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Legal Policy
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(By post and email: consultation@sra.org.uk)

Dear Sirs

Response of the CLLS Professional Rules and Regulation Committee to the Indicative guidance on financial penalties consultation (the "Consultation")

The City of London Law Society ("CLLS") represents approximately 15,000 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 specialist committees. This response to the Consultation has been prepared by the CLLS Professional Rules and Regulation Committee (see list of members attached).

1. The SRA has said that the Consultation is currently of most relevance to alternative business structures (ABSs) because its powers to fine traditional law firms are limited. While that is true, we understand the SRA continues to seek a significant increase in those powers. In that regard the CLLS strongly supports previous representations made by both the Law Society and the Solicitors Disciplinary Tribunal (SDT) and in particular the continued separation of regulatory supervision on the one hand and disciplinary enforcement on the other. We believe the separation of roles actively supports an open dialogue and reporting regime with the SRA whether through relationship managers or via direct reporting under the SRA Handbook.

2. The starting point in any case is that the circumstances of the relevant conduct must meet the three conditions in Rule 3 of the SRA Disciplinary Procedure Rules 2011 ("DPR Rule 3").

   (a) The first condition relates to the serious nature of the conduct involved, in many cases involving some form of unreasonable behaviour by the firm or individual or otherwise having a potential to cause loss or affecting a vulnerable client, or forming part of a pattern of misconduct or other regulatory failure.

(b) Conditions 2 and 3 are that:

(i) A penalty is a proportionate outcome in the public interest; and

(ii) The relevant act or omission was neither trivial nor justifiably inadvertent.

3. It is also important to keep in mind the purpose of sanctions such as financial penalties. This has been summarised by the Master of the Rolls as:

(i) To punish a solicitor for his/her conduct and to deter others;

(ii) To ensure the solicitor does not have an opportunity to repeat the offence; and

(iii) (most fundamentally) to uphold the collective reputation of and the public trust and confidence in the profession[1].

4. In this context we are very concerned by the worked example included in the Consultation paper, the circumstances of which do not appear to fall within DPR Rule 3 at all.

(a) The example concerns an inadvertent failure of supervision procedures in ABC & Co, leading to clients being overcharged which the firm had remedied immediately upon discovery of the problem and had itself reported to the SRA. While the facts of the example are relatively limited (and did involve a loss to clients) this does not on its face seem to be a regulatory breach which ought properly to be subject to disciplinary action. An inadvertent failure in supervision, particularly when recognised and remedied by the firm, should not call for a punishment which is intended to deter others, nor should it be regarded as misconduct. A breach of the Handbook does not always equate to conduct which ought to be subject to sanction.

(b) The example gives the rather unfortunate impression that the SRA's starting point is that a breach of the Handbook will lead to disciplinary action, the perception of which is likely to be detrimental to the SRA's supervision objectives as firms will be less inclined to engage in an open and proactive dialogue with the SRA and fewer breaches will be reported. In encouraging firms to be open with it, the SRA has repeatedly assured the regulated community that its objective is not to punish inadvertent breaches, but the worked example contradicts such an approach to supervision. Nor is the result obviously aligned with the SRA's public statements that the purpose of OFR is not to *""catch firms out" but to ensure that compliance is achieved, risks managed and any weaknesses addressed".*[2]

(c) The example also contradicts the SRA's stated strategy of proportionate and targeted enforcement which expressly recognises that advice and guidance through supervision may be more effective ways to raise a firm's standards than a formal sanction.

[1] Bolton v The Law Society [1994] 1 WLR 512

[2] SRA Policy Statement 30 November 2010

(d) In any event the proposed £9,000 financial penalty is not a proportionate outcome at all particularly given the firm had immediately remedied the breach and associated loss once discovered.

5. Fines received are currently paid to H M Treasury. This may be appropriate in industry sectors where the costs of regulation are paid by the public purse, but we do not think this is justified where a profession pays for its own regulation. We would therefore encourage the SRA in its ongoing discussions with the Ministry of Justice to seek a change so that any fines collected are kept by, or otherwise made available to, the regulator to be used to defray the cost of regulation and accordingly the profession's contribution to those regulatory costs.

The Consultation Questions

We turn now to the specific questions raised in the Consultation (adopting below in each case the numbering in the consultation paper):

1. We agree that the SRA should adopt some form of guidance or guidelines to assist in the determination of financial penalties which would significantly aid transparency and consistency.

2. We do not believe it is possible to categorise all forms of misconduct but in any event we agree that any guidance should be broad to provide sufficient flexibility for the decision maker to make a determination which is proportionate in the particular circumstances of each case. The SDT's Guidance Note on Sanctions adopts a similarly broad approach. It would seem to make more sense for the SRA to adopt a process which is broadly aligned with that of the SDT to avoid inconsistencies in enforcement action as between traditional law firms and ABSs, although one alternative might be to extend the SDT's jurisdiction to ABSs (which would require legislation).

3. We do not agree that the process currently suggested by the SRA is fair or appropriate, although we do not object per se to a staged approach. Our concern is that the proposed stages do not give appropriate weight to the nature of the relevant conduct nor the mitigating or aggravating behaviour of the firm (whether at the time or once the breach is discovered) which ought to be part of the process by which a basic penalty is calculated rather than a subsequent adjustment. In our view the SDT's approach is more just and equitable in this regard because it assesses "seriousness" using a combination of factors which include the culpability of the respondent, the harm caused to the profession and both aggravating and mitigating factors.

