

EXPLANATORY MEMORANDUM TO
THE LEGAL SERVICES ACT 2007 (COMMENCEMENT NO.2 AND
TRANSITORY PROVISIONS) ORDER 2008

2008 No. 1436 (C. 65)

1. This Explanatory Memorandum has been prepared by the Ministry of Justice and is laid before Parliament by Command of Her Majesty.

2. Description

2.1. The instrument commences a range of provisions in the Legal Services Act 2007 ('the 2007 Act') which, among other things, amend the powers of regulators of legal services, such as the Law Society, to enable them to operate more effectively.

2.2. This instrument commences provisions relating to the funding of the Solicitors Disciplinary Tribunal ('the SDT') which amend the regime for payment of members of the SDT and the mechanism for agreeing the budget of the SDT. Provisions are also commenced which permit costs orders for pro bono representation; amend the investigative powers of the claims management services regulator; alter the rules for the remuneration of solicitors; transfer certain functions from the Secretary of State to the Lord Chancellor; and allow registered foreign lawyers to be managers of recognised bodies. The definition of 'manager' is also commenced for electronic billing provisions.

2.3. This instrument further makes transitory provision pending the full constitution of the Legal Services Board (the "Board"), which will occur upon formal appointment of the Chief Executive. At that time the Board will be fully constituted and financial responsibility will transfer from the sponsoring department to the Board.

2.4. This instrument also commences provisions in respect of the regulation of legal services in Scotland; allowing the Scottish Legal Complaints Commission to handle consumer complaints about the service provided by legal practitioners in areas reserved to the UK Parliament.

3. Matters of special interest to the Joint Committee on Statutory Instruments

3.1 None.

4. Legislative Background

4.1. This instrument commences provisions of the 2007 Act which received Royal Assent on 30 October 2007. This is the second commencement order under section 211 and the second order making transitory provision under section 208 (2) and (4) which enables the Lord Chancellor to make appropriate "transitory, transitional or

saving provision” or “adaptations of provisions of [the] Act”. The 2007 Act introduces a new regime for the regulation of legal services and makes a large number of amendments to the legislation which governs legal services regulators. This includes amendments to the Solicitors Act 1974, the Administration of Justice Act 1985, the Courts and Legal Services Act 1990 and the Compensation Act 2006.

5. Extent

5.1 This instrument relates to provisions which apply to England and Wales, save where otherwise stated.

5.2 Provisions referred to in paragraph 7.9 apply to Scotland.

6. European Convention on Human Rights

6.1. The Parliamentary Under Secretary of State, Bridget Prentice, has made the following statement in relation to the provisions of this Order which modify the 2007 Act:

In my view the provisions of the Legal Services Act 2007 (Commencement No.2 and Transitory Provisions) Order 2008 are compatible with the Convention rights.

7. Policy Background

7.1. The 2007 Act reforms the way in which legal services are regulated in England & Wales. The 2007 Act establishes an oversight regulator; the Board, and an independent complaints handling body; the Office for Legal Complaints (“the OLC”). It also provides for alternative business structures (‘ABS’), which will enable firms to explore new ways of organising their business. In addition, the 2007 Act establishes a single set of regulatory objectives (section 1) which will apply to the Board, the OLC and approved regulators (e.g. the Law Society, Bar Council).

7.2. A key aim of the legislation is to simplify the existing regulatory framework, which has a number of oversight regulators, including the Master of the Rolls, the Secretary of State of Justice and the Archbishop of Canterbury. The Board, as oversight regulator, will be able to ensure greater consistency of standards across the legal sector, while approved regulators will be responsible for day-to-day regulation. Another driver for change was the need to improve the way in which complaints are dealt with and to improve consumer confidence. The OLC will be an independent body that will administer an ombudsman scheme which will deal with consumer complaints about legal services providers. The scheme will be able to provide quick and fair redress. Furthermore, the 2007 Act facilitates ABS which offers greater choice for the legal profession and consumers about the way that services are provided, including permitting different kinds of lawyers and non-lawyers to work together, and allowing for external investment.

