

# Independence, Representation and Risk:

An Empirical Exploration of the Management  
of Client Relationships by Large Law Firms

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## DISCLAIMER

This report has been prepared on an independent basis for, and on behalf of, the Solicitors Regulation Authority but does not necessarily represent its views.

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## KEY FINDINGS

- All of our interviewees discussed a **shift in the balance of power** from law firms to clients, represented by the way in which major corporates and financial institutions seek to impose their own terms of engagement on law firms. This shift is not necessarily reflected in the current SRA approach to regulation, which assumes the law firm is setting its terms of engagement.
- We were struck by increased pressure on firms to **deliver 'value for money' in a competitive market**. Responding to that pressure may be challenging, but firms, and their lawyers, are nevertheless required to comply with their duties and professional obligations.
- Despite around three quarters of interviewees outlining a scenario whereby they are forced to accept more and more challenging terms of engagement with little room for discussion, **some firms routinely push back on terms** that they deem unacceptable, and continue to receive instructions. We found no correlation between a firm's size or heritage and its ability to resist more challenging terms of engagement.
- Clients' contractual requirements constitute a form of regulation of the law firm by the client. This private regulation of the corporate and finance practices of large law firms and their corporate finance lawyers via contract has the potential to reduce the distinctiveness of those lawyers as legal professionals, such that they are seen as, perceive themselves to be, and begin to behave like, **mere 'service providers'**.
- The seeking by clients to restrict, via contract, who a firm can and cannot act for has reshaped the market for financial services litigation. This goes to **access to representation issues**, in that some litigants are no longer able to secure their lawyers of choice. Whether this is also an access to justice issue is unclear, and we accept that there is no absolute right to a lawyer, or law firm, of first choice. Of most concern are claims from some lawyers that these contractual provisions might be used strategically by some clients to deny claimants representation from a tier of firms. It was suggested to us by a minority of our interviewees that law firms may be appointed to those panels, and made to sign 'no sue' clauses, where the client has little or no intention of giving that firm work. We accept that we do not have the other side of this story. However, if these matters are true, they are concerning.
- By agreeing to accept the terms imposed by clients who seek to restrict or control a firm via contract, a firm may be taking on **obligations that have the potential to affect duties it owes or could owe** to other or future clients. This may create an information asymmetry between the firm and its less dominant or powerful clients. Accepting that clients and their law firms are generally free to engage on terms they see fit, we would question whether firms should be required to seek consent to disclose these terms, as appropriate.
- The potential for **breaches of confidentiality to arise from client terms** - via inbound secondments, IT and data protection audits, most favoured nation clauses etc - struck us as being high, but our **interviewees seemed confident that this risk was being managed appropriately**.
- **Firms have responded to changes in their engagement in different ways**. Some use Risk Committees, Opinion Committees and/or Pricing Committees. In some firms, partners appear to

have almost total discretion as to the terms they sign up to. Other firms have formal processes in place for the review and sign off of these terms (even if, as we were told, those processes are not always followed by individual partners). We were struck by the apparent lack of sophistication on risk management in some of the world's largest law firms that we spoke with. This echoes other empirical work on legal risk management by in-house lawyer teams.<sup>1</sup>

- Our interviewees' **understanding of the concept of independence was generally poor**. Some respondents suggested that they are not independent, nor do clients expect them to be so. This may be because lawyer independence is a complex and nuanced concept, or may be for other reasons. It is our view that the current definition of independence in the SRA Handbook does not necessarily account for many of the complexities and nuances of independence in today's large legal practices.
- A number of structural pressures on independence exist, and some specific threats. The most worrisome of which, in our view, is third-party payers seeking in some contexts to influence the behaviour of advisers to other parties on a transaction. We have coined the term '**shadow clients**' to denote the power that these third parties (commonly borrowers) have to choose which law firms act for other parties on their deals, and to dictate their roles.
- We were struck by the view of some interviewees of the role of the **COLP as the 'holder' of professional values** for the firm, and raise the question of whether such has the potential for individual lawyers to become less aware of, and less interested in, their own professionalism, professional identity and professional obligations.
- There is a lack of sophistication to the ways in which a number of our participating firms **mitigate independence risks at more junior levels** within their organisations, in particular the lack of systematic training and development on professional obligations (and the potential threats to those obligations).
- Our data suggests **an increase in the risks accepted by firms**, particularly with regard to: wrapping liability of third party advisers; working on an uncapped liability basis; giving reliance letters; and signing indemnities. We do not consider these transfers to be of regulatory concern, but perhaps a matter for relevant representative bodies, though we note the potential build-up of systemic risk in the profession.
- There was **no discernible difference between the practices observed by interviewees at firms of different heritage** (US US Heritage firms, or English or English Heritage firms) but it is clear that **US practices are having a significant influence** on client requests, especially as regards commercial conflicts, liability caps, individual liability and reliance letters.

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<sup>1</sup> See: Richard Moorhead and Steven Vaughan, 'Legal Risk: Definition, Management and Ethics' (Executive Report, 2015) – see: [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2594228](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2594228)

## EXECUTIVE SUMMARY AND CONCLUSIONS

In August 2014, we were commissioned by the Solicitors Regulation Authority (SRA) to conduct, on its behalf, a piece of independent research on lawyer-client relationships in large commercial firms, looking at how those relationships impact, or may impact, professional independence, ethics, standards and risk.

The impetus for commissioning the research lay in concerns raised with the SRA by a number of stakeholders. In particular, the SRA asked us to focus on three broad questions that linked to these concerns:

- (a) how commercial and client pressure affect large firms and their lawyers' professionalism and what systems and controls are used to identify and monitor those pressures;
- (b) how lawyers identify, monitor and mitigate potential liability arising from client driven risk allocation mechanisms, and how widespread these mechanisms have become; and
- (c) whether powerful clients (particularly financial institutions) are influencing their law firms' engagement decisions in a manner that is inhibiting access to representation.

The SRA was told that issues might specifically arise in situations where law firms are engaged by large clients via the use of panels (a practice we discuss in depth in Chapter 2). Our focus in this research is not on the use of panels *per se*, but rather on the extent to which law firms may be willing, or feel forced, to sacrifice elements of their independence, or compromise aspects of their other professional obligations, to satisfy the needs and wants of large clients with significant buying power.

There is comparatively little empirical research on corporate and finance lawyers or how large law firms interact with in-house legal teams, despite the fact that corporate and finance practices comprise a very significant part of the legal services market, and despite the rise of the in-house lawyer (where numbers have more than doubled in the last decade). In addition to seeking views on these issues from Compliance Officers for Legal Practice (COLPs),<sup>2</sup> the SRA was interested in the perspective of senior lawyers engaged in transactional corporate and finance services, practice areas that together contribute the most significant proportion of the turnover of City firms.

With input from several members of the External Reference Group (ERG), we worked with the SRA to draw up a topic guide (see Appendix 1) that reflected a broad number of interests and potential issues. These form the core chapters of this report and are summarised below. In the core chapters, we also talk about conflicts of interest. We feel it important to stress that this was not a topic on the topic guide, and was not one of the issues raised with the SRA that led to this project. However, it was, almost universally, the first matter that our interviewees wanted to speak with us about.

Between December 2014 and March 2015 we conducted 53 interviews, speaking with a mix of senior corporate and finance partners (often department heads), COLPs, risk officers and others, from 20 leading English and US law firms delivering corporate and finance legal services from England & Wales: 15 English/English heritage ('EH') firms; and five US/US heritage ('US') firms. When these interviews were transcribed, we had almost 1,000 pages of data. The interviews were anonymous. The SRA did not, and does not, know which law firms we contacted and/or which

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<sup>2</sup> <http://www.sra.org.uk/lawyers/colp-cofa/ethos-roles.page>

partners, COLPs and others participated. Ethical approval for the project was given by the University of Birmingham. Further detail on our sampling methodology and approach is set out in Appendix 2.

At the start of May 2015, we met with five senior in-house lawyers from five separate financial institutions and spent two hours with them discussing our interim findings. While this meeting does not, and cannot, reflect the views of the entire community of in-house lawyers, it did provide useful context for some of the changes in lawyer-client engagement that we learned of, and offers a counterpoint to some of the opinions expressed by our private practice lawyer interviewees. Chapter 6 sets out the views represented at this meeting in full. One striking comment from this meeting concerned where legal teams now tend to be housed within their organisations. We were told that the legal departments at the five investment banks represented no longer sit within the business, but are instead part of the central corporate function, alongside IT, HR, Compliance and other non-fee generating teams. We wonder if this changes the dynamic of in-housers engaging external law firms.

What follows in this Executive Summary and Conclusions serves two aims: first, we set out our findings; second, we comment, where appropriate, on the extent to which our findings may raise issues of regulatory concern for the SRA, or, alternatively, raise issues that The Law Society, The City of London Law Society, the profession at large, other regulators or other stakeholders may wish to consider. This Executive Summary intentionally does not contain any of the quotes from our interviewees. It should, therefore, be seen and read as a taster of what follows in the main chapters of this report.

The dynamics between large law firms and their clients are complex. Some of the issues we present below are 'purely' commercial matters in that they do not concern the regulatory objectives or professional principles set out in the Legal Services Act 2007 and/or the professional obligations or other requirements in the SRA Handbook. Despite this, shining a light on these practices is important for two reasons: (i) it allows for a sense of how lawyer-client relationships have changed, and are changing over time (i.e. it paints a picture of market practice that is currently missing); and (ii) it signals to the large law firm sector that the SRA is aware of the pressures those lawyers and firms are facing and has sought evidence that will enable the profession, its representative bodies and other stakeholders to debate and consider appropriate responses. However, we would suggest that some of the issues we raise do go to the regulatory objectives, lawyers' professional obligations and the management of claims risk. Some issues also question the extent to which the regulatory objectives and professional obligations fit different types of practice. In particular we question whether the concept of independence has matured and adapted to a changing legal services market.

It is important to note that we have not been asked to provide, in this report, concrete suggestions as to what the SRA should do next with our data.

