Welcome
31 March 2009 saw two major changes to the way that law firms can practice and to how they are regulated. Since that date firms have been able to become Legal Disciplinary Practices. In addition, the Solicitors Regulation Authority has moved towards firm-based regulation in its oversight of law firms. In this @risk we examine these two changes.

Legal Disciplinary Practices

What are they?
In Legal Disciplinary Practices (‘LDPs’) both lawyers and non-lawyers can be ‘managers’. ‘Manager’ is the slightly strange name given by the Legal Services Act 2007 to partners in partnerships, members of LLPs and directors of companies.

The ‘lawyer’ element of managers doesn’t just mean solicitors. Other ‘lawyers’ who can be managers in LDPs are: licensed conveyancers; legal executives; notaries public; patent and trade mark agents and law costs draftsmen. Barristers won’t be able to become managers until the Bar Standards Board amends its Code of Conduct.

Non-lawyers can also be managers in LDPs provided they do not make up more than 25 per cent of the ownership and management. 75 per cent of the ‘management and control’ must be in the hands of lawyers.

The upshot of all of this is that it is now possible to make legal executives, licensed conveyancers, finance/HR/IT directors, practice managers etc, partners, members or directors of your firm.

What are the requirements?
The ‘management and control’ requirement is that:

- at least 75% of the ‘managers’ must be lawyers or ‘legally qualified bodies’;
- lawyers must make up at least 75% of the ultimate beneficial ownership;
- lawyers and/or ‘legally qualified bodies’ must exercise, or control the exercise of, at least 75% of the voting rights.

The 25 per cent restriction on non-lawyers means that small law firms won’t be able to appoint such individuals as managers. A sole practitioner cannot take on his or her secretary as a partner, just as a two partner firm cannot take on a non-lawyer partner as the 75 per cent lawyer manager requirement would not be met.

With non-lawyers only being allowed to have 25% of the voting rights in an LDP, the Law Society practice note on firm-based regulation cautions that it ‘is in the best interests’ of practices that voting arrangements are both ‘clearly defined and transparent’. It goes on to warn that ‘the SRA and the Solicitors Disciplinary Tribunal will take a dim view of complex voting arrangements employed to provide non-lawyer managers with, effectively, a greater share in the ownership of the practice than is permitted in the Rules’.

Prior to appointing a non-lawyer manager, a firm must apply to the SRA for approval of the individual and must satisfy the SRA that the individual is fit and proper to take on the role. This is similar to the FSA’s ‘approved person’ test. It includes a criminal records check and requires information such as: employment history for the previous five years; directorships for the previous ten years; business interests that may conflict with the role of manager; past regulatory investigations; county court judgements; previous regulatory refusals.

What the SRA’s test does not do is establish whether the individual is competent for their intended role. That’s something for the appointing firm to decide upon; it’s a risk management issue in itself.
Non-lawyers cannot simply be investors in LDPs. They must be managers. Pure investment from outside sources won’t be permitted until Alternative Business Structures (ABS) become possible in 2011 or 2012.

When it comes to non-solicitor lawyers, no SRA approval is required prior to appointment. However, you must obtain written confirmation from the relevant regulator (e.g. the Bar Standards Board, the Council of Licensed Conveyancers, the Institute of Legal Executives) that the lawyer is entitled to practice, and is not subject to conditions that would preclude that person from becoming a manager.

LDPs regulated by the SRA cannot be solicitor free. Whilst lawyers must make up at least 75 per cent of the managers there is a requirement for at least one manager to be a solicitor with a current practising certificate or a Registered European Lawyer ('REL'). For LDPs which are partnerships or LLPs made up of limited companies, at least one of the corporate partners or members must have a solicitor or REL as a director.

What can LDPs do?
LDPs regulated by the SRA can only provide services that can be provided by solicitors, notaries and foreign lawyers. An example in the Law Society practice note on LDPs is that of an accountant within an LDP; he or she may not provide company audit services to clients because that is outside the scope of a solicitor’s practice. However, the accountant may provide the firm’s clients with tax advice, general accounting services, management advice, or investment advice within the limits of the Solicitors’ Financial Services (Scope) Rules 2001 because all these activities are within the scope of a solicitor’s practice.

