CCBE RESPONSE TO THE SECOND CONSULTATION FROM THE *SOLICITORS REGULATION AUTHORITY* (SRA) ON AMENDMENTS TO RULE 3 (CONFLICT OF INTEREST) AND RULE 4 (DUTIES OF CONFIDENTIALITY AND DISCLOSURE) OF THE SOLICITORS' CODE OF CONDUCT 2007

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CCBE response to the second consultation from the *Solicitors Regulation Authority* (SRA) on amendments to rule 3 (conflict of interest) and rule 4 (duties of confidentiality and disclosure) of the Solicitors' Code of Conduct 2007

The Council of Bars and Law Societies of Europe (CCBE) is the representative organisation of around 1 million European lawyers through its member bars and law societies from 31 full member countries, and 11 further associate and observer countries. The CCBE regularly responds on behalf of its members on policy issues affecting European citizens and lawyers.

The CCBE response to the Second consultation of the *Solicitors Regulation Authority* (SRA) on amendments to rule 3 (conflict of interest) and rule 4 (duties of confidentiality and disclosure) of the Solicitors' Code of Conduct 2007 is as follows[1]:

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I - On the proposed amendments to rule 3 regarding conflict of interest.

Question 1:

By its first question, the SRA asks stakeholders whether it has found the right balance between the exception to rule 3 and safeguarding against risks to clients and the public.

The CCBE believes that this is not the case.

As it had indicated in its response to the first consultation, the CCBE believes that relaxing the rule on the conflict of interest creates more risks than benefits. **This relaxation goes against the interests of clients, which deontological rules are intended to protect.**

It is also harmful to law firms, to the profession and to Europe.

On the interests of the client

The possibility for a client, even a "sophisticated" client to be advised by a law firm which provides services to another client with conflicting interests, shows significant and identifiable risks:

First, the relaxation of the rule of conflict of interest is meant for *"sophisticated clients"*. This relaxation of the rule discriminates based on the client's quality, whether sophisticated or not. Sophisticated clients will not, in fact, be denied the opportunity to choose a law firm advising another client with conflicting interests, whereas non-sophisticated clients will be excluded. These non-sophisticated clients will suffer all the more since they will no longer be able, in some cases, to speak to the few firms which have the necessary expertise since they advise sophisticated clients with conflicting interests.

The effect of this discrimination is exacerbated by the uncertainty around the qualification of *« sophisticated client »*[2]. This phrase would refer to *clients who are lawyers or have access to a company lawyer or who have obtained independent legal advice on the subject matter before giving their informed consent and who are able, according to the firm, to understand the implications arising*

1 The UK delegation officially dissents from the CCBE position at the request of the Law Society of England and Wales. It does so on the principle that the CCBE should not interfere in national matters unless requested to do so by the national delegation concerned. The other members of the UK delegation reserve their position on the substance of the issue.

2 Definition of the term "sophisticated client" given by the draft rule 3.02.4 of the Solicitors' Code of Conduct (p.12 of the draft consultation).

from their agreement that the firm act, on the same topic, for other clients with conflicting interests. It results, from the last part of that sentence, that it ultimately falls to the firm, being a judge and a party to the conflict of interest, to determine whether the client is sophisticated or not, and therefore if he/she may or may not benefit from the relaxed rule.

The protection of citizens will be undermined. However, the equal treatment of clients, whatever their importance, is a fundamental principle of professional practice. There cannot therefore be any different ethical rules depending on the type of client which is addressed.

The CCBE has already taken a stand against discrimination based on the quality of the client in its « *Comments on Commission progress report on competition in professional services* ». This text has been approved unanimously by the CCBE delegations during the CCBE Plenary Session of 19 November 2005. It provides that lawyers are the subject of regulations which are in the public interest, not in the interest of the more or less sophisticated skills of clients who use their services:

"*In the recent financial scandals which shook the US business world – Enron, Worldcom – the users of professional services have been very sophisticated repeat purchasers of these services, but the victims of the crimes committed were ordinary people, such as shareholders, employees, and pensioners, often numbered in thousands.These victims often suffered devastating financial losses, which ruined their lives. The lawyers in important commercial cases are not regulated just so as to protect the sophisticated business executives who use them (although they will also need protection), but in the public interest, which will include people who may have a direct or indirect stake in the outcome of the transaction, even though they are not the actual client*".

