties, but it is important to emphasise that the assumptions made in their final report are those of PwC and not the Government.<sup>60</sup>
- 6.46. One aspect of PwC's report that has attracted a number of concerns relates to the potential for efficiency savings resulting from the establishment of the OLC when compared to the cost of operating the existing array of individual schemes. In this context, the Joint Committee on the Draft Legal Services Bill commented that:

*It is unclear to us how PwC move from the assumption of 15% efficiency savings, to estimating a running cost of almost 40% lower than current costs ...*<sup>61</sup>

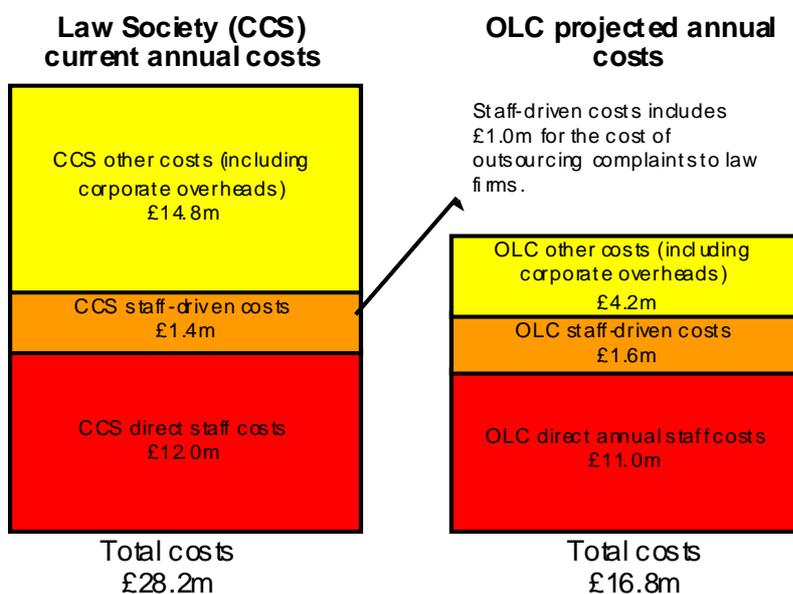
The key issue here is that the 15% efficiency savings that PwC estimated were only one of a number of assumptions that contributed to the overall cost reduction of 40% in moving from the existing complaints handling service operated by the Law Society to that operated by the OLC.

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<sup>60</sup> To view the PwC Report see - [http://www.dca.gov.uk/legalsys/pwc\\_finanalysis\\_060524.pdf](http://www.dca.gov.uk/legalsys/pwc_finanalysis_060524.pdf)

<sup>61</sup> Joint Committee on the Draft legal Services Bill, Session 2005-06, Volume 1 Report, HC 1154-1, HL Paper 232-I

## 'Direct Cost' comparison of CCS and the OLC



*\* Note - the OLC will not have to bear overheads of some £3.8million currently applied to the CCS. Approved regulators will either continue to bear these costs or seek to reorganise their operations to reduce these costs.*

6.47. It is clear from the above table that the estimated 40% savings were made up of a number of individual elements. In respect of the efficiency savings in particular, PwC took the view that it was reasonable for a new organisation with a clear consumer focus for the delivery of quick and fair redress, and with modern operating systems and processes, to be able to realise a 15% efficiency gain over the Law Society's current case-handling arrangements. As well as this 15% efficiency gain, PwC also assumed that there would be a reduction in the overhead costs which are currently levied on the CCS by the Law Society, costs towards the OLSCC and general administrative costs borne by the CCS. In reaching their assumption, PwC were further influenced by research conducted by Experian in January 2004 for the Lyons Review into the effect that public sector relocation can have on embracing different working methods and technologies.<sup>62</sup>

6.48. A complaint that involved legal and non-legal professions in the ABS firm could lead to confusion among ARs, the OLC and the regulatory bodies of the non-legal professions as to how it should be handled. Any lack of consistency among legal and non-legal handling bodies could lead to increases in the operational and compliance costs of ABS firms. However, licensing authorities would be required to have suitable and transparent arrangements with non-legal regulators in place before being authorised to allow license ABS firms.

6.49. Confusion could also arise for consumers if their complaints were passed from the OLC to a non-legal complaints handling body. However, this confusion would be mitigated by ABS firms making it clear at the outset that different regulators have regard to different services provided by the firm. By having the authority to enter into

<sup>62</sup> For more information see: <http://www.hm-treasury.gov.uk/media/98E/EB/ExperianResearch.pdf#search=%22Experian%3A%20%E2%80%98The%20Impact%20of%20Relocation%E2%80%99%20January%202004%22>

discussions with other statutory regulators, the LSB would have the opportunity to ensure that the handling of the complaint would be consistent across the professions involved.

## 7. Small Firms Impact Test

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- 7.1. The Law Society's database shows there were 9,081 private solicitors' firms in 2004, with 78,092 solicitors with practising certificates working in them. Sole practitioners made up 45.9% of all solicitors' firms (4,168), while 98.6% of all firms (8,954) had no more than 25 partners. However, the data excludes information on non-admitted fee earners, as well as the number of administrative and support staff employed by solicitors' firms.
- 7.2. Among the 11,564 barristers who were practising in independent private practice in 2004, 2.2% were practising as sole practitioners outside chambers.
- 7.3. As well as providers of reserved legal services, a much larger number of small businesses are also consumers of reserved legal services and other professional services (e.g. through incorporation, conveyancing, litigation, auditing, leasing and consultancy work).<sup>63</sup>
- 7.4. As discussed earlier, there is a risk that an LSA that would carry out all regulatory functions would produce additional regulatory burdens on the professions, thus incurring significant additional compliance costs for existing and potential new suppliers. In particular, these costs might fall disproportionately on small legal practices.
- 7.5. Under the Government-preferred option, the LSB would act as a relatively small oversight regulator, while delegating day-to-day regulatory functions to ARs. As a result, the LSB is not expected to impose any additional compliance costs on small legal practices. Moreover, since the establishment of the LSB would lead to a reduction of inconsistencies in the current regulatory framework, the LSB model should result in a reduction in regulatory burdens for small legal firms. However, there is a possibility that new regulatory costs would fall onto the small practitioners of those currently unregulated professions, if the LSB decided to bring them into its regulatory net.
- 7.6. Both the LDP and the 'licensing' models are expected to provide benefits to small firms that act as consumers of legal and non-legal services, in that both models allow the provision of one-stop shops, bringing greater convenience for consumers.
- 7.7. There is a risk that the anticipated increase in the level of competition facilitated by both LDP and 'licensing' models might lead to closure of small, inefficient legal suppliers in some locations. However, this risk would be mitigated by the possibility provided by both models that practitioners from different professions are allowed to join up to ensure that it is economically viable for them to continue to provide legal and associated services, and to gain from efficiency savings.<sup>64</sup>
- 7.8. There is a risk that some smaller firms would experience a disproportionate burden from the cost of the licensing fee, such that they might completely withdraw from

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<sup>63</sup> According to the Federation of Small Businesses (FSB), there are currently around 4.3 million businesses in the UK, of which 99% are defined as "small" and 63% are sole proprietors. Small and Medium Enterprises employ 58% of the private sector workforce and turnover totals 50% of UK GDP. 60% of all commercial innovations come from small businesses. <http://www.fsb.org.uk>

<sup>64</sup> Data from the Law Society of New South Wales, Australia indicated that among the 452 Incorporated Legal Practices (ILPs) in the state, which have business structures broadly similar to those proposed in the 'licensing' regime, the vast majority of these ILPs were previously sole practitioners or small partnerships. Mark, S A and Cowdroy, G, (2004), "Incorporated legal practices – A new era in the provision of legal services in the state of New South Wales", *Penn State International Law Review*, 22, pp. 671 -693 - [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=673021](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=673021)

providing reserved services. In such a case, the LSB and ARs would have discretion to alter licensing conditions according to the nature of the entities being regulated, if it would be in the public interest. This would help to maintain and enhance access to justice (especially in rural areas), while ensuring that high standards of service are delivered. The FSA has a power to set different licensing fees according to the size of the firm seeking a licence, a practice that ARs would be free to replicate.

- 7.9. The Law Society, which represents solicitors in England and Wales, including those in small firms, has expressed its broad support for the Government's proposals. In particular, the Society's former president has publicly said that the proposals '*will create a dynamic legal market offering a better deal for consumers and fresh opportunities for solicitors*'.<sup>65</sup>
- 7.10. The Federation of Small Businesses (FSB) has also expressed its broad support for the Government proposals and is one of five organisations that are represented on the Legal Services Reform Consumer Panel. In particular, the FSB is very supportive of the one-stop shop option that ABS provides.
- 7.11. As providers of legal services, the FSB views ABS as an excellent opportunity for smaller legal service providers to continue to compete effectively with larger firms and counter the threats posed in the modern marketplace by globalisation, the Internet, legal expense insurance etc. ABS will also allow small legal service providers to pool resources with other firms that provide complementary services. The FSB suggests that enabling the formalisation of the current practice of co-operation between small businesses with similar target markets will lead to a reduced risk of business failure through product diversification, increased retention of key staff and access to a lower cost of capital on external financing.
- 7.12. As consumers of legal services, the FSB sees ABSs as complementing the current trend towards small businesses wishing to purchase their professional services under 'one-roof'.<sup>66</sup> This allows small businesses to benefit from efficiency savings passed on through reduced professional fees and allow them to manage the risks associated with buying in professional services more easily.
- 7.13. DCA officials have consulted the Small Business Service (SBS), who are content with our approach.

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<sup>65</sup> The Law Society, (22 March 2005), *The future of legal services*. Press release.

