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## **ACCOUNTABILITY AND THE REGULATION OF THE LARGE LAW FIRM LAWYER**

**Joan Loughrey\***

### **Abstract**

The regulation of solicitors in England and Wales has undergone great change in the wake of the Legal Services Act 2007. This article considers these regulatory developments through the lens of accountability, focussing on the regulation of transactional lawyers and the large commercial firms. It examines to what extent the Solicitors Regulation Authority's regulatory framework promotes accountability, examining entity regulation, outcomes-focussed and principles-based regulation, reporting and disclosure obligations, the Compliance Officer for Legal Practice and the sanctions system. It argues that although transactional lawyers cannot claim the benefit of the ethical principle of non-accountability, as far as they and their firms are concerned, the regulatory framework is both unnecessary and insufficient. It duplicates the function of accountability to the client and fails to hold transactional lawyers to account for significant regulatory risks that they present, such as the practice of creative compliance.

**Key words:** legal profession; accountability; regulation; Legal Services Act 2007.

A

### **INTRODUCTION**

The legal services market in England and Wales and the legal profession's regulatory framework has undergone immense change in response to the Legal Services Act 2007. This article considers the significance of regulatory developments through the lens of accountability, an under-explored concept in the literature on legal professional regulation, focussing on the regulation of corporate lawyers carrying out transactional work and large commercial firms. This specific focus is warranted as it has long been recognised that there are significant differences between the various sectors of the profession, such that changes in the legal services market and in regulation may have a very different implications depending on the sector concerned.<sup>1</sup> It will be argued that as far as the large commercial firms and their lawyers are concerned, the regulatory framework is both unnecessary and insufficient. It duplicates the function of accountability to the client and fails to hold transactional lawyers to

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<sup>1</sup> J. P. Heinz and E. O. Laumann, *Chicago Lawyers: The Social Structure of the Bar* (Illinois: Northwestern University Law Press, 1982) 319; A. Francis, 'Legal Ethics, the Marketplace and the Fragmentation of Legal Professionalism' (2005) 12 *International Journal of the Legal Profession* 173.

account for significant regulatory risks that they present, such as the practice of creative compliance. This term, coined by McBarnett and Whelan,<sup>2</sup> refers to:

the use of technical legal work to manage the legal packaging, structuring and definition of practices and transactions, such that they can claim to fall on the right side of the boundary between lawfulness and illegality. It is essentially the practice of using the letter of the law to defeat its spirit, and to do so with impunity.<sup>3</sup>

The accountability, or lack thereof, of transactional lawyers is a matter of considerable societal importance, not least because of creative compliance, which is a feature of tax avoidance activities<sup>4</sup> as well as the financial engineering that caused so much harm during the financial crisis.<sup>5</sup> For example lawyers acting for banks and financial institutions assisted their clients in designing off balance sheet and structured finance products that technically met regulatory requirements but were deliberately designed to circumvent risk based capital adequacy regulation and evade regulatory controls.<sup>6</sup> The purpose of the regulatory controls was to ensure that banks had sufficient capital to absorb unexpected losses and declines in assets values. However the use of off balance sheet finance and structured credit allowed banks to increase their level of risk exposure whilst disguising the true level of risk they were exposed to, which in turn left them ‘hugely vulnerable to shifts in confidence and liquidity’.<sup>7</sup> The result was that many banks were inadequately capitalised when the crisis began and unable to absorb the losses that materialised. While structured finance can be used for

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<sup>2</sup> D. McBarnett and C. Whelan, ‘The Elusive Spirit of the Law: Formalism and the Struggle for Legal Control’ (1991) 54 MLR 848, 848.

<sup>3</sup> D. McBarnett, ‘After Enron Will “Whiter than White Collar Crime” Still Wash?’ (2006) 46 British Journal of Criminology 1091, 1091.

<sup>4</sup> HC Committee on Public Accounts, Tax Avoidance: The Role of Large Accountancy Firms HC 870 (2013), 8-9. While this report highlights accountancy firms, it is likely that tax lawyers, who compete with these firms, also engage in this practice.

<sup>5</sup> D. McBarnett, ‘Financial Engineering or Legal Engineering? Legal Work, Legal Integrity and the Banking Crisis’ in I. MacNeil and J. O’Brien (eds), *The Future of Financial Regulation* (Oxford: Hart Publishing 2010); S. Ashby, ‘The Turner Review on the Global Banking Crisis: A Response from the Financial Services Research Forum’ 17 at <http://www.nottingham.ac.uk/business/forum/documents/researchreports/papers.pdf> (last visited 30 October 2013)

<sup>6</sup> McBarnett, *ibid*, 69-74.

<sup>7</sup> FSA, *The Turner Review: A Regulatory Response to the Global Banking Crisis* (March 2009) 20.

beneficial and legitimate ends, designing products that enable clients to evade the controls aimed at by the regulatory framework in the public interest and that defeat the protective purposes of that regulation raises profound problems of accountability. A lawyer who is answerable only to the client may have little incentive to resist client demands to devise such products. Nor is it a sufficient response that it is up to regulators to police such behaviour: as McBarnet has argued, the financial products were designed by lawyers to be opaque, making it extremely difficult for regulators to see ‘through the fog of complexity’.<sup>8</sup> Such designed opacity allows ‘the culture of circumvention’<sup>9</sup> to go unchallenged, and impedes the ability of regulators to hold those responsible to account. It also obstructs debate over the legitimacy of such activity and the degree to which lawyers should be accountable for it.

The article is structured as follows. It first considers what is meant by accountability, a concept that has been termed a ‘chameleon’.<sup>10</sup> It then argues that transactional lawyers cannot claim the benefit of the principle of non-accountability. Next it identifies the various ends accountability might serve before turning to the regulatory framework in England and Wales. As the majority of large law firm lawyers are solicitors and regulated by the Solicitors Regulation Authority (SRA), we are concerned with the regulatory mechanisms introduced by the SRA. The accountability implications of entity regulation, outcomes-focussed and principles-based regulation will be assessed before turning to examine particular accountability mechanisms, namely reporting and disclosure, the Compliance Officer for Legal Practice (COLP) and the sanctions system. It finally assesses what transactional lawyers are accountable for under the present regime, before concluding.

## A **THE SCOPE OF ACCOUNTABILITY**

### B **Defining accountability**

Accountability is widely accepted to be an elusive concept, not least because its meaning is affected both by the context in which it is used and by the discipline defining and analysing

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<sup>8</sup> McBarnet, n 5 above, 80.

<sup>9</sup> Ibid.

<sup>10</sup> A. Sinclair, ‘The Chameleon of Accountability: Forms and Discourses’ (1995) 20 *Accounting, Organizations and Society* 219.

it.<sup>11</sup> In the context of the literature on the legal profession and legal ethics, those who argue that lawyers should be accountable sometimes mean that lawyers should feel responsible for what they do, that is, that they should feel an inward sense of moral obligation or internal accountability to their conscience for acting in ways that affect the lives of others.<sup>12</sup> For example when Rhode argues that moral integrity requires lawyers to bear personal accountability for the consequences of their professional actions, she states that this requires that, when acting as lawyers, they should ‘assess their decisions under the same kind of consistent, disinterested and generalizable principles that are applicable in other settings’.<sup>13</sup> This emphasises the exercise of personal judgment and the self-evaluation of behavior. When lawyers assess their conduct against a set of internalised standards that derive from professional standards and values, this type of accountability can be referred to as professional accountability or role responsibility.<sup>14</sup> However, as Mulgan points out, because a person will only feel responsible when they have internalised professional values, accountability in this sense is not just professional but also personal.<sup>15</sup>

Others draw a distinction between accountability and responsibility, and see accountability as an external mechanism imposed on an actor, rather than a personal quality. This sense of accountability looks outwards and comprises a number of core elements, namely that an actor is called to account and obliged to explain and justify their conduct to a third party who can ask questions and pass judgment.<sup>16</sup> The legal ethics literature envisages a number of audiences to whom lawyers could be required to provide their account. For example Schwartz refers to the legal, professional and moral accountability of lawyers,<sup>17</sup> thus encompassing an audience of the courts and external regulators with responsibility for law

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<sup>11</sup> *ibid*, 221, arguing that the more we try to define the concept the murkier it becomes.

<sup>12</sup> D. Rhode, *In the Interests of Justice: Reforming the Legal Profession* (Oxford: Oxford University Press, 2000) 66-67. See also Sinclair, *ibid*, 230-231; R. Mulgan, “‘Accountability’: An Ever Expanding Concept?” (2000) 78 *Public Administration* 555, 556;

<sup>13</sup> D. Rhode, ‘Personal Integrity and Professional Ethics’ in K. Tranter, F. Bartlett, L. Corbin, M. Robertson and R. Mortensen, *Reaffirming Legal Ethics: Taking Stock and New Ideas* (Abingdon: Routledge, 2010) 29.

<sup>14</sup> J. R. Lucas, *Responsibility* (Oxford: Clarendon Press, 1993) 193-194; Sinclair, n 10 above, 223, 229.

<sup>15</sup> Mulgan, n 12 above, 560.

<sup>16</sup> *ibid*, 555; M. Bovens, T. Schillemans and P.’T Hart, ‘Does Public Accountability Work? An Assessment Tool’ (2008) 86 *Public Administration* 225, 234.

<sup>17</sup> M. Schwartz, ‘The Professionalism and Accountability of Lawyers’ (1978) *California Law Review* 669, 673.

enforcement (legal accountability), professional regulator(s) (professional accountability) and, possibly, society (moral accountability). Lawyers may also be required to give an account to superiors within their organization, which is a form of managerial accountability, and may be held to account by their clients, through reporting obligations.<sup>18</sup>

External accountability also incorporates the idea that the actor may face consequences, which can include rewards or sanctions.<sup>19</sup> What is important is the possibility of consequences being visited upon the actor, rather than their actual imposition: it is the former that ‘makes the difference between non-committal provision of information and being held to account’.<sup>20</sup> Consequences can include formal regulatory sanctions, such as the disciplinary sanction of the courts or regulators, or the imposition of legal liability through civil suits.<sup>21</sup> The legal ethics literature often uses accountability in this formal sense when critiquing the inefficacy of the profession’s disciplinary processes in holding to account and sanctioning lawyers who fail their clients.<sup>22</sup> However consequences can also include informal social and commercial sanctions and even rewards, such as those imposed by clients through the grant or loss of business.<sup>23</sup>

While external accountability often refers to an ex post process of providing an account of certain decisions or conduct to a third party,<sup>24</sup> it can also refer to ex ante mechanisms that act as ‘checks on decision-making’,<sup>25</sup> that is, mechanisms that operate to

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<sup>18</sup> C. Whelan and N. Ziv, ‘Privatizing Professionalism: Client Control of Lawyers’ Ethics’ (2012) 80 *Fordham L. Rev.* 2577, 2605-2607 and generally.

<sup>19</sup> M. Bovens, ‘Analysing and Assessing Accountability: A Conceptual Framework’ (2007) 13 *European Law Journal* 447, 451.

<sup>20</sup> *ibid.*

<sup>21</sup> W. Bradley Wendel, ‘Informal Methods of Enhancing the Accountability of Lawyers’ (2003) 54 *South Carolina Law Review* 967, 969; R. Hillman, ‘Whatever Happened to the Market for Partners’ Desks? The Milberg Indictment as an Inquiry into Accountability’ (2007) 2 *Journal of Business and Technology Law* 415, 416; S. Saab Fortney, ‘Law as a Profession: Examining the Role of Accountability’ (2012) 40 *Fordham Urban Law Journal* 177, 214-215

<sup>22</sup> See for example, D. Rhode, ‘Opening Remarks: Professionalism’ (2001) 52 *South Carolina Law Review* 458, 467-470.

<sup>23</sup> Bradley Wendel, n 21 above; W. Bradley Wendel, ‘Nonlegal Regulation of the Legal Profession: Social Norms in Professional Communities’ (2001) 54 *Vanderbilt Law Review* 155.