7.3. It is anticipated that the Board and the OLC will not be fully operational until 2010 and therefore this instrument deals with measures necessary prior to the establishment and formal constitution of those bodies. Provisions also relate to some reforms incorporated following consultation with the Law Society to update regulatory powers, for example reforms to the regime of remuneration of solicitors and the funding of the SDT.

7.4. Reforms to the rules relating to the funding and remuneration of the SDT are contained within Part 1 of Schedule 16 to the 2007 Act which amends the Solicitors Act 1974. Paragraph 48 of Schedule 16 envisages that the Board will approve the budget of the SDT, in consultation with the Law Society. The Board will be unable to discharge this function until it is formally constituted. Transitory provision has been incorporated to enable the SDT to exercise such functions with the approval of the Law Society. In the event that the Society fails to agree the budget, the SDT or Society may ask the Master of the Rolls to approve the budget. Similarly, paragraph 47 of Schedule 16 is commenced, creating equality in respect of remuneration between solicitor and 'lay' members of the Tribunal. The levels for fees or allowances will be approved by the Law Society pending the establishment of the Board.

7.5. Section 194 of the 2007 Act will be commenced within this instrument. This provision relates to the Court's powers to make costs-orders in civil proceedings where a party has received pro-bono (or free of charge) representation. The provision prevents a losing party escaping orders for costs solely on the basis that their successful opponent received representation free of charge. This section provides for the payment of the costs award to a registered charity prescribed by Order of the Lord Chancellor. The charitable funds will be employed to fund further pro-bono help and advice. To accommodate this provision, amendments must be made to the Civil Procedure Rules and an order made to prescribe the registered charity. As such, the full provision is to be commenced with an in-force date of 1 October 2008. Certain subsections are to be commenced in June 2008 to enable the necessary preparatory work to take place.

7.6. This instrument commences provisions in Schedule 19 to the 2007 Act which extend the powers of the Claims Management Services Regulator to enter and search premises and take possession of written or electronic documents found in the course of an investigation. Such provisions ensure consistency between the powers of the Regulator and the Board. Similarly, in respect of the investigative powers of the Law Society, this instrument commences paragraph 38(iii) of Schedule 16 to the 2007 Act. This provision empowers the Law Society to take such steps necessary in determining not only whether indemnity rules are being broken, as provided for in existing legislation, but also if such regulations have been complied with in the past.

7.7. In terms of the remuneration of solicitors, this instrument commences amendments to the Solicitors Act 1974 contained in Schedule 16 (paragraph 54(3)),

which remove prescriptive statutory provisions in respect of the rates and scales employed in non-contentious business agreements. With regard to contentious business agreements, the Solicitors Act 1974 currently includes a prohibition from excluding liability for negligence in such agreements. This instrument commences amendments to the Solicitors Act 1974 (in Schedule 16, paragraph 56(c) of the 2007 Act) which relax this provision, enabling such clauses, save where the client is a natural person and the agreement is made outside of his trade, business or profession. This policy was adopted to allow the possibility of preferential rates being offered in exchange for liability limiting clauses, creating fiscal advantages for businesses. Consumer protection against the unfair exclusion or limitation of liability remains by virtue of the Unfair Contract Terms Act 1977 and the Unfair Terms in Consumer Contracts Regulation 1999 and their accompanying case law. Finally, with reference to contentious business agreements, in the event of the insolvency of a recognised body causing a cessation of work, the definition of 'insolvency' is to be brought in line with that of the Insolvency Act 1986 by this instrument by virtue of paragraph 112(a) of Schedule 16 of the 2007 Act.

7.8. Section 207 of the 2007 Act contains the definitions employed for the purposes of this legislation. In the Legal Services Act 2007 (Commencement No.1 and Transitory Provisions) Order 2008 (S.I. 2008/222), provisions were commenced which provided for the possibility of electronic billing. Such bills are signed off by managers of recognised bodies. This instrument commences the statutory definition of 'manager' for this purpose. Equally, Paragraph 128(c)(ii) of Schedule 16 of the 2007 Act provides for registered foreign lawyers to be managers of recognised bodies, complementing the existing application of many Law Society rules to registered foreign lawyers.

7.9. This instrument also commences changes which update terminology. References to the Law Society have been changed from "Council" to "Society", in line with current parlance. Amendments transfer the functions of the Secretary of State to the Lord Chancellor. This is in accordance with policy maintained throughout the 2007 Act, in view of the politically neutral function of the role of the Lord Chancellor being in line with the specificity and independence of the legal profession.