[<http://www.lawsociety.org.uk/newsandevents/pressreleases/view=newsarticle.law?NEWSID=228090>]

<sup>66</sup> This approach complements the support offered by the Government <http://www.businesslink.gov.uk>. *Business Link* brings together a host of high quality advice and support for start-up and growth businesses. In the last year, Business Link gave advice to 170,000 people thinking of starting up, and half a million existing businesses. Furthermore, as announced on 22 March 2006, the Department of Trade and Industry is spearheading a Government-wide initiative to streamline business support at a local, regional and national level:

<http://www.gnn.gov.uk/environment/detail.asp?ReleaseID=192196&NewsAreaID=2&NavigatedFromDepartment=False>

## 8. Legal Aid Impact Test

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- 8.1. The Legal Services Commission (LSC) has reported that the cost of legal aid has risen from £1.5 billion in 1997 to over £2 billion today, an increase of 10% in real terms. Further, the cost of criminal legal aid in 2004-2005 was £1,192 million accounting for over half of the legal aid budget (i.e. 58%).<sup>67</sup> This continual growth is putting enormous pressure on vital services for vulnerable people, provided through civil and family legal aid.<sup>68</sup>
- 8.2. In 2004-2005, £846 million was spent on civil legal aid. In 2004-2005 solicitors' fees covering civil representation and legal help accounted for 53% of total gross cash payments, while not-for-profit fees accounted for 5%.<sup>69</sup>
- 8.3. The supply base for criminal defence services is fragmented and is characterised by a large number of relatively small suppliers. Approximately 2,500 firms claimed for criminal defence work in 2004-2005. Of these, more than 1,100 (40%) received a revenue of less than £100,000 for criminal defence work and approximately 600 firms (around 25% of all firms) claimed less than £50,000 for criminal defence work in 2004-2005. Only just over 80 firms (3%) had turnover in excess of £1 million from criminal defence work.<sup>70</sup>
- 8.4. A large number of firms generate only a small amount of money from civil legal aid. 33% of firms have a civil legal aid income of between £0 and £10,000. However, there are also firms that generate substantial amounts: 11% have income of over £200,000, while 5% have income over £1 million.<sup>71</sup> The profitability of undertaking legal aid work tends to be greater in firms that undertake legally aided work for over 33% of their total work. Firms that specialise in legal aid work (over 66% of total work) had a higher profitability than other firms, although the majority of this may be attributed to the fact that they undertook more criminal than civil work, which is generally more expensive.<sup>72</sup>
- 8.5. We envisage that through the ABS proposals, larger firms will be better enabled to create optimal structures to better improve their efficiency and gain a larger share of the market. This will affect small to medium size firms that use a mixture of private and legal aid work to retain their share of the market.
- 8.6. However, although it is anticipated that small to medium size firms may face challenges in competing effectively in the market, they could also use the ABS proposals to pool their resources with other legal or non-legal services providers to generate efficiency gains through the provision of services that are both transactional by nature and human capital intensive. For example, recruiting/allocating staff to specialise in particular areas of law will reduce the cost of research and the procurement of external expertise to provide certain services efficiently.
- 8.7. For smaller firms who undertake a mixture of private and legal aid work, there is no evidence to suggest that greater competition in the private market will prevent them

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<sup>67</sup> LSC Annual report, 2004-2005 [http://www.legalservices.gov.uk/docs/about\\_us\\_main/AR05.pdf](http://www.legalservices.gov.uk/docs/about_us_main/AR05.pdf)

<sup>68</sup> Lord Carter Review (February, 2006) "Procurement of Criminal Defence Services- Market-based reform". [http://www.legalaidprocurementreview.gov.uk/docs/carter\\_review.pdf](http://www.legalaidprocurementreview.gov.uk/docs/carter_review.pdf)

<sup>69</sup> Data sourced from LSC. Based on gross cash payments to suppliers by type, 2004-2005. These figures are indicative only and not entirely conclusive.

<sup>70</sup> Data sourced from LSC; Lord Carter Review (March 2006)

<sup>71</sup> Data sourced from Frontier Economics

<sup>72</sup> DCA and Otterburn Legal Consulting (2003) "Review of Demand, Supply and Purchasing Arrangements: Survey of Legal Aid firms 2003"

from diversifying, expanding and achieving greater efficiency as a result of the ABS proposals. We have had some very supportive comments from organisations representing small providers about the opportunities for small businesses, under the ABS proposals.<sup>73</sup>

- 8.8. Lord Carter's review of legal aid procurement in England and Wales<sup>74</sup> outlined a number of proposals to address the inefficiencies in the current procurement framework. The aim is to create a sustainable procurement system driven by best-value competition based on quality, capacity and price. The recommended procurement reforms could lead to much better control and predictability of legal aid spending and create greater efficiency in criminal defence practices and the operation of the justice system, which should ease the pressure on civil and family legal aid. If the proposals are adopted, by 2010 the Government will have achieved a steady-state procurement system. This will be achieved following a phased-implementation process to introduce competition into the public legal services market. Such an approach could see the introduction of interim measures, such as the introduction of fixed fees into police station work, in advance of the moving to market competition, effective from 2009.<sup>75</sup>
- 8.9. The Government's preferred option for facilitating ABS will be most relevant to this sector. The precise impact of ABS on the criminal legal aid market is difficult to predict though, coupled with Lord Carter's proposals, procurement-driven restructuring will encourage an increase in the average size of firms through growth and mergers, rationalisation and harmonisation of the way separate services are delivered.<sup>76</sup>
- 8.10. Lord Carter's current proposals are for the achievement of best value through market-based reform, where tenders in steady-state will be judged on the criteria of quality, capacity and price. The proposed billing arrangements are intended to encourage risk sharing and the introduction of fixed fees to reduce administration costs. The procurement of work, ultimately through price-competitive bids, will be structured in such a way to encourage a greater number of efficient, high-quality suppliers who will profit from increased volumes of work, delivered at a lower cost.<sup>77</sup> These proposals, coupled with ABS will remove existing barriers, generating parallel incentives to grow and increase efficiency in order to bid for more work.
- 8.11. Our proposals will have the effect of providing legal providers with a wider range of business structures, through the provision of shared services, than is currently possible. This greater flexibility could ease the implementation of Lord Carter's proposals. The proposals will provide firms with greater opportunities to obtain external investment and will allow lawyers and non-lawyers to work together on an equal footing. ABS will give providers more options when considering cutting their costs and upgrading their infrastructure, and in applying fresh ideas about providing services, using more 'consumer-friendly' methods. By increasing competition in the market, ABS could potentially generate a higher standard of quality than currently exists in the legal aid market, improving access to justice for the most vulnerable sections of society.
- 8.12. Our proposals have raised concerns about the opportunities for small businesses in the legal aid market. Under the ABS proposals, legal aid service providers, small firms included, will find it easier to organise themselves to improve efficiency gains

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<sup>73</sup> See Small Firms Impact Test

<sup>74</sup> 'Legal Aid: A market-based approach to reform' Lord Carter's Review of Legal Aid Procurement, Lord Carter of Coles (July 2006) Available from: <http://www.legalaidprocurementreview.gov.uk/publications.htm>

<sup>75</sup> *ibid*

<sup>76</sup> *ibid*

<sup>77</sup> *ibid*

and increase capacity. However, through Lord Carter's proposals there will not be a 'one size fits all' approach to the distribution of contracts. The proposals will provide smaller firms with a greater opportunity to compete in the market through a change in the minimum threshold needed to compete successfully for contracts.

- 8.13. Through permitting individual providers to work with lawyers and non-lawyers in the provision of legal services, ABS will encourage the creation of flexible structures to better use the spare capacity in the market where appropriate. For example, a large provider, having taken on legal aid work, might then sub-contract it to existing smaller firms around the country. This could mean that some of the smaller sub-contracted firms end up with more legal aid work than they would have been able to obtain on their own. This is an added benefit for smaller providers as they could pursue growth as a single firm or form consortium with others, if they chose.
- 8.14. The impact of LSR on civil legal aid should be equally positive. Lord Carter proposes that suppliers of civil legal aid should provide a more efficient client-focused service concentrated around differing local needs through the establishment of community legal advice centres and networks of which LSR proposals could complement.
- 8.15. The LSC's recent proposals for Community Legal Advice Centres (CLACs) and Community Legal Advice Networks (CLANs) are intended to produce better co-ordination of the delivery of services to better serve clients with multiple problems which can often lead to social exclusion. These entities will bring a number of services and suppliers together providing core legal services covering 'social welfare' law. These entities could also benefit from the access to external finance that the ABS proposals will permit.
- 8.16. The options provided by ABS could potentially help these structures to benefit from easier access to external finance and new management practices, further improving efficiency. Additionally, ABS firms could help firms grow by facilitating the formation of consortia or franchises to provide a combination of services in areas where there is a scarcity of them. It may encourage big firms with non-lawyer owners to utilise existing resources more efficiently to provide 'transaction-type' legal services. For example, firms with a strong brand focus in others area such as car insurance or retailing could do well in this area because of the customer service culture and existing infrastructure which includes call centres, customer database etc. ABS firms would be better placed to offer a range of high quality complementary services compared to more restrictive traditional law firms.
- 8.17. The introduction of ABS should potentially create a greater supply of civil legal aid providers through wider access to external finance for expansion and diversification through the accommodation of legal and non-legal business areas. However, it has been argued that these providers will only contribute effectively if they are providing the type of services that are lacking in the existing supply base. If driven by the profit motive, which ABS will further induce by making it easier for providers to gain efficiencies, then this is unlikely. If this problem does materialise, the LSC will need to provide further incentives for firms in order to alleviate this problem.
- 8.18. Lord Carter's proposals on the reform of the legal aid system are currently going through a consultation process whereby the profession, stakeholders and representative groups will be able to respond to the proposals laid out in '*Legal Aid: A sustainable future*' (published in July 2006 by the LSC). The Government's response to this will be published in mid-November and therefore, on this basis, the analysis presented here is speculative and therefore subject to whether the Government chooses to advance Lord Carter's recommendations to reform the

current procurement system for legal aid.