The financial scandals which were in part responsible for the economic crisis reflect the keenness and topicality of the position of the CCBE. Bernard Madoff defrauded the most sophisticated clients with a simple "Ponzi scheme" by promising investors very high rates thanks to the money of other investors also attracted by enormous profit until the speculative bubble burst. Therefore, to have a relaxation of fundamental rules of ethics based on the so-called "sophistication" of clients is therefore illusory.

Secondly, the first consultation indicated that the relaxation offered by the "*City of London Law Society (CLLS)*" would be beneficial to clients. It is now *"an erroneous notion of the relationship between lawyers and their clients.(...) First, the principle upon which the legal profession is based is independence, also necessary with regard to the client. A client cannot oblige a lawyer to act contrary to the lawyer's conscience nor code of conduct*"[3].

The CCBE Charter of core principles of the European legal profession recalls in other words the importance of the independence of lawyers towards their clients:

Principle (a) of the Charter, the independence of the lawyer, and the freedom of the lawyer to pursue the client's case:

"(...) *The lawyer must also remain independent of his or her own client if the lawyer is to enjoy the trust of third parties and the courts. Indeed without this independence from the client there can be no guarantee of the quality of the lawyer's work."*

Thirdly, according to the principle of trust, the interest of the client calling upon a lawyer is to obtain the best advice and defence. "*And yet, if the lawyer is subject to different interests, the lawyer would be forced to prioritise them and thus to favour one client at the expense of others*"[4].

This risk is explicitly recognised in the guidance accompanying the amendment of Article 3. Indeed, it predicts that in the circumstances of an unsolvable conflict, it will be impossible for a law firm to advise different clients. The guidance calls for an agreement, whenever possible, between the affected clients and the law firm to predict the consequences of the exacerbated conflict. In this situation, the law firm will choose the client it will continue to advise (page 18, paragraph 10 of the consultation paper).

In this case, *"the second client will be forced to instruct another firm while time has passed and the firm originally instructed has prospered, by the amount of fees earned.*

The second client will have further difficulty in educating the new firm. This will cost more (fees to the former firm and fees to the new firm).

3 CCBE response to the first consultation of the SRA regarding the conflict of interest and confidentiality, p.2.
4 CCBE response to the first consultation of the SRA regarding the conflict of interest and confidentiality, p.2.

The long-term interest of the client is to see all conflicts of interests settled immediately. It would be proper to protect clients through strict conflict of interest rules and not to take into consideration the short-term interest of one particular client[5].

Fourthly, the limited relaxation of the rule on conflict of interest to non-litigation only also generates a new prejudicial risk for conflicting clients receiving advice from the same firm: If the client decides to go to litigation, the relaxed rule no longer applies, and in some cases the firm will have to get rid of one or more of its clients, with the consequences described above. To prevent this, some firms may tend to exclude litigation from their options and to limit as much as possible disputes between clients, thus impacting on their defence.

Fifthly, the supply to clients of legal providers with skills in a particular area will be reduced. Indeed, the relaxation of the rule on conflict of interests will allow law firms of significant size to concentrate on a large number of clients at the expense of other firms wishing to enter the market. This will result in the creation of new oligopolies and strengthening oligopolies in certain fields of specialised activities.

"And yet, every oligopolistic situation necessarily leads to an increase in the price of the service and, sometimes, a decrease in the quality.

Finally, the client who would wish to render their advisor liable, on account of a dereliction of the duty of advice, in the presence of exacerbated conflict of interests, will not instruct other firms who will have exactly the same practices.

Eventually, this will lower firms' levels of professional, ethical responsibility."[6]

The dwindling supply of legal services therefore threatens the long-term interest of clients.