7.10. This instrument also commences provisions in respect of the regulation of legal services in Scotland. Amendments are introduced to the Legal Profession and Legal Aid (Scotland) Act 2007 (the 'LPLA'), the Immigration and Asylum Act 1999 (c. 33) and the Law Reform (Miscellaneous Provisions) (Scotland) Act 1990 (c. 40) by sections 195 and 196 of and Schedule 20 to the 2007 Act. The amendments will allow the Scottish Legal Complaints Commission to handle consumer complaints about the service provided by legal practitioners in areas reserved to the UK Parliament (consumer credit, insolvency, immigration and financial services).

Consultation and Guidance

7.11. The 2007 Act is the result of extensive consultation both before and during the Parliamentary process. The key groups that were consulted were consumer organisations, regulatory bodies, other professional representative bodies and other key stakeholders, such as the Offices of the Legal Services Ombudsman and Legal Services Complaints Commissioner. In particular, the Government consulted following the 2001 report on competition in the professions by the Office of Fair Trading¹, and published a report into competition and regulation in the legal services market.² Further to that, in 2003, Sir David Clementi was appointed by the Government to conduct an independent review of the regulation of legal services³, which was the basis for the proposals set out in the Government's White Paper, *The Future of Legal Services: Putting Consumers First*, published in October 2005. A summary of the responses to the White Paper are included in section 2 of the Regulatory Impact Assessment ('RIA') which is attached to this memorandum.

7.12. The draft Legal Services Bill was published in May 2006 and was subject to pre-legislative scrutiny by a Joint Committee of both Houses of Parliament. The Joint Committee reported in July 2006, and the Government published its response to this in September of the same year.

7.13. A Consumer Panel was also established in 2005 to advise in the development of the 2007 Act, and it continues to advise on the implementation of the legislation. In addition, the Government continues to consult with relevant stakeholders during the commencement of the legislation and has set up the Implementation Working Group (established in April 2006) which includes representatives from existing legal regulators and consumer groups, amongst others.

8. Impact

8.1. A full RIA was prepared for the Legal Services Bill in November 2006, and a supplementary memorandum was published in June 2007. The full RIA can be found at <http://www.dca.gov.uk/risk/ria-legal-services.pdf> and the supplementary memorandum can be found at <http://www.justice.gov.uk/docs/RIA-Supplement-v021.pdf>. The full RIA includes sections which examine the options considered and

¹ Office of Fair Trading, 2001, *Competition in the Professions – A Report by the Director General of Fair Trading*

² Department for Constitutional Affairs, 2003, *Competition and Regulation in the Legal Services Market – A Report Following the Consultation “In the Public Interest?”*

³ Clementi, Sir David, 2004, *Review of the Regulatory Framework for Legal Services in England and Wales – Final Report*

our reasoning for the final recommendations which were brought forward in the 2007 Act.

8.2.The regulatory impact of this instrument is specifically considered in Part 11-Enforcement Sanction and Monitoring of the full RIA of November 2006, as referred to in paragraph 8.1. This is attached at **Annex A**.

8.3.The forecasts for implementation and running costs of the Board and the OLC are set out in the supplementary memorandum. The implementation costs are forecast to be £32.1 million (in 2007-08 current prices), of which £19.9 Million would be recovered through the levy on approved regulators, £9.8 million would fall directly on the Law Society and £2.4 million would fall to the Ministry of Justice. The running costs will also be met through the levy and at current 2007-08 prices, are £4.0 million for the Board and £19.9million for the OLC.

9. Contact

9.1.Any enquiries about the contents of this Memorandum should be addressed to:

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Annex A: Full Regulatory Impact Assessment

11. Enforcement, Sanctions and Monitoring

Administrative burdens – a risk-based approach

11.1. The recent Hampton Review of Inspection and Enforcement (March 2005)⁹¹ recommended that all regulatory agencies should adopt a risk-based approach to regulation. The Government accepted all its recommendations. All regulatory activity for legal services should be on the basis of a clear, comprehensive risk assessment.