- 8.19 The Government has consulted with the LSC and they have expressed their full support of the ABS proposals. In particular, there are numerous benefits that consumers of legal aid would experience through the pooling of expertise, accountability and improvements in the volume and quality of advisory services currently curtailed by existing restrictions. In addition, they envisage that the ABS proposals could potentially enable significant cost savings through the possibility of single contracts, in cases that involve solicitors and barristers, rather than the scheme of double contracting they currently operate.
- 8.20 In conclusion, the proposals under the Government's preferred option, particularly the facilitation of ABS, could potentially have a positive impact on the legal aid market. The legal aid impact test has identified a number of areas where benefits will accrue to the legal aid consumer through an increase in the level of legal aid service provision and the facilitation of complementary services provided through the integration of mixed service providers, thus improving access to justice. Although we have identified some possible risks in the challenges that small firms may face through increased competition and the lack of incentives for suppliers to provide services that are particularly scarce in the market, it is clear that the potential benefits clearly outweigh the costs. Overall the Government's preferred option should have a largely positive effect on legal aid provision.

## 9. Diversity Impact Assessment

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- 9.1. The Department has completed a Diversity Impact Assessment including a Racial Equality Impact Assessment and based on the following findings, has concluded that there would be a significant impact on black and minority ethnic (BME) groups and female legal service providers, which the Department has identified to be largely positive. We did not identify any disproportionate impact on consumers or providers of legal services with disabilities or any other group.
- 9.2. In 2001, the size of the minority ethnic population was 4.6 million or 7.9% of the total population of the United Kingdom.<sup>78</sup>
- 9.3. Under the Government preferred option there is an increased likelihood that through the higher levels of competition envisaged, as a result of facilitating ABS for the provision of legal services, firms may experience an increase in efficiency and a reduction in costs. If these reduced costs encourage lower prices for consumers, the proposals could lead to greater access to legal services for those minority ethnic groups on lower incomes.
- 9.4. Research has indicated that people from minority ethnic groups were more likely than white people to live in low-income households in 2000/2001.<sup>79</sup> Almost 60% in this group were living in low-income households before housing costs were deducted. This increased to 68% after housing costs. The potential reduction in the cost of legal services will be especially advantageous for any minority ethnic consumers in the 'middle bracket' who do not qualify for legal aid but would struggle to purchase legal services privately.<sup>80</sup>
- 9.5. In the year ending 31 July 2005, 9,665 students enrolled with the Law Society. Of these students 25.2% were drawn from the minority ethnic groups compared to 68.3% of white Europeans. Of the new trainees registered, 18% of trainees with known ethnicity were drawn from minority ethnic groups, compared with 81.6% of white Europeans.<sup>81</sup>
- 9.6. Minority ethnic group solicitors make up 9.4% of solicitors on the Roll, of whom around a quarter are resident abroad. 73.9% of the 11,874 minority ethnic group solicitors on the Roll had practising certificates.<sup>82</sup>
- 9.7. Recent research from the Law Society shows that in 2005 there were 9,081 solicitors' firms, of which 7,809 were classified as relatively small firms with four or fewer partners. This makes up 86% of all private firms.
- 9.8. Nearly half of minority ethnic solicitors (47%) work in firms with four or fewer partners compared to only 28.7% of White Europeans. In addition, 7.9% of solicitors from minority ethnic groups are sole practitioners, compared with only 5.1% for all white European solicitors in private practice.
- 9.9. There is a possibility that the anticipated increase in the level of competition facilitated by both LDP and 'licensing' models could pose significant challenges to smaller legal suppliers in some locations. There is little empirical evidence on which

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<sup>78</sup> Data from The Office for National Statistics:  
<http://www.statistics.gov.uk/CCI/nugget.asp?ID=273&Pos=1&ColRank=2&Rank=896>

<sup>79</sup> Data from The Office for National Statistics: [http://www.statistics.gov.uk/cci/nugget\\_print.asp?ID=269](http://www.statistics.gov.uk/cci/nugget_print.asp?ID=269)

<sup>80</sup> The 'middle bracket of consumers' refers to those consumers whose income is too high to be eligible for legal aid, but too low to purchase the required services privately.

<sup>81</sup> Law Society Strategic Research Unit 2005 *op cit*.

<sup>82</sup> *ibid*.

to estimate the proportion of small legal suppliers in the markets that could be characterised as inefficient after the introduction of ABS, and therefore would be unable to evolve to compete effectively. On this basis, we cannot speculate as to distribution of closures across the market.

- 9.10. In 2005, 7,809 private practices in the UK had four or fewer partners (86% of all private practices).<sup>83</sup> Empirical and anecdotal evidence has shown that smaller firms disproportionately employ solicitors from the minority ethnic groups, with nearly half of minority ethnic solicitors (47%) working in firms with four or fewer partners.<sup>84</sup> We envisage that these smaller firms will be most interested in adopting ABS in order to either expand the size of their practice or diversify, to increase efficiency even if they wish to remain small.
- 9.11. Currently, there is no direct evidence to suggest that minority ethnic solicitors will be faced with restricted labour market mobility due to discrimination, and therefore the ABS proposals could provide many opportunities to increase diversity with the legal profession.
- 9.12. The introduction of ABS could potentially create a high demand for legal and non-legal services in the legal service labour market that will increase the training and employment opportunities available to BME solicitors. In addition, the move away from the traditional-type of firm structure to a corporate-type structure will bring many of the positive ethics of corporate practice that encourage diversity and equal opportunities in the workplace. This will improve career progression for BME solicitors, who have often found they are facing a 'glass ceiling' that prevents progression past middle management and into partnership.<sup>85</sup>
- 9.13. Under the Government's preferred option, the LSB will act as an oversight regulator, delegating day-to-day functions to ARs. The LSB will be under a duty to act in a manner consistent with the regulatory objectives, including 'encouraging a strong, effective and diverse legal profession'. A similar duty will also apply to ARs. This will include a duty to publish policy statements on how the statutory objectives are being achieved, on which the LSB will be able to issue guidance if necessary.
- 9.14. If ARs were found to be acting inconsistently with the regulatory objectives, the LSB will also have effective enforcement powers and will be able to set sanctions, for instance the power to direct the failing AR. This system will ensure that ARs will be free to use their expertise to fulfil the objectives in the most efficient way, but also enables the LSB to intervene when the interests of consumers and disadvantaged groups are compromised.<sup>86</sup>
- 9.15. The Diversity Impact Assessment also highlighted some potential benefits for women in the legal profession who are largely limited by the traditional partnership structures. The ABS proposals could introduce a greater range of opportunities with high responsibility within legal and non-legal entities.
- 9.16. In 2004-2005, 64% of students enrolling with the Law Society, 62% of trainees and

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<sup>83</sup> *ibid*

<sup>84</sup> *ibid*

<sup>85</sup> Research by the Law Society has shown that whereas 38.9% of white solicitors in private practice are at partnership level, the corresponding proportion from BME groups is much lower at 23%. Law Society : *Minority ethnic group solicitors, Fact sheet information series* (2004) [http://www.lawsociety.org.uk/secure/file/147419/d:/teamsite-deployed/documents//templatedata/Publications/Research%20fact%20sheet/Documents/minorityethnic04\\_v1.pdf](http://www.lawsociety.org.uk/secure/file/147419/d:/teamsite-deployed/documents//templatedata/Publications/Research%20fact%20sheet/Documents/minorityethnic04_v1.pdf)

<sup>86</sup> Department for Constitutional Affairs – Nov 2005, "Increasing Diversity in the Legal Profession: A report on Government proposals", [http://www.dca.gov.uk/legalsys/diversity\\_in\\_legal\\_2col.pdf](http://www.dca.gov.uk/legalsys/diversity_in_legal_2col.pdf) reported that there were a number of factors preventing women and ethnic minority groups from succeeding in legal careers. The Panel recommended that the LSB should be properly resourced to conduct or commission its own research into issues such as racial equality and diversity, and in addition to be able to facilitate future monitoring or diversity within the professions

60% of admissions to the roll were women.<sup>87</sup> Women are more likely to be trainees in sole practices, small or medium size firms (2-25 partners) and less likely to be trained in large firms with 26+ partners.

- 9.17. Women with practising certificates are less likely to work in private practice: women make up over half (56%) of solicitors in government, 35% in private practice and 45% in commerce and industry. One-fifth (20%) of female solicitors in private practice are partners, compared with over two-fifths (44%) of men. The pay disparity between male and female solicitors is also significant, as women solicitors, on average, earn less than men do.<sup>88</sup>
- 9.18. As the ABS proposals increase competition in the legal services market, there is a risk that inefficient firms would be pushed out of the market, possibly affecting smaller firms that find it difficult to innovate and expand with the market in order to compete successfully. This may have a disproportionate effect of female trainees, of whom the majority train in sole practices, small or medium-sized firms, potentially reduce the number of training opportunities for women.
- 9.19. However, the diversity impact assessment highlighted the potential growth in the number of legal and non-legal entities that will emerge in the market actually increasing the number of training opportunities available. In addition, the move away from the traditional partner structures towards a more flexible, diverse and corporate style structure will present women with more high responsibility opportunities where they can progress while maintaining a successful work-life balance.
- 9.20. In conclusion, the Government expects that the proposals for the reform of legal services will have a largely positive impact on BME groups in the legal profession. The ABS proposals could provide opportunities for smaller firms employing BME solicitors to expand, diversify and improve their efficiencies. In addition, through the possible reduction in prices, as a result of competition, the department anticipates that BME groups on lower incomes, but still within the 'middle bracket' of consumers, will have greater access to legal services through affordability, thus potentially improving access to justice.

