



CCBE RESPONSE TO THE SOLICITORS REGULATION AUTHORITY'S CONSULTATION ON NEW FORMS OF PRACTICE AND REGULATION FOR ALTERNATIVE BUSINESS STRUCTURES

CCBE response to the Solicitors Regulation Authority's consultation on new forms of practice and regulation for alternative business structures

I. Introduction

The Council of Bars and Law Societies of Europe (CCBE), through its member bars and law societies, represents more than 700,000 European lawyers.

In this capacity the CCBE wishes to comment, from a European perspective, on the issue of non-lawyer owned firms as discussed by the Solicitors Regulation Authority (SRA) of England and Wales in its consultation paper on regulating alternative business structures (ABS): ABSs in this sense are business structures which "enable lawyers and non-lawyers to share the management and control of a business which provides reserved legal services to the public." (3.1)

While the SRA, in response to the Legal Services Act 2007 (the Act), no longer discusses whether it is desirable at all to grant licenses to non-lawyer owned or non-lawyer managed business structures providing legal services, and merely wants to learn how such business structures should be regulated, the CCBE has always taken the view that in the best interest of clients, including consumers, the introduction of such business structures should be avoided.

The SRA consultation focuses on ABSs as opposed to Legal Disciplinary Practices (LDPs). LDPs of mixed kinds of lawyers, and with up to 25 per cent non-lawyer managers, have already been regulated and some are already in existence.

II. SRA Consultation Paper Objectives

The SRA, like the Legal Services Board (LSB), is clear about its objective that the first ABS licenses will be granted by mid-2011. The intention is to open the legal services market to non-lawyers and facilitate new entry in such a way that non-lawyer entrants into the market would work together with lawyers to provide legal and other services within a single ABS. Such business structures need to be licensed to be allowed to provide reserved legal services.

The SRA's approach starts from three assumptions:

- the prompt liberalisation of legal services as set out in the Act is assumed and in the SRA's eyes to be welcomed in the public interest;
- the debate should concentrate upon the desired outcomes for consumers and how regulation can best assure those outcomes;
- there should be no assumption that traditional business structures are inherently safe and new structures are inherently risky.

While we may share the view that the debate should concentrate upon the desired outcomes for clients and how regulation can best assure those outcomes, we disagree in so far as we believe that the discussion between the SRA and European bars and law societies outside England and Wales will have to include the question of whether ABSs are qualified at all to improve access to justice or promote consumer interests in any other way. Furthermore, it is anything but obvious to us that opening the legal services market to non-lawyers could be the appropriate means to encourage an independent, strong, diverse and effective legal profession. In our eyes existing law firms from England and Wales have proven to be very competitive and economically successful abroad.

The SRA, like the LSB, seem to take it for granted that market mechanisms will bring about additional benefits once the market has been opened to non-lawyers. The consultation paper does not explain however why the same market mechanisms do not or would not bring about the same benefit within the existing competition between solicitors, barristers, and other professions in the legal services market. These professions are organised into very different business structures such as sole

practitioners, small and medium-sized law firms, as well as Magic Circle firms. This approach may be due to the fact that the Act itself is actually based on the assumption that existing legislation and professional rules have constrained consumers and restrained normal market pressures on law practices (1.2). This may also explain why the authors of the LSB discussion paper consider that opening the legal services market to non-professionals will undoubtedly bring about advantages, while they assume that these business structures do not constitute additional risks for clients' interests.

The SRA identifies three types of ABS that it considers likely to emerge:

1. firms, which are basically like traditional law firms or LPDs, but with involvement of one or more individual non-lawyer managers (which may not be limited, as now, to 25 per cent ownership or control, without external ownership, and providing solicitor-type services only);
2. complete or partial external ownership with the legal services being provided through a so-called ring-fenced entity;
3. combinations of different services within one entity, the MDP model.

It is to be understood that for all three structures it is envisaged that solicitors practise under their professional title.