On the interest of firms

The only clearly identifiable interest of the relaxation of rule 3 is to increase the number of clients of the same law firm and therefore its turnover. However, the long-term risks for firms are greater than the benefits possible in the short term:

Firstly, the SRA, to a large degree, puts the assessment of the compliance with the relaxed rule on the law firm which benefits from the relaxation. This creates an initial conflict of interests within the firm which must mediate between, on the one hand, respect for ethical rules, of which it becomes the guarantor, and secondly, the business purpose to increase its profits. In a competitive market, it is likely that the arbitration will be in favour of the second objective, to the detriment of the standard of service provided to the client and the respect of ethical rules.

Secondly, none of the provisions in the consultation document seem to be able to prevent this risk. The control of conflicts of interest by an independent authority, if necessary, will be done *a posteriori*, once the conflict is declared. This unnecessarily increases the liability of the law firm. However, prevention is better than cure, therefore it is better to limit or prohibit the right for a law firm to act for conflicting clients.

Thirdly, the relaxed rule on conflicts of interest will only benefit structures of a certain size, which can fit legal requirements. The application of this rule could create conflicts between associates, or the firm would be likely to split (see p.3 as in the first CCBE response).

Furthermore, the relaxed rule introduces discrimination based on the size of firms: firms with sufficient resources to comply with the relaxed rule will be able to advise clients in situations of conflict while those which do not, will not be able to do so. Combined with discrimination based on the quality of clients - sophisticated or not - this creates a two-tiered ethics: one applicable to firms of a certain size advising sophisticated clients, and another applicable to other law firms advising unsophisticated clients.

5 CCBE response to the first consultation of the SRA regarding the conflict of interest and confidentiality, p.3.
6 CCBE response to the first consultation of the SRA regarding the conflict of interest and confidentiality, p.3.

On the interest of the profession

First, the relaxed rule is explicitly intended for a limited number of firms, mainly for the large-scale structures based in London. As the CCBE indicated in its first response, *"a minority of law firms, certainly amongst the largest, would impose an amendment of a rule, already accepted by all the regulations, to the detriment of the majority"*[7].

This relaxation would result in a lessening of public confidence in general, and of clients in particular towards the legal profession. It would occur at the least favourable time, i.e. after an economic crisis which revealed that the market failure was principally caused by a lack of regulation.

Secondly, the amendment of Article 3 introduces a distinction between litigation and counselling, the latter being the only activity covered by the relaxation. To preserve the unity of the profession, the application of different ethical rules based on the field of activity should be minimised.

On the interest of Europe

The prevention of conflicts of interest is an essential rule for all European Bars. The Charter of Core Principles of the European legal profession emphasises the fundamental nature of this rule:

"Principle (c) - avoidance of conflicts of interest, whether between different clients or between the client and the lawyer:

For the proper exercise of his or her profession, the lawyer must avoid conflicts of interest. So a lawyer may not act for two clients in the same matter if there is a conflict, or a risk of conflict, between the interests of those clients. Equally a lawyer must refrain from acting for a new client if the lawyer is in possession of confidential information obtained from another current or former client. Nor must a lawyer take on a client if there is a conflict of interest between the client and the lawyer. If a conflict of interest arises in the course of acting for a client, the lawyer must cease to act. It can be seen that this principle is closely linked to principles (b) (confidentiality), (a) (independence) and (e) (loyalty)."

This principle is transcribed in paragraph 3.2 of the Code of Conduct for European lawyers, which provides that:

"3.2. Conflict of interest

3.2.1. A lawyer may not advise, represent or act on behalf of two or more clients in the same matter if there is a conflict, or a significant risk of a conflict, between the interests of those clients.

3.2.2. A lawyer must cease to act for both or all of the clients concerned when a conflict of interests arises between those clients and also whenever there is a risk of a breach of confidence or where the lawyer's independence may be impaired.