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<sup>87</sup> *Women Solicitors: Fact sheet series from research*, (The Law Society, May 2006) Source: Law Society Regis Database

<sup>88</sup> *ibid.*

## 10. Competition Assessment

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- 10.1. The Department has completed the competition filter test and, based on the following findings, concluded that a simple competition assessment is required. In the following paragraphs the impact on competition is considered under each of the Government-preferred options.

### **Impact of proposed Legal Services Board**

- 10.2. The proposed LSB will act as an oversight regulator, while delegating day-to-day regulatory functions to ARs. As such, we expect that there will not be any significant additional regulatory costs for firms compared to the current regulatory arrangements, and they should not fall disproportionately on smaller firms. However, additional regulatory costs will fall on practitioners of currently unregulated professions, if the LSB decides to bring them into its regulatory net.

### **Impact of proposed Office of Legal Complaints**

- 10.3. As the OLC will be funded through a levy on those who generate complaints, regulatory costs will fall more heavily on those against whom complaints are made. However, it will be open to the OLC to ensure that the cost per complaint is lower in types of work where providers are more likely to generate complaints. This will ensure that providers in areas of law that are more prone to complaints do not suffer disproportionately.

### **Impact of ABS Licensing Model**

- 10.4. Under the 'licensing' model, set-up costs should be lower for new entrants to the legal services market, as access to external financing increases the scope of sharing the risks of starting a new firm. Moreover, as current legal firms that wish to become ABS firms have to be subject to the same set of regulations as new ABS firms, we do not expect that new entrants will have to meet higher ongoing regulatory costs.
- 10.5. As the proposals aim to stimulate greater competition, innovation and consumer choice in the legal services market, they are expected to have a positive effect on the market structure. Reduced regulatory inconsistencies, lowered risk in starting-up new legal business afforded by external financing, and the potential to offer legal and associated services under one roof, would all act as draws for potential new owners of ABS firms to enter the legal services market.
- 10.6. In the long run, this can increase the number of participants in the legal services market, and can potentially make it more competitive. There is also a possibility that existing legal and non-legal firms may merge to take advantage of the gains from economies of scale and scope, increasing their size or the range of services they offer.
- 10.7. It is not anticipated that the new regulatory framework will directly restrict the ability of legal firms to choose the price, quality or location of their services, as the Government is not proposing any regulatory rules on these topics. Rather, the Government's proposals are facilitative, enabling firms to organise themselves in more efficient ways, resulting in new more efficient market structures, with as a result, a new vector of market-derived prices. However, the range of services these firms wish to provide may be influenced by the regulatory arrangements required for them. If those services fall under the ABS regulatory net, firms will be faced with an

additional cost.

- 10.8. This regulatory cost will be counterbalanced by both the anticipated increased benefits to both firms and consumers through the formulation of such firms. Both firms and consumers will benefit from firms' increased opportunities to take advantage from economies of both scope and scale. In addition, it must be highlighted that, among other things, an objective of good regulation is to manage the most prevalent risks by implementing mechanisms that may incur costs to the profession as a whole, while ensuring that those operating in the profession can still operate efficiently with minimal restrictions.
- 10.9. Firms that choose to adopt the ABS proposals may face new cost structures for their businesses because of the changes in service provision. By changing the cost structure of the firm, the determination of price will also be influenced according to the cost structure adopted to accommodate the new services. In addition, the make-up of the market could also have an effect on the way prices are determined. By introducing access to external finance and permitting lawyers and non-lawyers to work together to provide legal and associated non-legal services, there could be a greater supply of suppliers entering the legal services market further reducing prices, while increasing competition, technological innovation and quality.
- 10.10. For example, investment in new IT systems needed for different services may increase operating costs through the need for training and maintenance, whereas contractual burdens and savings gained through the 'bundling' of services will reduce costs in certain areas. These changes will enhance the firms' capacity for price competition in the market and therefore is envisaged to have a positive effect on competition in the legal services market and therefore, greater benefits for consumers,
- 10.11. One of the new costs firms are likely to face in their adoption of ABS is the cost of licensing fees charged by licensing authorities. This may increase the cost of providing legal services and place firms at a disadvantage in competing in the legal services market. The firms most likely to experience this burden are those that choose to access external investment through non-lawyer ownership and/or form partnerships between lawyers and non-lawyers, on an equal footing, to provide reserved legal services.<sup>89</sup> However, it is necessary to provide adequate regulatory safeguards to ensure that the potential risks generated by the proposals are managed sufficiently in the interests of consumers and the professional reputation of the legal services market.
- 10.12. There is a risk of an adverse effect on firms who are currently effectively regulated under arrangements that will fall under ABS regulation once the proposals come into force. They may be required to change their regulatory arrangements in order to comply with the new regime. However, the current number of such firms is a small proportion of the market, so the envisaged overall effect will be minor.<sup>90</sup>
- 10.13. Not-for-profit bodies that provide reserved services will also be subject to ABS licensing conditions. This might generate a disproportionate burden on entities that have different priorities and fewer resources than the private sector.
- 10.14. Such a burden might have so great an effect on these entities that they might completely withdraw from providing reserved services. In such a case the LSB and

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<sup>89</sup> 'Reserved' services are those services subject to statutory regulation. They include litigation, advocacy, immigration services, probate service, conveyancing, notarial acts and oaths.

<sup>90</sup> Principally Licensed Conveyancers (some 42 firms), with a very limited number of patent agent and trade mark attorney firms who are currently permitted to have external ownership by non-lawyers.

licensing authorities will have discretion to waive or alter any or all of the licensing conditions according to the nature of the entities in question, if it would be in the public interest. This will help to maintain and enhance access to justice, while ensuring that high standards of service are delivered. Small firms entering or operating within the market may also benefit from the discretion the authorities will have to alter the level of licensing fees if they feel that would further enhance competition in the market. The FSA has a power to set different licensing fees according to the size of the firm seeking a licence, a practice that ARs would be free to replicate.

- 10.15. Where a firm chooses to make only minor changes to its business structure it might still have to be regulated as a ABS firm and therefore be subject to a regulatory burden considered disproportionate to the changes made. Again, the LSB and licensing authorities will be responsible for ascertaining the effect of such changes on the risk profile faced by the consumer. An example of this could be where different types of lawyers wanted to enter into partnership but were concerned about the regulatory burden that would be incurred by adopting such an arrangement. In this scenario, such an arrangement will fall outside of ABS regulation and therefore would not be subject to any additional regulatory burdens.
- 10.16. In conclusion, the Government's proposals are likely to have a positive impact on competition facilitated mainly by the ABS proposals. In order to ensure that the market achieves the competition objective of the LSB, the LSB will be under a duty to consult with the OFT when authorising new ARs and licensing authorities, or adding or removing from the list of reserved legal services. The LSB will also be under a duty to respond to any OFT report published and take appropriate action. This will ensure that the LSB fully utilises the expertise of the OFT when assessing competition in the legal services market.
- 10.17. This consultation requirement will also help to prevent anti-competitive practices in the market and help ensure that regulation is carried out in accordance with the LSB's objectives for competition in the legal services market. In addition, the ABS proposals will lift the current restrictions that prevent firms from choosing to arrange their business through alternative structures, if such arrangements would generate greater efficiency.
- 10.18. If a firm chooses to adopt ABS, there is a great likelihood that the benefits acquired, both for the providers and potential clients, will significantly outweigh the cost of the regulatory burden which also have the effect of mitigating against any increased risk consumers may face through changes that take place in the reformed market.

## 11. Enforcement, Sanctions and Monitoring

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### **Administrative burdens – a risk-based approach**

- 11.1. The recent Hampton Review of Inspection and Enforcement (March 2005)<sup>91</sup> recommended that all regulatory agencies should adopt a risk-based approach to regulation. The Government accepted all its recommendations. All regulatory activity for legal services should be on the basis of a clear, comprehensive risk assessment.
- 11.2. Effective regulation ensures that consumers are protected. But too much regulation is damaging because it imposes costs, stops consumers getting what they need, and puts unnecessary burdens on providers. Regulation must be proportionate and based on an assessment of risk. Risk-based regulation means identifying and assessing the risk, determining the strategy for managing the risk and communicating it.
- 11.3. All parts of the new regulatory framework will need to keep up to date with developments in regulation and the sector and adopt best practice.
- 11.4. Regulators should be able to justify their activities on the basis of risk, and communicate this effectively. Good regulators use the full range of tools at their disposal, such as providing good advice to facilitate better compliance as well as a proportionate response to non-compliance.
- 11.5. There are a number of best practice guides but the Better Regulation Executive (BRE) has set out principles of good regulation.
- 11.6. The BRE guidelines say that regulation should be:
- **proportionate:** regulators should only intervene when necessary. Remedies should be appropriate to the risk posed, and costs identified and minimised
  - **accountable:** regulators must be able to justify decisions, and be subject to public scrutiny
  - **consistent:** Government rules and standards must be joined-up and implemented fairly
  - **transparent:** regulators should be open, and keep regulations simple and user friendly
  - **targeted:** regulators should be focused on the problem, and minimise side effects.

The Government strongly supports the adoption of these principles by the Legal Services Board in executing its powers and carrying out its duties.