III. CCBE views on LDPs / MDPs and ABSs

From a European perspective, the view is quite different. Legislation and professional regulatory rules in all EU Member States have, within a short period of time, been liberalised to an extent that was unimaginable a few decades ago. The number of practising lawyers in most Member States has more or less exploded and competition has intensified. Regulations that restricted legal services locally have been removed. Through the Lawyers' Services Directive (77/249/EEC) in conjunction with other instruments, lawyers and law firms from EU Member States can provide legal services in 30 European states, with even more jurisdictions, including practice in the respective national law in all jurisdictions concerned. Due to the European Lawyers' Establishment Directive (98/5/EC), individual lawyers and law firms can establish a practice in any Member State. Thus, legal services markets have been extended enormously.

Liberalisation of Member State regulations and increasing competition have brought about significant changes in the way legal services are offered, as well as changes to the structure of existing law firms. The process will continue not only due to competition but also due to a changed perception of professional conduct rules. Whereas in the past professional rules focused on the profession, and to a certain extent served the interests of the professionals themselves, nowadays it is common ground that professional rules can solely be justified by reasons relating to the public interest, especially the protection of clients and the proper administration of justice. What used to be regarded as a privilege of the lawyer can only be upheld if it in fact protects clients or is necessary to serve other reasons in relation to the public interest. Likewise, restrictions to the way in which law is practised by individual members of the profession must be justifiable in a public interest, like the requirements for the proper administration of justice or client protection. We believe that any further development that might be necessary to meet clients' needs will be achieved within the existing European legal services market provided by the respective legal professionals in an increasing number of law firm structures, and do not see any advantage for clients if the market is opened for non-lawyers.

Legislation and professional regulatory rules differ from Member State to Member State. But all jurisdictions have in common the concept of the legal profession's core values protecting the client's interest, and at the same time guaranteeing the proper administration of justice: independence, confidentiality, and the avoidance of any conflict of interest. In addition to these professional conduct safeguards, competition as well as professional rules have substantially improved the quality of legal services, notably by means of continued professional training and specialisation. Within a few decades the legal profession has adapted to changes in society and clients' needs, and has within a very short period of time undergone more substantial changes than in the whole century before. In the eyes of almost all Member State legislators, as well as in the eyes of the profession itself, it seems evident that this desirable evolution progresses within the existing system of the legal profession, whereas the benefits of opening the market to non-lawyers are uncertain and could compromise the integrity of the legal profession.

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IV. European legal framework

Articles 43, 49, and 56 EC grant freedom of establishment, freedom to provide services, and prohibit all restrictions on the movement of capital between the Member States. These provisions are subject to certain conditions laid down in Articles 44-48, 50-55, and 57-60 EC.

Restrictions on the freedoms of establishment, service, and on the free movement of capital can also derive from Member State regulation, when justified by overriding reasons of public interest, provided that these restrictions are applicable without discrimination on the grounds of nationality, are appropriate for securing the objective pursued, and do not go beyond what is necessary for attaining that objective.

To achieve the liberalisation of specific legal services (as provided for by Article 52 paragraph 1 EC and Article 44 paragraph 1 EC), the European institutions have adopted the Lawyers' Services Directive 77/249/EEC and the Lawyers' Establishment Directive 98/5/EC. Both Directives contain an exhaustive list of professions considered to be lawyers in the sense of the Directives. As far as the United Kingdom is concerned, the Directives are applicable to Advocates, Barristers and Solicitors. Both Directives address the individual members of the listed professions, and joint practices of lawyers, as defined in the Directives, are authorised in all jurisdictions.

The situation is different, however, for business structures in which some persons are not members of the profession. Under Article 11 paragraph 1 point 5 Directive 98/5/EC, a Member State may refuse to allow a lawyer registered under his home-country professional title to practise in its territory, in his capacity as a member of his grouping, insofar as it prohibits lawyers practising under their own professional title from practising in such business structures. In fact, almost all European jurisdictions have chosen to do so. Most jurisdictions prohibit all business structures where persons who do not have the status of lawyer within the meaning of the definitions given in both Directives hold entirely or partly the capital of the grouping, use the name under which it practises, or exercise de facto or de jure the decision-making power.