<sup>24</sup> Bovens, Schillemans and ’T Hart, n 16 above, 227.

<sup>25</sup> J. Freeman, ‘The Private Role in Public Governance’ (2000) 75 *New York University Law Review* 543, 664-665.

affect decision-making processes and therefore the content of particular decisions. On other occasions, particularly in the US context, accountability refers not to external mechanisms of accountability, but rather to a set of standards for evaluating the behaviour of actors.<sup>26</sup> This highlights the normative nature of accountability.<sup>27</sup> These standards reflect a moral order and communicate ‘ideals of accepted behaviour’.<sup>28</sup> Thus Rhode identifies the inadequacy of the US profession’s bar codes in setting appropriate standards of behaviour as a failure of accountability.<sup>29</sup> The question of what constitutes appropriate behaviour can be contentious, as a previous furore over whether transactional lawyers should report on misbehaviour by corporate management exemplified.<sup>30</sup>

Finally accountability is sometimes correlated with ‘responsiveness’, being the extent to which actors anticipate and pursue the wishes or needs of those on whose behalf they act.<sup>31</sup> This usefully draws attention to the fact that being accountable does not necessarily involve actually giving an account but rather refers to the ability of others to require an account to be given and to the fact that those being held to account may adjust their behaviour not because they are actually held to account, but because they anticipate their conduct being scrutinised in the future.<sup>32</sup>

It is important to be clear about the sense in which accountability is being used because it can influence the preference for, and choice of, regulatory mechanisms. For

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<sup>26</sup> Bovens, Schillemans and ‘T Hart, n 16 above, 226-227.

<sup>27</sup> See further H. A. Simon, D. W. Smithburg, V. A. Thompson, *Public Administration* (New York: Knopf, 1950) 513.

<sup>28</sup> J. Roberts and R. Scapens, ‘Accounting Systems and Systems of Accountability-Understanding Accounting Practices in their Organisational Contexts’ (1985) 10 *Accounting Organizations and Society* 443, 448.

<sup>29</sup> D.L. Rhode, ‘Defining the Challenges of Professionalism: Access to Law and Accountability of Lawyers’ (2003) 54 *South Carolina Law Review* 889, 894-895. See also M. Ellis, ‘Developing a Global Program for Enhancing Accountability: Key Ethical Tenets For the Legal Profession in the 21<sup>st</sup> Century’ (2003) 54 *South Carolina Law Review* 1011, 1012 asserting that the profession’s accountability can be enhanced through codes of professional conduct.

<sup>30</sup> See S.P. Koniak, ‘When the Hurlyburly’s Done: The Bar’s Struggle with the SEC’ (2003) 103 *Columbia Law Review* 1236, 1269-1279; J. C. Coffee Jr., *Gatekeepers: The Professions and Corporate Governance* (Oxford: Oxford University Press, 2006) 219-220.

<sup>31</sup> M.G. O’Loughlin, ‘What is Bureaucratic Accountability and How Can We Measure It?’ (1990) 22 *Administration and Society* 275, 284.

<sup>32</sup> Mulgan, n 12 above, 567.

example those who emphasise internal accountability can link it to recommendations to reduce the demands of external accountability and to place more trust in the independent judgment of the actors.<sup>33</sup> Similarly those who equate responsiveness to clients with accountability are more likely to place faith in private-sector market style management mechanisms, rather than external accountability to regulators.<sup>34</sup>

This highlights that another reason for distinguishing between forms of accountability is that finding that a lawyer accountable in one sense does not settle the question of whether they are, or should be, accountable in other senses. Lawyers may be sufficiently responsive to clients but it does not follow that adequate mechanisms are in place to hold them to account for all the activities they engage in that may present ethical or regulatory challenges. Moreover different types of accountability can emphasise different values and pull in different directions. Thus Mulgan argues, ““(p)rofessional” accountability is largely a matter of probity and being business-like while personal accountability raises issues of honesty and the public interest’.<sup>35</sup> As Whelan’s work demonstrates, lawyers’ interpretation of what the professional value of commitment to the client’s interests requires can lead to them assisting clients in conduct which harms the public interest.<sup>36</sup> Thus an accountability structure that incorporates public interest concerns may conflict with accountability in the form of responsiveness to the client and vice versa. Moreover while regulatory mechanisms may successfully impose external accountability, they may fail to promote, and even undermine, internal accountability. In other words instigating one form of accountability might degrade others.

For the sake of clarity therefore the present discussion refers to internal accountability as responsibility and confines the term accountability to refer to external mechanisms of being held to account. There is no necessary link between these two concepts: a person can be accountable without feeling a sense of responsibility. On the other hand when we say that someone is responsible for a state of affairs we often mean that they have control over it, or were instrumental in bringing it about, or that they have been assigned responsibility for the matter as part of their job or role. These conditions must usually be satisfied before we

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<sup>33</sup>        ibid, 571.

<sup>34</sup>        ibid, 568 and 571.

<sup>35</sup>        ibid, 562.

<sup>36</sup>        C. Whelan, ‘Some Realism About Professionalism: Core Values, Legality and Corporate Law Practice’ (2007) 54 Buffalo Law Review 1067, 1086, 1125-1127.



would think it fair to hold a person accountable for that state of affairs, or the conduct that led to it.<sup>37</sup> Responsibility in this sense is therefore a necessary condition for, but prior to, accountability.

## B **What should transactional lawyers be accountable for?**

In the context of legal professional ethics much of the discussion about accountability has focussed on the concept of non-accountability. Nonaccountability forms part of what has been termed ‘the standard conception of legal ethics’.<sup>38</sup> According to the standard conception, lawyers’ role as professionals requires them to zealously defend and advance their clients’ interests (partisanship) and adopt a neutral non-judgmental approach to their clients’ instructions (neutrality).<sup>39</sup> Given the requirement to be neutral, lawyer should not be held accountable for their clients’ actions, nor for the things they do on their clients’ instructions (non-accountability).<sup>40</sup>

There are long standing arguments that the justifications for neutrality and non-accountability are not applicable to transactional work. As many have pointed out, the importance of these principles derives from their role in the criminal defence context.<sup>41</sup> In that context it is important that lawyers are not held responsible for the beliefs and behaviour of their clients so that they are not discouraged from representing unpopular clients and causes. This serves the public interest by facilitating access to justice and to adequate legal representation for those accused of crimes.<sup>42</sup> These considerations do not apply to transactional work. On the other hand neutrality in this context can be defended on the basis that it prevents lawyers from imposing upon the client their paternalistic views of the

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<sup>37</sup> Mulgan, n 12 above, 561. See also H.L.A. Hart *Punishment and Responsibility* (Oxford: Oxford University Press, 1968), 211-215 and 225-227.

<sup>38</sup> G. J. Postema, ‘Moral Responsibility in Professional Ethics’ (1980) 55 *New York University Law Review* 63, 73.

<sup>39</sup> *ibid*; T. Dare, *The Counsel of Rogues? A Defence of the Standard Conception of the Lawyer’s Role* (Burlington: Ashgate, 2009) 5-11.

<sup>40</sup> D. Luban, *Lawyers and Justice: an Ethical Study* (Princeton: Princeton University Press, 1988) 7 and 52.

<sup>41</sup> For example, R. Gordon, ‘A New Role for Lawyers? The Corporate Counselor After Enron’ (2003) 35 *Connecticut Law Review* 1185, 1204-1207.

<sup>42</sup> Luban, n 40 above, 59-60; *ibid*, 1206-1207.

rightness or wrongness of the client's instructions.<sup>43</sup> This promotes client autonomy and access to the law, by enabling clients to achieve objectives that would not be possible without a lawyer's assistance.<sup>44</sup> Refusing assistance would fail to respect autonomy and would be objectionable because it fails to respect an individual as a moral person.<sup>45</sup> Problematically however the transactional lawyer's client is often a company. Companies are not moral persons,<sup>46</sup> and unlike autonomous moral persons, companies, or more specifically those acting on their behalf, are unable to take into account the full range of moral considerations when determining what the company can do, but must instead focus on shareholder interests.<sup>47</sup> The principle of respect for persons does not therefore require respect for a company's autonomy: it is doubtful that it is even legitimate to describe companies as autonomous.<sup>48</sup> Given this, a significant rationale for lawyers adhering to neutrality and suspending their moral judgment does not apply.<sup>49</sup>

However both Bradley Wendel and Dare have offered defences of the standard conception and of the principles of neutrality and non-accountability which could justify their application in the transactional context. Bradley Wendel argues that law constitutes a shared framework for co-operative action in a pluralist society and for the authoritative resolution of disagreements.<sup>50</sup> By mediating between differing views of right behaviour the law contributes to social solidarity. To facilitate this process lawyers must suspend their judgment about, and should represent their clients irrespective of, the rightness or wrongness of their client's cause because in doing so they permit competing voices to be heard and thereby support 'a complex

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<sup>43</sup> S. Pepper, 'The Lawyer's Amoral Ethical Role: A Defense, A Problem and Some Possibilities' (1986) *American Bar Foundation Research Journal* 613, 618.

<sup>44</sup> *ibid*, 617.

<sup>45</sup> J.S. Mill, *On Liberty* (London: John W Parker and Son, 1859) (2<sup>nd</sup> edn), 26-27, 104-109 and 113-114.

<sup>46</sup> Not all agree: see discussion G. Moore, 'Corporate Moral Agency: Review and Implications' (1999) 21 *Journal of Business Ethics* 329, 331-332.

<sup>47</sup> See *Companies Act 2006*, s.172. B Hannigan, 'Board Failures in the Financial Crisis: Tinkering with Codes and the Need for Wider Corporate Governance Reforms: Part 2' (2012) *Company Lawyer* 35, 39-40.

<sup>48</sup> Luban, n 40 above, 217.

<sup>49</sup> J. McMorrow and L. Scheuer, 'The Moral Responsibility of the Corporate Lawyer' (2011) 60 *Catholic University Law Review* 275, 286-290.

<sup>50</sup> W. Bradley Wendel, *Lawyers and Fidelity to the Law* (Princeton: Princeton University Press, 2010), 9 and Ch 3.

institutional arrangement that makes stability, coexistence and cooperation possible in a pluralistic society'.<sup>51</sup> Consequently lawyers should not be blamed for acting in this way.

Dare similarly sees law as a mediating institution essential to the flourishing of a stable pluralistic society.<sup>52</sup> The community's decision-making procedures constituted in the law do not privilege any one person's view of the good but are structured to take all reasonable views seriously. This view of the law legitimises and requires neutrality, because a lawyer who allows his or her moral views to prevail over the client's denies the client the right to have his or her views taken seriously and to have disputes over what should be done resolved through the procedures and institutions of the law. Neutrality is required because it is not for lawyers to arrogate to themselves the right to determine what the community should do.<sup>53</sup> In addition, because decisions over which interests should receive legal protection should be left to the community's legal institutions, lawyers should not be deterred from acting to protect unpopular but 'protected views of the good' by the prospect of being held accountable for doing so.<sup>54</sup>

A significant objection to this approach is the extent to which transactional lawyers create law rather than giving effect to law made elsewhere.<sup>55</sup> Dare argues that decisions about the public good (such as what sort of tax system we have) are things to be decided in the public arena of politics and 'not in private in the offices of particular lawyers'.<sup>56</sup> Yet this influential private ordering is exactly the kind of activity that transactional lawyers engage in.<sup>57</sup> Much of the innovative legal solutions devised by lawyers are rarely subject to public scrutiny and do not involve the rights-adjudicating institutions of the State.<sup>58</sup>

Furthermore often lawyers are not simply neutral passive conduits of the client's instructions, confined to executing instructions given to them by the client: often they lead the way and frequently transactions cannot proceed without their participation.<sup>59</sup> Lawyers not only

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<sup>51</sup> *ibid*, 10 and Ch 4.

<sup>52</sup> n 39 above, 61-63.

<sup>53</sup> *ibid*, 74-75.

<sup>54</sup> *ibid*, 75.

<sup>55</sup> See for example, M. Powell 'Professional Innovation: Corporate Lawyers and Private Lawmaking' (1993) 18 *Law and Social Inquiry* 423.