Non-lawyer managers are prohibited by Rule 12.06 of the Solicitors’ Code of Conduct from being held out in any way as a lawyer and from undertaking certain reserved legal work including:
- advocacy in open court or in an immigration tribunal
- the conduct of litigation or immigration tribunal proceedings
- notarising documents
- administering oaths

However, non-lawyer managers are permitted to undertake other reserved or unreserved legal work under adequate supervision, including:
- giving legal advice
- advocacy in chambers
- preparing legal documents

Changes to structure
LDPs are required to notify the SRA within seven days of any change of manager.

Where a change results in non-lawyers constituting more than 25 per cent of the managers or having more than a 25 per cent stake in the firm, the LDP has 28 days to ‘correct the situation’. This is likely to cause greatest difficulty for small firms, where choosing a partner can be akin to choosing a spouse. For example, in a four partner firm, which has one non-lawyer partner, if one lawyer partner dies or leaves, the firm will quickly have to replace that lawyer partner or de-equitise the non-lawyer partner. Small firms should consider a clause in the non-lawyer partner’s contract that the lawyer managers have the option to require him or her to cease being a manager in the event that the regulatory requirements will be breached.

Systems and procedures
Any firm thinking of becoming an LDP should be reviewing its office manual to check whether any changes to the structure of the firm will necessitate the manual being updated. For example, if the manual currently states that only partners are authorised to give undertakings on the firm’s behalf, should this be amended so that only solicitor or lawyer partners can do so?

Non-solicitor managers will have the right to handle client money and will be subject to the Solicitors Accounts Rules. They will share in the liability of all the managers in the firm for any loss of client money. It’s vital therefore that before allowing anyone to handle client funds, he or she is provided with training on the Rules and with the firm’s processes.

Management training
If appointing someone new (whether lawyer or non-lawyer) to the position of manager, some formal management training wouldn’t go amiss. Management skills don’t always come naturally. You want to ensure that the individual has the appropriate skills to perform his or her ‘manager’ role successfully.
Choice of regulator
It is possible to move to a regulator other than the SRA but to do so a firm would have to cease being a solicitor firm. This will trigger the run-off provisions of the Minimum Terms and Conditions in the Solicitors’ Indemnity Insurance Rules.

Regulators can only regulate firms that provide services for which they are the approved regulator. For example, the Council of Licensed Conveyancers (CLC) currently regulates licensed conveyancing firms that undertake conveyancing and probate services. Those firms cannot provide other legal services to clients even if they have a solicitor manager.

Any solicitor working in a non-SRA regulated firm will have their work for the firm regulated by the firm’s regulator, e.g the CLC. However, the solicitor will still need a practising certificate from the SRA and will remain subject to rule 1 (core duties) of the Solicitors’ Code of Conduct.

LPDs – the response so far
Very few firms have become LDPs to date. This is in contrast to the SRA’s prediction at the end of last year that hundreds of firms would become LDPs in 2009. Numerous reasons have been suggested for this low take up, including:

- with many firms facing reduced fee income and making redundancies, there are not many practices looking to appoint new managers;
- potential managers may be reluctant to inject capital into law firms given the current economic situation;
- solicitors generally remain reluctant to give ownership roles to non-solicitors;
- allowing non-solicitors to be managers may cause problems for firms with offices in other jurisdictions where non-lawyer ownership may be in breach of local rules;
- LDPs are a temporary measure and will eventually be superseded by Alternative Business Structures. Some firms may be waiting to see how the ABS regime will operate before committing to LDPs.

If you plan to appoint any non-solicitor managers then please tell us. We do need to know.

Firm-based regulation
On 31 March the SRA moved towards a system of firm-based regulation. This has empowered the SRA to regulate and impose sanctions not just upon individual solicitors but also upon both legal practices and any non-solicitor managers and employees of such practices. Previously the SRA focused on the qualification, discipline and regulation of individual solicitors. Firm-based regulation is not a new concept – the FSA regulates employers as well as employees.

