

Red paper

# The Legal Services Act 2007

Implications for Law Firms

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## History in the making

2011 is a historic year for the UK legal sector. The Legal Services Act (LSA) 2007, which will be fully implemented in October, will completely transform the legal sector landscape. The Act aims to provide a regulatory framework that promotes diversity, increases competition, improves public access to justice, and ultimately to protect consumers' interests – all worthwhile objectives to deliver value for money to the consumer and drive innovation in a typically traditional industry.

The Legal Services Act 2007 requires the Solicitors Regulation Authority (SRA) to support the Act by encouraging transparency and accountability among legal services providers. On its part, the SRA believes that this is an opportunity to overhaul and modernise the regulation of the profession. It has developed an 'outcome focussed' approach in an attempt to move away from the current prescriptive style of regulation to a more qualitative way of evaluating professional conduct and quality of legal services delivered to consumers. Some argue that regulatory compliance in the post-LSA world will be even more complex than previously, due to its open-ended, ambiguous nature.

Against this backdrop, law firms are faced with both challenges and uncertainty. The recently announced findings of a report by Baker Tilly<sup>1</sup>, a firm of accountants and business advisors, reveals that 83 per cent of those surveyed believe that their business will change significantly in 18 months time.

More often than not, change is good. By embracing the new regulation wholeheartedly, law firms will find that the LSA removes numerous restrictions on how they can run their businesses. It is a platform for innovation and in all likelihood, opportunities will be plentiful. It however, does require a change in mindset and perhaps a re-think of business objectives and strategy for growth plans. This is already beginning to happen. 50 per cent of respondents in the Baker Tilly survey have either changed their firms' plans or expect to, due to the LSA.

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## LDPs, ABSs, etc.

October this year will see the formation of legal services providers based on Alternative Business Structures (ABS) – a more wide-reaching structural change than the creation of Legal Disciplinary Practices (LDP) since March 2009. In LDPs, non-solicitors can be partners in law firms, but 75 per cent of partners have to be solicitors; and all non-solicitor partners require SRA approval. ABSs on the other hand, can be wholly owned by non-solicitors.

This means that practically any organisation, regardless of whether it has prior legal market experience, can offer legal services to customers. Recently, high street retailer WHSmith<sup>2</sup> announced that it has entered into a partnership with QualitySolicitors, to offer legal services such as conveyancing, personal will packages and fixed-fee advice sessions to customers visiting their stores. WHSmith has over 1,000 stores and over 70 per cent of the population visit them every year. Similarly, the AA and Co-operative Financial Services have also announced that they plan to launch ABSs. The strength of these household brands and their access to a captive audience could potentially drive out smaller and stand alone legal practices.

Legal Services Board Chairman, David Edmonds, refutes this view. He believes that there will be a variegated market with room for legal firms and ABSs of all sizes, encouraging them to innovate, resulting in more easily accessible and affordable services to the consumer, ultimately enhancing access to justice.

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## Re-think business objectives

Clearly, there are diverging opinions and the true potential impact of the legislation is hazy. Only time will tell how it all shakes out.

However, in view of the sweeping changes and almost certain ensuing increase in competition in the industry, "doing nothing" is ill-advised. Law firms must re-assess their medium to long term business objectives and devise compelling strategies to position themselves well to take advantage of the new opportunities the new legal sector environment will bring. More importantly, they must change their way of thinking from being purely professional services providers to simultaneously taking an entrepreneurial approach to running their businesses profitably in a very lucrative industry.

There are threats to generalists, especially small to medium-sized firms, who don't have a niche, market expertise or geographic dominance. For instance, firms that rely heavily on domestic conveyancing and legal aid work, will see reduced business come through their door as not only are both these areas very price competitive, but also that legal aid work itself is reducing in view of the current public sector cuts. Further, law firms with poor profitability levels may find themselves unable to attract younger partners. This, combined with rising professional indemnity premiums, and the increasing regulatory compliance will make business unsustainable, if necessary action is not taken proactively.

Law firms must evaluate their business models with a more pronounced focus on financial performance. Do they need to expand their range of services; and if so is merger the best option? Perhaps entering a network of smaller firms with different specialties or even considering franchise opportunities?

Similarly, for larger firms, is this a good time to bring in external investment, merge with another law firm to internationalise the business, convert from a partnership into a limited company or even consider a stock exchange flotation?

Irwin Mitchell<sup>3</sup>, ranked amongst the top 25 UK law firms by Legal Week, is the first British law firm to announce plans to float on the Stock Exchange under new LSA rules. Managing Director John Pickering is quoted in The Times as saying, "The reforms will create exciting opportunities for strong, well-financed legal businesses to accelerate their growth plans. We intend to be at the forefront of these changes and have taken the decision to seek external investment to further our ambitious plans." Irwin Mitchell specialises in personal injury law, but also has a growing commercial practice that provides high-volume, commoditised legal services to businesses including banks and insurers, such as recovering debts and handling contracts.