<sup>56</sup> n 39 above, 77 and see also 117.

<sup>57</sup> Whelan, n 36 above, 1126-1130.

<sup>58</sup> McMorrow and Scheuer, n 49 above, 291-294.

<sup>59</sup> M. Sargent, 'Lawyers in the Perfect Storm' (2003) 43 *Washburn Law Journal* 1, 33.

implement client choices, they identify which choices are available and influence which are made and, as such, are valued as ‘deal-makers’.<sup>60</sup> For these reasons McMorrow and Scheuer argue that transactional lawyers cannot avail themselves of the principle of neutrality and are accountable for, and must justify what they do, by reference to the content of their work itself, that is, by reference to the social good it achieves.<sup>61</sup>

Bradley Wendel recognises these problems and argues that transactional lawyers must show fidelity to the law and interpret it reasonably, given that their interpretations will not be subject to external adjudication.<sup>62</sup> However it is certain that at least some of transactional lawyers’ work involves creative compliance, which involves lawyers adopting strained and technical interpretations of the law in order to defeat its purposes. The full extent of such activity is unclear, because these activities are shielded from scrutiny by legal professional privilege.<sup>63</sup> Nevertheless there have been occasions when that veil has been pulled aside and creative compliance revealed. For example the charges brought against Standard Chartered Bank by the New York State Department of Financial Services, alleging that the bank had concealed Iranian involvement in financial transactions, relied on the contents of privileged communications.<sup>64</sup> These showed that while the bank’s in-house lawyers and the bank may have hoped that the transactions were technically legal, it was clear that they violated the spirit of the law, and the bank seemed to be indifferent to warnings from outside counsel that the transactions crossed the line of legality.<sup>65</sup> Again, prior to the financial crisis, lawyers

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<sup>60</sup> R. Painter, ‘The Moral Interdependence of Corporate Lawyers and their Clients’ (1994) *Southern California Law Review* 507, 543-546 and 579; R. Lee, *Firm Views: Work of and Work in the Largest Law Firms* (Law Society, Research Study 35, 1999) 16.

<sup>61</sup> n 49 above, 307-308.

<sup>62</sup> n 50 above, 189 and 203-204.

<sup>63</sup> See for example *Barclays Bank PLC v Guardian News & Media Ltd* [2009] EWHC 591 (QB): a newspaper was gagged from revealing Barclays aggressive tax avoidance activities as the leaked documents subject to legal professional privilege.

<sup>64</sup> See New York State Department of Financial Services, *In the Matter of Standard Chartered Bank, New York Branch*, at <http://www.dfs.ny.gov/banking/ea120806.pdf> (last visited 12 October 2012); the charges were settled with Standard Chartered agreeing inter alia to pay a fine of \$340,000,000 : New York State Department of Financial Services, *In the Matter of Standard Chartered Bank, New York Branch, Consent Order* (14 August 2012), at [http://www.stepto.com/assets/htmldocuments/5.%20DFS%20Consent%20Order\(2\).pdf](http://www.stepto.com/assets/htmldocuments/5.%20DFS%20Consent%20Order(2).pdf) (last visited 4 June 2014).

<sup>65</sup> *ibid*, at paras 20-21 and 33- 34 for example. See also R. Moorhead, ‘On the Wire’ *New Law Journal* (17 August 2012).

advised financial institutions on how to design credit swap securitizations and derivatives so as to avoid regulation.<sup>66</sup> ‘Elite’ law firms were also involved in assisting Barclays Bank plc and others in aggressive tax avoidance schemes.<sup>67</sup> Moreover an empirical study has demonstrated that lawyers influence client behaviour away from normative compliance and towards game-playing and creative compliance.<sup>68</sup>

Neither Bradley Wendel’s nor Dare’s view of the standard conception support exempting lawyers from accountability for such conduct. Thus Bradley Wendel argues that transactional lawyers should not engage in loophole lawyering, nor act on dubious interpretations of the law that violate its spirit, though respecting the letter.<sup>69</sup> Dare meanwhile draws a distinction between ‘mere zeal’ and ‘hyper-zeal’, the former being concerned with zealously seeking to secure the client’s legal rights and permissible, whilst the latter impermissibly involves pursuing every advantage obtainable for the client through the law, even when this might involve legal ‘dirty tricks’.<sup>70</sup> It follows that transactional lawyers cannot plead neutrality and non-accountability in order to defend creative compliance. For these reasons, and because there is no dispute that lawyers should be accountable for how they discharge obligations to their clients, even if one adheres to the standard conception and to the principle of non-accountability, it still makes sense to discuss why and how transactional lawyers should be held accountable for at least part of what they do.

## **B Why make lawyers accountable?**

Just as there are various definitions of accountability, so there is more than one answer to the question of why we might want lawyers to be accountable and what purposes accountability

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<sup>66</sup> McBarnet, n 5 above, 68-72, 76.

<sup>67</sup> F. Lawrence and D. Leigh, ‘New Whistleblower Claims over £1bn Barclays Tax Deals’, *The Guardian* (19 March 2009); *Barclays Bank PLC v Guardian News & Media Ltd* [2009] EWHC 591 (QB).

<sup>68</sup> C. Parker, R. Rosen and V. Nielsen, ‘The Two Faces of Lawyers: Professional Ethics and Business Compliance with Regulation’ (2009) 22 *The Georgetown Journal of Legal Ethics* 201, 224-225, 237-240; however the study focussed on in-house lawyers.

<sup>69</sup> n 50 above, 9 and 53-54, 81-85.

<sup>70</sup> n 39 above, 76-77. Dare does not however make clear how one is to differentiate between zeal and hyper-zeal in the transactional context, particularly when the law is unclear. His discussion is primarily directed at the litigation context, or to disputes between citizens, rather than to legal engineering that involves no disputes: at 78-88. Bradley Wendel’s account, in emphasising compliance with the spirit and objectives of the law (when these are apparent) is more useful in this respect.

could serve. Firstly it may be thought that requiring lawyers to exercise their moral faculties, and respond thoughtfully to questions about why they have acted as they have is a good in itself, regardless of whether it alters their behaviour.<sup>71</sup> Requiring persons to give reasons for what they do, and to make judgments about their character and conduct, renders their lives intelligible and meaningful. It is constitutive of moral identity and promotes moral agency.<sup>72</sup>

Secondly accountability may be aimed at altering lawyers' behaviour. It could do this by encouraging lawyers to have a more finely tuned sense of responsibility for their actions. For example Rhode has suggested that if lawyers are morally accountable for what they do on their client's behalf, then their personal and communal responsibility for justice will become integral to their practice, which in turn would improve the quality of justice and the administration of justice in society.<sup>73</sup> Lawyers' sense of responsibility could also affect the behaviour of others in socially beneficial ways. Thus Schwarcz has argued that banking lawyers, as independent outsiders who had intimate knowledge of the transactions at the heart of the financial crisis, could have drawn attention to potential problems inherent in these transactions and could have challenged the unreasonable assumptions being made by market participants.<sup>74</sup> But lawyers' capacity to do this would be compromised if they considered that their responsibility was only to execute their instructions and not to have regard to wider implications of the transaction.

Accountability could also alter or deter behavior without instilling any corresponding sense of responsibility such as when, for example, a person is held to account for breaching rules that they consider lacks legitimacy. Such a situation is problematic, because it could undermine responsibility: literature on law and social norms suggests that if the only reason rules are obeyed is because of the fear of external sanctions, the force of the rules as a guide for behaviour will weaken and eventually collapse, unless the possibility of sanctions is high.<sup>75</sup>

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<sup>71</sup> McMorrow and Scheuer, n 49 above, 308.

<sup>72</sup> W. Schweiker, 'Accounting for Ourselves: Accounting Practice and the Discourse of Ethics' (1993) 18 *Accounting, Organizations and Society* 231, 234-235.

<sup>73</sup> Rhode, n 12 above, 66-67, 79-80 .

<sup>74</sup> S. Schwarcz, 'The Role of Lawyers in the Global Financial Crisis' (2010) 24 *Australian Journal of Corporate Law* 214, 218-219.

<sup>75</sup> M. Eisenberg, 'Corporate Law and Social Norms' (1999) 99 *Columbia Law Review* 1253, 1260-1261; R. Jones and M. Welsh, '*Towards a Public Enforcement Model for Directors' Duty of Oversight*' (2012) 45 *Vanderbilt Journal of Transnational Law* 343, 368-371.

Thirdly external accountability may be necessary to debias individual lawyers' decision-making and offset the influence of self-interest, rationalisation, denial and avoidance behaviour.<sup>76</sup> Lawyers, like others, are not capable of fairly judging (or checking) themselves. They are just as vulnerable to the effects of egocentrism which causes people to interpret information in ways that favor themselves, and to confirmation bias whereby people look for information that confirms the correctness of their view and disregard negative information.<sup>77</sup> This has obvious implications where there is a conflict between the lawyer's interests and the client's, but it also has ramifications where the lawyer's and client's interests coincide but conflict with the public interest in respect for the law. Without external accountability as a check, there is a real risk that lawyers will find excuses for unethical conduct.<sup>78</sup>

Fourthly accountability may be used to address defective decision-making processes within regulated firms that can undermine regulatory compliance. It has been argued that when firms are set externally formed regulatory goals, but given a discretion regarding how to achieve these, they may act in ways that, while achieving the appearance of compliance, minimise disruption to existing practices, promote the firms' objectives and undermine the efficacy of the external goals.<sup>79</sup> This is most likely to occur where the regulatory objectives, such as an obligation to prioritise the public interest, conflict with efficiency and the firm's self interest.<sup>80</sup> Bamberger argues that such behaviour occurs due to decision-making pathologies buried deep within the structures of firms. These include: the segmentation of information, which means that relevant information about, for example, regulatory risk may not reach top management, as employees consciously and unconsciously suppress information that reflects badly upon themselves; and the impact of existing routines in shaping the type of information communicated, which may ignore information about new and

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<sup>76</sup> D. Barnhizer, 'Profession Deleted: Using Market and Liability Forces to Regulate the Very Ordinary Business of Law' (2004) 17 *Georgetown Journal of Legal Ethics* 203, 225-227.

<sup>77</sup> L. Levin, 'Bad Apples, Bad Lawyers or Bad Decisionmaking: Lessons from Psychology and From Lawyers in the Dock' (2009) 22 *Georgetown Journal of Legal Ethics* 1549, 1583-1584, 1566.

<sup>78</sup> Barnhizer, n 76 above, 225-226. See also *ibid*, 1583-1584.

<sup>79</sup> K. Bamberger, 'Regulation as Delegation: Private Firms, Decision-making, and Accountability in the Administrative State' (2006) 56 *Duke Law Journal* 377, 427-429. See also K. Krawiec, 'Cosmetic Compliance and the Failure of Negotiated Governance' (2003) 81 *Washington University Law Quarterly* 487, 523 and 533; Bradley Wendel, n 50 above, 203-204.

<sup>80</sup> Bamberger *ibid*, 417.

unanticipated risks.<sup>81</sup> Accountability, in the form of mechanisms that disrupt insular ways of thinking, is required to address these problems.<sup>82</sup>

Fifthly accountability may be aimed at monitoring and controlling power<sup>83</sup> in order to prevent corruption and induce proper standards of conduct.<sup>84</sup> The sophisticated clients of transactional lawyers are far from immune from the threat that lawyers may abuse their position of power and trust, but these clients nevertheless possess a counter-veiling market power to impose retaliatory sanctions. There is therefore less need for regulatory accountability directed at client protection in this context. On the other hand, Barnhizer has argued that corporate lawyers should be more highly regulated than others because they exercise significant power over the quality of the law and its strength as an institution, and manipulate social and economic policy on behalf of their influential clients.<sup>85</sup> Related to this is the argument that where those accountable are entrusted with a discretion regarding how to exercise power, accountability is necessary to ensure that trust is not abused. The broader the discretion the greater the degree of accountability required.<sup>86</sup> Given that corporate lawyers have more discretion than advocates and litigators in how to interpret the law and structure deals, since much of what they do is not in public view, there is again arguably a pressing need for them to be subject to accountability.