11.2. Effective regulation ensures that consumers are protected. But too much regulation is damaging because it imposes costs, stops consumers getting what they need, and puts unnecessary burdens on providers. Regulation must be proportionate and based on an assessment of risk. Risk-based regulation means identifying and assessing the risk, determining the strategy for managing the risk and communicating it.

11.3. All parts of the new regulatory framework will need to keep up to date with developments in regulation and the sector and adopt best practice.

11.4. Regulators should be able to justify their activities on the basis of risk, and communicate this effectively. Good regulators use the full range of tools at their disposal, such as providing good advice to facilitate better compliance as well as a proportionate response to non-compliance.

11.5. There are a number of best practice guides but the Better Regulation Executive (BRE) has set out principles of good regulation.

11.6. The BRE guidelines say that regulation should be:

- **proportionate:** regulators should only intervene when necessary. Remedies should be appropriate to the risk posed, and costs identified and minimised
- **accountable:** regulators must be able to justify decisions, and be subject to public scrutiny
- **consistent:** Government rules and standards must be joined-up and implemented fairly
- **transparent:** regulators should be open, and keep regulations simple and user friendly
- **targeted:** regulators should be focused on the problem, and minimise side effects.

The Government strongly supports the adoption of these principles by the Legal Services Board in executing its powers and carrying out its duties.

⁹¹ Hampton, Philip (2005) Reducing Administrative Burdens: Effective Inspection and Enforcement. [<http://www.hmtreasury.gov.uk/media/A63/EF/bud05hamptonv1.pdf>]

Consistent Enforcement

11.7. Under *existing arrangements*, the making and application of regulations is generally carried out by legal professional bodies. However, schedule 4 to the Courts and Legal Services Act 1990 (as amended by schedule 5 to the Access to Justice Act 1999) requires that certain rules maintained by the legal professional bodies must first be approved by the Secretary of State before they may have effect (essentially those rules which relate to the granting or exercise of a right of audience or a right to conduct litigation). The Secretary of State also has the power to alter these rules by Order. In the case of the Council for Licensed Conveyancers, all rules of the Council require the approval of the Secretary of State before they may have effect, but the Secretary of State has no power to alter rules of the Council. As well as making and applying their rules, the legal professional bodies are also responsible for enforcing their rules, including through various conduct and disciplinary arrangements.

11.8. Under the Government's *proposed arrangements*, professional bodies recognised by the Legal Services Board (LSB) as Approved Regulators (ARs) will continue to be responsible for making their rules, but those rules will require the approval of the LSB before they can have effect. The LSB will also have the power of direction which it can use to amend the rules of ARs. In practice, we expect that the LSB may choose to waive the requirement for its approval of ARs rules in certain cases. For example, where it is content that the AR concerned has a proven track record in a particular area, or where it judges that certain categories of rules do not present a significant risk when judged against its statutory objectives.

11.9. In practice we foresee little change in the burden on either the ARs or providers of legal services as a result of this change. In fact, we expect the process for approval to be quicker than the existing arrangements under which the Secretary of State generally refers rule change applications submitted by legal professional bodies to the Legal Services Consultative Panel (a statutory body established under the provisions of the Access to Justice Act 1999, which has a voluntary membership and generally meets once a month).

11.10. Disciplinary tribunals, as currently maintained by each front-line regulator, will continue to enforce decisions on allegations of professional misconduct.

11.11. The OLC will make enforceable awards on consumer redress of up to a limit of £20,000. These awards will be enforceable through the courts as a civil debt. At present, not all of the ARs are able to make enforceable awards.

11.12. Under the *alternative model* all rules would be made and enforced by a new Legal Services Authority. The legal professional bodies would have no statutory regulatory powers and their role would effectively be reduced to that of representative bodies.

11.13. Again we would see little change in the burden on either the ARs or providers of legal services as a result of this change.

Proportionate Powers

11.14. Under the *existing arrangements* the legal professional bodies are responsible for the application of sanctions where their members fail to observe their rules of conduct or other regulations that may have effect. This will usually follow an investigation by the professional body often arising out of a consumer complaint. Some sanctions are applied directly by ARs, but more serious matters generally require the matter to be considered by an independent tribunal.