### **Consistent Enforcement**

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<sup>91</sup> Hampton, Philip (2005) Reducing Administrative Burdens: Effective Inspection and Enforcement. [<http://www.hm-treasury.gov.uk/media/A63/EF/bud05hamptonv1.pdf>]

- 11.7. Under **existing arrangements**, the making and application of regulations is generally carried out by legal professional bodies. However, schedule 4 to the Courts and Legal Services Act 1990 (as amended by schedule 5 to the Access to Justice Act 1999) requires that certain rules maintained by the legal professional bodies must first be approved by the Secretary of State before they may have effect (essentially those rules which relate to the granting or exercise of a right of audience or a right to conduct litigation). The Secretary of State also has the power to alter these rules by Order. In the case of the Council for Licensed Conveyancers, all rules of the Council require the approval of the Secretary of State before they may have effect, but the Secretary of State has no power to alter rules of the Council. As well as making and applying their rules, the legal professional bodies are also responsible for enforcing their rules, including through various conduct and disciplinary arrangements.
- 11.8. Under the Government's **proposed arrangements**, professional bodies recognised by the Legal Services Board (LSB) as Approved Regulators (ARs) will continue to be responsible for making their rules, but those rules will require the approval of the LSB before they can have effect. The LSB will also have the power of direction which it can use to amend the rules of ARs. In practice, we expect that the LSB may choose to waive the requirement for its approval of ARs rules in certain cases. For example, where it is content that the AR concerned has a proven track record in a particular area, or where it judges that certain categories of rules do not present a significant risk when judged against its statutory objectives.
- 11.9. In practice we foresee little change in the burden on either the ARs or providers of legal services as a result of this change. In fact, we expect the process for approval to be quicker than the existing arrangements under which the Secretary of State generally refers rule change applications submitted by legal professional bodies to the Legal Services Consultative Panel (a statutory body established under the provisions of the Access to Justice Act 1999, which has a voluntary membership and generally meets once a month).
- 11.10. Disciplinary tribunals, as currently maintained by each front-line regulator, will continue to enforce decisions on allegations of professional misconduct.
- 11.11. The OLC will make enforceable awards on consumer redress of up to a limit of £20,000. These awards will be enforceable through the courts as a civil debt. At present, not all of the ARs are able to make enforceable awards.
- 11.12. Under the **alternative model** all rules would be made and enforced by a new Legal Services Authority. The legal professional bodies would have no statutory regulatory powers and their role would effectively be reduced to that of representative bodies.
- 11.13. Again we would see little change in the burden on either the ARs or providers of legal services as a result of this change.

#### Proportionate Powers

- 11.14. Under the **existing arrangements** the legal professional bodies are responsible for the application of sanctions where their members fail to observe their rules of conduct or other regulations that may have effect. This will usually follow an investigation by the professional body often arising out of a consumer complaint. Some sanctions are applied directly by ARs, but more serious matters generally require the matter to be considered by an independent tribunal.
- 11.15. In addition to sanctions applied to practitioners by the professional bodies, the Legal Services Ombudsman (LSO), established under the Courts and Legal Services Act

1990, considers cases referred by consumers and will generally investigate the way a professional body has handled a complaint. The LSO can ask a professional body to reconsider a complaint, or order a professional body to pay compensation to a consumer if they have suffered as a result of poor handling of the complaint.

- 11.16. The Access to Justice Act also provided for the establishment of a Legal Services Complaints Commissioner (LSCC) with the power to set targets for complaints handling by legal professional bodies and to fine those bodies if they fail to meet the targets set. The LSCC was established in 2004 with powers directed at the Law Society.
- 11.17. Under the Government's **proposed arrangements** ARs would be responsible for applying its powers to those persons or bodies which they regulate, in much the same way that they do under the existing arrangements. However, the LSB would have available to it a range of powers which it could apply in respect of ARs where they fail effectively to discharge their regulatory functions. As ARs will no longer handle consumer complaints, the functions of the LSO and LSCC in sanctioning ARs for inadequate complaints handling will no longer be required.
- 11.18. In terms of the burdens on providers of legal services we foresee little change to the existing arrangements; ARs will continue to sanction their members in much the same way as they do under the existing arrangements. However, ARs are likely to be under a **potentially** greater burden, given the range of powers that will be available to the LSB in the event that ARs fail to perform effectively (such a range of powers is currently not available to any of the existing oversight regulators). However, the burden, which will only be applied where ARs fail, is considered to be more than outweighed by the benefits to consumers.
- 11.19. Under the **alternative model** ARs would be removed from the equation and powers would be applied directly upon providers of legal services by a new single regulator, the Legal Services Authority (LSA). There is no evidence to suggest that the burden that would be applied to practitioners by the LSA would be any more onerous than if it were applied by ARs.

### **Risk-based Monitoring**

- 11.20. Under existing arrangements, the performance of providers of legal services is generally monitored by the legal professional bodies. The performance of the legal professional bodies in regulating their members is variously monitored by a range of oversight regulators including the LSO and LSCC in terms of complaints handling, the Office of Fair Trading in respect of competition matters, the Master of the Rolls in respect of rules of the Law Society and the Secretary of State for Constitutional Affairs in respect of certain rules of the main professional bodies, and, in effect, as regulator of last resort.
- 11.21. Under the **proposed arrangements** ARs will remain primarily responsible for monitoring the conduct of providers of legal services, but the LSB will act as the single oversight regulator charged with the responsibility of monitoring the performance of ARs. This will rationalise the existing "regulatory maze" identified by Sir David Clementi in his Report of December 2004, and, because they will be dealing with a single oversight regulator, is expected to reduce the overall burden on ARs.
- 11.22. In terms of complaints handling, the responsibility for dealing with consumer complaints will be removed from ARs and given to the new OLC. This should remove a considerable burden from ARs. The OLC's performance will be monitored

by the LSB. We do not anticipate any significant impact on the providers of legal services, although we expect consumers to receive a much more effective complaints handling experience.

- 11.23. Under the ***alternative model*** the responsibility for monitoring the conduct of providers of legal services would be removed from legal professional bodies and transferred to an LSA. As with the preferred arrangements, this would rationalise the existing “regulatory maze” and reduce the overall burden on ARs.
- 11.24. In terms of complaints handling, the responsibility for dealing with consumer complaints would similarly be removed from ARs and given to the new OLC.

### **Compensatory simplification measures**

- 11.25. The Government’s preferred options should be seen as simplification measures in their own right. The proposed regulatory framework is designed to provide a clear and consistent regulatory oversight regulation. The creation of an new body to provide a single point of oversight will eliminate the problems of the current framework, in terms of regulatory proliferation, confusion and fragmentation; the propensity of the current structure to create regulatory anomalies and gaps; and difficulties of interface and co-operation, thus increasing transparency, consistency and accountability.
- 11.26. Moreover, the removal of the restrictive nature of current business structures in legal services will facilitate more competition and innovation in the provision of legal services and offer more choice to consumers. It will also open up more opportunities for existing and potential new suppliers to offer new types of legal services.
- 11.27. In addition, the establishment of a single complaints handling body will simplify the complaint systems for consumers to use and also increase the efficiency with which the systems are run.

## 12. Implementation, Delivery Plan and Post-Implementation Review

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- 12.1. Implementation of the proposals in the Legal Services Bill will be managed by the Department for Constitutional Affairs (DCA) working in consultation with stakeholders. The DCA considers the input of stakeholders to be key to the successful delivery of the reforms and is committed to a consultative approach to working throughout the implementation process.
- 12.2. To ensure that implementation is taken forward in a structured manner, which enables progress to be carefully monitored, programme management will be used in line with principles of best practice. This will provide for continual assurance of the implementation and planning process including benefits realisation, management of risk and stakeholder engagement.
- 12.3. Consultation with other Government departments and organisations with experience in managing comparable or similar implementation programmes will be factored into the delivery plan as will benchmarking exercises to identify best practice in regulation and complaints handling.

### **Implementation period**

- 12.4. Engagement with stakeholders is already ongoing. This will continue throughout the passage of the Bill and beyond.
- 12.5. Planning for implementation and preliminary work is in hand. Full-scale implementation will begin once the Bill has received Royal Assent, in line with Government Accounting rules. After further work to refine implementation plans, our expectation is that, following Royal Assent, implementation will take a minimum of two years. This timetable incorporates implementation of supporting secondary legislation.

### **Funding of transition costs and effect on the profession**

- 12.6. The Government's position is that the reforms it is introducing are needed to correct failures in the existing system, particularly in terms of more effective and independent complaints handling arrangements and greater competition. These changes are essential to ensure that the market for legal services operates more effectively and in the consumer interest. The changes will of course mean there will be additional costs in establishing the new machinery. There have been calls from many for the Government to make a contribution to these costs. While this could be achieved through an increase in general taxation, the Government considers the more appropriate arrangement would be for those being regulated to bear these costs. The Legal Services Bill therefore includes provision for the Legal Services Board to make a levy on the profession to fund the cost of establishing and running the new arrangements.
- 12.7. In their report of May 2006, PwC estimated the total transition costs (for LSB and OLC) to be some £26.8 million.<sup>92</sup> It has been argued that it is unreasonable to expect the professions to bear the full cost of these transitional arrangements. However, it is important to set these into the context of the overall value of the legal

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<sup>92</sup> PwC's independent report is published on DCA's website and can be found at: <http://www.dca.gov.uk/legalsys/lreform.htm>

sector. For example, in 2003 the sector achieved an annual turnover of some £19 billion. In their associated report of June 2006 on compensation fund arrangements, PwC identified that some 144,000 members were subject to regulation by the seven bodies that are identified in the Legal Services Bill as approved regulators<sup>93</sup>, so at the most basic level, we could conclude that each regulated person is responsible for generating a turnover of around £132,000 year.

- 12.8. It will be for the LSB to apportion costs on a fair and proportionate basis between approved regulators. And in turn it will be for approved regulators to pass on these costs, again on a fair and proportionate basis, to those they regulate. As per the PwC report, total transition costs are £26.8 million. Of this, £11.0 million will fall directly on the Law Society, £8.0 million of which represent costs currently incurred by the Law Society (parallel running of CCS at Holborn and avoidable overheads). At the most basic level, and assuming that every member regulated by the Law Society were to make the same contribution, with approximately 101,000 members, the additional one-off costs of approximately £3 million equates to a one-off cost of £28.56 per member for one year.
- 12.9. The LSB, in consultation with the Approved Regulators, will also agree how best to apportion the remaining £15.8m of transition costs on a fair and proportionate basis between the Approved Regulators. Again at the most basic level, these transition costs, which PwC identified as directly associated with the establishment of the LSB and OLC, would represent a contribution of some £44 per person, per year, for two-and-a-half years for each member of a currently approved regulator (including members of the Law Society). This assumes that implementation takes place in accordance with year PwC's base-case scenarios and implementation timetable.