Sixthly accountability may also be necessary to achieve or maintain legitimacy and in particular to legitimate power by ensuring ex ante that decisions are taken in an informed, balanced and open manner<sup>87</sup> and ex post by holding abuses of power to account. Thus the profession's reputation as a whole could be damaged if lawyers are not accountable for misconduct towards clients.<sup>88</sup> Again, the practice of creative compliance by transactional lawyers arguably constitutes an abuse of the power they exercise on their clients' behalf, also

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<sup>81</sup> *ibid*, 418-421. On decision making biases within organizations see also D. Langevoort, 'Organized Illusion: A Behavioral Theory of Why Corporations Mislead Stock Market Investors (And Cause Other Social Harms)' (1997) 146 *University of Pennsylvania Law Review* 101, 120-126 and 131-136.

<sup>82</sup> Bamberger, *ibid*, 439.

<sup>83</sup> Mulgan, n 12 above, 563..

<sup>84</sup> Bovens, Schillemans and 'T Hart, n 16 above, 225.

<sup>85</sup> Barnhizer, n 76 above, 221-222.

<sup>86</sup> T. Frankel, 'Accountability and Oversight of the Internet Corporation for Assigned Names and Numbers (ICANN)' (Boston University School of Law, Working Paper no. 02-15, 2002), 31 at <http://ssrn.com/abstract=333342> or <http://dx.doi.org/10.2139/ssrn.333342> (last visited 30 October 2013).

<sup>87</sup> *ibid*, 25-27.

<sup>88</sup> Rhode, n 22 above, 467-470.



raising questions of legitimacy, particularly the legitimacy of legal professional privilege. Legal professional privilege is said to be necessary to encourage frank disclosure of the facts by clients to their lawyers thus allowing lawyers to give accurate legal advice which, in turn, enables clients to order their affairs in accordance with the law.<sup>89</sup> However insofar as it shields creative compliance it may serve no public interest. On the contrary, by concealing this practice from scrutiny and rendering lawyers and their clients unaccountable for such behaviour, it may work against the public good and in the service of purely private interests.

Problems of legitimacy also arise for the SRA if it fails to institute adequate systems to hold large law firms and their lawyers to account, whilst pursuing lawyers in smaller firms.<sup>90</sup>

Finally accountability may be a means of facilitating corrective justice, by ensuring that those harmed by another's actions are compensated for that harm, or it may have a retributive function, facilitating the punishment of a person who has done wrong.

In sum, just as different versions of accountability may mean quite different things so accountability may have different purposes and ends. A regulatory framework that performs well in promoting certain goals through accountability may nevertheless perform poorly in relation to others.

A

## **THE REGULATORY FRAMEWORK IN ENGLAND AND WALES**

In the light of the preceding discussion, this section considers the implications of the regulatory framework in England and Wales for the accountability of large law firms and their lawyers. It first considers the accountability implications of entity, risk-based and outcomes-focussed regulation. It then assesses key regulatory accountability mechanisms namely reporting and disclosure, the Compliance Officer for Legal Practice (COLP), and sanctions.

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<sup>89</sup> Three Rivers v Governor and Company of the Bank of England (No. 6) [2004] UKHL 48, [2005] 1 AC 610 at 649-650 per Lord Scott; R (on the application of Prudential plc) v Special Commissioner of Income Tax [2013] UKSC 1; [2013] 2 AC 185 at [117]-[118] per Lord Sumption, at [143] per Lord Clarke.

<sup>90</sup> See for example, the Society of Black Lawyers, Breaking the Silence: Who is Regulating the Regulator? Preliminary Findings and Case Studies on Inequality, Disproportionality and Alleged Wrongdoing by the Solicitors Regulation Authority (March 2012) at [http://www.legalservicesboard.org.uk/what\\_we\\_do/consultations/closed/pdf/sbl\\_response\\_to\\_consultation\\_doc.pdf](http://www.legalservicesboard.org.uk/what_we_do/consultations/closed/pdf/sbl_response_to_consultation_doc.pdf) (last visited 30 October 2013).

## Entity regulation

B

Both individuals and firms are regulated by the SRA under the SRA's Code of Conduct and Handbook. Firms are also required to comply with the terms of their licence to practice.<sup>91</sup> Although entity regulation is not entirely new-law firms have been regulated under the money-laundering regulations and could be enjoined from acting in situations of conflicts of interest<sup>92</sup>- the present system marks a significant move towards 'management-based regulation' whereby firm structures and management practices are co-opted into improving compliance with regulatory objectives.<sup>93</sup>

Commentators are divided over the wisdom of entity regulation. Some argue it is necessary because of the organisational influence that firms exercise over the behavior and thinking of their lawyers: entity regulation motivates firms to put in place 'ethical infrastructures' and remove organisational incentives for unethical conduct.<sup>94</sup> Others argue that entity regulation will undermine individual accountability even if accompanied (as in England and Wales) by individual liability for regulatory breaches, because it is easier for regulators to hold firms accountable than to track down the individuals responsible for infractions.<sup>95</sup> The extent to which this fear will be realised will depend on the nature of the breach and the SRA's attitude.<sup>96</sup> It may be obvious from a firm's files which individual is

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<sup>91</sup> Legal Services Act 2007, s18 and s176; SRA, Authorisation Rules for Legal Services Bodies and Licensable Bodies 2011, r 8.1 and r 8.2.

<sup>92</sup> Marks & Spencer Plc v Freshfields Bruckhaus Deringer [2004] EWCA Civ 741; [2005] PNLR 4; Money Laundering Regulations 2007 SI 2007/2157 r 3(9).

<sup>93</sup> C. Parker, T. Gordon and S. Mark, 'Regulating Law Firm Ethics Management: An Empirical Assessment of an Innovation in Regulation of the Legal Profession in New South Wales' (2010) 37 Journal of Law and Society 466, 470; J. Black, 'Paradoxes and Failures: "New Governance" Techniques and the Financial Crisis' (2012) 75 MLR 1037, 1045-1046.

<sup>94</sup> T. Schneyer, 'Professional Discipline for Law Firms' (1991) 77 Cornell Law Review 1, 10-11; E. Chambliss and D. Wilkins, 'A New Framework for Law Firm Discipline' (2003) 16 Georgetown Journal of Legal Ethics 335.

<sup>95</sup> J.R. O'Sullivan, 'Professional Discipline for Law Firms? A Response to Professor Schneyer's Proposal' (2002) 16 Georgetown Journal of Legal Ethics 1, 19-20 and 23.

<sup>96</sup> See G. Treverton-Jones, 'Entity Regulation-Solicitors Beware' Law Society Gazette (5<sup>th</sup> July 2012): SRA took action against a firm because of a lawyer's misconduct even though the firm was not at fault. Charges were eventually dropped.

responsible for acting in a conflict situation for example, whereas it may be less clear who exactly failed to ensure that an effective compliance system was in place. Experience with financial services regulation suggests that these fears may be well grounded: the Financial Services Authority (FSA) explained its failure to take action against senior individuals in the financial services sector partly on the fact that it had been unable to prove that individuals were personally culpable for regulatory failures. The larger the firm the more difficult it became to identify which senior individuals were responsible and hold them accountable, which bodes ill for the SRA's ability to hold lawyers in the largest firms to account.<sup>97</sup>

On the other hand, by requiring all firms to designate a Compliance Officer for Legal Practice (COLP), who has responsibility for taking reasonable steps to ensure compliance with regulatory requirements by a firm, its managers, employees or owners, the legal profession's regulatory framework may have addressed this problem.<sup>98</sup> Not only can COLPs be held accountable if they fail to do this, but they will be in a better position than the SRA to identify and report on which individuals within their firms are responsible for infractions.

Even so, individual accountability may be rare if the SRA is 'captured', 'conned', or 'cowed' by 'powerful individuals who are very successful and very used to getting their own way'<sup>99</sup> (as, arguably, the FSA was<sup>100</sup>). This problem is more likely to arise when dealing with large firm lawyers, particularly given that the SRA has been criticised in the past for failing to understand their work.<sup>101</sup> Again, proceedings against individuals are more likely to be fought hard, with concomitant implications for stretched regulatory resources. For example the FSA's one formal enforcement action against a senior bank director for decisions that led to bank failure cost it £5.4 million, or nearly 12 per cent of its annual enforcement budget, and resulted in a fine of £500,000.<sup>102</sup> Such considerations may well deter regulatory action against individuals.

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<sup>97</sup> Parl. Comm. on Banking Standards, *Changing Banking For Good* HL 27-II; HC 175-II (2013) 500-501 at <http://www.publications.parliament.uk/pa/jt201314/jtselect/jtpcb/27/27ii.pdf> (last visited 28 September 2013).

<sup>98</sup> SRA, n 91 above, r 8.5 (c)(i).

<sup>99</sup> Evidence of Julia Black, n 97 above, 502.

<sup>100</sup> Evidence of David Kershaw *ibid.*

<sup>101</sup> N. Smedley, *Review of the Regulation of Corporate Legal Work* (2009) 25-28.

<sup>102</sup> Parl. Comm. on Banking Standards, *'An Accident Waiting to Happen': The Failure of HBOS* HL 144; HC 705 (2013) 40-41 at <http://www.publications.parliament.uk/pa/jt201213/jtselect/jtpcb/144/144.pdf>. (last visited 1st November 2013).

Nevertheless it has been argued that even when regulators only proceed against firms, individuals do not necessarily escape accountability. Entity regulation can lead to greater investment in firm-level risk management which in turn could increase individual accountability<sup>103</sup> because firms will then be better placed than the regulator to identify regulatory infractions and wrongdoers and may decide to take action even when a regulator does not.<sup>104</sup> O’Sullivan disputes this, arguing that firms will avoid disruptive disciplinary processes that could embarrass senior management and result in expensive litigation.<sup>105</sup> Yet firms seem to experience little difficulty in removing partners and employees when they want to, whilst partners and employees may be wary of being stigmatised if they litigate against their former firms.<sup>106</sup> Nevertheless it is possible that firms could balk at the publicity risk should they remove a senior person for conduct reasons, rather than for performance related issues, or to increase profitability. Again, while firms could informally sanction individuals, by closing them out of profitable work, thus causing them to miss their targets, or by failing to award increments and bonuses or failing to promote, it is unclear whether they would act against key fee-earners because of their financial importance.<sup>107</sup>

Finally it has been argued that entity regulation undermines accountability by signaling that compliance and the creation of an ethical infrastructure is a firm rather than an individual matter.<sup>108</sup> As Chambliss has pointed out, this assumes that in the absence of entity regulation individuals will feel responsible for creating ethical infrastructures, which flies in the face of available evidence.<sup>109</sup> Moreover just because an individual does not feel responsible for creating a firm-wide ethical infrastructure, it does not necessarily follow that they would feel less obliged to comply with their individual regulatory obligations.

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<sup>103</sup> E. Chambliss, ‘New Sources of Managerial Authority in Large Law Firms’ (2009) 22 *Georgetown Journal of Legal Ethics* 63, 68.

<sup>104</sup> J. Arlen and R. Kraakman, ‘Controlling Corporate Misconduct: An Analysis of Corporate Liability Regimes’ (1997) 72 *New York University Law Review* 687, 693.

<sup>105</sup> O’Sullivan, n 95 above, 25.

<sup>106</sup> C. Binham, ‘Three UK Law Firms Announce Job Cuts’ *The Financial Times* (25 January 2013).

<sup>107</sup> For an account of the informal ways that firms can deal with individuals see H. Sommerlad, L. Webley, D. Muzio, J. Tomlinson and L. Duff, *Diversity in the Legal Profession in England and Wales: a Qualitative Study of Barriers and Individual Choices* (London: Legal Services Board, 2010) 46-47.

<sup>108</sup> O’Sullivan, n 95 above, 20-21, 23.

<sup>109</sup> Chambliss, n 103 above, 89.