Some European jurisdictions allow LDPs and Multi-Disciplinary Partnerships (MDPs) under certain conditions. In some jurisdictions non-lawyers may become partners of a law firm if they are members of a regulated profession whose professional code of conduct is comparable to that of the legal profession. Where LDPs or MDPs exist, this does not necessarily imply that clients will enjoy the benefits of a "one-stop-shop" where the whole range of services of all professions present in the LDP or MDP can be demanded. In Germany for example, where MDPs have a long tradition, the different roles and responsibilities of lawyers, notaries, and auditors often leads to incompatibilities: if a notary has assisted the concerned parties in conveyancing or any other contract, his partners must neither advise nor represent any of the parties involved if questions about the interpretation or the validity of such contract arise; if lawyers have advised or represented one party in a due diligence or in contractual negotiations, their notary partner is prohibited from notarising the contract that his lawyer partners have negotiated. An auditor may be prohibited from auditing a company that relied on his partner's advice, or his drafting of contracts and similar activities to the extent that the auditor would have to evaluate the outcome of his partner's activities. The view is that the auditor's independence in this case would be compromised, while the notary's impartiality towards all parties concerned and the lawyer's duty to act in the sole interest of the client are incompatible.

Thus, in many cases the client's expectations cannot be met and the "one-stop-shop" will be perceived as being a form of deceptive packaging. On the other hand, the absence of these strict rules would compromise the integrity of all professions involved.

Whereas LDPs and MDPs are accepted to a certain extent, Member State legislators outside the UK are not likely to come to the conclusion that ABSs could be helpful to improve the scope of legal services as demanded by consumers and other clients. France, Italy and Denmark seem to accept non-lawyers, who earn their living in a law firm, becoming partners of that very law firm. The only Member State which accepts external capital in law firms, to a certain extent, is Spain. There is no evidence yet whether such Spanish firms will be regarded as law firms by other European jurisdictions.

Under Article 11 paragraph 1 point 5 of the Lawyers' Establishment Directive 98/5/EC, if the same prohibition is applied to home-state lawyers, a host Member State may refuse to allow European lawyers to practise in its territory in their capacity as a member of such a grouping.

If a Member State applies Article 11 paragraph 1 point 5 to LDPs, MDPs and ABSs, the question arises whether primary European law – the EC treaty - as interpreted by the ECJ could be in conflict with the provisions of the Directive.

The ECJ has recently held, in *Commission vs. Italy (C-531/06)* – which concerned pharmacists, not lawyers – that Member States may take the view that the interests of a non-pharmacist in making a profit would not be tempered in the same way as those of a self-employed pharmacist would be (para. 84), if non-pharmacists were to be allowed to acquire stakes in pharmacies, or if non-pharmacists were to be allowed to run retail pharmacies, and rules designed to ensure the professional independence of pharmacists would not be observed in practice. In the absence of EC directives or regulations dealing with the ownership of pharmacies, the ECJ examined the Member State legislation in the light of the EC treaty alone, i.e. the freedom of establishment and the free movement of capital. Although the Member State legislation considered in the case restricts both freedoms, according to the ECJ these restrictions can be justified by overriding reasons in the public interest.

Although it is undeniable that lawyers, like other persons, will have the objective of making a profit, due to their professional status lawyers - like pharmacists (para. 61) - are presumed to operate their law firm not with a purely economic objective, but also from a professional perspective. Their private interest connected with the making of profit is thus tempered by their training, by their professional experience, and by the responsibility which they owe, given the fact that any breach of the legal rules of professional conduct undermines not only the value of their investment but also their own professional existence.

It seems evident to us that non-lawyers who invest their money in ABSs can neither be expected to be in that situation, nor can they be expected to refrain from the legitimate demand to influence the firm's policies and to seek the economically appropriate return on investment.

The overriding reasons relating to the public interest are, of course, different in the lawyer's case. It is not the protection of the public health that is at stake. In the absence of specific Community rules in this field, the ECJ has consistently held that Member States are free to regulate the exercise of the legal profession in their respective territories (*Wouters C-309/99* para. 99). The overriding public interest reasons are the sound administration of justice, protection of the ultimate consumers of legal services, in conjunction with the necessary guarantees in relation to the lawyers' integrity and experience. Rules applicable to the legal profession may greatly differ from one Member State to another. Thus, there is no conflict between the provision of Article 11 of the Lawyers' Establishment Directive and primary European law.