1 Climate change: forecasting the impact of the Legal Services Act Oct 2010

2 WHSmith moves into legal services, The Telegraph, 7 April 2011

3 Law firm ready to break new ground with listing, The Times, 20 April 2011

## MDP – yet another organisation structure!

Going a step further, the growing belief is that a multi-disciplinary practice (MDP) is the future business structure of legal professional services organisations. Practices will not just consist of solicitors, but also accountants, independent financial advisers, estate agents, surveyors, and any other professional services providers, working together under one roof. Clients would be able to solicit advice on conveyancing, tax and financial planning, personal injury and wills, from a single firm.

So what will this entail? To begin with, numerous legal compliance issues. The ensuing entities will not only need to comply with the LSA, but also with legislations of other industry sectors like accountancy and financial services. This will make compliance, which is already complex, even more challenging.

Further, regulation is being revamped across industry sectors. So these newly formed organisations will need to come to grips with varied regulation that are 'works in progress' in themselves. To illustrate, the Institute of Chartered Accountants in England and Wales (ICAEW) is considering whether to apply to become an approved regulator under the LSA. However, there are a number of issues that require clarification before this idea can progress. There are questions pertaining to issues such as legal privilege and financial management. Currently, an advisor is protected in correspondence with a client when dealing with tax matters. But in MDPs will a solicitor working on a tax matter have legal privilege, but not the tax accountant who shares the same office? Also, in a MDP, will the organisation need to account for monies accruing from legal work separately from other monies, and only the former will be subject to an accountant's report?

Similarly, in the financial sector, the regulation of financial advisors is also being revamped. From 2012, all investment advisors will require accreditation from the Financial Services Authority, called a Statement of Professional Standing.

Interestingly, the challenge is not just for the professional services providers. These new compliance frameworks are new territory for the regulating bodies too. The Ministry of Justice's (MoJ) Road Traffic Accident (RTA) Personal Injury (PI) claims reforms are a case in point. The issues experienced by the MoJ, technology providers and law firms in launching and using the Personal Injury Portal, are well documented.

Further, should these MDPs have international aspirations, they would also need to comply with country specific and common international laws such as Money Laundering Regulations 2007; European legislation such as the Statutory Audit and the Company Reporting Directives, together commonly referred to as the EU's version of the Sarbanes-Oxley Act.

Internationalisation will require a greater focus on risk management as exposure – not only from the point of view of the financial investment and cost control, but also for non-compliance in this growing and evolving regulatory minefield.

## Operational efficiency key to any type of practice

Regardless of law firms' future plans – be it merging with another firm, entering into a network of law firms to expand reach, bringing in external investment or seeking private equity or becoming a MDP – the ability to demonstrate operational efficiency, compliance and corporate governance will be crucial in being perceived as attractive businesses. This also means that practices will need to do more than just be good at law and/or any other discipline – they will need to be equally good at collaboration, project management and good financial planning, as is expected of any profitable business. Achieving synergies and cost efficiencies in the day-to-day operations of practices will become imperative to ensuring a healthy bottom line. The need for these capabilities will be more pronounced as the shift in the payment structure from an hourly invoicing model to a fixed fee becomes the norm.

Given the potential varied scope of professional services offerings from multi-faceted practices, perhaps for the first time, law firms now need to consider technology that is wider in scope than the traditional practice and case management systems used up until now, but also different models for IT adoption such as IT outsourcing.

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## Enterprise resource planning indispensable

Adopting the mindset of large enterprises, law firms or MDPs need to consider implementing workflow-based enterprise resource planning (ERP) systems that encompass everything from client management, case management, resource planning, finance and accounting, compliance, reporting and business intelligence.

Such tools can deliver several advantages to firms. For instance, practices will need to comply with the SRA alongside other regulatory bodies. ERP systems can enable more efficient integration through the use of a single system. They can help identify patterns and similarities across regulatory requirements and reduce duplication effort, delivering cost efficiencies in managing exposure to risk and non-compliance. In addition, they can ensure that firms always maintain audit trails of all transactions, billings and payments in adherence with the various country specific and industry legislations. This will become more pertinent than ever before as non-industry specific personnel become involved in running these businesses, ensuring that corporate policy is enforced and guesswork reduced. Similarly, from a Human Resources department perspective, an ERP system can help forecast budgets, identify need for new skills, meet staffing needs, and ensure that professionals with the right expertise are allocated to clients – this is especially important given the SRA's move towards a more qualitative style of measuring professional conduct and service delivery to customers.

## Conclusion

Whatever be the strategic objectives of law firms, they must actively take advantage of the changing landscape, overcoming the natural instinct to continue in the same vein as before. While there are serious hurdles to overcome, the opportunity is equally immense. Today, law firms have the opportunity to add new offerings across multiple disciplines by creatively taking advantage of the new types of business structures. This has never been possible before. The downside of course is that the LSA will abet the commoditisation of legal services, already set into motion by the growth of internet-based offerings. This, along with the entry of household brands with substantially more financial muscle means that law firms that don't think strategically and out of the box, will face an unprecedented, uphill struggle to survive. Adopting the right technology, but also leveraging alternative ways of consuming technology through IT and business process outsourcing and software-as-a-service will tremendously contribute to the success of practices, whatever be their size. It is the means to business performance and growth.

## For more information

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