Nevertheless there are risks in signaling that compliance is someone else's responsibility, a matter that will be returned to later.

In sum, while the COLP role may address some of the risks to individual accountability posed by entity regulation it cannot eliminate them all. Experience from financial services regulation suggests that adequately resourced regulators that are prepared to proceed against individuals are key to promoting accountability and compliance.

## **B Risk-based regulation**

Historically in England and Wales large law firm lawyers have not been particularly accountable to the regulator. The SRA had adopted a reactive approach to regulation, approaching firms only once complaints had been made<sup>110</sup> and, with some notable exceptions, the sophisticated clients of these firms tended not to complain to the regulator but to adopt self-help remedies.<sup>111</sup>

The SRA has now adopted risk-based regulation whereby the greatest regulatory attention will be paid to firms that pose the greatest regulatory risk.<sup>112</sup> The level of risk will be assessed by reference to: i) the risks inherent in individual firms, how they manage risk and their approach to, and history of, compliance ii) 'thematic risks' that affect groups of firms or sectors of the legal profession and iii) risks presented by reports of 'events' to the SRA which include reports of misconduct, a significant change in composition of the firm, or a downturn in the firm's financial position.<sup>113</sup> In determining the level of regulatory intervention required, the SRA will not rely solely on the existence of complaints against a firm but will also assess the impact of a particular risk against the probability that this risk will occur, and the firm's 'regulatory footprint'. This will require the SRA to take account of the size of the firm, the vulnerability of its clients and the amount of client money it holds.<sup>114</sup> Large law firms would be high risk on one of these criteria at least. However the SRA has indicated that firms that have effective risk management systems in place may experience

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<sup>110</sup> SRA, Strategic Plan 2013-2015 (16 September 2013), section 3.

<sup>111</sup> See Marks and Spencer Group Plc v Freshfields Bruckhaus Deringer [2004] EWCA Civ 741; [2005] PNLR 4.

<sup>112</sup> SRA, Regulatory Risk Framework (December 2012) 5.

<sup>113</sup> SRA, Supervision: Firm and Thematic (5 August 2013). See also SRA, Regulatory Risk Index (December 2012).

<sup>114</sup> SRA, Regulatory Risk Framework, n 112 above, 9 and section 4..

less intrusive relations.<sup>115</sup> As large law firms have sophisticated compliance and financial systems in place, the SRA may take the view that failure in these firms is less likely than in smaller firms. It is presently unclear how these considerations will be balanced. It may be that risk based regulation will lead to increased scrutiny of large law firms by the SRA and so increased accountability. Signs that this might be so include relationship management, which involves SRA staff visiting firms with a view to understanding the firms' business models, compliance systems, risk management and finance functions, and handling of conflicts.<sup>116</sup> The SRA has stated that relationship management, which is resource intensive, should be focused on large firms because they present a diverse range of more complex regulatory issues that require greater engagement from the SRA to enable it to gain a better understanding of the firms involved and to better assess their risks.<sup>117</sup> However this process may also promote accountability by encouraging dialogue and explanation between the regulator and the regulated.

## **B Principles-based and outcomes-focussed regulation**

The SRA has introduced principles-based and outcomes-focused regulation (OFR) regulation. The Code of Conduct contains ten mandatory all pervasive high-level Principles and is divided into mandatory outcomes and non-binding indicative behaviours, which set out a non-exhaustive list of types of behaviour that may demonstrate compliance with or contravention of the Principles and whether outcomes have been met.<sup>118</sup>

Principles-based regulation sets behavioural standards and, as a regulatory technique, is designed to reduce the ability of the regulated to exploit regulatory gaps and engage in minimal technical compliance.<sup>119</sup> OFR, as introduced by the SRA, leaves it to firms to determine how to achieve the outcomes set out in the Code of Conduct, on the basis that 'one size does not fit all' and firms are best placed to determine what systems need to be put in place to achieve the prescribed outcomes in their particular circumstances.<sup>120</sup> Requiring firms to design their own internal systems to achieve externally set regulatory goals is another

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<sup>115</sup> SRA, Risk Framework: Questions and Answers (5 May 2011).

<sup>116</sup> SRA, Relationship Management Pilot Report (21 October 2011).

<sup>117</sup> *ibid.*

<sup>118</sup> SRA, Code of Conduct (2014) Introduction; SRA, Handbook (2014), Introduction para 3(a).

<sup>119</sup> J. Black, *Rules and Regulators* (Oxford: Clarendon Press, 1997) 216-217.

<sup>120</sup> SRA, Outcomes Focussed Regulation at a Glance (October 2011) paras 3.2 and 5.1.

aspect of ‘management-based regulation’ and, it has been asserted, is more likely to promote better ethical behaviour than detailed ‘process-oriented’ regulation which prescriptively sets out the processes the regulated must follow.<sup>121</sup> This technique may also operate as an accountability mechanism, by making the firms and individuals responsible for the design of effective compliance systems,<sup>122</sup> thus promoting mindful effort in the design of more effective systems.

Nevertheless this strategy has risks. Particularly where regulatory goals conflict with firms’ self interest or established routines, firms may adapt the goals in ways that achieve the appearance of legitimacy while undermining the efficacy of regulation.<sup>123</sup> The broad nature of the regulatory rules under outcomes and principles based regulation make such conduct difficult to detect.<sup>124</sup>

Parker though argues that outcomes negotiated between the regulator and the regulated are easier to apply, monitor and enforce than rules set by the regulator. The regulator has more flexibility to hold the regulated to account through dialogue, which can lead to better compliance.<sup>125</sup> Failing this, the regulated can be held to account through sanctions. The precise accountability mechanism required may vary with the type of regulatory objective being pursued and in particular, on the degree to which the regulated are motivated to comply with that objective and the degree to which it runs contrary to their self interest. A minimal degree of accountability may suffice when the profession has other incentives to comply, but the more the regulatory goal conflicts with the profession’s self interest, the less incentive there is to comply and the greater the degree of accountability likely to be required.<sup>126</sup> The success of outcomes-focused and principles-based regulation therefore depends on the accountability mechanisms put in place to support them, and to this we now turn.

## **B Accountability mechanisms**

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<sup>121</sup> Parker, Gordon and Mark, n 93 above, 470 and 473-474.

<sup>122</sup> Freeman, n 25 above, 656.

<sup>123</sup> Bamberger, n 79 above, 427-428.

<sup>124</sup> Black, n 119 above, 222.

<sup>125</sup> C. Parker, ‘Reinventing Regulation within the Corporation: Compliance-oriented Regulatory Innovation’ (2000) 32 *Administration and Society* 529, 547-548.

<sup>126</sup> C. Parker, ‘Competing Images of the Legal Profession: Competing Regulatory Strategies,’ (1997) 25 *International Journal of the Sociology of Law* 385, 401.

## C Reporting, Disclosure and Dialogue

The Handbook contains a number of reporting and notification requirements and the Code of Conduct stipulates that, as a matter of professional conduct, lawyers and their firms must comply with these.<sup>127</sup> A firm or lawyer must report the following to the SRA: any action taken against them by another regulator; a serious failure by the firm or lawyer to comply with the Principles, rules, outcomes and other requirements of the Handbook;<sup>128</sup> the outcome of any investigation into whether another person has a claim for redress against the lawyer or firm;<sup>129</sup> and serious misconduct of other persons or firms regulated by the SRA.<sup>130</sup>

Meanwhile COLPs are under a separate obligation to report material breaches of any regulatory requirement by a firm, its managers, employees or those holding an interest in it (such as shareholders) to the SRA as soon as reasonable,<sup>131</sup> and COLPS of ABS entities must also report non-material breaches in an annual information report to the SRA.<sup>132</sup>

Reporting and disclosure can facilitate accountability by providing information which enables the performance of the regulated to be evaluated by the regulator and may flag up ‘events’ that could lead to the SRA ‘engaging’ with the firm and holding it or a lawyer to account through dialogue or sanctions.<sup>133</sup> The requirement to report can also act as a check on decision-making and may lead to the development of further checks in the form of better compliance processes. The SRA has indicated that one way of demonstrating compliance with the conduct rules relating to reporting is for regulated persons to actively monitor their performance in relation to these obligations ‘in order to improve standards and identify non-achievement’,<sup>134</sup> and to have a whistle-blowing policy.<sup>135</sup> Firms will therefore need to

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<sup>127</sup> Code of Conduct (2014), O(10.1).

<sup>128</sup> *ibid* O(10.3).

<sup>129</sup> *ibid* O(10.11)(b).

<sup>130</sup> *ibid* O(10.4).

<sup>131</sup> SRA, n 91 above, r 8.5 (c)(iii); Guidance Notes para (x) (guidance on materiality).

<sup>132</sup> Legal Services Act 2007, s 91(1)(b); *ibid*, r 8.5(c)(ii)(A), r 8.7(a).

<sup>133</sup> On the definition of ‘events’ and engagement see SRA, Supervision: Firm and Thematic (5 August 2013).

<sup>134</sup> Code of Conduct (2014), IB (10.1).

<sup>135</sup> *ibid*, IB (10.10).



develop processes that will enable them to monitor for and detect incidents of non-compliance.

Reporting may also counter-act the cognitive biases and self-interest that impair reflective informed decision-making, including the bias towards construing information in a manner that confirms prior attitudes and beliefs such as, for example, a belief that the firm is compliant, or that a conflict of interest is non-material. Again it may counter-act the self-serving bias which leads people to interpret information in a manner favourable to them, or in a manner that avoids confrontations with key partners or clients, and to disregard or fail to recognise the significance of information that indicates problems.<sup>136</sup>

However whether reporting will have such effects depends on several factors. Thus when those being held to account are required to justify a decision that they have already taken, experiments suggest that accountability may actually entrench their commitment to that decision even if it is demonstrably incorrect. This effect was greater the more vulnerable the accountable person felt.<sup>137</sup> Reporting could therefore cause the regulated to resist learning from their mistakes and perhaps resist the legitimacy of regulation itself. Such an effect may materialise when firms report past regulatory breaches, although the fact that the firms will have self-identified the event as a reportable breach may reduce the inclination to justify it.

The requirement to account may also be counter-productive when the audience is perceived as intrusive, illegitimate and controlling. Conversely it has been found that providing an account is more likely to promote self-critical thinking when the audience is seen as well informed and as having a legitimate reason to require the account.<sup>138</sup> As to this, the profession's views of the SRA are mixed.<sup>139</sup> The lobbying by City lawyers for separate regulation evidences a lack of trust in the present regulatory system.<sup>140</sup> Meanwhile smaller

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<sup>136</sup> S. M. Kim, 'The Banality of Fraud: Re-situating the Inside Counsel as Gatekeeper' (2005) 74 *Fordham Law Review* 983, 1027-1034, 1049.

<sup>137</sup> P. Tetlock, L. Skitka and R. Boettger, 'Social and Cognitive Strategies for Coping With Accountability: Conformity, Complexity, and Bolstering' (1989) 57 *Journal of Personality and Social Psychology* 632, 633.

<sup>138</sup> J. Lerner and P. Tetlock, 'Accounting for the Effects of Accountability' (1999) 125 *Psychological Bulletin* 255, 258-259.

<sup>139</sup> See SRA, *Measuring the Impact of Outcomes-focused Regulation (OFR) on Firms*, (February 2013) 8 and 49; The Law Society, *Regulatory Performance Survey*, Winter 2012-13.