## **LAWYER-CLIENT RELATIONSHIPS**

One of the principal messages that emerged from our interviews was the concept of a shift in the balance of power from law firms to clients, represented by the way in which major corporates and financial institutions seek to impose their own terms of engagement on law firms. A number of these clients now transact with law firms via panel processes in which there is fierce competition for work and where appointments are often accompanied by detailed, mandatory sets of terms and conditions (also often known as 'outside counsel guidelines'). These guidelines cover a variety of matters, from fee arrangements to secondments, IT security, conflicts of interest and much more. Christopher Whelan and Neta Ziv have suggested that these sorts of guidelines may amount to the



privatisation of professionalism, a situation in which clients blur the lines of lawyer governance and control.<sup>3</sup> All of our interviewees told us that the panel terms that they must sign up to in order to be eligible for instructions have become longer and more detailed; that the terms clients are seeking to impose have become more onerous; and that the use of panels has itself become far more widespread. This is particularly the case in the five years since the credit crisis.

Despite around three quarters of our interviewees outlining a scenario whereby they are being forced to accept more and more onerous terms of engagement with little room for discussion, we did find that four or five of the firms we interviewed said that they routinely pushed back on terms that they deemed unacceptable. Crucially, these firms continued to receive instructions, including where they refused to accept positions on panels because of terms that they could not get comfortable with. The perception, therefore, that we encountered among many other firms that 'everyone is agreeing to these terms' appears misplaced. Interestingly, we did not find *any* apparent relationship between either the size of the firm, or its heritage (US or English law firms), and the ability or willingness of firms to push back on terms.

While client requests have clearly become more numerous, lengthy, and sophisticated in detail, we found mixed views amongst partners as to whether these changes give cause for concern in anything other than a commercial context. Undoubtedly the biggest challenges for law firms that come out of panel requirements are financial, with fee arrangements a particular issue. While we accept there is debate over the ethicality of different billing practices, nothing from our data suggested that this was an area requiring regulatory intervention. The three matters that did concern us, however, are set out in depth in Chapters 3, 4 and 5, which respectively cover conflicts of interest (and access to representation), lawyer independence (and the power of borrowers/sponsors to appoint the banks' lawyers), and the transfer of risk from clients to firms.

### INFLUENCING ACCESS TO REPRESENTATION

The phrase 'conflicts of interest' is capable of meaning a number of different things. On one level, we are concerned with 'legal' conflicts (i.e. those reflected in the SRA's Handbook) that seek to prevent lawyers and firms from acting for or against different clients on the same matter. On other more amorphous and more complex levels, law firms having multiple clients means that there is the risk that:

- (i) that firm will act against any given client on any given matter (contentious or non-contentious) where that client has other legal representation; and/or
- (ii) that firm will advance arguments which could, in future matters, be to the detriment of any given client (e.g. suggesting a clause be drafted or interpreted in way X for client Y, which would go against the drafting or interpretation that they would advance for client Z); and/or
- (iii) that firm will advise a competitor of any given client in a matter wholly unrelated to any work it is doing for client X, but in a way that advances the interests of client Y to the detriment of client X; and/or

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<sup>3</sup> Christopher J Whelan and Neta Ziv, 'Privatising Professionalism: Client Controls of Lawyer Ethics' (2012) 80 Fordham Law Review 2577

(iv) that firm will advise another client in a matter in which a given client has no immediate involvement, but that proves to be to the detriment to any given client's commercial interests.

These wider contentious and commercial conflicts are not explicitly referred to by the SRA in the Principles or the Handbook: the SRA's conflicts focus appears to us to be on lawyers' relationships with a 'matter client' (i.e. acting for X on Y) rather than their relationships with 'clients of the firm' on an ongoing basis across multiple matters (i.e. X and Z being clients of the firm with potentially competing interests).

Given the growing use of panels precisely to shift relationships from an individual to an institutional context, and from a given-matter-basis to a long-term basis, this presents challenges. In these wider contentious and commercial conflicts situations, lawyers and firms need to juggle acting "with integrity" (Principle 2), not allowing their "independence to be compromised" (Principle 3) and "acting in the best interests of each client" (Principle 4). There may be consumer protection issues here. Whilst information asymmetry is not generally of concern with sophisticated clients, if firms are signing up to extensive conflicts provisions that may affect their engagements with other clients, or potential clients, we would question whether they might in fact be required to secure consent and disclose them.

What our data also shows is that lawyers and firms, in these situations, need to be mindful of contractual promises they have made to clients on conflicts in their terms of engagement. The seeking by clients to restrict, via contract, who a lawyer and a firm can and cannot act for was of almost universal concern to our interviewees, and the first matter they raised when we asked them to talk about particularly challenging provisions in terms of engagement. Where these clauses restrict the ability of firms to sue their clients (on matters where those clients are represented by another law firm), this gives rise to potential issues for third parties who may not be able to secure representation from their first choice of lawyer or firm. This practice has been raised previously by the Tomlinson Report as of specific concern in the context of financial institutions, and the same theme comes out from our data.<sup>4</sup> What is less clear, however, is whether these practices (i.e. 'no sue' clauses) and their consequences (i.e. a reshaping of the field in terms of who is willing to sue whom) give rise to regulatory issues with which the Financial Conduct Authority, the Competition and Markets Authority and/or the SRA should concern themselves. Equally, whether these practices engage access to justice issues is unclear. Access to justice is commonly framed in terms of access for those unable to afford legal advice, an issue of unmet legal need (itself a complex concept).<sup>5</sup> Here we have the situation where litigants may be able to secure legal representation (see below) but that representation is not, perhaps, the representation they would have chosen in a different world. This may or may not be an access to justice challenge, depending on how one defines access to justice.

Half of our interviewees were of the view that these practices have led to boutique litigation firms opening up and firms developing bank litigation practices that have cornered a niche in the market and offer representation where needed. The other half, while accepting these niche firms had opened, questioned the quality of representation at those niche firms (primarily because of their view that, say, specialist financial litigation requires the claimant firm to also have a specialist finance practice in addition to a litigation practice). Quality in legal services is, however, another challenging concept, and we might debate the indicators of quality in these sorts of contentious

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<sup>4</sup> <http://www.tomlinsonreport.com/docs/tomlinsonReport.pdf>

<sup>5</sup> Deborah Rhode, *Access to Justice* (OUP 2004)

matters between firms with (on the face of it) equally well-qualified and equally well-educated partners. We also accept that it is in the self-interests of those with whom we spoke to say that the quality of these boutique firms is questionable. We were not told of potential litigants being unable to find *any* representation. Rather, those litigants have, perhaps, not been able to find the representation they would have preferred.

What seems clear to us is that the market for litigation has been reshaped as a result of contractual provisions on conflicts of interest. What concerns us are comments from *some* of our interviewees that some of these contractual provisions were introduced strategically by *some* clients to deny claimants representation from a tier of firms in situations where firms are appointed to panels (and made to sign up to these 'no sue' clauses) where the panel client had no intention of giving that firm much, or any, work. These comments are alarming and we accept that further work is needed to substantiate them, such that one might counter argue that frustrated lawyers restricted by contract as to whom they can and cannot act for might seek to put forward explanations which cast those contractual provisions in a negative light. If (and we accept that this is a big 'if') SRA-regulated in-house lawyers are active in these practices, we might question whether they are really in compliance with Principle 1, a lawyer's obligation to 'uphold the rule of law and the proper administration of justice'. Relatedly, Richard Moorhead has suggested that, "In theory, lawyers' firms entering into contracts which restrain them from acting against banks which is broader than professional conflict rules might be criticised for compromising their independence."<sup>6</sup> While we would agree with this possibility (that criticism might be so directed), we accept that others feel differently. There is no set answer to this matter at present.

These concerns go not only to 'no sue' clauses but are equally relevant (if harder to pin down) in the context of commercial conflicts provisions introduced by clients into lawyer terms of engagement. We were told that these clauses seek to prevent lawyers from acting adverse to their clients on transactional matters (where those clients have other legal representation) and extend to the more amorphous 'thou shalt not act adverse to our interests' clauses, which include denying firms the ability to advance issues (e.g. the drafting or interpretation of a clause in a contract) which might, in future, be prejudicial to a given client. A number of the firms we spoke to routinely push back on these sorts of clauses.

We are unclear, and have been unable to find clarity elsewhere, on the extent to which the professional obligations on lawyers and regulated entities restrict the ability of those lawyers and firms to enter into these types of contracts with their clients.<sup>7</sup> One view might be that such contracts are permissible save where they are in tension with the Principles and Handbook. However, such would assume (wrongly) that there are neat answers to the complex questions we raise in Chapter 3 on conflicts of interest. At the same time, a number of firms told us that they have signed up to contractual provisions on conflicts with their clients where the firms are not sure they are able to comply with those provisions (for example because the provisions are so wide in scope and the client has hundreds of subsidiaries operating in multiple jurisdictions). Is this a question of those firms really acting 'in the best interests of each client' (Principle 4), or is this simply a commercial matter (a risk decision) for firms to decide as they see fit (and not a matter for the SRA)? There may be situations in which the contractual arrangement has the potential to cut across duties owed to, or

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<sup>6</sup> <https://lawyerwatch.wordpress.com/2013/11/28/independence-matters-banking-and-big-law-in-the-news/>

<sup>7</sup> We note the situation involving tobacco litigation, Leigh Day and Irwin Mitchell in which the two law firms agreed to withdraw claims (and to not pursue future claims) to stop their existing clients from paying costs in litigation they had lost against tobacco companies. See: Austin Sarat and Stuart Scheingold, *Cause Lawyering and the State in a Global Era* (OUP 2001) 151. We are grateful to Richard Moorhead for bringing this example to our attention.

interests of, other clients of a firm. For example, there could be an asymmetry of information between the firm and its less significant or sophisticated clients, as to the contractual arrangements the law firm has been required to put in place with its most powerful clients.