11.15. In addition to sanctions applied to practitioners by the professional bodies, the Legal Services Ombudsman (LSO), established under the Courts and Legal Services Act 1990, considers cases referred by consumers and will generally investigate the way a professional body has handled a complaint. The LSO can ask a professional body to reconsider a complaint, or order a professional body to pay compensation to a consumer if they have suffered as a result of poor handling of the complaint.

11.16. The Access to Justice Act also provided for the establishment of a Legal Services Complaints Commissioner (LSCC) with the power to set targets for complaints handling by legal professional bodies and to fine those bodies if they fail to meet the targets set. The LSCC was established in 2004 with powers directed at the Law Society.

11.17. Under the Government's *proposed arrangements* ARs would be responsible for applying its powers to those persons or bodies which they regulate, in much the same way that they do under the existing arrangements. However, the LSB would have available to it a range of powers which it could apply in respect of ARs where they fail effectively to discharge their regulatory functions. As ARs will no longer handle consumer complaints, the functions of the LSO and LSCC in sanctioning ARs for inadequate complaints handling will no longer be required.

11.18. In terms of the burdens on providers of legal services we foresee little change to the existing arrangements; ARs will continue to sanction their members in much the same way as they do under the existing arrangements. However, ARs are likely to be under a *potentially* greater burden, given the range of powers that will be available to the LSB in the event that ARs fail to perform effectively (such a range of powers is currently not available to any of the existing oversight regulators). However, the burden, which will only be applied where ARs fail, is considered to be more than outweighed by the benefits to consumers.

11.19. Under the *alternative model* ARs would be removed from the equation and powers would be applied directly upon providers of legal services by a new single regulator, the Legal Services Authority (LSA). There is no evidence to suggest that the burden that would be applied to practitioners by the LSA would be any more onerous than if it were applied by ARs.

Risk-based Monitoring

11.20. Under existing arrangements, the performance of providers of legal services is generally monitored by the legal professional bodies. The performance of the legal professional bodies in regulating their members is variously monitored by a range of oversight regulators including the LSO and LSCC in terms of complaints handling, the Office of Fair Trading in respect of competition matters, the Master of the Rolls in respect of rules of the Law Society and the Secretary of State for Constitutional Affairs in respect of certain rules of the main professional bodies, and, in effect, as regulator of last resort.

11.21. Under the *proposed arrangements* ARs will remain primarily responsible for monitoring the conduct of providers of legal services, but the LSB will act as the single oversight regulator charged with the responsibility of monitoring the performance of ARs. This will rationalise the existing “regulatory maze” identified by Sir David Clementi in his Report of December 2004, and, because they will be dealing with a single oversight regulator, is expected to reduce the overall burden on ARs.

11.22. In terms of complaints handling, the responsibility for dealing with consumer complaints will be removed from ARs and given to the new OLC. This should remove a considerable burden from ARs. The OLC’s performance will be monitored by the LSB. We do not anticipate any significant impact on the providers of legal services, although we expect consumers to receive a much more effective complaints handling experience.

11.23. Under the *alternative model* the responsibility for monitoring the conduct of providers of legal services would be removed from legal professional bodies and transferred to an LSA. As with the preferred arrangements, this would rationalise the existing “regulatory maze” and reduce the overall burden on ARs.

11.24. In terms of complaints handling, the responsibility for dealing with consumer complaints would similarly be removed from ARs and given to the new OLC.

Compensatory simplification measures

11.25. The Government’s preferred options should be seen as simplification measures in their own right. The proposed regulatory framework is designed to provide a clear and consistent regulatory oversight regulation. The creation of a new body to provide a single point of oversight will eliminate the problems of the current framework, in terms of regulatory proliferation, confusion and fragmentation; the propensity of the current structure to create regulatory anomalies and gaps; and difficulties of interface and co-operation, thus increasing transparency, consistency and accountability.

11.26. Moreover, the removal of the restrictive nature of current business structures in legal services will facilitate more competition and innovation in the provision of legal services and offer more choice to consumers. It will also open up more opportunities for existing and potential new suppliers to offer new types of legal services.

11.27. In addition, the establishment of a single complaints handling body will simplify the complaint systems for consumers to use and also increase the efficiency with which the systems are run.