<sup>140</sup> Smedley, n 101 above; The City of London Law Society, *Review of the Legal Services Regulatory Framework*, CLLS Submission to the Ministry of Justice (September 2013), 2 at

firms have claimed that they are unfairly targeted by the SRA.<sup>141</sup> Sustained dialogue is therefore needed to build trust and facilitate consensus and co-operation between the regulated and the SRA. A process of dialogue would also be necessary to enable the SRA to introduce regulatory norms that would otherwise be perceived of as intrusive and contentious, such as norms that place client interests second to public regarding norms. Other benefits of dialogue would be that if it occurred ex ante a breach it could enable firms to avoid undesirable conduct and improve performance or, ex post, provide an opportunity to learn from mistakes through feedback.<sup>142</sup>

Dialogue may be informal or informal and may take the form of generally available regulatory guidance, 'Dear Managing Partner letters', rulings on particular matters, or engagement with individual firms.<sup>143</sup> The SRA has introduced relationship management for the largest law-firms<sup>144</sup> and has pioneered a new supervisory approach of active engagement with other firms, proportionate to the risk that the firms pose.<sup>145</sup> Evidence suggests that these interactions can have a positive effect on the relationship between firms and the SRA.<sup>146</sup> Although this evidence was produced by the SRA itself, similar regulatory initiatives in other spheres have shown similar outcomes.<sup>147</sup> Moreover these types of dialogue can, themselves, constitute accountability mechanisms such as when, for example, SRA supervisors ask firms to assess what risks they face and explain how they are mitigating those risks, with the

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[http://www.citysolicitors.org.uk/attachments/article/108/20130906-CLLS-response-to-MOJ-Review-of-Legal-Services-Regulation-\(final\).pdf](http://www.citysolicitors.org.uk/attachments/article/108/20130906-CLLS-response-to-MOJ-Review-of-Legal-Services-Regulation-(final).pdf) (last visited 9 November 2013).

<sup>141</sup> Letter from Society of Black Solicitors to Legal Services Board (12 March 2012), 3 at [http://www.legalservicesboard.org.uk/what\\_we\\_do/consultations/closed/pdf/sbl\\_response\\_to\\_consultation\\_doc.pdf](http://www.legalservicesboard.org.uk/what_we_do/consultations/closed/pdf/sbl_response_to_consultation_doc.pdf) (last visited 9 September 2012).

<sup>142</sup> Bovens, Schillemans and 'T Hart, n 16 above, 232.

<sup>143</sup> J. Black, 'Talking About Regulation' (1998) Public Law 77, 78-79.

<sup>144</sup> SRA, n 116 above.

<sup>145</sup> SRA, Supervision Pilot Report (3 September 2012) 2-3.

<sup>146</sup> *ibid*, 1 and 7; SRA, n 139 above, 8 and 46.

<sup>147</sup> J. Freedman, 'Responsive Regulation, Risk, and Rules: Applying Theory to Tax Practice' (2011) 44 UBC Law Review 627, 644-645. It is consistent with the view that on-going face to face relationships between the regulator and the regulated are essential to successful regulation: J. Braithwaite, 'Relational Republican Regulation' (2013) 7 Regulation and Governance 124, 136; C. Ford, 'Prospects for Scalability: Relationships and Uncertainty in Responsive Regulation' (2013) 7 Regulation and Governance 14. See also D. Kingsford Smith, 'A Harder Nut to Crack? Responsive Regulation in the Financial Services Sector' (2011) 44 UBC Law Review 708-709.

possibility of enforcement action where there is evidence of serious problems.<sup>148</sup> However they also create the risk of regulatory capture, and so less accountability, although the SRA has proposed mechanisms to address this.<sup>149</sup>

Another important factor influencing the effect of reporting as an accountability mechanism is whether those being held accountable know the views of the regulator on the matters under report. If they do not, experimental evidence suggests that they will think ‘in more self-critical, integratively complex ways’ considering multiple perspectives as they try to anticipate the objections that might be raised to their position.<sup>150</sup> They will consider alternatives and contrary evidence and be ready to defend their arguments. This leads people to be more vigilant, to take account of a broader range of information and to be more likely to detect information that contradicts their settled mind sets. In turn this can offset decisional biases, reduce mindless commitments to previous courses of action and over-estimates of group effectiveness, whilst focussing attention on problems that would otherwise be missed.<sup>151</sup> In contrast if the audience’s views are known, it becomes more likely not only that those being held to account will shift their accounts to accord with those views, but also that they will provide unreflective responses that exacerbate biases. This is because people are ‘cognitive misers’, who seek to minimise the effort that they put into mental calculations and also seek the approval of others: one way to achieve these goals is to conform.<sup>152</sup> Accountability in such circumstances can result in more rigid, less reflective thinking that could manifest as a box ticking mentality.<sup>153</sup> This suggests that when lawyers press for guidance on what constitutes compliance in the context of OFR, the SRA should be cautious about conceding to such demands if firms are better placed to make this assessment such as, for example, concerning what constitutes an adequate compliance system within a firm or what regulatory risks the firm should guard against. Presently the Code of Conduct does leave these questions to firms and the SRA has provided only broad guidance.<sup>154</sup>

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<sup>148</sup> SRA, n 145 above, 3.

<sup>149</sup> *ibid*, 3 and 7.

<sup>150</sup> Lerner and Tetlock, n 138 above, 257.

<sup>151</sup> Lerner and Tetlock, n 138 above, 263.

<sup>152</sup> P. Tetlock, ‘Accountability: The Neglected Social Context of Judgment and Choice’ (1985) 7 *Research in Organizational Behavior* 297, 311.

<sup>153</sup> Tetlock, Skitka and Boettger, n 137 above, 638-639.

<sup>154</sup> SRA, n 91 above, Guidance Notes to r 8, para (iii); SRA, n 120 above.

The above is subject to an important proviso: Lerner and Tetlock argue that where those being held to account have to justify a choice between different actions, rather than making a judgment about something (such as whether a firm's compliance arrangements are adequate for example) and the audience's views are unknown, people will choose options that either represent a compromise, choose the dominant option (on the basis that this is likely to be easier to justify), or choose options where the outcomes of the choice are more certain<sup>155</sup> Given this it might be hypothesised tentatively that if lawyers are left without guidance on how to act in particularly ethically challenging contexts, they might act in a manner consistent with the dominant norms of the profession, or of their firm, or the unit they belong to within that firm. If so, and if one of the aims of regulation is to challenge dominant paradigms-by requiring corporate lawyers to act in a way that demonstrates commitment to public serving values for example- the SRA may need to be specific about what conduct is required. An example might be a specific regulatory requirement for corporate lawyers to blow the whistle to avert serious financial harm to third parties.

None of the reporting requirements imposed by the SRA presently require firms to engage in periodic self-evaluation. It appears that annual information reports will only be required of ABSs and will only include data about regulatory breaches. However, by adopting this position, the SRA may have missed an opportunity to maximise the accountability impact of its reporting requirements. Experience in New South Wales indicates that formal self-evaluation reports on compliance can have positive regulatory outcomes. There, all incorporated legal practices must complete a self-assessment document which is then provided to the Office of the Legal Services Commissioner (OLSC).<sup>156</sup> This measures firms' compliance systems against a set of objectives that address areas which were identified as particular problems on the basis of client complaints levels and were drawn up after extensive consultation with the profession and other stakeholders.<sup>157</sup>

This process decreased client complaints against incorporated law firms in New South Wales by two thirds, although the precise mechanisms by which this was achieved were

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<sup>155</sup> Lerner and Tetlock, n 138 above, 264.

<sup>156</sup> See S. Mark, 'View from an Australian Regulator' (2009) *Journal of Professional Lawyer* 45, 49.

<sup>157</sup> T. Schneyer, 'On Further Reflection: How "Professional Self-Regulation" Should Promote Compliance with Broad Ethical Duties of Law Firm Management' (2011) 53 *Arizona Law Review* 577, 622; S. Fortney and T. Gordon, 'Adopting Law Firm Management Systems to Survive and Thrive: A Study of the Australian Approach to Management-Based Regulation' (Hofstra University Legal Studies Research Paper No. 13-02), 11-13 at <http://ssrn.com/abstract=220530> (last visited 2 November 2013).

unclear.<sup>158</sup> Parker et al suggested that: self-assessment may have been preceded by structural change (during the process of incorporation), which meant that the firms concerned managed themselves better, or may have promoted this change;<sup>159</sup> it may have raised the consciousness of individual lawyers and reminded them of the need to observe compliance procedures;<sup>160</sup> changes in behaviour may have been due to an intrinsic commitment to doing the right thing; or self assessment may have increased the lawyers' sense that the regulator was observing them and so they responded to the risk of sanctioning.<sup>161</sup> These hypotheses are consistent with the possibility that accountability played a part. Thus the requirement to pass judgment on the firm's processes against externally set outcomes may have acted as a check on decision-making and changed attitudes and conduct. The periodic nature of these reports may have disrupted settled patterns of thinking, thus increasing the likelihood of problems being detected.<sup>162</sup> Reporting to an external party, the OLSC, reduced the risk that individuals would simply assume that their firms were compliant, without actively addressing their minds to it, and could have led to more self-critical thinking.

## C Assigning Responsibility to Individuals: The Role of the COLP

Bamberger has argued that firms can be rendered more accountable by making an individual who holds a central position within a firm's power structure accountable for compliance decisions. The accountability thereby engendered in this individual can be disseminated throughout the firm in the form of effective checks on a firm's decision-making processes.<sup>163</sup> The success of the regulatory regime in New South Wales suggests that he may be correct. There, all incorporated legal practices must appoint a legal practitioner director (LPD) who must be a senior member of the firm.<sup>164</sup> The LPD is generally responsible for the management of legal services<sup>165</sup> and more specifically is responsible for implementing and maintaining appropriate management systems to enable the provision of legal services in

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<sup>158</sup> Parker, Gordon and Mark, n 93 above, 485 and 493- 494.

<sup>159</sup> See Fortney and Gordon, n 157 above, 30.

<sup>160</sup> *ibid*, 29: lawyers found process educational and raised awareness.

<sup>161</sup> Parker, Gordon and Mark, n 93 above, 494. See also *ibid*, 39 highlighting role of regulatory audit.

<sup>162</sup> Bamberger, n 79 above, 449.

<sup>163</sup> *ibid*, 448.

<sup>164</sup> Legal Profession Act 2004 (NSW), s 140(1).

<sup>165</sup> *ibid*, s 140(2).

accordance with solicitors' professional obligations and other regulatory obligations imposed by the Legal Profession Act 2004.<sup>166</sup> The LPD generally completes the self- assessment forms discussed above and may function as a significant accountability mechanism.<sup>167</sup>

In England and Wales the Legal Services Act 2007 requires all ABSs to appoint a Head of Legal Practice who is responsible for taking reasonable steps to ensure that the business complies with its licence and other regulatory requirements.<sup>168</sup> The SRA subsequently decided that all regulated firms should have an equivalent position, the COLP.<sup>169</sup> The obligations of the LPD in New South Wales and the COLP in England and Wales are very similar. COLPs also have obligations to take reasonable steps to ensure that their firm, its managers, employees and owners comply with regulatory requirements and record and report any failure to comply.<sup>170</sup>

The precise powers of the COLP are likely to vary from firm to firm but ideally the COLP should be able to pose questions to others within the firm and engage in a dialogue that can lead to those others providing the COLP with an account of their behaviour and how they have implemented compliance. This could promote accountability throughout the firm by reminding other lawyers of their responsibility for compliance and the fact that they personally could be held to account externally. Again, because the COLP will be accountable for explaining to the SRA the actions or inaction of others (such as where the COLP has to report breaches of regulatory requirements), the COLP is likely to bring an independent mind to bear in intra-firm discussions about compliance, anticipating the SRA's arguments and questions. This is likely to reinforce the mindfulness engendered in individuals when they are required to focus on and explain a particular decision. Moreover an internal dialogue with the COLP may be less defensive and more reflective than a dialogue with an external regulator such as the SRA, and this could reduce the risk of lawyers becoming entrenched in their way of thinking. Empirical evidence on similar embedded roles in other spheres of regulation indicate that it is important for COLPs to have good relational skills and to act as 'problem solving consultants' and not as agents of regulatory enforcement, and that they are independent, which may be facilitated if professional networks develop amongst COLPs to

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<sup>166</sup> *ibid*, s 140 (3) and (4), s 141 and s 143. Mark, n 156 above, 47-50

<sup>167</sup> Fortney and Gordon, n 157 above, 23 and 27.

<sup>168</sup> See Legal Services Act 2007, s 91 and Sched 11 para 11(2).