In her work, Joan Loughrey has suggested that if we see default regulatory conflicts rules as something to contract out of then we see conflicts as “purely private” matters and we fail to acknowledge, as the SRA itself acknowledges,<sup>8</sup> the importance of conflicts to the public interest.<sup>9</sup> Similarly, we might argue that firms accepting to widen their conflicts obligations via contract also frames conflicts in terms of the private and ignores the public. This resonates with the argument by Whelan and Ziv, discussed earlier, that clients are “privatising professionalism” through their use of detailed outside counsel guidelines. A potential counter to this may lie in how the common law has historically understood conflicts in terms of “undivided loyalty” to clients on a matter centric basis.<sup>10</sup> What seems clear is that the profession is concerned about these issues: although the SRA did not ask us to focus specifically on conflicts, a number of interviewees raised these concerns with us (and these concerns were the first things they wanted to speak to us about).

## LAWYER INDEPENDENCE

The issue of lawyer independence was, as set out above, one of the core drivers for this research. However, independence in the legal profession is a complex and nuanced concept. At its most basic, it is the practice of advising and acting free from inappropriate influence and is commonly understood as a tripartite relationship between the client, the lawyer and the state. However, and as represented below in Figure 1.1, we would suggest that independence is better understood as a series of interconnected and multiple relationships, which each have the potential to impact on the role of, and advice given by, any individual lawyer or any law firm. We would also suggest that, in the context of the lawyer-client relationship, the following matters have the potential to influence the independence of any given lawyer: (i) the balance of power between lawyer, firm and client; (ii) the reliance of the lawyer and/or firm on the client for business; (iii) the willingness and potential for lawyers and firms to say ‘no’ to clients; (iv) the acceptance by lawyers and firms that affirming independence may have negative financial consequences; (v) the closeness of the lawyer and/or firm to the client; (vi) law firm culture and the ownership and management of ethics, compliance and risk; and (vii) the ways in which firms structure and distribute incentives. Our view is that the current definition and exposition of independence in the SRA Handbook (via Principle 3 and associated guidance) does not account for these nuances.

We asked our interviewees what they understood by the term ‘lawyer independence’ and whether they had encountered situations in which their independence, or the independence of other lawyers, had been challenged. Our interviewees were, in general, unable to clearly articulate what the principle of independence meant. This may well be because, as we have set out, independence is complex and contested. However, when pushed, most could understand the importance of lawyer independence, although a minority were of the fixed view that they were not independent, and were not appointed by clients to be independent. This is a concerning lack of understanding of the SRA Handbook as regards independence, but (as we show later) the regulation could be clearer. We

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<sup>8</sup> The SRA describes conflicts of interest (in Chapter 3 of the Code) as “a critical public protection”.

<sup>9</sup> Joan Loughrey, ‘Large Law Firms, Sophisticated Clients, and the Regulation of Conflicts of Interest in England and Wales’, (2011) 14(2) *Legal Ethics* 215, 230; SRA Code of Conduct, Chapter 3

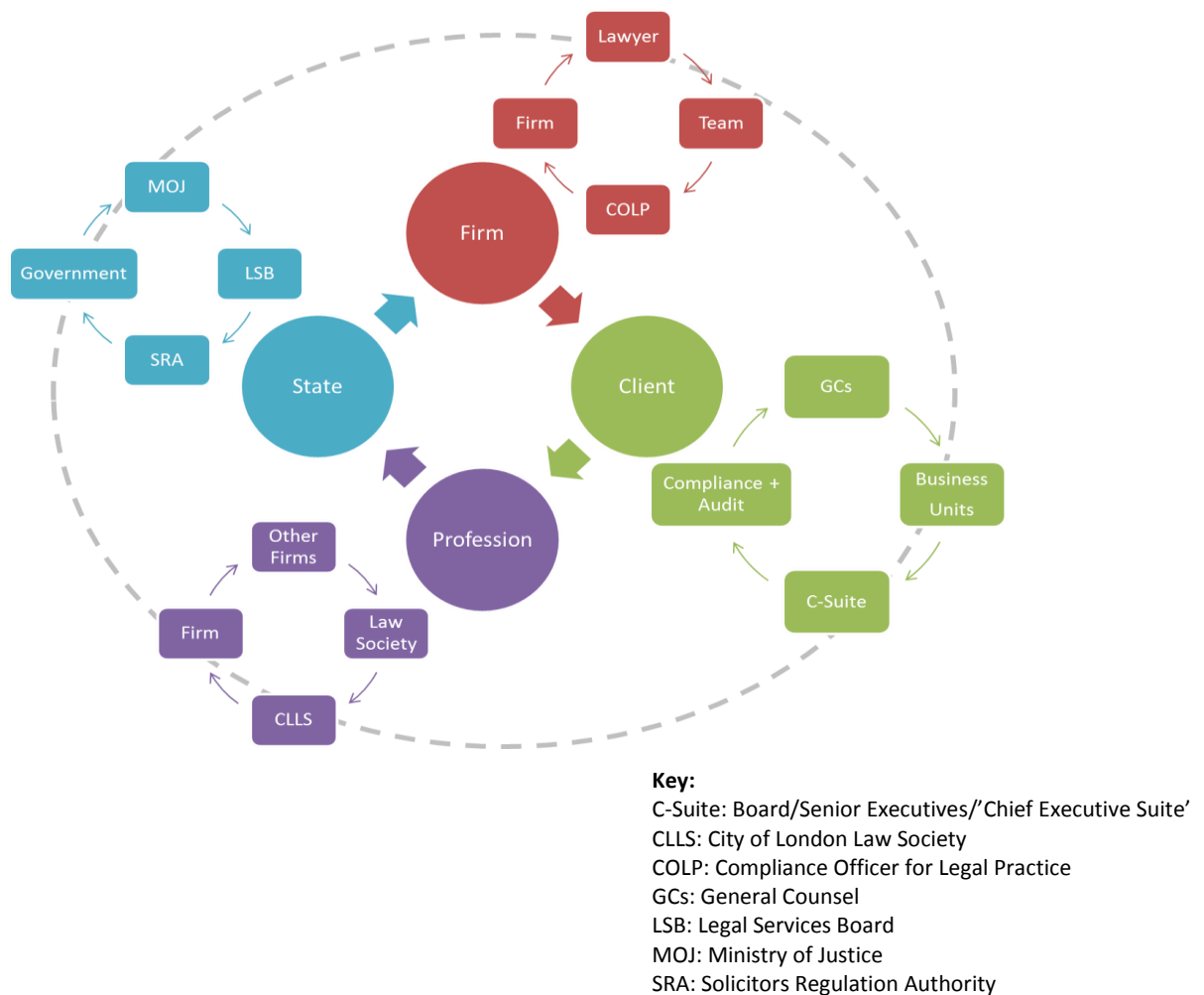
<sup>10</sup> *Clark Boyce v Mouat* [1994] 1 AC 428, 435; *Farrington v Rowe McBride & Partners* [1985] 1 NZLR 83, 90.

There is a view that loyalty at common law only applies to the matter on which the solicitor is acting. We are of the view that while this may have been the case in *Clark Boyce v Mouat*, we are not wholly convinced that this is still true today.

were also told by our interviewees of a number of structural pressures on independence, such as fee arrangements, law firm compensation models, and individual partners becoming overly reliant on any one given client. In the 2012 Upjohn Lecture, Lord Neuberger, President of the Supreme Court, commented as follows on the ‘purpose’ of the legal profession:

“A vibrant, independent legal profession is an essential element of any democratic society committed to the rule of law. It is not merely another form of business, solely aimed at maximising profit whilst providing a competitive service to consumers. I am far from suggesting that lawyers ought not seek to maximise their profits, or ought not provide a competitive service. What I am saying is that lawyers also owe overriding specific duties to the court and to society, duties which go beyond the maximisation of profit and which may require lawyers to act to their own detriment, and to that of their clients.”<sup>11</sup>

**FIGURE 1.1 – THE INTERCONNECTED NATURE OF LAWYER INDEPENDENCE<sup>12</sup>**



<sup>11</sup> Lord Neuberger, ‘Reforming Legal Education’ (Association of Law Teachers Lord Upjohn Lecture, November 2012) 7 – see: <https://www.supremecourt.uk/docs/lord-neuberger-121115-speech.pdf>

<sup>12</sup> We accept that it is possible to push this figure further and to include other actors. Richard Moorhead has helpfully suggested that these other actors might include, say, insurers and additional State regulatory bodies. Moorhead has previously used the work of Andrew Abbott to discuss the interconnected nature of professionalism see: Richard Moorhead, ‘Precarious Professionalism: Some Empirical and Behavioural Perspectives on Lawyers’ (2014) 67(1) Current Legal Problems 447, 452

Two specific threats to lawyer independence were brought to our attention (unprompted) by interviewees, namely: (i) the risks arising from clients seeking to put pressure on the way in which legal opinions are drafted; and (ii) third-party payers seeking, in some contexts, to influence the behaviour of advisers to other parties on a transaction (often by dictating who those lawyer advisers could be) – for example, a borrower telling its funder bank which lawyers that bank can use on the loan. The second matter strikes us as problematic and less amenable to resolution by a simple reaffirmation of the SRA Handbook Principles. We have coined the term “shadow client” to denote the power that these third parties (commonly borrowers or private equity sponsors) have to choose which law firms act on which transactions. While we were not given any specific examples by our interviewees of this practice resulting in tangible violations of the Handbook, many of our interviewees were concerned by the potential for lawyers appointed by third parties to possibly act, in ways subtle and refined, in the interests of those third parties over the interests of their clients. We would agree, and this point was also raised (unprompted) by one of the in-house lawyers to whom we presented our interim findings.

Finally, we were struck by the lack of sophistication as to the ways in which a number of our participating firms mitigate independence risks at non-partner levels within their organisations, in particular the lack of systematic training and development on professional obligations (and the potential threats to those obligations).<sup>13</sup> This may or may not be reflective of the wider market. We were also struck by the view, held by a number of interviewees, of the role of the COLP as the ‘holder’ of professional values for the firm, and raise the question of whether such has the potential for individual lawyers to become less aware of, and less interested in, their own professionalism, professional identity and professional obligations and how they were mitigating potential liability here.