## **Key milestones**

### Royal Assent

- 12.10. Subject to receiving Royal Assent, expenditure on implementation can begin in line with Government Accounting rules. The first task will be the appointment of the LSB and the OLC and their Chief Executives and senior managers. Our intention is to begin the recruitment process immediately following Royal Assent. Six to nine months is usually considered to be the lead-in time required to make an upper-tier appointment.

### Staff appointments

- 12.11. With the exception of the appointment of an interim Chief Executive of the OLC by the Secretary of State, staff appointments to both organisations will be made by the LSB and the OLC. We expect that staff appointments will take upwards of 4 months.

### Building acquisition and/or fit out

- 12.12. The expectation is that building acquisition and/ or fit out will begin in tandem, or shortly before, the staff appointments process and will also take between 6 to 12 months.

### Post-Implementation Review

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<sup>93</sup> The seven approved regulators are The Law Society, Bar Council, CLC, ILEX, CIPA, ITMA and CoF. 'Financial Analysis on Compensation Fund Options for the Legal Services Sector', PwC (June 2006). Available at: <http://www.dca.gov.uk/legalsys/lrreform.htm>

- 12.13. At the point of Programme closure a review will be carried out to assess and evaluate the performance of the programme and its management processes to identify lessons that may help other programmes. The closure process will also be used to identify whether a further review, after closure of the programme, might be required to provide a complete assessment of the overall benefits realisation process.
- 12.14. This RIA will provide the baseline against which any post-implementation review will be measured.
- 12.15. The DCA will also seek to review the effectiveness of the reforms on a continual basis in its capacity as sponsoring department. The DCA will continue to work with stakeholders as part of this process.
- 12.16. Additionally, the proposed reforms have levels of accountability built in to ensure compliance with the legislation.
- 12.17. The **Legal Services Board** will be accountable to Parliament through the Secretary of State for Constitutional Affairs as sponsoring Minister. It will be required to present an annual report to the Secretary of State, who will lay it before Parliament and make it available publicly. The annual report will include the LSB's assessment of:
- the discharge of its functions,
  - how it has met the regulatory objectives,
  - its performance against standards of service delivery, and
  - its statement of accounts.
- 12.18. The LSB will also have a duty to report to the Secretary of State at his request on any matter concerning the discharge of its duties.
- 12.19. Additionally, the Government expects that the Constitutional Affairs Select Committee will want to scrutinise the LSB's work by calling the Chair or other members to give evidence under existing select committee powers.
- 12.20. The Chief Executive of the LSB will act as the accounting officer for the LSB. This will include responsibility for the propriety and regularity of finances, for keeping proper records, and for safeguarding assets. As accounting officer, the Chief Executive will be responsible to the Permanent Head of the Department for Constitutional Affairs as accounting officer of the sponsoring Department.
- 12.21. Although the OLC will be wholly independent in its handling of complaints, the OLC will remain accountable to the LSB in respect of its targets and funding. The LSB will be able to remove the chair of its board or board members in cases of poor performance or conduct, or of bringing the OLC into disrepute.

## 13. Summary and Conclusion

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### Options preferred by the Government

- 13.1. As a result of the cost-benefit analysis that the Government has carried out on the three options for reforming the regulatory framework for legal services, the Government has concluded that in order to simplify the current regulatory framework for legal services, the creation of an independent Legal Services Board (LSB) is the Government's preferred option.
- 13.2. The creation of the LSB will provide an independent, single point of oversight regulation to the legal service profession with effective powers to ensure that the day-to-day regulatory functions of the Approved Regulators (ARs) are in accordance with the overall objectives of the LSB, including improving access to justice, protecting and promoting consumers' interests, and encouraging a strong, effective and diverse legal profession.
- 13.3. The effective powers granted to the LSB will ensure that consumers' interests are put at the forefront of legal service provision, and transparency and accountability are achieved in the legal services market. The LSB will be responsible for authorising the ARs to conduct the day-to-day regulatory functions if it were satisfied with their competence and governance arrangements, and also that the ARs have demonstrated that they have satisfactorily separated their regulatory and representative functions.
- 13.4. The LSB will also have statutory powers to intervene if ARs are judged to be failing in their duties, which ensures that the incompetence of an AR will not persist to the detriment of consumers. In further demonstrating its commitment to protecting and promoting consumers' interests, the LSB will set up and maintain a Consumer Panel to ensure that it is in touch with the views and demands of different consumers.
- 13.5. The LSB will also be able to propose to the Secretary of State that additional legal service activities will be brought into, or taken out of, the scope of the LSB's regulatory reach by secondary legislation. This mechanism will ensure that the powers and functions of the LSB have the flexibility to adapt to potential future changes in the regulatory requirements of the legal services market.
- 13.6. As per the analysis conducted using PwC's independent report, the Government is confident that the slight increase in ongoing running costs (£2.4 million), and the one-off transition costs (£2.3 million) associated with the LSB option, are justified by the benefits accruing to consumers and the legal service sector as a whole, from the introduction of an oversight regulator. This increase in regulatory costs under the LSB option should be seen in conjunction with the decrease in annual running costs attributable to bodies involved in the regulatory framework from the creation of a single, independent complaints handling body (£12 million).
- 13.7. As a result of the cost-benefit analysis that the Government has conducted on the three options proposed for facilitating alternative business structures, we have concluded that the option for facilitating full Alternative Business Structures (ABS) via a licensing regime is best suited to meeting the objectives of the reform for legal services.
- 13.8. The proposal will enable lawyers and providers of non-legal services to work together, with external financing, to provide services under a licensing regime. This will be subject to the approval of a licensing authority that has obtained an

authorisation from the LSB to regulate that form of ABS. By permitting this form of business structure in the legal services profession, ABS will encourage competition, innovation and efficiency in service delivery while simultaneously improving the quality of legal services for consumers.

- 13.9. In order to assess the suitability of a prospective ABS firm, the licensing authority must be satisfied that the prospective ABS has attained the set standards. In particular, a prospective ABS firm will be required to satisfy the LSB's compensation fund and indemnity insurance requirements and to nominate a Head of Legal Practice (HOLP) and a Head of Finance and Administration (HOFA) to ensure that the conduct of legal business and practice management is in accordance with the regulatory rules.
- 13.10. External investors of the ABS firm will also have to pass a robust 'fitness to own' test set by the licensing authority before being permitted to invest in the firm.
- 13.11. The ABS option is much less restrictive than the LDP option we also considered, allowing firms to offer both legal and associated non-legal services. ABS firms that contain a mixture of lawyers and non-lawyers could lead to the sharing of good management practice, technological innovation and efficiencies across the market, enhancing competition among firms and potentially reducing the price of legal services. In addition, access to external finance will enable firms to spread start-up risks, access equity to possibly expand their business, diversify and improve the efficiency of their service provision to the benefit of consumers.
- 13.12. The Diversity Impact Assessment (including the Racial Equality Impact Assessment) revealed that the ABS proposals have the potential to have a positive effect on the BME consumers and solicitors through the expected reduction in prices and the changes in business structures. The Diversity Impact Assessment also indicated that female legal practitioners could also benefit from the increased opportunities that the ABS proposals could promote.
- 13.13. The Government expects the ABS proposals to have a positive effect on legal aid suppliers. The Legal Aid Impact Test has identified a number of areas where benefits will accrue to the legal aid consumer through an increase in the level of legal aid service provision and facilitation of complementary services provided through the integration of mixed service providers. In addition, through the potential reduction in prices, there could be an improvement in access to justice through affordability for the middle bracket of consumers.
- 13.14. The Government has carried out a Small Firms Impact Test and is satisfied that the proposed options will provide greater opportunities for small firms to access equity, diversify, expand and effectively compete in the market for legal services.
- 13.15. As a result of the cost benefit analysis that the Government has conducted on the three options proposed for reforming the complaints handling arrangements in legal services, we propose the establishment of a new Office for Legal Complaints (OLC) to take over the role of the professional bodies in handling consumer complaints. The OLC will provide an independent complaint handling system with effective powers to deal with complaints made against providers that cannot be resolved at the local level.
- 13.16. The OLC will also be empowered to provide redress to consumers, set standards for complaints handling and identify best practice.
- 13.17. Through the independence of the OLC, we envisage that consumer confidence in the complaints handling system will increase, which will encourage consumers to file

legitimate complaints against inefficient providers.

- 13.18. The OLC will be accountable to the LSB for its overall operation, to ensure that the LSB has proper oversight of the entire regulated legal service sector and that the OLC is operating in accordance with the LSB's objectives for the regulation of legal services.
- 13.19. As per the analysis conducted using PwC's independent report, the Government is confident that the transition costs associated with the OLC option (£23.6m), are justified by the benefits accruing to consumers and the legal service sector as a whole from the introduction of a single, independent complaints handling body. These one-off costs should be seen in the context of the estimated £12m decrease in annual running costs of the complaints handling system.