3.2.3. A lawyer must also refrain from acting for a new client if there is a risk of breach of a confidence entrusted to the lawyer by a former client or if the knowledge which the lawyer possesses of the affairs of the former client would give an undue advantage to the new client.

3.2.4. Where lawyers are practising in association, paragraphs 3.2.1 to 3.2.3 above shall apply to the association and all its members."

The proposed amendments go against the CCBE Code of Conduct. Moreover, *"it could lead to hindering the creation of a European Code of Conduct under the aegis of the CCBE which constitutes, at the time of globalisation of legal services, freedom of movement of services which is a genuine demand from clients and a necessary harmonisation of Europe for lawyers"*[8].

7 CCBE response to the first consultation of the SRA regarding the conflict of interest and confidentiality, p.4.
8 CCBE response to the first consultation of the SRA regarding the conflict of interest and confidentiality, p.4.

Question 2:

By its second question, the SRA asks stakeholders whether the rules and guidance proposed in the consultation protect against the three main risks:

- that the requirements of Article 1 of the Solicitors' Code of Conduct are not adequately met,

- that the client does not have the knowledge or experience necessary to understand the arrangement fully, and

- that confidential information leaks.

On the fulfillment of Article 1 of the Solicitors' Code of Conduct

Article 1 of the Solicitors' Code of Conduct provides the basic obligations of Solicitors (Core duties). Solicitors and law firms to whom these requirements apply aim to serve both *"clients and society"* (paragraph 1 of rule 1).

These obligations include integrity, independence, interests of clients, standard of service and public confidence.

The CCBE believes that relaxing the rule on conflict of interest undermines the obligations under Article 1 of the Code of Conduct and that it is highly detrimental to clients.

Following on from its previous response, the CCBE considers in particular that this relaxation goes against the independence of lawyers, particularly with regard to clients. The convergence of interests, including economic ones, within the same firm which advises clients in situations of conflict is likely to harm the standard of service provided.

This relaxation will also go against, for the above reasons, the interests of clients and public confidence in the profession.

On the opportunity for the client to knowingly decide

The evolution of a conflict of interest being by nature unpredictable, clients - even sophisticated ones - are unable to give informed consent.

Where the risk of unmanageable conflict occurs, the disastrous consequences for the client are the same, be the client sophisticated or not.

Therefore, it is impossible for a client to make informed choices. In addition, limiting the relaxation of the rule to sophisticated clients only does not give additional protection against the risk of an exacerbated conflict.

On the leakage of confidential information

The consultation acknowledges that the protection of a client's confidential information is "fundamental" (e.g., page 6, paragraph 2.3.11). The Charter of core principles of the European legal profession clarifies the scope of this principle:

"Principle (b) - the right and duty of the lawyer to keep clients' matters confidential and to respect professional secrecy:

It is of the essence of a lawyer's function that the lawyer should be told by his or her client things which the client would not tell to others - the most intimate personal details or the most valuable commercial secrets - and that the lawyer should be the recipient of other information on a basis of confidence. Without the certainty of confidentiality there can be no trust. The Charter stresses the dual nature of this principle - observing confidentiality is not only the lawyer's duty, - ***it is a fundamental human right of the client.***"

However, the risk that confidential information may be used against the interests of a client is *de facto* increased when the same law firm advises clients with opposite interests.

The consultation paper provides some measures to prevent this risk by informing the client, having a written agreement on the measures to put in place to ensure the confidentiality of information.

Whatever the technical and organisational means set up within a firm are, it is difficult to keep associates and employees of one firm from communicating, to the detriment of client confidentiality. This raises the question of the control of such confidentiality within the structure. This control is likely to be biased in the case where the firm is both judge and party.

Moreover, the confidentiality of information might oppose the concept of informed client consent. For a client to be able to decide knowingly, he/she will ask the firm a certain quantity of information on other clients with conflicting interests. Here, again, there is a risk of breach of confidentiality which the firm will have to officiate. This risk would not exist were it forbidden for a structure of practice to act in conflict of interest situations.

Question 3

By its third question, the SRA asks stakeholders if it has struck the right balance between the essential conditions established in rule 3 and the guidance which interpret it.

