

The Regulatory Balancing Act

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The Regulatory Balancing Act **Iain Miller, Partner at Bevan Brittan LLP**

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Many outside England and Wales regard the Legal Services Act of 2007 as revolutionary in its scope. At its heart sits the external ownership of law firm, known as Alternative Business Structures. The Act also quite deliberately pushes the emphasis of regulation away from the professional practitioner and towards the entity in which they work.

Those in this room may not feel that they have been taking part in a revolution. Eight years is a long time and the change has been slow. Our own perceptions may also reflect the fact that regulation is only one factor that determines what happens in a market. Legal Services have also been affected by technology, client activism and the wider economy. Now we are eight years on from 2007 it is as good a time as any to pause and reflect on whether these changes mean we need to recalibrate the regulation of legal services.

In 2007 legal services was a pretty settled place. There were a number of very clear boundaries. Only lawyers could own law firms. In house legal teams could normally act only for their employer. Lawyers made money by selling hours. The business model for law firms was partnership or latterly Limited Liability Partnership. Whilst it was possible to provide unregulated legal services, these providers tended to sit on the periphery of the market.

In such a settled market, regulation was simple. Having evolved over literally centuries, it focussed on the ethical conduct of the individual. Client money (or the misuse of it) was at the centre of most regulatory and disciplinary action. It was clear that lawyers in private practice presented the greatest regulatory risk not least because of client money but also because of client complaints. Although, in house lawyers had increased in numbers quite significantly from the 1970s onwards, they did not handle client money and did not generate complaints. They could be safely left to get on with their work without much regulatory oversight.

The effect of the Legal Services Act was to take legal services some way down the road already taken by the financial services industry. The architecture of the Legal Services Act has many similarities to the Financial Services Act 1986. That preserved the individual financial services sectors through Self-Regulatory Organisations just as the Legal Services Act kept the approved regulators and the existing legal professions. However, they are now collectively known as "authorised persons" under the Legal Services Act.

The SROs were swept away in the second wave of financial services reform, the Financial Services and Markets Act 2000. Markets were liberated and regulated by a light touch. The regulatory emphasis was on entities not individuals, a feature that I have already mentioned was inherited by the Legal Services Act. We will never know if in due course there would have been a Legal Services and Markets Act that swept away the legal professions and left us only with "authorised persons" because as the Legal Services Act reached its final stages there was the run on Northern Rock. Lehman Brothers collapsed less than a year later. The world had changed.

Since 2007 some of the features of the settled legal market I have described above have fallen away. Anyone suitable can own a law firm. Legal services are still sold by the hour but they may also be bundled with other services, sold at a fixed price or only recovered if certain criteria are met. Whilst the traditional law firm model persists, it has been joined by a range of regulated legal services providers who could be financial advisers, insurance companies or even accountants.

Those in house lawyers have continued to grow in number. At the same time the lines between in house and private practice have become more blurred. Some in house teams have sought to widen their net of available work and indeed some have become ABSs. Is a lawyer who works for an insurer but provides advice to his or her employer's customers in house or in private practice?

As the market evolves the risks have also evolved. The old risks are still there but there are also emerging risks in connection with the increasingly complex financial arrangements between legal services providers and their clients and/or third parties. These problems were not brought about by the Legal Services Act¹. In house lawyers also seem to be creeping on to the radar. It turns out that the duty to be independent and the safeguard the administration of justice may be difficult to balance when you also have a duty to act in your employers' best interest². Whilst the behaviour of lawyers in private practice has been the subject of extensive regulation for years, there are real and difficult ethical issues for those working in house that demand a clearer framework.

As the legal services regulators begin to address the new emerging risks it has become apparent that the statutory framework itself is lacking even though it is only 8 years old. The revolutionary nature of the Legal Services Act perhaps disguised some fundamental underlying issues. For example, the Legal Services Act did not grapple with the question of which legal services should be regulated. It simply passported the existing, and sometimes idiosyncratic, regulatory boundaries³. This did not seem a big problem in 2007 but as the market evolves non-regulated and regulated legal businesses are increasingly in competition and the boundary needs to be clear to consumers.

The obvious solution is to regulate more. Legal services sit at the heart of a free society and they need to operate effectively. It would be easy to think that if the scope of regulated legal services was widened then order would be restored.

However, this does not feel like a market that needs more regulation. Yes there are some aspects of legal services that are precious such as representation before a court but most of the rest of the market is simply about consumer protection and therefore no different from many other markets. Some of these have less onerous regulation. There are also some real practical issues. How do you regulate in house lawyers without regulating their employers' business? In any event, the present government is not likely to entertain any extension of regulation. So what is the answer?

The answer is to go back to the essential questions under the existing arrangements: What is regulated? Who is regulated? The debate about the reform of the scope of regulation is predicated on the assumption that the legal regulators need to regulate the legal services market. However, they don't regulate a market. They regulate certain groups of individuals and entities that provide services within that market. To achieve regulation the approved regulators have two levers. Protection of title and protection of some limited functions, the reserved legal activities.

On 10th June Mark Carney, the Governor of the Bank of England made his annual Mansion House speech⁴. I was struck by the phrase he used to describe the cause the many of the City's recent scandals, "ethical drift". One might wonder aloud as to whether this drift was helped by calling professionals "authorised persons" and focussing regulation on the entity and not the individual.

Fortunately for the legal profession, we did not have the second Legal Services and Markets Act and the professional and ethical structures in legal services remain in place. To my mind the future lies not in trying to manage the market whether by separate business rules or heightening the regulation of in house lawyers. The answer lies in re-emphasising the ethical basis of the legal professions. In the case of in house lawyers this will mean working through what are difficult issues as to what is the right thing to do. With a greater emphasis on ethics and the professions that will leave regulators to focus resources on the key risks. That in turn will give consumers a clear understanding of why they may be better off with a regulated professional.

Footnotes

1. See, for example, *Beresford and another v The Solicitors Regulation Authority and another* [2009] EWHC 3155 (Admin) which was one of a number of cases brought by the SRA in relation to firms involved in Miners Compensation Scheme Claims.
2. See *Alistair Brett v The Solicitors Regulation Authority* [2014] EWHC (Admin) which concerned a breach of duty by an in house solicitor to the court.
3. See Mayson and Marley, *The Regulation of Legal Services: Reserved Legal Activities*, August 2010. <https://stephenmayson.files.wordpress.com/2013/08/mayson-marley-2010-reserved-legal-activities-history-and-rationale.pdf>
4. <http://www.bankofengland.co.uk/publications/Pages/speeches/2015/821.aspx>



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