### Summary of expected benefits and costs

13.20. The table below summarises the expected benefits and costs of the Government's preferred options for the reform of legal services:

	<b>Benefits</b>	<b>Costs</b>
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<p><b>An oversight regulator (LSB)</b></p>	<p><u>Economic</u></p> <ul style="list-style-type: none"> <li>i. Consolidation of regulatory roles and responsibilities of the multiple oversight regulators to a single point of consistent regulatory oversight.</li> <li>ii. As a relatively small oversight regulator, LSB will be less bureaucratic and more efficient.</li> <li>iii. Simplified regulatory framework that reduces regulatory proliferation, fragmentation and inconsistencies. May lead to lower compliance costs for suppliers.</li> <li>iv. Risk of additional regulatory burdens reduced.</li> <li>v. Reduced likelihood of regulatory anomalies and gaps, offering greater protection to consumers.</li> </ul>	<p><u>Economic</u></p> <ul style="list-style-type: none"> <li>i. Risk of adding regulatory burdens on those suppliers of currently unregulated legal services, if these services are brought into the LSB's regulatory net.</li> <li>ii. Additional regulatory costs may be passed on to the consumer through higher prices. However, anticipated that additional regulatory burdens on professions will be minimal.</li> <li>iii. Risk of the professions formulating regulations that put the professions' interests above those of consumers. Risk minimised by LSB's ability to call in rules and to impose sanctions to ensure that regulations will not be set in such a way that would harm consumers.</li> </ul> <p><u>Social</u></p> <ul style="list-style-type: none"> <li>i. Removal of self-regulation could dilute ethical responsibilities and regulatory accountability of individual practitioners increasing the risk of lowering standards to the consumers' detriment. This risk should be minimised through ARs' responsibility for ethical and regulatory accountability.</li> </ul>
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	<ul style="list-style-type: none"> <li>vi. No self-regulatory element within the framework, ensuring that regulatory decisions are made in consumers' interest.</li> <li>vii. Reduced risk of regulations being set to the detriment of competition and innovation.</li> <li>viii. Less likely to lose regulatory expertise during transitional period.</li> <li>ix. Retention of day-to-day regulation in hands of professional bodies should increase quality standards reducing risk of rising monitoring and enforcement costs.</li> <li>x. Increased independence of regulatory decisions.</li> <li>xi. Increased consumer confidence via greater accountability, transparency and regulatory certainty.</li> <li>xii. Greater flexibility in the regulatory system, especially with regard to regulation of ABS firms.</li> <li>xiii. Duty to consult with OFT when authorising new ARs and observing market behaviour will reduce anti-competitive practices.</li> <li>xiv. Independence of oversight regulator will ensure that foreign consumers are not deterred from using the UK for international and commercial litigation and arbitration.</li> </ul>	
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	<p><u>Social</u></p> <ul style="list-style-type: none"> <li>i. Principle of the legal profession being independent of Government will be demonstrated more clearly than if the regulatory role were removed from the professional bodies entirely.</li> <li>ii. Greater ability to adjust to future changes in the legal services market and to make the appropriate regulatory response. This will aid the future development in the market, bringing positive benefits in terms of increasing access to justice and diversity within the legal professions.</li> <li>iii. Introducing the LSB will eliminate the inconsistencies in the existing framework and identify best practice to achieve the objectives of reforming the regulatory framework.</li> <li>iv. Oversight regulator will ensure that regulatory gaps are anticipated and tackled before consumers are put at risk.</li> <li>v. Increased consumer confidence and improvement in professional standing of legal service providers.</li> </ul>	
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	<ul style="list-style-type: none"> <li>vi. Promotion of consumer interests and achievement of regulatory objectives.</li> <li>vii. Consumer input in LSB, through Consumer Panel, will ensure that decisions are made in the interests of the consumers.</li> <li>viii. Consumers will be better enabled to understand the system and feel empowered to make well-informed choices about purchasing legal services.</li> <li>ix. Compulsory separation of regulatory and representative functions of ARs will lead to accountability, transparency and an increase in regulatory certainty.</li> </ul>	
	<b><u>Benefits</u></b>	<b><u>Costs</u></b>
<b>Facilitate alternative business structures (ABS) in the provision of legal and non-legal services via a licensing regime</b>	<p><u>Economic</u></p> <ul style="list-style-type: none"> <li>i. Competition enhanced by the removal of unduly restrictive professional rules.</li> <li>ii. Licensing regime is much less restrictive in the type of business structure ABS firms are allowed to operate under, thus widening the scope of competition.</li> <li>iii. Allowing new capital from outside the profession will help to increase capacity and exert a downward pressure on prices via increased competition.</li> <li>iv. Through fall in start-up costs for potential new suppliers, there should be an increase in suppliers, increasing competition and innovation in the market, leading to an increase in the quality of services.</li> </ul>	<p><u>Economic</u></p> <ul style="list-style-type: none"> <li>i. Confusion of different regulations among ABS regulators and firms. May also increase the risk of regulatory capture. Risk minimised by the statutory requirement of the LSB to seek advice and agreement with other regulators about cross-discipline regulatory decisions.</li> <li>ii. Risk of information protected under legal professional privilege being leaked due to unreasonable commercial pressure or conflict of interest. Mitigated by proposed safeguards (e.g. HOLP and HOFA)</li> </ul>

	<ul style="list-style-type: none"> <li>v. Opportunity for owners to diversify risks and lowers cost of capital.</li> <li>vi. Greater convenience to consumer by allowing one-stop shop of different types of legal and associated non-legal services.</li> <li>vii. Ability to provide legal and associated business under on roof increases scope of efficiency gains for suppliers.</li> <li>viii. Increased access to external financing and inherent flexibility encourages ABSs to innovate and to improve efficiency.</li> <li>ix. Facilitate building up of reputation, leading to increase in quality of legal services and higher protection for consumers.</li> <li>x. Integration of practitioners from different services should allow the sharing of good practice, innovation and technological advances across the profession.</li> <li>xi. Greater incentives for ABS firms to maintain quality services.</li> </ul> <p><u>Social</u></p> <ul style="list-style-type: none"> <li>i. Enhanced access to justice via new channels for delivering services.</li> <li>ii. Provide more opportunities for under-represented groups to enter, and help increase diversity in the legal profession.</li> <li>iii. Increased variety of legal services can be offered due to increased efficiency and scope of information-sharing across different business areas.</li> <li>iv. Facilitate more opportunities for disputes to be settled via Alternative Dispute Resolution methods, reducing the need of litigation and the demand on valuable court time.</li> </ul>	<ul style="list-style-type: none"> <li>iii. Risk that larger legal firms may seek to 'foreclose' competition from smaller firms which disproportionately employ BME and women solicitors. Risk minimised by AR's statutory objective of promoting competition.</li> <li>iv. Inefficient firms may be driven out of the market due to increased competition. This may not be considered as an economic cost if it raises the overall quality of legal services in the market.</li> <li>v. Licensing fees may pose a regulatory burden on NfP firms and those firms adopting minor changes bringing them into the regulatory net. However, LSB and ABS have discretion to waive or alter any or all of the existing rules if it is in the public interest. In addition, it is not expected that the licensing fee would act as a deterrent to new entrants.</li> </ul> <p><u>Social</u></p> <ul style="list-style-type: none"> <li>i. Greater competition may lead to closure of inefficient suppliers in some locations. They are more likely to be replaced under the licensing model by more efficient suppliers, and/or by new delivery methods.</li> <li>ii. Consumers face the risk of 'tying-in' practices, which is further enhanced if the majority of owners are non-lawyers influenced by commercial pressures. This risk should be reduced by the requirement that all ABS firms should nominate a HOLP who will ensure that the ABS firm adheres to the rules of the AR.</li> </ul>
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	<u>Benefits</u>	<u>Costs</u>
<b>A new complaints handling body, the Office for Legal Complaints (OLC)</b>	<p><u>Economic</u></p> <ul style="list-style-type: none"> <li>i. Independence for the complaints handling system, thus increasing consumer confidence in the legal services industry.</li> <li>ii. Single point of entry for all service complaints simplifies complaint-handling arrangements for consumers and eliminates duplication of roles across profession leading to time and overhead savings for ARs and suppliers</li> <li>iii. Greater consistency and clarity in the complaints handling process, leading to a more efficient and effective complaint mechanism, thus inducing savings for ARs and suppliers.</li> <li>iv. Reduced inefficiency in complaints handling system by ensuring complaints are directed to the correct AR.</li> <li>v. Redress award of up to £20,000 will provide an incentive for suppliers to improve quality of services to protect reputations of suppliers, thus reduce the likelihood of complaints lodged against them, potentially reducing administrative burdens.</li> <li>vi. Possibility of redress will also encourage legitimate complaints from consumers who have received a poor service, increasing their confidence when purchasing legal services.</li> <li>vii. Because the OLC will be an independent body with effective powers the legal professionals will have an incentive to adhere to the code of practice and disciplinary procedures as outlined by the ARs and OLC.</li> </ul>	<p><u>Economic</u></p> <ul style="list-style-type: none"> <li>i. Increased rise in complaints will lead to an increased workload to handle complaints for sub-standard suppliers, though this may act as an incentive for them to improve standards of services.</li> <li>ii. Legal professionals may become overly risk-averse and avoid taking more complex and difficult legal cases, reducing access to justice. But this risk already exists under the current system and there is no evidence to suggest that lawyers have been driven to avoid these types of cases.</li> <li>iii. Confusion among ARs, the OLC and other statutory regulators as to how complaints should be handled. The LSB's duty to liaise with other statutory regulators will ensure the handling of complaints will be consistent across the professions involved.</li> </ul>

	<p><u>Social</u></p> <ul style="list-style-type: none"> <li>i. Independence of the OLC will improve consumer confidence in the complaints system and aid the LSB in achieving its objectives through focusing on consumer interests.</li> <li>ii. The power that the OLC will have to share information about complaints will empower consumers to make better decisions when choosing their legal services provider and provides an incentive for providers to improve the quality of their services.</li> </ul>	<ul style="list-style-type: none"> <li>iv. Due to more effective complaints body, compliance costs for firms will rise in order to meet the standards set for 'in-house' procedures. However, this may act as an incentive for providers to improve standards to reduce likelihood of complaints being lodged against them.</li> </ul> <p><u>Social</u></p> <ul style="list-style-type: none"> <li>i. Confusion may arise for the consumers when using ABS firms, as to how the complaints concerning cross-service practitioners should be handled. However, licensing authorities will have to have suitable and transparent arrangements with non-legal regulators in place before being authorised to allow firms to provide non-legal services. Firms will also have to make it clear to consumers at the outset how different regulators regulated different services in them.</li> </ul>
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13.21. The tables overleaf summarise the operating and transitional costs of the options proposed by the Government on reforming the regulatory framework and complaints handling arrangements for legal services:

### Reforming the regulatory framework:

Option	Annual Running Costs	Transition Costs (two years before vesting)	Transition Costs (one year before vesting)	Transition costs (one year <u>after</u> vesting)
	£'000	£'000	£'000	£'000
<b>Do nothing</b>	64,900	n/a	n/a	n/a
<b>With a Legal Services Authority</b>	66,400	11,550	16,740	27,000
<b>With a Legal Services Board</b>	67,250	200	1,580	500

### Reforming complaints handling arrangements:

Option	Annual Running Costs	Transition Costs (two years before vesting)	Transition Costs (one year before vesting)	Transition costs (one year <u>after</u> vesting)
	£'000	£'000	£'000	£'000
<b>Do nothing</b>	32,520	n/a	n/a	n/a
<b>With a Postbox</b>	32,920	-	-	500
<b>With an Office for Legal Complaints</b>	20,590	140	12,280	11,140

*All Costs in 2005-06 prices*

13.22. PwC's report also identified £1 million of additional "implementation costs" from setting up a task force for detailed organisation design for the LSB and the OLC. These costs were estimated to fall in the year before powers and duties are vested in the new bodies.