### **Risk Transfers**

The SRA was interested in the extent to which law firms were being asked to accept additional and/or different forms of risk by clients and, if they were so accepting, how they managed the resulting risk. We asked our interviewees about the extent to which they are willing to accept liability for advice given to their clients by other advisers (e.g. by law firms based in jurisdictions where the initial firm did not have an office). We also asked firms whether clients sought indemnities from them, and the extent to which clients expected them to work on the basis of uncapped liability.

Our data suggests an increase in the risks accepted by firms, on an individual and systemic basis, with some (but not many) firms being robust in their push back against these three practices. While this is interesting, it is perfectly possible to see these changes as simply an allocation, or reallocation, of power between sophisticated parties – a matter of contract and negotiation (which in turn shapes the nature and extent of tortious obligations). If this is the right interpretation, the developments in risk transfer of which we were made aware would be of no proper regulatory interest to the SRA (and might instead be better taken forward by the relevant representative bodies).

However, we think there is an equally valid argument that sets out that these risk transfer practices operate to build up systemic risk in the legal profession, which could, in due course, lead to significant liability, the risk of law firm collapse, and a resultant undermining of the strength of the profession (in terms of brand and perception) on the international stage. Principle 8 of the SRA Handbook requires lawyers and firms to conduct their roles and businesses in accordance with,

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<sup>13</sup> This has been found elsewhere in other empirical work. See: Moorhead (n 12 above)

“sound financial and risk management principles.” It might be thought irresponsible for a firm to act on a matter which could give rise to liability greater than the firm could sustain, unless the firm also caps such liability at the amount of its insurance (or lower).

We were struck by the widely held view that accountants had been much more successful at resisting risk transfer from clients and wondered whether there were particular reasons for this. We would suggest that this is worthy of further exploration by the profession and its representative bodies, perhaps reviewing whether the SRA's minimum terms and conditions for PII are overly protective of claimants in this context, and engaging in a dialogue with insurers. We also found that firms varied as to the amount of discretion they gave to their partners, or that was simply exercised by individual partners regardless of firm controls, when agreeing engagement terms, opinions and the like.

### **The (Initial) Views from In-House Lawyers at Financial Institutions**

The five senior in-house lawyers from financial institutions that we met with told us of the significant pressures they are under as regards legal spend. We were also told of how their role has been significantly reoriented towards one of risk management in its broadest sense. All attendees at the roundtable meeting worked at financial institutions, but not all used panels to manage relationships with external legal advisers. All accepted that the terms of engagement that they now expect law firms to sign up to on receipt of instructions have become lengthier, but they did not see that as an issue which challenged those lawyers' professional obligations. Nor did they think it an issue that private practice lawyers felt there was little room to negotiate on the terms of business.

Those present felt strongly that their legal advisers should not be permitted to sue them on behalf of other clients, and their terms of engagement each include no-litigation clauses. These five in-house counsel did not make use of wider conflict clauses that require that their advisers should not act against their commercial interests, arguing instead that it is useful to have external lawyers with experience of working for other players in the market.

We asked the in-house meeting members to define what they expected in terms of professional independence from their advisers, and they struggled to articulate their expectations. Finally, we asked the meeting attendees about risk transfers, and particularly the issues of wrapping liability, indemnities, and liability caps. Those present did occasionally, but not always, ask their law firms to accept liability for the advice of third-party law firms on transactions. They did not use indemnities in their standard terms (or were not aware of them if they did). They all felt strongly that law firms should not be able to cap their liability, with all of those present arguing that lawyers should stand behind their legal advice just as banks have to stand behind their own advice. They further pushed back hard on firms trying to introduce liability caps under the radar, for example by sending engagement letters midway through deals that included caps on liability.

### **Where Next**

We would suggest that the data we present in this report could act as a useful point of departure for further research (funded by the SRA, Legal Services Board, Law Society, City of London Law Society, individual firms or others) in at least three areas:

(i) with additional in-house lawyers on their roles and responsibilities;<sup>14</sup>

(ii) with the insurers of legal services; and

(iii) on the role and function of COLPs, and how COLPs are perceived by the lawyers in their firms.

There are, in addition, a number of further projects on large law firms that could add further depth to the conclusions we have been able to draw.

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<sup>14</sup> Steven Vaughan is part of a team led by Richard Moorhead, with Paul Gilbert and Stephen Mayson, working on an 'Ethical Leadership' project in the context of in-house lawyers. More information can be found here: <http://www.legalfutures.co.uk/latest-news/work-starts-on-ethical-leadership-initiative-for-under-pressure-in-house-lawyers>



## CHAPTER 1 - INTRODUCTION

As set out above, in August 2014 we were commissioned by the SRA to conduct a piece of independent research on lawyer-client relationships in large commercial firms and how those relationships impact professional independence, integrity, duties to other clients, ethics, standards and risk. The following chapters of this report sets out the findings from that research. This short introductory chapter provides some context and factual background to the matters under discussion, and signposts the chapters that follow.

Concerns raised with the SRA by a number of stakeholders, discussed above in the Executive Summary, were translated into the SRA's Risk Outlook 2014/15, which identified a lack of independence from clients as a "priority risk" i.e. a risk the SRA is concerned about but the extent of which is unclear to it, or which it feels may not be widespread.<sup>15</sup> Our focus is therefore the extent to which law firms may be willing, or feel forced, to sacrifice elements of their independence, and/or to compromise aspects of their other professional obligations, to satisfy the needs and wants of large clients with significant buying power, and the extent to which these risks are being monitored and mitigated.

The balance of power is an important factor in any relationship, and the lawyer-client relationship is no exception. Where lawyer-client relationships do not rest on solid foundations of independent and ethical legal practice, there are significant implications for the rule of law and public trust in the provision of legal services. Large law firms are powerful economic actors. The top 196 law firms that the SRA categorises as 'high impact' firms (which formed the starting cohort for our research) employ 43,585 lawyers,<sup>16</sup> or one third of the 131,518 practising lawyers registered as of March 2015.<sup>17</sup> The annual turnover (generated from offices in England & Wales) of these 196 firms is just under £13bn,<sup>18</sup> which is more than the respective GDPs of 60 of the world's nation states.<sup>19</sup> Using data published by the Law Society in 2014, we see that the turnover from these specific 196 firms represents around half of the turnover of the entire legal services sector.<sup>20</sup> As large law firms have grown in significance, so too have there been significant shifts in the sophistication of in-house legal departments, and the way in which clients engage and use external legal services providers. Between 2000 and 2012, the in-house lawyer population doubled to 25,600 lawyers, or 18% of the total lawyer population.<sup>21</sup> We comment further on changes to 'big law', and the way in which clients engage legal services, in Chapter 2.

Despite the fact that a third of all lawyers work for the top 2% of law firms by turnover in England & Wales, and despite the fact that those firms account for half of the entire turnover of legal services in England & Wales,<sup>22</sup> there is surprisingly little empirical research on commercial firms and their corporate and finance lawyers.<sup>23</sup> There is also very little known about the way in which these firms

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<sup>15</sup> <http://www.sra.org.uk/lawyers/freedom-in-practice/ofr/risk/risk-outlook.page>

<sup>16</sup> Data provided to the research team by the SRA

<sup>17</sup> See: [http://www.sra.org.uk/sra/how-we-work/reports/data/lawyer\\_firms.page](http://www.sra.org.uk/sra/how-we-work/reports/data/lawyer_firms.page)

<sup>18</sup> Data provided to the research team by the SRA

<sup>19</sup> International Monetary Fund, 'World Economic Outlook Database' (April 2015)

<sup>20</sup> Law Society, 'Legal Services Forecasts – 2014' (28 August 2014) 3

<sup>21</sup> Oxera, 'The Role of In House Lawyers' (February 2012) 6

<sup>22</sup> As of March 2015, there were 10,316 law firms in England & Wales. See: [http://www.sra.org.uk/sra/how-we-work/reports/data/lawyer\\_firms.page](http://www.sra.org.uk/sra/how-we-work/reports/data/lawyer_firms.page)

<sup>23</sup> For a discussion of the research that does exist in this field, see: Richard Moorhead and Victoria Hinchly, 'Professional Minimalism: The Ethical Consciousness of Commercial Lawyers' (2015) *Journal of Law and Society* (forthcoming)

engage, interact, and manage long term relationships with their often highly sophisticated client base. Our research aims to fill part of that gap and, in so doing, will provide an evidence base for the SRA to use in deciding whether regulatory intervention or guidance, and/or a change of policy, is needed. These findings will also arm large firms and their lawyers, and their representative bodies, with an overview and exploration of market practice that would otherwise be opaque to them (for competition law related reasons).

## **REPORT STRUCTURE**

This report has five further chapters. Chapter 2 provides additional context on changes to ‘big law’ and to lawyer-client relationships, and how our interviewees perceived changes to those relationships. This chapter also sets out some of the issues raised with us by our interviewees that were either uncontentious (in that most interviewees accepted them as the current state of the market and largely acceptable) and/or were only of concern to a minority of those to whom we spoke. Chapters 3, 4 and 5, on the other hand, set out issues that were of more general concern to our interviewees, and which strike us as potentially problematic as regards challenges to the regulatory objectives or professional obligations set out in the Legal Services Act 2007 and/or the SRA’s Handbook.

Chapter 3 concerns the ways in which clients shape which other entities lawyers and law firms can act for, via conflicts provisions inserted into terms of engagement. This chapter includes consideration of issues of access to representation raised by Lawrence Tomlinson in his report for the government on banks’ lending practices.<sup>24</sup> Chapter 4 explores the principle of lawyer independence and sets out how our interviewees understood lawyer independence, as well as specific instances of situations in which we feel lawyer independence has the potential to be compromised. Chapter 5 then considers how clients seek to transfer risks to law firms, in three specific situations: (i) in firms taking on liability for advice provided to their clients by third parties (e.g. other law firms); (ii) in clients asking for indemnities from their lawyers; and (iii) in the ability (or, rather, inability) of law firms to cap their liability for the advice that they give. Chapter 6 sets out the views of the five in-house lawyers from financial institutions we met with to discuss our interim findings. Appendix 1 contains the topic guide we used in our interviews. Appendix 2 sets out the detail of our research methodology.