   As the SDT's approach does not include bandings for financial penalties it is not possible to carry out a direct comparison of the likely penalty (if any) which would be imposed by the SDT on ABC & Co using the worked example. However we think the SDT's approach would have more appropriately had regard to the inadvertent nature of the conduct and the remedial action taken by the firm because:

   (a) The level of culpability is likely to have been assessed as relatively low as the SDT would have been influenced by the lack of any motivation for the breach or deliberate conduct and the lack of any breach of trust.

   (b) The level of harm is likely to have been assessed as low since "harm" is assessed in the context of harm to the reputation of the profession rather than financial loss to the clients (who have been compensated).

(c) The lack of any aggravating factors, unless the period of time involved (six months) is considered to be significant.

(d) The presence of mitigating factors in that the firm immediately repaid clients upon discovery of the breach, had voluntarily reported the matter to the SRA and accordingly had made open and frank admissions at an early stage.

We also refer to our comments in response to question 5 of the Consultation below.

4. We agree as a matter of principle that it is sensible to distinguish between the nature of the conduct and the harm caused, subject to appropriate weighting. However, we are concerned that the SRA's definition of "harm" is misdirected to the financial loss caused in contrast to the SDT's approach of having regard to the harm caused to the profession as a whole, which more correctly reflects the purpose of sanctions. It is not the purpose of sanctions to compensate underlying financial loss and for that reason the level of loss ought not to be a deciding factor (save to the extent it gives rise to culpability issues).

5. We think that the method proposed by the SRA for assessing the seriousness of the misconduct is clearly set out but we do not think that the methodology currently proposed is fair. The categories of seriousness are too limited falling into either standard or serious with little differentiation of scoring, so that intentional misconduct (which might include criminal conduct) scores only 2 points higher than "standard" misconduct. We regard this as a significant flaw which has the potential to lead to unfair outcomes. So for example:

(a) Misconduct of a deliberate or criminal nature but which caused minimal loss or impact would result in a combined score of 3 leading to a basic penalty of either £500 or £1,000.

(b) Conduct which was not intentional nor formed a pattern of misconduct but which had the potential to cause significant loss would result in a combined score of 7 leading to a basic penalty of between £5,001 and £25,000.

The above illustrates to us that the proposals in their current form are not appropriate. It cannot be right that a deliberate course of criminal or reckless behaviour has the potential to result in a lighter financial penalty than inadvertent regulatory breaches. The proposals do not give adequate weighting to the nature of the conduct and do not distinguish between "harm" (to the profession) and financial loss (a civil liability) and therefore do not reflect the purpose of financial sanctions (see above).

6. We refer to our response to question 7 below. We think that the decision maker should have flexibility to exercise discretion. We can see that there may be cases where the rigidity of applying either a fixed penalty or a penalty by reference to turnover may result in a disproportionate sanction (including a disproportionately light fine). For that reason we think the decision maker should have the ability in all cases to look at both types of assessment. We do not comment as to whether there may be other bases upon which financial penalties might be calculated.

7. We are concerned at applying any form of distinction between firms of greater means and other firms. Turnover is not in itself an indicator of means; firms with greater turnover may well have commensurately greater overheads. Even supposing "*means*" could be consistently and fairly assessed, any threshold proposed would be inherently arbitrary and inflexible with the potential to produce unfair results for firms near the threshold.

8. No for the reasons set out in response to question 9 (see below).

9. We agree that financial penalties for individuals should not be based on the individual's income which would likely open up a very complex method of calculation and likely give rise to appeal.

10. We think the starting point for fines is reasonable, but the suggestion that a fine could in some circumstances be as much as 10% of turnover is we think excessive and so should we think be subject to a cap. A fine at that level could present a very serious threat to the ability of a firm to continue trading (and if the misconduct is serious enough there are other sanctions available besides a financial penalty). If a cap is thought inappropriate then we would suggest that the maximum percentage needs to be significantly reduced, perhaps to 2.5%.

11. We strongly agree that mitigating factors (as well as aggravating factors) should be taken into account. However, as set out above we believe that the proposed approach of applying these factors as discounts rather than as part of the integral assessment of the misconduct itself has the potential to cause unjust results. As set out above we consider the approach adopted by the SDT delivers a more equitable and proportionate outcome.

12. No, for the reasons set out in response to questions 3 and 11 above. In our view the SRA should consider significant changes to the approach and accordingly we do not think it helpful to suggest different percentages for discounts. Again, we think mitigation and intent should be integrated into the primary assessment of conduct and not marginalised to a secondary consideration once the initial decision on penalty has been made.

13. We agree with the principle, provided that in assessing such profit or gain the SRA has appropriate regard to any redress the firm has already made (thereby eradicating any profit or gain). However, the purpose of sanctions is to punish misconduct and in our view it would be wrong to focus purely on the profit or gain (which in many cases is likely to be the subject of a recovery in a civil action). As above, we are concerned that the proposals equate "harm" with financial loss rather than with harm to the reputation of, and public trust in, the profession.

14. No.

Yours faithfully

Alasdair Douglas
Chair , CLLS

THE CITY OF LONDON LAW SOCIETY
PROFESSIONAL RULES & REGULATION COMMITTEE

Individuals and firms represented on this Committee are as follows:

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Roger Butterworth (Bird & Bird LLP)

Raymond Cohen (Linklaters LLP)

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