- 13.23. PwC have also costed alternative scenarios over and above their base cases outlined above.
- 13.24. For the LSB, this included costing for an incremental increase in the level of activity and locating the LSB in the North of England or London. A combination of these variables could result in the annual ongoing running costs of the LSB could rising to £5.6 million. The LSB costs would therefore rise to £69.0 million. Under this alternative scenario, transition costs could also be expected to rise by approximately £600,000.
- 13.25. For the OLC, this included costing an incremental level of resource for higher volume of complaints, at 25% and locating the OLC in the West Midlands. A combination of these variables could result in the annual ongoing running costs of the OLC rising to £21.0 million (base-case plus incremental volume of complaints, with a single-site location in the West Midlands). Under this alternative scenario, transition costs could also be expected to rise by approximately between £3.5 million and £6.6 million (dependent on the nature of the increase in complaints).

## 14. Additional Impact Assessments

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### **Legal Profession and Legal Aid Bill (Scotland) Bill 2006**

- 14.1. The Bill contains Scottish provisions relating to the Scottish Legal Complaints Commission which the Legal Profession and Legal Aid (Scotland) Bill proposes to establish. Stage 3 of that Bill is scheduled to take place in the Scottish Parliament on 14 December 2006. The Scottish Legal Complaints Commission will take over responsibility for dealing with complaints about services which are currently dealt with by the Law Society of Scotland and the Faculty of Advocates. The legal professional bodies in Scotland are to retain responsibility for professional discipline and for dealing with complaints about the conduct of legal practitioners, though the Commission will have oversight of the way in which they handle conduct complaints. Section 17 of the Bill provides for the abolition of the Scottish Legal Services Ombudsman by order.
- 14.2. The main purpose of the Scottish provisions in the Legal Services Bill is to enable the Commission to consider complaints about financial services, immigration, insolvency and consumer credit services provided by Scottish lawyers. Because such complaints are outside the devolved competence of the Scottish Parliament, section 47 of the Legal Profession and Legal Aid (Scotland) Bill disapplies the Scottish Bill in respect of advice, services or activities relating to financial services, immigration, insolvency and consumer credit services. Enactment of the Scottish measures in the Legal Services Bill will confer competence on the Scottish Legal Complaints Commission in these reserved areas. A full Regulatory Impact Assessment in respect of the Scottish Legal Complaints Commission was prepared to accompany the Legal Profession and Legal Aid (Scotland) Bill.<sup>94</sup> A copy of this document is available for reference in the House library. More detailed information on the Scottish provisions is set out in the Explanatory Notes for the Legal Services Bill.

### **Compensation Act 2006**

- 14.3. The Bill contains provisions that amend Part 2 of the Compensation Act 2006, which sets out the statutory framework for the regulation of claims management services. The Compensation Act 2006 achieved Royal Assent on 25 July 2006 and provisions in Part 2 are expected to be commenced and the secondary legislation made between November 2006 and April 2007. This Bill includes amendments to the Compensation Act, the main purpose of which is to allow for the regulatory oversight of regulated claims management services to be transferred from the Secretary of State to the Legal Services Board. There are also amendments to provide for the complaints function in Part 6 of this Bill to apply to complaints made about authorised persons under the Compensation Act. The handling of complaints will therefore come under the jurisdiction of the Office of Legal Complaints.
- 14.4. DCA Ministers made it clear during the passage of the Compensation Act that the oversight responsibility and complaints handling would transfer at the appropriate time after the establishment of the relevant bodies. The amendments to the Compensation Act are relatively minor and do not amend the main provisions governing the operation of the claims management regulatory framework, other than

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<sup>94</sup> Full RIA for Scottish Legal Complaints Commission available at: <http://www.dca.gov.uk/legalsys/lrsreform.htm>

as above. A full Regulatory Impact Assessment in respect of the statutory regulation of claims management services was prepared to accompany the Compensation Act.<sup>95</sup>

## **Council for Licensed Conveyancers - costs provisions in the Courts and Tribunals Bill**

- 14.5. The Bill contains provisions that will enable the Discipline and Appeals Committee (DAC) of the Council for Licensed Conveyancers (CLC) to order costs to be paid by any party in any proceedings before it. The order may relate to all or part of the costs. The successful party would not automatically be entitled to costs and the award would be at the discretion of the DAC. The current costs provisions are unfair in that a costs order may be made against a licensed conveyancer but not in his favour. They are also inconsistent with the usual provisions for disciplinary tribunals.
- 14.6. These provisions will ensure the regulatory arrangements relating to costs provisions are fair and compliant with the Human Rights Act 1998 and the European Convention on Human Rights (ECHR). In terms of the wider regulatory reforms which the CLC is seeking, the DCA is taking forward a wide-ranging reform of the regulation of legal services. The provisions are most likely to have an impact on the CLC and the person on the basis of whose complaint the proceedings have been brought (if he exercises his right to be heard). Individual licensed conveyancers also have an interest in that they will now have the opportunity to recover costs if they win a case before the DAC. All parties have an additional interest in that the DAC will also have the power to award costs (or a portion of costs) to an unsuccessful party if deemed appropriate.
- 14.7. There are three main benefits in introducing a general power to enable the DAC to award costs to either party. First, it serves the interests of justice, equity and fairness in giving licensed conveyancers an opportunity to recover costs, as the CLC is already able to do, if they win a case before the DAC. Secondly, it avoids the possibility of challenge under Articles 6 (right to a fair trial) and 14 (prohibition of discrimination) of the ECHR by eliminating any difference of treatment between parties taking part in proceedings. Thirdly, it brings the costs provisions relating to the licensed conveyancing profession into line with analogous provisions relating to comparable professional regimes.
- 14.8. As the DAC does not currently have the power to award costs to licensed conveyancers who win cases before it, it is impossible to quantify the cost to the CLC (and by extension, individual licensed conveyancers) of the proposed provisions. However, we envisage that there may be an increase in license fees which in turn could be passed onto the consumer, but in practice the financial impact on licence fees is likely to be negligible.

### **Pro bono work**

- 14.9. The Bill contains a clause to enable the abrogation of the indemnity principle in *pro bono* cases. We are not proposing to abolish the principle in its entirety. The clause will allow the courts to award costs when no costs have been incurred and direct the costs to approved pro bono charities. As with any other successful case, the cost award will be at the discretion of the court and will be reasonable and proportionate. The clause will not amend any other rules of court. Costs will still only be

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<sup>95</sup> The full Regulatory Impact Assessment on the impact of the introduction of statutory regulation of the claims management sector to be introduced by the Compensation Act is available at: <http://www.dca.gov.uk/legist/compensation.pdf>

recoverable from privately funded parties and unsuccessful *pro bono* litigant cases will still be able to have costs awarded against them.

- 14.10. Because of the indemnity principle (which states that a costs award cannot be more than a client is liable to pay his lawyer), cost recovery is not possible in cases where *pro bono* representation means a lawyer has provided his services free of charge. This creates an unfair advantage to the unsuccessful party who will know from the outset that costs will not be an issue in their case and so have the upper hand in fighting or settling cases.
- 14.11. The proposal will level the costs playing field and enable more people to obtain access to justice, as the costs will be used to fund further *pro bono* work, primarily in law clinics and advice centres. This will especially benefit those middle income clients with limited means but no access to Community Legal Service help and other disadvantaged groups. Research undertaken by the Legal Services Commission indicates that advice at an early stage of a problem can prevent its escalation into something more complex. In their Civil Law and Social Justice Report 2004<sup>96</sup> they state that 37% of the population experience a justiciable problem each year but that 19% of people take no steps to address the problem because they do not know where to go for advice, think no advice is available or are unable to pay for the advice. These are the people that additional funding raised by *pro bono* costs awards could help.
- 14.12. This will not mean that the number of cases coming to court will dramatically increase. It has been estimated that 10% of all lawyers (some 10,000 individuals) undertake *pro bono* work each year and 95% of the cases they help are mainly of an initial advice nature. We envisage that a similar proportion of the funds raised by cost awards would go to increase the groundwork done in local legal clinics and advice centres. We estimate that only some 5% of cases handled by *pro bono* lawyers will come to court - about a thousand a year. Indications are that the average cost award in civil cases is around £800 so we envisage that the total amount of awards in any one year would be in the region of £800,000.
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<sup>96</sup> *Causes of Action: Civil Law and Social Justice* (2<sup>nd</sup> edn.) Summary of main findings available at: <http://www.legalservices.gov.uk/docs/news/Summary-Main-Findings-revised-Mar05.pdf>

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