As with any research of this nature, we set out in this report what we were told by those we interviewed. Our methodological approach was designed such that we were as random as possible in selecting the firms we contacted, but we cannot make any claims that our data is representative of all corporate and/or finance lawyers or the leading commercial firms they work in, or of the COLPs of those firms. However, we think it worth noting that we spoke with many heads (or ex heads) of Corporate and Finance teams at some of the world’s largest law firms, and with many partners who each had more than 30 years of post-qualification experience. As such we are confident that the conclusions we draw are robust and can withstand challenge.

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<sup>24</sup> See: <http://www.tomlinsonreport.com/docs/tomlinsonReport.pdf>

## CHAPTER 2 – LAWYER-CLIENT TERMS OF ENGAGEMENT

In this chapter we discuss how ‘big law’ and the engagement of large law firms has changed over time, both via accounts in the existing scholarship on these matters and via what we were told by our interviewees. The legal profession has changed significantly in the last three decades.<sup>25</sup> What was once a relatively homogeneous guild-like institution has morphed into a world of two distinct hemispheres (corporate-finance law/private client law).<sup>26</sup> Recent research on lawyers has tended to conclude that the demands of business are pulling the tide of decision-making within corporate-finance law firms,<sup>27</sup> and so instead of a legal ‘profession’ in corporate-finance law, some suggest that we now may have a capitalist service industry.<sup>28</sup> Views differ significantly, between and within academics and others, as to whether these changes are concerning or not. The work we reference below comes from the US, the UK and further afield. We acknowledge, for the avoidance of doubt, that there are different legal service markets and potentially different cultures/approaches in different geographic regions.

A number of commentators have, since the mid-1990s, been lamenting the decline of law firm culture more generally,<sup>29</sup> in which business demands, the ‘eat what you kill culture’ of some firms and/or sheer growth are said to be to blame.<sup>30</sup> There are those who suggest that the notion of a corporate/finance lawyer as a professional exercising professional judgment has all but disappeared: Gerard Hanlon writes of “commercialised professionalism”;<sup>31</sup> Andrew Boon and Jennifer Levin talk of these lawyers as “cogs in a machine”;<sup>32</sup> and Christopher Whelan and Neta Ziv argue that we have “privatised professionalism” due to the power of clients to dictate, via contract, exactly what their lawyers can and cannot do.<sup>33</sup> As such, some have argued that a “service provider” paradigm, in

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<sup>25</sup> For a more detailed account of why this is so, see the various accounts in: Hilary Sommerlad, Richard Young, Steven Vaughan and Sonia Harris-Short, *The Futures of Legal Education and the Legal Profession* (Hart Publishing, 2015)

<sup>26</sup> On the shift from a guild like institution, see: Andrew Abbott, ‘The Sociology of Work and Occupations’ (1993) 19 *Annual Review of Sociology* 187; Emil A Krause, *Death of the Guilds: Professions, States and the Advance of Capitalism* (Yale University Press 1996). On the two hemispheres, see: John P Heinz and Edward O Laumann, *Chicago Lawyers: The Social Structure of the Bar* (University of Chicago Press, 1982); and John P Heinz, Robert L Nelson, Rebecca L. Sandefur and Edward O Laumann, *Urban Lawyers: The New Social Structure of the Bar* (University of Chicago Press, 2005)

<sup>27</sup> Ronit Dinovitzer, Hugh Gunz and Sally Gunz, ‘Unpacking client capture: evidence from corporate law firms’ (2014a) 1 *Journal of Professions and Organization* 99; Ronit Dinovitzer, Hugh Gunz and Sally Gunz, ‘Reconsidering Lawyer Autonomy: The Nexus Between Firm, Lawyer, and Client in Large Commercial Practice’ (2014b) 51(3) *American Business Law Journal* 661

<sup>28</sup> Hilary Sommerlad, ‘The commercialisation of law and the enterprising legal practitioner: continuity and change’ (2011) 18 *International Journal of the Legal Profession* 73; Hilary Sommerlad, ‘Managerialism and the Legal Profession: A New Professional Paradigm’ (1995) 2 *IJLP* 159; Gerard Hanlon, ‘Professionalism as Enterprise’ (1998) 32 *Sociology* 43

<sup>29</sup> Elizabeth Chambliss, Measuring Law Firm Culture, in Austin Sarat (ed) *Law, Politics and Society: Law Firms, Legal Culture and Legal Practice* (Special Issue, 2010)

<sup>30</sup> Marc Galanter and William D Henderson, ‘The Elastic Tournament: The Second Transformation of the Big Law Firm’ (2008) 60 *Stanford Law Review* 1867; Milton C Regan, *Eat What You Kill: The Fall of a Wall Street Lawyer* (University of Michigan Press, 2004)

<sup>31</sup> Gerard Hanlon, *Lawyers, the State and the Market: Professionalism Revisited* (Palgrave Macmillan, 1998) 123

<sup>32</sup> Andrew Boon and Jennifer Levin, *The Ethics and Conduct of Lawyers in England & Wales* (Hart, 2<sup>nd</sup> ed, 2008)

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<sup>33</sup> Whelan and Ziv (n 3 above)

which the engagement of lawyers has been standardised, has replaced the paradigm of lawyers as professionals.<sup>34</sup>

David Wilkins argues that the corporate/finance lawyer-client relationship has undergone three stages of development over time: (i) initially there was a “Golden Age marriage” in which lawyers were trusted advisors to their corporate clients; (ii) this was then followed by a “divorce” in the late 1980s and onwards, when clients started to engage firms via spot contracting following the growth of in-house legal teams (the ‘We hire lawyers not firms’ model); and (iii) a more modern firm-client partnership model (in which clients rely on fewer firms but expect more and/or different things from them, using a blend of co-operation and competition to get what they want).<sup>35</sup> In 2010, Larry Ribstein published an article entitled ‘The Death of Big Law’ which predicted the eventual decline of the large firm because of a “basically precarious business model”.<sup>36</sup> To date, however, this demise seems to have been greatly exaggerated. Each of the world’s largest firms employ thousands of lawyers in dozens of offices across the globe and, as set out in Chapter 1, reap significant financial rewards.

Existing research suggests that the drivers for the changes in the practices of big law and how big law firms are engaged are varied: the globalisation of legal services has seen increased competition for work;<sup>37</sup> the rise of the in-house legal function has allowed clients to better understand which legal services they need and how much those services are worth;<sup>38</sup> large corporates have started to outsource and unbundle some of their work as part of a drive towards efficiency;<sup>39</sup> and the financial crisis has had a significant knock-on effect on how much clients have available, or are willing, to spend on external counsel (the ‘more for less’ agenda).<sup>40</sup> Christine Parker has argued that client pressure increases competition among law firms. This makes it essential for lawyers to ensure a degree of loyalty maintained with the client and, she argues, results in the possible unethical behaviour of lawyers.<sup>41</sup> We consider independence, and loyalty, in Chapter 4. We are not suggesting that there is anything necessarily untoward in clients seeking ‘more for less’ or better value from their law firms. We accept that there is a healthy competition for the top end of corporate and finance legal services and that, because of the various forces and changes highlighted above, clients now have greater purchasing power and greater control over and knowledge of what their law firms do. What we see in our research, however, are instances of law firms and lawyers reacting to these ‘more for less’ pressures in ways that, on occasion, may have the potential to compromise some of their professional obligations. This may be more of an issue, and a problem to be solved, for the lawyers than for the clients.

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<sup>34</sup> Laurel S Terry, ‘The Future Regulation of the Legal Profession: The Impact of Treating the Legal Profession as ‘Service Providers’ (2008) *Journal of Professional Lawyer* 189

<sup>35</sup> David B Wilkins, ‘Team of Rivals: Toward a New Model of the Corporate Attorney-Client Relationship’ (2009) *Fordham Law Review* 2067

<sup>36</sup> Larry Ribstein, ‘The Death of Big Law’ (2010) *Wisconsin Law Review* 749

<sup>37</sup> Daniel Sokol, ‘Globalization of Law Firms: A Survey of the Literature and a Research Agenda for Further Study’, (2007) 14(1) *Indiana Journal of Global Legal Studies* 5

<sup>38</sup> Robert L Nelson and Laura Beth Nielsen, ‘Cops, Counsel and Entrepreneurs: Constructing the Role of Inside Counsel in Large Corporations’ (200) 34 *Law & Society Review* 457; Steven Vaughan, ‘Lawyers in Corporate Decision Making’ (2011) 38(3) *Journal of Law and Society* 463

<sup>39</sup> Milton C Regan and Palmer T Heenan, ‘Supply Chains and Porous Boundaries: The Disaggregation of Legal Services’ (2010) 78 *Fordham Law Review* 2138; Richard Susskind, *The End of Lawyers?* (OUP, 2008)

<sup>40</sup> Whelan and Ziv (n 3 above); Mike Trotter ‘More for less’, (2013) 16(1) *Managing Partner* 28; Joan Loughrey, ‘Large Law Firms, Sophisticated Clients, and the Regulation of Conflicts of Interest in England and Wales’, (2011) 14(2) *Legal Ethics* 215

<sup>41</sup> Christine Parker, ‘Ethical Infrastructure of Legal Practice in Larger Law Firms: Values, Policy and Behaviour’, (2008) 31(1) *University of New South Wales Law Journal* 158, 182

Previous research has already established that clients are gaining increasingly significant control over lawyer's practices.<sup>42</sup> Robert Rosen has suggested that companies have instituted four separate, but interconnected, changes to the way lawyers are engaged and used: downsizing; outsourcing; self-managing teams (which have wide discretion in how they operate); and "porous borders" (which links to outsourcing and makes the distinction between the inside and outside of corporates more porous).<sup>43</sup> In their study of 20 sets of outside counsel guidelines and 20 interviews with in-house and private practice lawyers in the US, UK and Israel, Whelan and Ziv found a wide variety in how clients engaged their external counsel in terms of the scope, content and form of outside counsel guidelines deployed.<sup>44</sup> It has been suggested by Ronald Gilson,<sup>45</sup> and by Andrew Bruck and Andrew Canter,<sup>46</sup> that the larger the law firm and the more diverse its client base, the more resistant it is to client pressure as no single client or matter represents a material percentage of total firm revenues. Our data, as set out below, suggests this might not, in fact, be the case and, somewhat surprisingly, that there is no necessary correlation between firm size (or, in fact, firm heritage) and the resistance of a firm to client pressure.