<sup>169</sup> SRA, n 91 above, r 8.5(b).

<sup>170</sup> *ibid*, r 8.5(c).

assist them in developing good practice.<sup>171</sup> Finally the fact that COLPs must report regulatory infractions to the SRA may enable them to control ‘the partners with power’ who might otherwise resist the introduction of ethical frameworks that would prevent them from acting as they pleased for their clients.<sup>172</sup> A COLP who was unhappy with this behavior could also step down from their role (which would not necessarily mean resigning from the firm), the firm would be obliged to report this to the SRA within seven days, and this would be a red flag to the SRA, leading to further action.<sup>173</sup>

In order for COLPs to be successful, they need to have the power and authority to require others to direct their attention to the issue of compliance. However while the SRA rules require them to be of sufficient seniority and responsibility to fulfil their role, they do not need to be partners.<sup>174</sup> This contrasts with New South Wales, where the LPD is part of the firm’s senior management. The SRA, rather than having a bright line rule, has sought to preserve flexibility: in deciding whether to authorise an individual as a COLP, the SRA will take account of whether they have authority, or access to those with authority, to make decisions and changes within the firm and the larger the firm, the more complex its business, and the greater the regulatory risk it poses, the greater the COLP’s authority will need to be before they will be authorised.<sup>175</sup> Presumably in large law firms the COLP will be a partner, though it is not clear whether they will need to be on the management board.

The SRA has sought to alleviate fears that others within the firm will delegate their responsibilities to the COLP and thus feel less accountable for compliance, pointing out that under the Handbook and Code of Conduct both the firm and its managers remain fully responsible for compliance.<sup>176</sup> But this is not entirely satisfactory. Evidence from the UK financial services sector suggests that where a regulatory objective is seen as the responsibility of the compliance department, others will fail to engage with it. Meaningful engagement only occurs when senior management undertakes responsibility for

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<sup>171</sup> Freeman, n 25 above, 652.

<sup>172</sup> SRA, n 91 above, r 8.5(c)(ii); r 8.5 (c)(iii); r 8.7(a).

<sup>173</sup> *ibid*, r 18.1.

<sup>174</sup> *ibid*, r 8.5 (b)(iii).

<sup>175</sup> SRA, Decision-making Criteria: Compliance Officer for Legal Practice (COLP) and/or a Compliance Officer for Finance and Administration (COFA), Decision to Refuse or Approve With or Without Conditions (March 2012)

<sup>176</sup> SRA, n 91 above, Guidance Notes to r 8, para vii.

implementation.<sup>177</sup> This is particularly so where regulatory goals run contrary to the firm's goals, and also where the firm is required to make substantial changes to its practices.<sup>178</sup> This suggests that, particularly where the regulator is seeking to promote public regarding norms that conflict with firms' business objectives and client-centred values, responsibility must be expressly assigned to designated senior individuals to focus their attention in order to maximise firm accountability and compliance.<sup>179</sup>

## C Sanctions

It will be recalled that calls for greater accountability can sometimes refer to the need for more effective sanctioning. Sanctions can alter behaviour by acting as a deterrent. They can check and legitimise the power that lawyers exercise, by demonstrating that it is exercised within boundaries. Sanctions can also legitimise the regulator's power to discipline, by demonstrating a lack of discrimination against any part of the profession.

But sanctions can also undermine compliance. When decision-makers have publicly committed themselves to a particular position and are accountable to a sceptical or hostile audience for actions they cannot deny, they engage in self-justifying thinking rather than interrogating themselves about whether they are correct.<sup>180</sup> It has been argued that this unintended consequence of accountability could explain Abel's findings that lawyers who were subject to disciplinary proceedings failed to recognise that their behaviour was unethical. The disciplinary process intensified their sense of grievance and conviction that they had done nothing wrong, rather than teaching them the error of their ways.<sup>181</sup>

Furthermore for social, legal and regulatory norms to be most effective, they must be internalised by those to whom they apply. Norms that rely on sanctions alone to deter behaviour will weaken and eventually collapse.<sup>182</sup> Significant factors in determining whether a norm will be internalised is: whether those who are expected to comply with the norm

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<sup>177</sup> S. Gilad, 'Institutionalizing Fairness in Financial Markets: Mission Impossible?' (2011) 5 *Regulation and Governance* 309, 323, 325.

<sup>178</sup> *ibid.*, 327.

<sup>179</sup> Bamberger, n 79 above, 440-441; *ibid.*, 326.

<sup>180</sup> B.M. Staw, 'Knee-deep in the Big Muddy: A Study of Escalating Commitment to a Chosen Course of Action' (1976) 16 *Organizational Behaviour and Human Performance* 27; Tetlock, n 162 above, 323-324.

<sup>181</sup> Levin, n 77 above, 1575-1576.

<sup>182</sup> n 75 above.



believe it to be fair;<sup>183</sup> whether they receive signals that it is expected that they should comply; and whether they believe that others are complying with that norm.<sup>184</sup> The regulatory literature also suggests that if regulators resort too quickly and too often to sanctions this will not only undermine responsibility but will also breed a culture of resistance to regulation and lead to a game of ‘cat and mouse’ which undermines the authority of the regulator.<sup>185</sup> Consequently sanctioning should only be used as a last resort, after persuasion and warnings are ineffective,<sup>186</sup> or in response to serious misconduct, and only when lawyers, as a group, accept the legitimacy of the rules being enforced and believe that others are complying with them. This suggests that breaches of rules relating to client service and client loyalty can be sanctioned but that breaches of more contentious standards, such as norms promoting a public interest role, should not be. Even the former may be problematic as far as large firms are concerned, given that in both the US and the UK such firms have been lobbying for less stringent rules in the core fiduciary area of conflicts of interest.<sup>187</sup>

The SRA’s approach appears to address these concerns. It has indicated that it will pursue enforcement action where there is serious misconduct, or a risk to the public that cannot be resolved by working with the firm.<sup>188</sup> The matter must not be trivial and it must be in the public interest to act.<sup>189</sup> The SRA also has a range of penalties commensurate with the seriousness of the conduct: it may issue a written rebuke or impose a fine, whilst more serious cases requiring graver sanctions, such as, for example, striking off, can be referred to the Solicitors Disciplinary Tribunal if it is in the public interest to do so and there is a realistic prospect that the person will be found guilty.<sup>190</sup> The SRA may also ‘intervene’ in a practice-that is-take it over and close it down- and revoke a firm’s license.<sup>191</sup>

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<sup>183</sup> R. Jones, ‘Law, Norms and the Breakdown of the Board: Promoting Accountability in Corporate Governance’ (2006) 92 Iowa Law Review 105, 129.

<sup>184</sup> M. Blair and L. Stout ‘Trust, Trustworthiness and the Behavioral Foundations of Corporate Law’ (2001) 149 University of Pennsylvania Law Review 1735, 1796-1798; *ibid*, 147.

<sup>185</sup> I. Ayres and J. Braithwaite, *Responsive Regulation: Transcending the Deregulation Debate* (Oxford: Oxford University Press, 1992), 20.

<sup>186</sup> *ibid*, 35.

<sup>187</sup> J. Loughrey, ‘Large Law Firms, Sophisticated Clients, and the Regulation of Conflicts of Interest in England and Wales’ (2011) 14 Legal Ethics 215.

<sup>188</sup> SRA, n 113 above.

<sup>189</sup> SRA, (Disciplinary Procedure) Rules 2011 r 3.1(b) and [c], r 3.3 (b); Appendix 3 para 5.

<sup>190</sup> *ibid*, r 10.1; SRA, Code for Referral to the SDT (27 April 2012).

<sup>191</sup> Solicitors Act 1974, s 35 and Sched 1; Legal Services Act 2007, s 101 and s 102 and Sched 14.

But there are problems, specifically in relation to the SRA's ability to hold large law firms accountable. Excluding actions against convicted fraudsters, regulatory sanctioning of large law firm lawyers is extremely rare. There has been one such case in the last twenty years, when the Law Society imposed a fine of £9,000 upon a senior Freshfields' partner for acting in a conflict situation. This was almost unprecedented<sup>192</sup> and it can be no coincidence that it succeeded a Court of Appeal judgment which found that Freshfields had breached its fiduciary duties.<sup>193</sup>

Moreover while the SRA can fine ABSs up to £250 million, and an employee of an ABS entity up to £50 million,<sup>194</sup> and the SDT can impose fines of an unlimited amount,<sup>195</sup> the maximum fine the SRA can levy on traditional law firms and their lawyers is £2000.<sup>196</sup> The SRA has twice sought permission to raise these limits, and at the time of writing is consulting again, but the Ministry of Justice has been reluctant to act.<sup>197</sup> Given that, for the year ended April 2013 (for example) Allen and Overy's turnover was £1.189 billion and profit per equity partner was £1.1million, the SRA's current sanctioning powers remain too low to be a credible deterrent for most firms and lawyers.<sup>198</sup>

This lack of enforcement activity against large law firms has undermined the SRA's legitimacy with smaller firms.<sup>199</sup> The SRA might respond that the largest law firms are in fact better behaved and have better compliance systems. But history shows the importance of being able to sanction such firms: for many years the large City law firms disregarded the

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<sup>192</sup> See also 'A&O under fire over Safeway bid conflict' *The Lawyer* (19 May 2003).

<sup>193</sup> *Marks and Spencer Group Plc v Freshfields Bruckhaus Deringer* [2004] EWCA Civ 741; [2005] PNLR 4.

<sup>194</sup> Legal Services Act 2007, s 95; The Legal Services Act 2007 (Licensing Authorities) (Maximum Penalty) Rules 2011, SI 2011/1659, r 2.

<sup>195</sup> Solicitors Act 1974, s 47.

<sup>196</sup> Solicitors Act 1974, s 44D(2)(b).

<sup>197</sup> D. Bindman, 'If At First You Don't Succeed...SRA Tries Again to Increase £2,000 Fining Power' *Legal Futures* (29 January 2013) at <http://www.legalfutures.co.uk/latest-news/if-first-dont-succeed-sra-tries-increase-2000-fining-power> (last visited 25 August 2013); SRA, *Proposal to Increase the SRA's Internal Fining Powers: Consultation* (20 November 2013).

<sup>198</sup> Allen & Overy LLP, Annual Report and Financial Statements for the year ended 30 April 2013, 6 and 18 at <http://www.allenoverly.com/SiteCollectionDocuments/AR2013/Annual%20Report%20and%20Financial%20Statements.pdf> (last visited 24 November 2013).

<sup>199</sup> Letter from Society of Black Solicitors to Legal Services Board, n 141 above.

rules on conflicts of interest, and it was not until the Freshfields case that they began to take them more seriously.<sup>200</sup> Moreover, as Ayres and Braithwaite point out, there must be a realistic possibility of sanctions being imposed in serious cases where those regulated are wholly or partly motivated by economic concerns. A regulatory strategy that depends solely on persuasion and self-regulation will be exploited.<sup>201</sup>

In sum, although far from perfect, a number of regulatory mechanisms have been introduced by the SRA that could increase the accountability of large law firms. However even the most effective accountability mechanisms will only fulfil societal needs if the regulated are held to account against standards that meet those needs. The biggest problem in relation to the accountability of large firms and their lawyers lies in what they are held accountable for, and it is to this that we finally turn.

## **B Accountability and the SRA Code of Conduct**

The risk of financial failure aside, firms can present two main types of regulatory problem: agency and externality problems. Agency problems arise when lawyers harm clients by acting contrary to client interests. Externality problems refer to situations in which lawyers, together with their clients, engage in conduct that imposes unjustified costs on third parties and society, and includes creative compliance.<sup>202</sup> Large corporate law firms are more likely to present externality problems than agency problems since the sophisticated clients of these firms can effectively monitor their lawyers and reduce the occurrence of the latter.<sup>203</sup> However as externalities serve clients interests, clients may not restrain them.<sup>204</sup> Despite this, the Code of Conduct fails to hold lawyers to account for externalities and says very little of relevance to large firms generally.<sup>205</sup>

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<sup>200</sup> J. Griffiths-Baker, *Serving Two Masters: Conflicts of Interest in the Modern Law Firm*, (Oxford: Hart Publishing, 2002) 177.