The CCBE does not approve the content of the proposed amendment and does not consider it useful to answer this question.

Question 4

By its fourth question, the SRA asks stakeholders if certain aspects of the consultation paper could be clearer.

The CCBE does not approve the content of the proposed amendment and does not consider it useful to answer this question.

II - On the proposed amendments to rule 4 concerning confidentiality.

The CCBE believes that it is useful to begin by answering question 7.

Question 7

By its question 7, the SRA asks whether the protection provided by the amended rule 4 and the accompanying guidance are adequate.

As a reminder, Article 4, currently in force, allows a law firm keeping confidential information from a client to take instructions from a new client in conflict with the first client, in two cases:

- Clients give the firm informed consent and agree on measures to protect the confidentiality of their information.
- It is impossible to obtain informed consent from the client whose information need to be protected, but the law firm has already started to advise the new client when the problem appears. In this case, the firm can advise both clients on the condition that it establishes a Chinese wall according to the Common Law requirements.

The amendment of Article 4 would extend this second option if the firm is aware that it cannot obtain the consent of the client whose information must be protected. This extension depends on the establishment of a Chinese wall.

The CCBE wishes first to emphasise that for a client to be able to give informed consent, it is necessary that the firm previously provides him/her with information of other clients with conflicting interests it advises. The disclosure of this information could clearly be contrary to the obligation to protect confidentiality.

This assumption is explicitly envisaged by the consultation, which allows law firms to spare themselves informed consent when it is not possible, provided they set up a Chinese wall.

The CCBE believes that setting up a Chinese wall cannot overcome the risks related to confidentiality posed by the possibility for a law firm to advise clients with conflicting interests.

This practice is particularly reprehensible since it is unknown to the client, who cannot be informed of the situation.

The CCBE explained in its first response the reasons for which setting up a Chinese wall is insufficient to prevent the risks incurred by the client:

- The competitive environment between firms goes against the observance of the Chinese walls which would be established;
- The identity of economic interests of a same firm, although it has independent teams, and friendships between associates may also have the same effect;
- The mobility of young solicitors, who go from law firm to law firm, shows the artificiality of a Chinese wall.

The CCBE therefore believes that the protection under Article 4 is insufficient. The amendment of Article 4 would go *"against the interest of the client and, in the long term, against the interest of the firm which would lose the trust of its clients*"[9].

In addition, as indicated by the consultation, the establishment of Chinese walls is only achievable in a firm with necessary resources. In the same way as for rule 3, the amendment to rule 4 discriminates based on the means of a law firm. Less well-off firms will have less favorable ethics as they are excluded from the benefits of a relaxed rule 4.

The CCBE believes that, combined with a relaxation of the rule on conflict of interest, the relaxation of the rule on confidentiality goes against the loyalty of lawyers towards their clients. The principle of

9 CCBE response to the first consultation of the SRA regarding the conflict of interest and confidentiality, p.7.

loyalty indeed requires that the client can "*trust the lawyer as adviser and as representative. To be loyal to the client, the lawyer must be independent (see principle (a)), must avoid conflicts of interest (see principle (c)), and must keep the client's confidences (see principle (b))*"[10].

Question 5

By its fifth question, the SRA asks stakeholders whether it is necessary to add anything further to rule 4 and the accompanying guidance to make the position clearer.

The CCBE does not approve the content of the proposed amendment and does not consider it useful to answer this question.

Question 6

By its sixth question, the SRA asks whether it is necessary to better explain the use of the exception provided under rule 4.04. Is it clear that the 4.05 exception is intended to be a last resort?

The CCBE does not approve the content of the proposed amendment and does not consider it useful to answer this question.

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In conclusion, the Council of Bars and Law Societies of Europe considers, as expressed in its first response, that amendments to the rules of conflict of interest and confidentiality may clearly lead to weakening of ethical standards which ensure client confidence.

10 Charter of core principles of the European legal profession, principle (e) - loyalty to the client.