### LAW FIRM PANELS

There are many reasons why clients use panels to manage their legal advisers. Jonathan Rayner suggests panels allow clients to negotiate discounted rates and make the monitoring of external law firms easier.<sup>47</sup> Indeed, the use of panel reviews as powerful cost reduction tools is a common refrain in the literature.<sup>48</sup> Adam Frederickson and Charles Maddock observe that the numbers of law firms within panels are shrinking as clients want to focus on fewer external advisers.<sup>49</sup> When selecting which firm should be on the panel, a tender process is usually implemented. Richard Thomas comments that "demand to pitch for work is becoming a norm";<sup>50</sup> the tender process invites price competition among law firms, helps to push down growing legal costs and rationalises the number of practices used.<sup>51</sup> He further suggests the underlying reason for why panels are used is globalisation, in that "loyal and unquestioning local clients have become global companies with huge costs".<sup>52</sup>

The use of panels also introduces new dynamics to the role of general counsel. Karl Shehu argues that although GCs have discretion to choose which firm to instruct, they tend to choose firms they

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<sup>42</sup> Robert E Rosen, 'We're All Consultants Now': How Change in Client Organizational Strategies Influences Change in the Organization of Corporate Legal Services' (2002) 44 *Arizona Law Review* 637; Whelan and Ziv (n 3 above).

<sup>43</sup> Rosen, *ibid.*

<sup>44</sup> Whelan and Ziv (n 3 above)

<sup>45</sup> Ronald Gilson, 'Disputing through Agents: Cooperation and Conflict between Lawyers in Litigation', (1994) 94(2) *Columbia Law Review* 509, 531

<sup>46</sup> Andrew Bruck and Andrew Canter 'Supply, Demand, and the Changing Economics of Large Law Firms', (2008) 60 *Stanford Law Review* 9

<sup>47</sup> Jonathan Rayner 'News: Firms face panel purge', (2007) *Law Society Gazette* (22 Mar 2007)

<sup>48</sup> Ben Rigby 'Making the Grade', (2012) 8 *In-House Perspective* 23 ; Richard Thomas 'Of pitches and panels: the changing face of client relationships' (2007) 64 *European Lawyer* 23, 24; Emma Kaye 'The client crunch', 158 *NLJ* 1021

<sup>49</sup> Adam Frederickson and Charles Maddock 'Law firms must fight to impress in-house counsel', *Euro. Law.* 2003, 25, 10-11, 10

<sup>50</sup> Richard Thomas 'Of pitches and panels: the changing face of client relationships' (2006) 64 *Euro. Law.* 23, 23

<sup>51</sup> *ibid.* 24

<sup>52</sup> *ibid.* 25

have previously used.<sup>53</sup> Thus, the relationships between partners and GCs are important. Adam Frederickson and Charles Maddock argue that law firms need a coordinated firm-wide strategy on client service to maintain good relationship with GCs.<sup>54</sup> In relation to the impact on client-lawyer relationship, Elizabeth Wall argues that the use of terms of engagement and guidelines effectively increases the importance of the role of in-house counsel as they would bear the duty to manage and scrutinise the relationship with external law firms.<sup>55</sup> Similarly, Harold Barron suggests that the use of terms and guidelines changes the client-lawyer relationship in a way that external lawyers no longer deal directly with the corporate client and “the general counsel is now the most senior person providing legal advice and services to the client.”<sup>56</sup> However, our data, set out below, challenges this existing work. It strikes us that the role of the procurement team within large corporates and financial institutions is becoming increasingly prominent and that the role of the GC in engaging external law firms may be diminishing (or at the very least changing significantly).

Many commentators emphasise the role of terms of engagement as an important tool for law firms to limit their liabilities if things go wrong – as such, these authors argue that the scope of those lawyers’ duties and role must be clearly stated in the terms.<sup>57</sup> As we will see in Chapter 5, we have been told that the ability for firms to limit their liability via terms of engagement seems increasingly under pressure.

Turning to the selection process, Samantha Fairclough’s empirical work with in-house lawyers identifies six relevant considerations when clients choose law firms to be on their panel: (i) workload; (ii) ‘horses for courses’ (lower fees for routine work; higher fees for complex work); (iii) ‘willing workhorses’ (a number of smaller or regional firms to complement what Fairclough terms the “champion pedigree” largest firms; (iv) client specific knowledge; (v) price; (vi) history.<sup>58</sup> She also suggests that a law firm’s reputation plays a less important role as GCs are sophisticated buyers of legal services and can assess the quality of services themselves.<sup>59</sup> This finding is echoed in the 2014 survey of in-house lawyers conducted by *Legal Business*.<sup>60</sup> Instead, and reflecting the work of Shehu discussed above, Fairclough suggests that established relationships are paramount.<sup>61</sup> We would not disagree, but our research, set out below and in the chapters that follow, certainly suggests that the nature of the lawyer-client and GC/partner relationships are changing. As *Legal Business* concluded following its 2014 survey of in-house lawyers, “GCs are gaining more concessions from advisers year-on-year; there is no sign of the old client/adviser dynamic returning with a reviving UK economy.”<sup>62</sup>

## OUR FINDINGS

In order to position our report and properly understand the threats to professionalism that may be caused by client relationships, we first set out to properly understand the nature of lawyer-client

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<sup>53</sup> Karl Shehu ‘You Had Me at Hello or Let Them Go: Law Firm Selection, Retention, and Defection in the Investment Banking Industry’ (2011) 4 J. Bus. Entrepreneurship & Law 385, 404

<sup>54</sup> Frederickson and Maddock (n 49 above)

<sup>55</sup> Elizabeth Wall ‘Who owns the lawyers?’, (2002) 17 European Lawyer 62, 63

<sup>56</sup> Harold Barron ‘Ins and Outs of a Relationship’, (1997) 6(4) Business Law Today 14, 14

<sup>57</sup> Ian Gordon ‘Conflicts, confidentiality and Chinese Walls’, (2005) 20(6) JIBLR 299; David Snell ‘Risky Businesses’, (2003) 30 European Lawyer 34; Gary Sasso ‘Toward a New Understanding of Loyalty’, (2011) 38(1) Litigation 40, 46

<sup>58</sup> Samantha Fairclough, ‘Panel Games: How Client Organizations Pick Their Legal Advisors’ (The Novak Druce Centre for Professional Service Firms, University of Oxford, 2011) 2

<sup>59</sup> *ibid.* 4

<sup>60</sup> Kathryn McCann, ‘The In-House Survey’ 2014 *Legal Business* (6 October 2014)

<sup>61</sup> Fairclough (n 58 above) 6

<sup>62</sup> McCann (n 60 above)

terms of engagement in today's legal market. We asked our interviewees to tell us what sorts of requests their clients make that give them cause for concern, and that may impact their professional obligations. We then sought to draw out how these client requests have changed over time; whether particular types of client make particularly challenging requests; and whether panel relationships or the management of relationships through client relationship partners makes dealing with challenging requests any easier or harder.

In this chapter of our report we therefore lay out what our interviewees told us about how their relationships with large clients operate today, how this has changed, and what are the most worrisome outcomes for them of current engagement processes.

### ***Changes to Terms of Engagement Over Time***

One of the principal messages that emerged from our first set of questions to interviewees, in which we couched in very broad terms our enquiries about how requests from clients have changed over time, was the concept of a shift in the balance of power. A large number of our interviewees talked of major corporates and financial institutions seeking to impose their own terms of engagement on law firms, and in particular to impose conflict provisions that go beyond regulatory requirements, such that the law firms are no longer in the driving seat on the terms by which they operate. While we accept that this change may be challenging for firms (and significantly so), increased power on the client side does not, in and of itself, engage issues of professional regulation or the various professional obligations.

All of our interviewees told us that the panel terms that they must sign up to in order to be eligible for instructions have become longer and more detailed; that the terms clients are seeking to impose have become more onerous; and that the use of panels has itself become far more widespread. This is particularly the case in the five years since the credit crisis.

We were told of a number of factors driving this trend. In particular, our interviewees identified the growth of the use of panels as a theme deriving from large American purchasers of legal services, who figured out some time ago that their buying power could be put to better use if they focused their attentions on fewer providers. As the use of panels became more popular in the United States throughout the 1990s and the first half of the 2000s, so general counsel in Europe were exposed and made aware of the concept. We were told that large American corporations and financial institutions have often expanded into Europe and adopted the same buying practices; or they have relocated personnel to Europe who have shared experience; or personnel employed in legal teams at large American legal services buyers have moved jobs and shared their experience with European corporations and financial institutions.

A further driver of the trend, we were told, has been the economic downturn, which has pushed in-house legal departments to seriously reconsider spending on external legal advice, particularly at a time when legal and regulatory risk has moved rapidly up the corporate agenda. Our interviewees suggested that this focus on compliance risk, which is even more heightened within financial institutions, has also led to a much greater focus both on getting better value for money when buying legal services, and on the management of risk by the client organisations. As such, it is clear that major corporations and large financial institutions globally are now much more sophisticated purchasers of services from large law firms, and that competition among law firms to act for these clients is fierce.