The fact that freedom of establishment is guaranteed for companies as well as for individuals does not have an impact on this. Restrictions of companies' freedom of establishment can be justified for the same overriding reasons relating to the public interest as restrictions of natural persons' freedoms (*Inspire Art C-167/01* para. 107; *Centros C-212/97* para. 26). The ECJ makes a clear distinction: where the host-state rules of company law must not be applied, provisions concerning the carrying on of certain trades, professions, or businesses of the host state may, under certain conditions, restrict freedom of establishment (*Inspire Art* para. 121; *Centros* para. 26).

Thus, ABSs will be able to be established abroad and provide legal services, where these services in the host state do not fall within the scope of reserved activities. The scope of reserved activities differs from one jurisdiction to another.

Another question is whether legal services can be offered as lawyers' services. We expect that a large majority of jurisdictions will apply Article 11 paragraph 1 point 5 Directive 98/5/EC to ABSs. The effect would be that even advocates, barristers, and solicitors practising within an ABS could not provide legal services under their professional title in a large number of European jurisdictions.

V. Conclusions

The CCBE would advise, if this were the question put forward by the SRA, not to go ahead with the ABS project. We understand however, that the decision to license such business structures has been taken by the Act and is assumed from the SRA's point of view.

Regulating LDPs and MDPs already requires a delicate balancing of interests, economic and non-economic. We see the lawyer's duties to maintain independence, to avoid conflicts of interest, and to respect client confidentiality endangered if non-lawyers are allowed a significant degree of control over the affairs of the firm. Different roles, different professional rules, and different reserved activities constitute conflicts that need additional and more detailed regulation.

Non-lawyers, who do not practise as regulated professionals themselves, constitute additional risks to clients and the due administration of justice. The public's perception of their participation as investors, or Heads of Legal Practice, or both, could compromise the integrity of the business structure as a whole. The way in which legal services are delivered has effects not only on the clients themselves but also on the judiciary and third parties. It is of utmost importance, that not only clients but also courts, the public sector, and even the adverse party in a conflict can rely on the lawyer's integrity.

Lawyers in most jurisdictions are obliged to accept instructions that, from a purely economic perspective, are not profitable e.g. legal aid. The client needs to be confident that its case, even under these circumstances, is given the necessary attention. Where mere economic aspects seem to prevail, doubts will arise whether the defence of clients' rights is taken more seriously than other interests, even where the regulation stipulates that the company's duty to the court will prevail over all other duties, and the duties to its clients will prevail over the duty to the shareholders.

The SRA seems to be aware of the fact that ABSs need additional and more detailed regulation, and envisages that supervisory visits by the regulator may become necessary (1.1). If opening the legal services market has to go hand-in-hand with additional, more complicated and probably less transparent regulation, as well as regulators interfering in day-to-day practice, there are concerns whether this really constitutes a liberalisation and is in the interest of the consumer.

It may be preferable to have fewer, but clear and strict, professional rules which are transparent for lawyers as well as for clients. We share the view that punishing non-compliance should not be the only outcome of regulation. We believe that less complicated, clear, and transparent rules deriving from the European core values of the legal profession are more apt to support and encourage firms to comply with professional rules, than the entry of non-lawyers combined with more detailed regulation and supervisory visits.

If ABSs are licensed, it should be made transparent to clients that these structures are not law firms, and it should be mandatory to make this obvious in the company's firm name. In addition, due to the fact that lawyers will practise within these structures under their professional title, the regulation of ABSs should provide for the following rules:

- The possibility that different activities of the ABS could be incompatible should be regulated in the sense that instructions, that are incompatible with other instructions already accepted by a member of the business structure, must not be accepted by another member practising within the same firm;
- The observation of lawyers' professional duties must be made mandatory by state regulation, not only by contract, for all natural persons holding shares or working within the structure.

The CCBE thus agrees with the SRA's intention to regulate law firms, LDPs, MDPs, and ABSs, as well as individuals, so that the code of conduct and other relevant rules and regulations, including enforcement and disciplinary powers, are directly applied to the firm itself, and to all managers and employees.