

THE CORPORATE STRUCTURES AVAILABLE TO FIRMS OFFERING LEGAL SERVICES IN ENGLAND AND WALES

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In this presentation, I will be talking about the corporate structures available to firms offering legal services in England and Wales. The options for firms will become significantly wider towards the end of 2011 as the rules governing these structures are relaxed, following the implementation of the Legal Services Act 2007.

As background, it may be helpful to talk briefly about the way in which the market for legal services is currently structured in England and Wales. The bulk of the profession are solicitors who provide a full range of services and are normally the first port of call for anyone seeking legal advice. Using broad figures there are 117,000 people practising as solicitors and offering services to the public. They fall into a number of categories:

Sole practitioners - 4,000
2 - 4 partner firms - 4800
5 -25 partner firms - 1400
>25 partner firms - 1600

Typically, sole practitioners and smaller firms provide services to consumers - property transfer, wills, employment advice and crime. They will provide services in a single location, possibly with one or two satellite offices. It is worth pointing out, however, that while number of partners in a firm is usually a sound indicator of the size of a firm, there are an increasing number of firms where a small number of solicitors oversee the work of a substantial number of unqualified staff undertaking relatively simple work.

Larger firms will tend to concentrate on commercial work (though many will have significant private client work) and will have offices in a number of cities throughout the country. The largest firms have significant presence globally. Although the smaller firms are largest in number, the highest proportion of the profession (over 40%) are in the top 100 firms.

About 10% of the profession is made up barristers but, since they currently can only act as self-employed, sole practitioners, unless they are employed by a firm of solicitors, they are excluded from this presentation.

Legal services are different from most other services offered by corporate bodies because of the duties that are owed by lawyers. These are first, to the court and second to the client. They are required to provide independent advice, to act in good faith, to avoid conflicts of interests. The rules and duties governing lawyers frequently require lawyers to act against their commercial interests - in that they must give advice that a client may dislike or may have to cease acting in an otherwise lucrative matter because their professional duties force them to do so.

Solicitors also hold significant amounts of money belonging to clients - typically this would include money from the sale or for the purchase of a property, the proceeds of an estate, damages from litigation or money to pay for experts or other investigatory work.

These duties and the requirements to ensure that the profession is trusted when it handles money have given rise to significant regulatory requirements and, as a result, solicitors are among the more highly regulated professions which the SRA overseeing a complex set of, qualification, ethical and conduct requirements, together with detailed rules governing accounts and a compensation fund to protect clients.

At present, there are limitations on the corporate structures under which lawawyers can do business. Aside from sole practice, there are two models:

- Partnership, with joint and several liability between the partners; or
- A limited liability partnership, whereby the liability is limited.

Until 2009 only lawyers could be members of a partnership. Since then, solicitors have been able to take on non-lawyer partners, provided that they did not comprise more than 25% of the ownership of the firm. This has been used to permit finance or IT managers to join the partnership and so provide a tool to help retention.

The partnership model has had a number of advantages – it recognises the partners' ownership of the risk in the business and, for many, it has proved a way of providing a lucrative way of financing retirement, of repaying the initial investment in the partnership. It provides a continuity and, it has been argued, by limiting ownership of a firm to those who are subject to the same duties then it will ensure the integrity of the profession and its obligations.

There are, however, a number of disadvantages:

- It limits the scope for outside investment and, therefore, innovation;
- The size of partnerships have grown considerably in the last couple of decades and this has put strains on the governance of firms. It is hard to get agreement on major or controversial decisions among a partnership of more than 50 – firms have been required to develop governance structures for taking major decisions within the partnership.
- The growth in numbers has in the larger firms has arguably diminished the level of control and ownership that partners actually have.
- At the other end of the market, as the environment changes, many solicitors are finding that the model is unhelpful for them and does not provide the security for retirement that they had hoped while the time and risks associated with the increased burden of regulation makes ownership of a firm less attractive.

From October this year, it is planned that a wider range of business models should be open to lawyers. These are known as Alternative Business Structures. Under the legislation such a structure is defined as being a body offering legal services where one of the owners or managers is a lawyer and one of them is not. This covers a wide variety of situations:

- Legal Disciplinary Practices under the present arrangements;
- A multi-disciplinary practice owned or managed by a number of different professionals – accountants, lawyers, surveyors etc;
- A firm owned by another entity, such as an insurance company, a bank or a supermarket;
- A firm floated on the stock market.

There is obviously substantial potential for overlap between these different models and there may well be other structures that we have not thought of.

These structures raise considerable opportunities for solicitors and other legal services providers. The range of services available to consumers is likely to increase and there will be increased scope for innovation. In addition, solicitors may find that they are able to avoid some of the burdens of compliance and management that may take them away from their core skills. If there is an influx of larger firms onto the market, there may be improved terms and conditions for employed solicitors than can be provided by smaller practices. They provide real opportunities for growth within the sector.

However, the following concerns have been raised:

- The need to ensure the integrity of those who own and manage firms so that the core professional principles are maintained;
- The need to ensure a level playing field so that there is no regulatory advantage for one business form over another;
- The effect on access to justice if large players enter the market and reduce the number of firms able to give advice, particularly in less profitable areas.

The regime governing the ABSs deals with these concerns in the following ways:

- Firms wishing to offer services in an alternative business structure must be licensed by a licensing authority that can grant rights to undertake the legal activities to individuals. The Solicitors Regulation Authority (SRA) has applied to be such a licensing authority.
- That authority must have ways of ensuring that it is able to verify that individuals are fit and proper. The SRA's procedures will, in effect, require individuals to demonstrate that they are fit and proper people and, in particular, that they do not have criminal convictions, links to criminal groups, avoid conflicts of interest and are suitable to run a law firm;
- All ABS firms must have Head of Legal Practice who is responsible for ensuring compliance with regulatory and legal requirements;
- ABS firms will be subject to the same requirements as traditional law firms – they will be required to pay appropriate contributions to the profession's compensation fund and will be subject to the same insurance requirements.

This has provided quite a significant change in the way in which professional regulation is undertaken. Traditionally, the emphasis has been on the individual – his or competence, fitness and conduct and there has been limited powers over entities (though the SRA has for many years had the power to intervene in practices). The new philosophy is to have control over entities as well as individuals – and this is clearly essential given the new corporate structures.

These safeguards are likely to ensure that the integrity of lawyers within the legal system is protected and that there will be firm regulation to achieve this. With that, then it is likely that the new structures will provide significant opportunities for the profession and benefits for consumers.