This shift in the balance of power is of particular relevance in the context of legal market regulation, where the current guidance is, we would suggest, drafted with a view to protecting vulnerable (individual/personal/consumer) clients from much more sophisticated law firms in a way that is now arguably less relevant in the large firm-large client context. In her work on corporate lawyers, Joan Loughrey has questioned the extent to which the SRA approach to regulation fits the particular practices of law among the larger firms.<sup>63</sup> We note, for example, that Chapter 1 of the SRA Handbook sets out an understanding of law firm-client engagement in which it is the law firm that sends its terms and conditions to the client at the start of any given matter.<sup>64</sup> However, our interviewees told us that the majority of their work is now engaged on terms given to them by their clients and that firms are doing less and less work on their own terms and conditions:

*“The general thrust of our compliance, as overseen by the SRA, involves a sort of perception of the relationship between lawyers and clients roughly along the lines of, on the one hand you have rather sort of benighted clients who never have worked with a large firm of lawyers, may not have ever worked with any firm of lawyers before, completely at sea, and really sort of don’t know what’s going on. And on the other hand, rather sort of wily lawyers, only too happy to take advantage of them, who need restraining by a proper system of regulation. And I can see all that. I think when it comes to city firms, the boot’s rather on the other foot.”* EH COLP 3

*“But you’re required to sign a relationship agreement. It certainly doesn’t feel like a balanced relationship. They [clients] impose their terms; they won’t accept limits on liability; they won’t accept law firms’ terms of business – and some of that is totally unfair. They don’t see it as an equal relationship – that would for sure be clear. We are the kind of humble functionary in all of this.”* EH Finance 8

*“We are pinpricks compared to some of the clients we have and the relationship is entirely biased one way.”* EH COLP 13

*“I’ve seen in the past that firms, or in-house lawyers, simply peremptorily say ‘Well, you know, all very interesting about your terms and conditions, but ours prevail,’ and, you know, you are left in the end ordinarily in the uncomfortable position that whether or not that is correct as a matter of law is sometimes sort of just ignored and sort of the work got on with. The biggest thing I would say is just the imbalance, the sheer imbalance of the relationship now between large companies and law firms in a way that, when I started off my career, I acted for some of the world’s largest companies and certainly I would say nowadays I feel that imbalance far more than I did when I started my career.”* EH Corporate 1

Where commercial risk may arise is where lawyers pitching for work and anxious to generate revenue become more concerned about securing a panel appointment or large engagement than they are about the details of the client’s outside counsel guidelines. Furthermore, we found a significant amount of evidence that law firms believe they are presented with terms of engagement by their clients and have limited ability to negotiate. The majority of our interviewees told us that terms were presented as a ‘take it or leave it’ proposition, with law firms being told that if they did not accept the terms, the work would go elsewhere, with plenty of other law firms willing to sign up. It is perhaps ironic that clients come to these firms (in part) for their ability to negotiate but then do not accept their lawyers using those skills to negotiate their own terms of engagement. There is also

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<sup>63</sup> Joan Loughrey, *Corporate Lawyers and Corporate Governance* (CUP 2011). This echoes the findings of the Smedley Review: Nick Smedley, ‘Review of the Regulation of Corporate Legal Work’ (31 March 2009)

<sup>64</sup> <http://www.sra.org.uk/lawyers/handbook/code/part2/content.page>



a third problem, highlighted better in Chapter 5, in that law firms and their lawyers may not be seriously, or appropriately, thinking about what the terms of their engagement are and how they need to adapt their practices to comply or to minimise risk. We wonder if some lawyers, and some firms, see terms of engagement simply as a cumbersome step towards winning work and not as a risk management issue that requires careful thought.

*“Annoyingly many of our clients refuse to negotiate. The bigger the client, the more they are likely to just take a view that they don’t negotiate. And we’ll get the thing that frustrates the hell out of me, that many partners don’t seem to second guess, but I certainly do, is, ‘Well, you know, we have a number of firms on our panel. All the others have signed this and no one’s raised any of the concerns you have’.”* EH Conflicts Officer

*“We all know full well there are rivals out there who will be nipping at our heels if we don’t pretty much say yes to everything. And that is a constant concern in terms of the back of one’s mind.”* EH Corporate 1

*“Increasingly in that exercise I feel we are kind of on the cusp of that almost becoming a sort of an irrelevant exercise, because now I think I am sensing that people are saying, ‘We don’t really care. These exceptions you are identifying, you’ve got to just sign up in full. Everybody else is signing up in full, nothing special about you. You’ve got to do it.’ I don’t think we are quite there but I sense that there is more push back coming down the line on those guidelines.”* EH Corporate 2

*“You can’t push back. It is just not possible at all. If you don’t complete, if you don’t provide them with what they want then there are plenty of other people who will do. I mean at the end of the day whatever we might think, it is effectively a buyers’ market for large organisations seeking legal advice and we have to decide whether we are prepared to play their game or not, which is why we don’t frequently.”* EH Corporate 3

One particular challenge raised by law firms about the way appointment processes work today concerns the role of procurement teams in the relationship. We were told that the days of partners at law firms negotiating with general counsel about the terms of an engagement are gone, and today procurement teams within major corporates and financial institutions will typically oversee the appointment process. In this context, several interviewees referenced the supermarket supplier analogy, referring to the way in which suppliers to supermarkets are forced to compete vigorously to get those companies to sell their products, often with profit margins challenged considerably as a result:

*“It’s a competitive market...law firms should be treated in a different league to other suppliers of goods and services. What we’re seeing increasingly is that we’re actually no longer dealing with lawyers in the legal department, more dealing with the business people who are actually dealing with procurement. We’re dealing with procurement professionals for our panel negotiations and so any notion that this is a two-way relationship is completely gone in my view.”* EH Finance 2

This changed practice by clients may make perfect commercial sense, and the ‘competitive market’ point in the above quotation is important. As we discussed earlier, there is a healthy market for corporate and finance legal services from large law firms and we were struck, on occasion, by our interviewees focusing on their relationships with clients/future clients and not necessarily on the wider market in which they were competing against other firms for work.

The SRA asked us to explore with law firms whether particular types of clients make particularly challenging requests. We were told that financial institutions are the most prolific users of law firm panels, and that US banks in particular have developed sophisticated terms of engagement for their legal services providers. Major corporations also make use of panels, but corporate practices do not deal with panel engagement terms on anything like the routine basis that their peers working in financial services do. Some large buyers of legal services, such as private equity firms, still rarely institute such formal buying processes.

Despite around three quarters of our interviewees outlining a scenario whereby they are being forced to accept more and more onerous terms of engagement with little room for discussion, we did find that four or five of the firms we interviewed routinely pushed back on terms that they deemed unacceptable. Crucially, these firms continued to get instructions, including where they refused to accept positions on panels because of terms that they could not get comfortable with. The perception, therefore, that 'everyone is agreeing' appears misplaced:

*"Individual partners are generally very timid about doing anything to rock the boat. We do push back on some terms, we do talk to some clients and I'm a big believer in what's really important is that firms, if they sign up to these terms, do so openly and say 'Yes, we're accepting that restriction', rather than letting it sort of just run in the background and breach them. And again, can you negotiate them? Some clients you can, some you can't. For those clients that won't listen and won't negotiate it is a bit of a power struggle issue, it's often used as a kind of well you agreed to our terms or you're just not through to the next stage of the process." EH COLP 10*

*"We've certain bank clients here where we're off panel and we do a significant amount of work for them off panel and we love it." US COLP 1*

*"I take the view that we're effectively a very large organisation ourselves, so we have the ability to say no if we want to say no. I don't feel we're like the supermarket supplier who has its pricing terms squeezed by the [large supermarkets] of this world and can't do much about it, and I don't think the law firms, the major law firms, are really in that position." EH Corporate 8*

*"We've turned down some big financial institutions where they've said, 'You would not act in a hostile takeover against us,' and we've thought, well look there are a number of clients we've currently got that might well want to do that." EH Corporate 2*

Interestingly, we did not find any relationship between either the size of the firm or its heritage (US versus English law firms), in terms of an ability, or willingness, to push back on terms. As we come to discuss later on in this report, in some firms the COLP or General Counsel is used to negotiate terms direct with the client. This interviewee (US Finance 2) referenced the strength of the client relationship in determining the ability to negotiate deviations from standard terms:

Q *"Do you get much room for negotiation when they send you a pack like that?...You do?"*

R *"Yeah."*

Q *"That's interesting, because some firms say the opposite. It must be the way you sit."*

R *"The stronger your relationship with the organisation is, the more you have."*

We would argue that the strength of relationship in this context refers to the confidence of the law firm to push a point that it is unhappy with, which may in turn relate to the law firm's perception of its own importance to the client, and the client's overarching desire to instruct the firm.

#### CLIENT REQUESTS THAT GIVE CAUSE FOR CONCERN

##### *Commercial Challenges*

While client requests have clearly become more numerous, lengthy, and sophisticated in detail, we found mixed views amongst partners as to whether these changes give them cause for concern in anything other than a commercial context. Undoubtedly the biggest challenges for law firms that come out of panel requirements are financial, with fee arrangements a particular issue. Many of our respondents talked of pricing that bordered on uneconomic, which in turn creates risk to quality and service levels, but that is a commercial decision that firms must make when choosing whether or not to accept an engagement. All regulated firms, in any industry, need to decide whether they can meet the required standards at the going rate. If they cannot, their practices become unviable.

*"If you're an in-house lawyer you're balancing the risk of the thing going wrong against the price. And if the risk is pretty low and there's lots and lots of firms who can do that sort of stuff, why not go for the cheapest apparently competent firm?"* EH COLP 6

*"Some of those fee arrangements are really quite tough, sort of the aftermath of the financial crisis. Also I think reflecting the fact that the market is not growing at the moment and so there are a lot of law firms broadly competing for the same work. So clients have the opportunity to sort of play one firm off against another. But that pressure on fees, and some of those discounts are quite significant and where we might be held to a fee rate which was the rate enforced three or four years ago. That puts pressure because partners know they are judged in part by reference to realisation."* US COLP 4

Several firms that we spoke to had introduced pricing committees with a view to mitigating the risks associated with pressures on pricing, essentially taking the decision on whether to accept challenging fee arrangements out of the hands of the partners most closely tied to the client relationship. This strikes us as a useful, and sensible, commercial development.