<sup>201</sup> Ayres and Braithwaite, n 185 above, 19.

<sup>202</sup> D. B. Wilkins, 'Who Should Regulate Lawyers?' (1992) 105 *Harvard Law Review* 799, 820.

<sup>203</sup> *ibid*, 825-827.

<sup>204</sup> See however C. Whelan, 'Law Firm Ethics in the Shadow of Corporate Social Responsibility' (2013) 26 *Georgetown Journal of Legal Ethics* 154.

<sup>205</sup> See also D. Kershaw and R. Moorhead, 'Consequential Responsibility for Client Wrongs: Lehman Brothers and the Regulation of the Legal Profession' (2013) 76 *Modern Law Review* 26, 57.

Turning first to the over-arching high level Principles which, according to the SRA, apply to all aspects of practice,<sup>206</sup> these can be categorised into: those that concern the lawyer's and the firm's conduct towards clients; those that concern the manner in which the business is run; and those with a public interest dimension. Principles in the third category outnumber those in the other two and include: Principle 1, the requirement to uphold the rule of law and the proper administration of justice; Principle 2, the requirement to act with integrity; Principle 3 which stipulates that lawyers should not allow their independence to be compromised; Principle 6 which requires the regulated to behave in a way that maintains the trust the public places in them and in the provision of legal services; Principle 7 which requires the regulated to co-operate with regulators and Principle 9 which requires that legal businesses be run in a way that encourages equality of opportunity and respect for diversity. Furthermore the guidance notes provide that if two or more Principles conflict, the Principle which takes precedence is the one which best serves the public interest in the particular circumstances, especially the public interest in the proper administration of justice.<sup>207</sup>

This list suggests an emphasis on public regarding norms, which could enable lawyers to be held accountable for activities that impose costs on third parties through creative compliance. Thus Principle 1 is arguably infringed where lawyers assist their clients in setting up schemes that, while strictly legal, undermine the spirit of the law. Such conduct could also be viewed as failing to act with integrity and as betraying lawyers' duties as officers of the court, thus breaching Principle 2. Principle 3 could be interpreted as requiring lawyers to maintain independence from powerful clients and could provide grounds for resisting unethical client demands. Lawyers who assist clients to do things that attract social opprobrium could potentially breach Principle 6.

However these interpretations are highly contestable. As the debate over the principle of non-accountability demonstrates, there is likely to be disagreement about whether lawyers who act as hired guns are breaching Principles 1 and 2. As for Principle 3, lawyers could exercise their independent judgment and decide to do what the client requires: Whelan has shown that this is precisely what occurs.<sup>208</sup> In relation to Principle 6, corporate lawyers' behaviour does not tend to attract social sanction even when their clients have been criticised for conduct that the lawyers have assisted with. Left to their own devices lawyers are unlikely

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<sup>206</sup> SRA, Code of Conduct (2014), Introduction.

<sup>207</sup> *ibid.*

<sup>208</sup> Whelan, n 36 above, 1086 and 1120-1126.

to accept interpretations of the Principles that would require them to refrain from conduct that served the client's interests, with potentially adverse implications for firms' and lawyers' business objectives. They are more likely to interpret the Principles in a manner that minimises or even eliminates their public facing potential.

Given this, much will depend on how the SRA interprets and applies the Code. The notes to the Principles, and the remainder of the Code itself, suggest that the SRA is neither focussed on the work of transactional lawyers nor on holding lawyers accountable for creative compliance. For example the notes to Principle 1 state that while the requirement to uphold the rule of law and administration of justice imposes obligations not only to clients but also to the court and to third parties, it refers only to those third parties with whom the lawyer or his firm deals with on the clients' behalf and refers the solicitor to Chapters 5 and 11 of the Code of Conduct.<sup>209</sup> Chapter 5 requires lawyers to advise clients when their duty to the court outweighs their duty to the client<sup>210</sup> and indicates that lawyers should refuse to act if the client attempts to mislead the court.<sup>211</sup> However it is expressly limited to conduct in the course of litigation or advocacy. Chapter 3, which concerns relations with third parties, contains four mandatory obligations, three of which are largely irrelevant to transactional lawyers. The other requires that regulated persons do not take unfair advantage of third parties in either their professional or personal capacity and could conceivably be of relevance to transactional lawyers.<sup>212</sup> Finally the notes to Principle 3 state only that lawyers' ability to give independent advice to the client should not be compromised and that lawyers should not give control of their practice to a third party so as to put it out of the regulatory reach of the SRA. Nothing is said about independence from the client.<sup>213</sup>

The remainder of the Code does not advance matters and its detailed focus is on the type of work carried out by high street lawyers rather than large law firms. There is nothing to suggest that lawyers would breach any regulatory obligations if they engaged in creative compliance. Rather, under the Code, large law firm lawyers and their firms will be held accountable where they act contrary to client interests, provide poor service, maintain poor internal financial and compliance controls and fail to co-operate with the regulator. Given

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<sup>209</sup> SRA, Handbook (2014), Principles para 2.5.

<sup>210</sup> O(5.5).

<sup>211</sup> IB(5.4) and IB (5.5).

<sup>212</sup> O(11.1).

<sup>213</sup> SRA, Handbook (2014) Principles para 2.7.

this, as far as transactional lawyers are concerned, the Code both over- and under-regulates. It over-regulates because it duplicates market based accountability mechanisms: corporate lawyers are already highly accountable to their powerful clients who can penalise them through the removal of work or through litigation. In addition, over the last decade, large law firms had already developed centralised risk management functions which had nothing to do with the regulator but were a response to the increased complexity of law firms, client requirements and an increased compliance culture.<sup>214</sup> At the same time the Code under-regulates by wholly failing to hold these lawyers to account for the primary risk that they represent. Even the most efficient accountability mechanisms cannot address such a regulatory deficit.

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## CONCLUSION

The regulatory framework for the solicitor's profession in England and Wales incorporates a range of accountability mechanisms. Experience in New South Wales, which the English framework closely resembles, suggests that these could have some success in improving compliance in some firms. But as far as large law firms are concerned, the current framework both over and under-regulates. These considerations appear to have led to suggestions that regulation of large firms could be scaled back.<sup>215</sup> At the same time large firms have argued that they are adequately accountable to the SRA and have no need to be answerable to other regulators.<sup>216</sup>

However what is required is not the deregulation of large law firms but a regulatory framework that is capable of holding them accountable for externalities. The systems that large law firms have instituted are unlikely to address such issues and the regulatory framework does not. There are admittedly difficult questions about how corporate lawyers could be held accountable for acting contrary to the public good, but this article provides

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<sup>214</sup> Charles River Associates, *Benchmarking the Supply of Legal Services by City Law Firms* (August 2011), 59-60 at <https://research.legalservicesboard.org.uk/wp-content/media/City-law-frims-and-regulation-2011.pdf> (last visited 14 November 2013).

<sup>215</sup> Westminster Legal Policy Forum, *The Future of the Legal Services Market – Alternative Business Structures and Challenges for Effective Regulation* (September 2011), 42.

<sup>216</sup> City of London Law Society Professional Rules and Regulation Committee, *Response to Committee on Standards in Public Life Consultation "Lobbying: Issues and Questions Paper"* (13 August 2013), 1-2 at <http://www.citysolicitors.org.uk/attachments/article/108/Response%20to%20Committee%20on%20Standards%20in%20Public%20Life%20Lobbying%20Issues%20and%20Quest~.pdf> (last visited 14 November 2014).

some indications.<sup>217</sup> A requirement to promote the public interest, whatever its precise content, is likely to run contrary to the lawyer and the firm's self interest, even those who are intrinsically motivated to comply with their professional obligations may interpret it in a minimalist fashion that undermines its effectiveness. Consequently, when the regulator has a clear idea of what behaviour is required, an equally clear direction is preferable to broad exhortations in order to promote conformity, and reduce the possibility of regulatory requirements being 'read down' by the regulated, which could increase resistance to the regulator's interpretations of the standards.<sup>218</sup> The possibility of broad standards being given meaning that subverts regulatory goals increases the more powerful the regulated are, and so is a very real risk in the context of large law firms.<sup>219</sup> There remains a role for general exhortations, such as a professional obligation to respect the spirit as well as the letter of the law, but in either case accountability is critical, though the appropriate accountability mechanisms may vary depending on the nature of the rule.

In relation to more detailed prescriptions Ayres and Braithwaite's tiered approach to enforcement could be adopted with negotiation being utilised before sanctions with those reluctant to comply. As Braithwaite has advocated, it is necessary to 'engage those who resist with fairness' as this makes it more likely that they can be flipped into a commitment to comply,<sup>220</sup> but sanctions should be imposed if there is continuing non-compliance.<sup>221</sup> Promoting accountability through dialogue also makes it more likely that when dialogue fails and the SRA resorts to sanctions, this action will be perceived to have greater legitimacy, which in turn would strengthen the SRA's position and make future compliance more likely.<sup>222</sup> Accountability should also lead to positive outcomes: compliance should be praised and rewarded, for example by a down-grading of risk profile, a strategy that will reinforce desired behaviour (and the absence of which could undermine motivation to comply).<sup>223</sup> For general obligations, such as an obligation to obey the law, sanctions would be inappropriate

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<sup>217</sup> See also J. Loughrey, *Corporate Lawyers and Corporate Governance* (Cambridge: Cambridge University Press, 2011) Ch 9; Kershaw and Moorhead, n 205 above.

<sup>218</sup> Freedman, n 147 above, 632. See also C. Ford, 'Macro-and Micro-Level Effects on Responsive Financial Regulation (2011) 44 UBC Law Review 589, 618.

<sup>219</sup> Ford, *ibid*, 606

<sup>220</sup> J. Braithwaite, 'The Essence of Responsive Regulation' (2011) 44 UBC Law Review 475, 476 and 501.

<sup>221</sup> Ayres and Braithwaite, n 185 above, 38-39 and 49-50.

<sup>222</sup> Braithwaite, n 220 above, 486, 501

<sup>223</sup> *ibid*, 476; Freedman, n 147 above, 645-646.

and counter-productive, absent some breach of the law, which would not be present in cases of creative compliance. A more appropriate accountability mechanism might be for law firms to evaluate and report on how they are discharging their obligation to respect the spirit of the law. This should not be a tick box exercise and so the SRA should issue only the most limited guidance on what constitutes compliance, in order to encourage reflective critical thinking. Such a process could not only act as a check on the firm's decision-making and promote moral accountability, it might even, occasionally, make a difference to behaviour. Meanwhile, again, sanctions could be imposed on those who persistently failed to take their obligation to report seriously and who did not respond to dialogue and persuasion.

Parker has commented that the profession lacks 'a framework of accountability and responsiveness to dialogue with the community.'<sup>224</sup> To redress this, lawyers could be required to explain and justify their behaviour to the community's representatives. Lawyers are not often summoned before public inquiries, such as those into the financial crisis for example. There are, for sure, obstacles to this proposal. It would require greater disclosure and transparency of the activities of corporate lawyers and might necessitate the restriction of legal professional privilege. Yet although commentators have queried the importance of privilege in the corporate sphere in particular, there seems little prospect of the courts restricting it.<sup>225</sup> This proposal would also require the community to be paying attention to what lawyers do: academics, the press and social media have a role to play here. Of course, while greater scrutiny might make it more likely that lawyers' conduct could attract social and reputational sanctions, it may not lead to any alteration of behaviour, given the financial incentives to comply with client wishes. Nevertheless large law firms, given the power they wield, and the privileges they benefit from, should not continue to be immune from scrutiny, nor from accountability to society whose laws they shape, apply and, at times, may subvert.

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<sup>224</sup> Parker, n 126 above, 404.

<sup>225</sup> See for example the approach of the Supreme Court in *R (Prudential plc) v Special Commissioner of Income Tax* [2013] UKSC 1; [2013] 2 AC 185.



