The City of London Law Society

4 College Hill
London EC4R 2RB

Tel +44 (0)20 7329 2173
Fax +44 (0)20 7329 2190
DX 98936 – Cheapside 2

mail@citysolicitors.org.uk

www.citysolicitors.org.uk

David McIntosh QC (Hon)
Chairman

26 April 2011

Alison Crawley
Solicitors Regulation Authority
Ipsley Court
Berrington Close
Redditch
B98 0TD

Dear Madam,

Re: Consultation on ABS Fee Structure

The City of London Law Society ("CLLS") represents approximately 14,000 City lawyers through individual and corporate membership including some of the largest international law firms in the world. These law firms advise a variety of clients from multinational companies and financial institutions to Government departments, often in relation to complex, multi jurisdictional legal issues.

The CLLS responds to a variety of consultations on issues of importance to its members through its 17 specialist committees. This response in respect of the "Alternative business structures fee structure" consultation has been prepared by the CLLS Professional Rules & Regulation Committee. The Committee is made up of a number of solicitors from thirteen City of London firms who have specialist experience in the area of the regulation of the profession.

Question 1

The proposed approach assumes, first, that the cost of regulation of an ABS will be broadly the same as the cost of regulation of an equivalent traditional firm and, secondly, that the same general principles can therefore underpin the fee structure for both. Whilst it is reasonable to assume that certain of the costs should be the same, we believe that there are significant points of distinction where the ABS is part of a larger business entity and therefore that the second element of the fee structure – charging the "firm" element by reference to turnover – will have to be reviewed.

We would add the following. As you know, the fees charged bear no relation to the actual cost of regulation and we therefore urge you to give more priority to developing a risk based/level of supervision fee structure. We appreciate that the SRA does not have unlimited resources and that it has a number of other projects which require attention, but would suggest that you announce a date by which you will move to a risk-based fee structure in order to bring focus to what we regard as an important matter.

Question 2

In your paragraph 6, whilst we would agree that the fee structure should not act as a barrier to new entrants to the legal market and reflect ability to pay, as you will know, the current fee structure already takes into account ability to pay.

We do not think it should follow that new entrants should automatically benefit from that "ability to pay" discount. The discount built in to the banded turnover rates was introduced in order that the owners of large firms – high turnover being the proxy for ability to pay - subsidise the cost of regulating others with a lower turnover (mainly small high street firms). Whilst the ability to pay element might be justified where those others, such as small high street firms, are genuinely less able to pay, it cannot be justified where the recipients of the subsidy are large, well-capitalized businesses. It would not be acceptable to our members to be asked to subsidise businesses which are well-able to pay fees (which would include a number of the entities which have announced their intention to become ABSs). We would therefore ask that you look at ability to pay in a more sophisticated way than simply by looking at turnover. We would suggest that you will have to devise another proxy or proxies for ability to pay where turnover is not a proper indicator. We hope that the following example helps to highlight our concern.

Bank B, with a market capitalisation of £35bn, sets up a retail legal services subsidiary, Company B, to provide wills and conveyancing services. Company B takes on premises and a substantial number of staff. It spends heavily on marketing and in its first year has expenditure of, say £100m. Its turnover in the first year is minimal, say, £1m. Bank B can finance the deficit by injecting capital of £99m, or by lending £99m to Company B or by guaranteeing £99m external borrowings by Company B. In all cases, Company B and the larger business group of which Company B is part has the ability to pay and we believe that the expenditure of that company is a much better proxy of ability to pay than income.

A second example would be where Company B charges well below market price or does work for free to gain market share and therefore has a low turnover, subsidised by injections of capital, etc., from its parent.

Turnover in both examples may well come in later years, but we do not believe that paying the proper level of fees in later years can be used to justify our members being asked to subsidise the early years of trading for Company B on the basis that Company B cannot afford to pay fees.

We would add that all existing firms are meeting the set-up costs of the ABS structure and framework of regulation at the SRA and understand that ABSs will not be asked to contribute through application fees to the costs incurred to date. They will simply be asked to pay fees covering actual application costs and the periodic fees going forward which will not take into account the sunk costs. The ABS structure is therefore heavily

subsidised already in favour of new entrants and we believe that this point adds weight to our request that actual or estimated turnover alone is not used to measure fees for substantial new entrants.

To conclude, we believe that unless the turnover element is reviewed to take into account the issue raised above, the existing structure will have a negative impact on larger traditional firms through their being asked to subsidise others, based on a measure of ability to pay which throws up a false result.

Question 3

Our concern is that whilst all turnover in traditional law firms is captured in the existing fee structure, there is considerable scope for ABSs which are part of larger businesses to distort their turnover. We would therefore ask you to set out how you would propose to ensure that all relevant turnover will be captured. The areas which immediately occur to us as having potential to cause problems are cross-subsidizing services and bundling of services, some of which are, and some of which are not, legal services.

For example, Company B in the earlier example could offer a “free” will writing service if the consumer opens a bank account with its parent, Bank B. Bank B could meet Company B’s expenses in providing the service in the ways mentioned in the example above or could pay a fee to Company B per will. It would not matter to the group how the deficit in Company B is met, as the intercompany amounts would cancel out on consolidation. If no fee were to be paid, there would be no fee payable to the regulator. We believe that, where there is a choice on how to meet the deficit, any commercial organisation would choose to meet it in a way that gives rise to least cost and so would be unlikely to choose payment if it meant higher fees being charged.

On bundling services, an example might be where a will, probate and funeral were offered for an all-inclusive price. How would the cost of the will, probate and funeral be spread over the legal services? Another example might be a mortgage lender offering free conveyancing - how would the interest rate on the loan be divided up, if at all, between the lending and conveyancing services?

We appreciate that it will require a degree of sophistication not present in the current fee structure to stop those with the ability to pay from avoiding an appropriate level of fees. We consider that the turnover test by itself is inadequate and will therefore have to be supplemented in some way. We believe that fairness in this context trumps simplicity and therefore that this point must be addressed properly.

One possible solution that occurs to us would be to have a mechanism for setting a minimum fee where turnover is not considered to be a suitable proxy for ability to pay. The fee could reflects the size of the legal services business measured not by reference to turnover but, say, by reference to expenses (including, importantly, shared costs such as brand advertising) with a suitable profit multiplier to give a figure equivalent to turnover in a traditional firm on which the fee could be based.

Questions 4 and 5

The same point made in answer to Question 3 will apply where there is cross-subsidizing of services or free services in MDPs.

Questions 6, 7 and 8

See the point above in relation to turnover as a proxy for ability to pay, as applied particularly in start-up situations.

Estimated turnover (or a more sophisticated proxy where necessary) would seem to be a sensible approach in the examples where this is suggested.

Question 9

No, a more sophisticated proxy for ability to pay is required in the interests of fairness.

Question 10

We believe that the business models of (1) use of large numbers of unregulated staff, both in ABSs and traditional firms, doing regulated work under supervision by a small number of regulated persons and (2) regulated persons doing unregulated work should be looked at over time to determine whether the advent of new business structures places an unfair fee burden on firms where there is a very high level of regulated staff in relation to the turnover. It may be that a risk-based/level of supervision fee structure will supersede the need to consider this question.

Yours faithfully,

David McIntosh
Chair
CLLS

THE CITY OF LONDON LAW SOCIETY
PROFESSIONAL RULES & REGULATION COMMITTEE

Individuals and firms represented on this Committee are as follows:

Chris Perrin (Clifford Chance LLP) (Chair)

R. Butterworth (Bird & Bird LLP)

R. Cohen (Linklaters LLP)

Ms S. deGay (Slaughter and May)

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