Recognised bodies
In order to facilitate the move to firm-based regulation, the SRA now requires all solicitor firms to be ‘recognised bodies’.

Law firms practising as LLPs or limited companies have long been required to be recognised bodies registered with the SRA. Since 31 March partnerships have also been required to be recognised. Existing partnerships will have been ‘passported’ to become recognised bodies by the SRA and will automatically have had their records updated to reflect their new status.

Existing sole practitioners will be passported to become ‘recognised sole practitioners’ from 1 July 2009. Recognition is renewable annually with the first renewal in November 2009.

Code of Conduct
Since the SRA now regulates firms as well as everybody within them, the Code of Conduct now applies to firms themselves as well as to all managers and employees of such firms. The Law Society practice note on firm-based regulation points out that where there is a breach of the Code, the SRA now has the power to determine whether the breach arose because of a failing of the individual manager or employee, a systematic failure of the practice, or a combination of both. It can take action, including reference to the Solicitors’ Disciplinary Tribunal, against individuals and/or the firm itself.

Since the Code will apply to everyone within your firm, not just solicitors, it would seem logical for training on the Code to be rolled out throughout the entire firm. The Law Society practice note states that practices should ensure that:

- ‘all employees receive an appropriate level of training and guidance in relation to their responsibilities under the Code’; and
- ‘the practice has necessary systems in place to minimise the risk associated with breaching the rules and requirements of the Code’.
Information
All law firms will have to provide the SRA with information about their businesses annually at practicing certificate renewal time. This is likely to include information concerning: ownership; turnover; work types; equality, complaints; training. It’s possible that the SRA will use the information received to monitor closely those firms that they identify as posing a risk to the public. It’s imperative therefore, that you provide all the required information and present your firm in the best possible light.

Regulatory approach
There are different views about how firm-based regulation will operate in practice. The Law Society has urged the SRA not to impose a heavy regulatory burden by taking action against both firms and individuals. The Law Society has stated that this would be the 'worst of both worlds' as firm-based regulation should 'prevent individuals from being blamed for the failures of the organisation'. The Society has also pointed out the danger of the SRA pursuing 'all avenues of redress until they get the required result rather than choosing the correct approach in the first place'. In contrast, some legal commentators have expressed concern that the SRA will concentrate on taking disciplinary action against firms to the exclusion of action against individuals. It remains to be seen exactly what approach the SRA will adopt, but what is clear is that it now has significantly more power to take action against firms and all those who work within them. Knowledge of, and compliance with, the Code of Conduct by everyone in your firm has never been more critical.

The future – Alternative Business Structures
Alternative business structures will be able to carry out a broader range of both legal and non-legal services. They will allow non-lawyers, including commercial organisations, to own firms that provide legal services. ABSs are not due to be authorised until sometime in 2011 or 2012; LDPs are a dress rehearsal. LDPs that have non-lawyer managers will be required to convert to ABSs. LDPs that have only lawyers as managers will be able to continue as LDPs. If you are planning to become an ABS attracting outside investment, you will need to act now to be able to demonstrate to potential investors that you are a well managed practice, committed to high standards of service and risk management and compliant with the Code of Conduct.

and the winners are...
Thanks to readers who gave us their views on @risk by filling in the questionnaire sent out with the March issue.

Congratulations to Helen Kloosman of Kloosman Solicitors and Piers Wigan of TLO Insurance Services Ltd whose names were drawn at random from entrants to the questionnaire competition and who each win £250 of Marks & Spencer vouchers.

Contact Zurich
@risk
Editor Andrew Nickels
Telephone 020 7648 3698
Staff writer Lindsay Kerr
Telephone 020 7648 3735
Email riskman@uk.zurich.com

Sales
Telephone 0845 606 3322
Sales Fax 0845 600 4036
Claims Helppline 0845 600 4035
Claims Fax 0845 600 4034

Zurich Professional & Financial Lines
London Underwriting Centre,
Third Floor, 3 Minster Court,
Mincing Lane, London EC3R 7DD
www.zurichprofessional.co.uk

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