Two other issues were mentioned in the context of client pressure which, on balance, we consider to be commercial rather than professional in their implications. First was the use of strict billing requirements, which many firms talked about as an issue, whereby bills to large financial institutions must be presented in a certain way otherwise they will simply not be paid. Like fees, these requirements do not impact professional obligations but do change the balance of power, as this interviewee points out:

*"You have hugely stringent billing requirements, like if you do not submit your bill within three days of the end of the month to which it relates you don't get paid full-stop, or you don't get paid for another three months or something of that sort. Massive credit periods, 90 days, 120 days, things of that nature. And increasingly highly complex, very difficult to use computer billing systems, for which we often have to pay to be trained as a condition of acting for the client. They don't all directly impact on our professional obligations, but they distort our professional relationship, and when you're signing up with a client of that sort day one, the idea of trust and faith just goes out the window. They quite clearly demonstrate by*

*their approach they don't trust you, they're not interested in trusting you, they want to manage you within an inch of your life. It is difficult acting for people like that.” EH COLP 1*

Finally, several firms talked about difficult requirements on data protection that restricted the way in which the firm and its employees could work on a day-to-day basis. For example, we were told of banks that insisted the law firms that they employ cannot allow their employees to work on laptops on their files, or may not be allowed access to web-based email services such as Hotmail because of perceived security risks. These requests can run entirely counter to a firm’s own policies (e.g. that work email addresses not be used for personal communications). We accept that there may be challenging issues for firms balancing confidentiality duties to different clients in complying with multiple, different data protection policies.

### **Challenges That Interviewees Accept**

Some of the things that we asked our interviewees about were, in their own minds, generally less important and less concerning. These were:

#### *[i] Secondments*

The SRA wanted us to ask whether partners experienced clients asking them to take secondees, and what the implications of doing so were for the confidential information of other clients. We were told that firms now routinely provide outbound secondees to large clients – raising separate issues dealt with below – but inbound secondees are a much rarer occurrence. Where (a minority of) firms were accepting secondees from their clients into their firms, they were well aware of the risks to the confidential information of other clients, and only accepted the secondees where they were confident the risks could be managed with proper systems and controls. While these firms did not present inward secondees as of significant concern to them (i.e. risks were present, but they were seen as manageable and managed) we can see how those situations must offer up real and challenging issues for firms as regards confidentiality, data security, managing competing duties to different clients etc.

On the topic of outbound secondments – which themselves raise commercial challenges for firms obligated under panel terms to provide resource to clients at their own cost – a number of challenges were brought to our attention. One of these was ‘virtual secondments’, raised by one interviewee:

*“The biggest challenge we have at the moment is what we call virtual secondments, where a client wants us to second someone, but they want them to be seconded while staying here in the office. Working, say, two days a week for the client. And that’s actually very difficult, because that then generates all sorts of problems. Because generally we tend to view a secondment as the individual goes off on secondment and they are under the control of the client, and generally we don’t require them to conflicts-check every piece of work they do for the client. Because we say, “For the purposes of that secondment they’re quarantined”. But that doesn’t work if they’re here.” EH Conflicts Officer*

Another issue raised in the context of outbound secondments was the unwillingness of the recipients to accept liability for the individuals concerned:

*“We accept that information the secondees are privy to at the bank is confidential to the bank, we accept all of that. In terms of insurance and liability, with indemnities we’ve seen*

*some quite aggressive approaches from some of the banks. It's quite difficult when we're not allowed to have conversation with the employee, with the secondee, who remains on our head count rather than the bank, and there are some junior people as well as senior people. So they require us to not have the conversation with the employee as to what are you doing, what are you up to and... and then accept liability for their actions."* EH Finance 2

Finally, the growing use of secondments in itself gives rise to interesting dynamics within in-house teams, such that lawyers from one firm can be taking instructions from a client, and negotiating a position, only to find that the 'client' is actually a lawyer from a competitor firm. We were told:

*"It used to be that you'd have one secondee in a legal department surrounded by 12 or 13 full time lawyers, now you've got six secondees in a legal department of nine people and it doesn't work for us as it used to."* EH Finance 5

The potential for breaches of confidentiality on inbound and outbound secondments strikes us as being high, but our interviewees were confident that this potential could be, and was being, managed appropriately. We did not, however, have the time to understand exactly why this was the case.

#### *[ii] Audit provisions*

Secondly, we were asked by the SRA to find out whether clients were asking to audit law firms' IT systems; whether firms were allowing them to do so; and how firms protected the confidential information of other clients during those audits. We were asked to look into this as an example of a situation where conflicts or independence might be challenged so we could understand how it was managed.

Our interviewees told us that audit provisions were indeed becoming more common, and audits were being conducted more frequently. However, firms viewed these audits as a time-consuming administrative challenge for the most part, and all seemed confident in their ability to protect the confidential information of other clients during these processes. One COLP explained:

*"We've got one ongoing at the moment, and well, it is just like pulling teeth, because they're – you know – It's some administrator with a tick box checklist, and, yeah, it's taking just an enormous amount of time. Just to go through and answer –it's not that we can't answer the questions, it's just that it physically takes so much time. So, yes, audit provisions. Very, very common across a lot of these. I think this is the first one that I'm aware of that's actually come in and done this. This is an IT security audit. I mean, there are two classes of audit provisions. There are general, 'We want to come in and audit you', and then there's the, 'We want to come in and audit your IT infrastructure'. And it's very intrusive. Sometimes you just have to say, 'Look, we're not prepared to tell you exactly how to hack into our system, thank you very much.' You know? Sometimes the questions they ask are incredibly intrusive. To things that are actually none of their business."* EH COLP 7

One might see this approach as firms being forced into managing cyber risks via client regulation through terms of engagement. One might also question whether such practices give rise to threats to duties of confidentiality to different clients. Together, secondments, data protection management and IT audits strike us as combining to form very serious challenges to confidentiality with which firms are needing to grapple.

### **Less Widespread Challenges That Cause Concern**

In addition to the widespread concerns set out above and explored further in subsequent chapters, and the SRA concerns that we explored and found not to be particularly worrisome for firms, several issues were raised by only a few respondents but nevertheless strike us as concerning.

In this category, several interviewees talked about Most Favoured Nation (MFN) clauses in fee agreements, whereby firms sign up to guaranteeing the client in question that its fees will be the best available to any of the firm's clients. Such provisions are difficult to enforce, because fee arrangements are increasingly complex based on several variables beyond pure hourly rates, and potentially give rise to issues about acting in the best interests of other clients. We are concerned about how firms manage competing duties to different clients where MFN clauses require some, even abstract, disclosure of agreed fee rates, billing practices etc. We were told:

*"The sort of provisions that cause me concern would be sort of most favoured nation provisions in terms of fees, because they are almost impossible to police and almost impossible to deliver. In that sense they're also potentially anti-competitive themselves in that they prevent you doing different deals with different people." EH COLP 10*

A *"Things like best rates, so somebody may offer you relatively modest amounts of work but they want you to guarantee you will match the best rates and of course what we do for our very best clients is not something we'd want to give to everyone and they would feel pretty offended if we did. So trying to balance those interests.*

Q *Does that give rise to issues of confidentiality for other clients or I suppose they wouldn't know which clients are getting which rates?*

A *No, that's right. But they, some of them, the more ambitious ones do actually take us into dangerous territory with confidentiality because they insist on knowing things about what we are up to." EH COLP 13*

*"It's very difficult to police, particularly if you're multijurisdictional, as well as difficult to compare apples to apples. Clearly impacting on duties to other clients. And we do have clients that talk to each other about fees that they pay us, so you can't take the view that no one will ever find out." US COLP 2*

The other area of concern here related to clients dictating to their firms how matters should be handled, and specifically how they should be resourced. We were told:

*"There's also an increasing tendency for clients to set out what they will and won't pay for, in terms of the legal work undertaken. So a classic example would be if you have a partner and an associate working on a matter and the partner and the associate need to speak to each other to agree what's going to be done or consider some options, you'll see some of the outside counsel guidelines will say that they will only pay for the time of the more senior of the two lawyers engaged in that conversation. Which in my view is completely and utterly crackers because how else, unless you say every single matter that you instruct us on you should only expect to have a partner working on it and not have any assistant or associate, that just does not make sense because how can more than one person work on the same matter unless they communicate with each other?" EH COLP 9*

In this area, Ben Heineman (former GC at GE) and David Wilkins have questioned whether we will have a "lost generation" of associates who were unable to secure the training and development they

needed because of fee pressures from clients. We expect that the SRA would have little sympathy here, and that they would expect the associates to receive the training they needed, at the firm's cost.<sup>65</sup> Other firms raised issues with terms that obliged them to effect introductions to other clients of the firm that may be useful to the instructing client; to share information on the profitability of the instructing client's work for the firm vis-à-vis other clients; and not to purchase supplies for the firm from providers that were competitors of the instructing client. In all of these instances, interviewees accepted the blurring of the line between commercial and professional pressures, but highlighted the balance of power challenges that arose.

## HOW FIRMS MANAGE OUTSIDE COUNSEL GUIDELINES

As panel arrangements, outside counsel guidelines and other engagement terms have changed over time, so too firms have had to adapt their own internal processes to cope with these changes. Here, we explored with our interviewees the role of client relationship partners in deciding whether or not to accept terms put forward by clients, and the role of the COLP and other risk professionals in monitoring and mitigating issues arising from client terms.

In subsequent chapters we will explore the role of client relationship partners and COLPs in identifying, managing and mitigating risks within their firms. Suffice to say here that many of the firms that we interviewed still left primary responsibility for accepting or refusing engagement terms with the partner instructed, though these individuals were frequently (but not exclusively) expected to run terms past the COLP or risk team before making the call. In many firms, any decision to deviate from the law firm's standard terms should be referred up to the COLP and/or to a risk committee of some description, but while these systems have been put in place in the past few years, not all COLPs were confident that they were seeing everything that the firm had signed up to:

*"I wouldn't say it's 100% but it's quite close now...I've taken over conflicts as well as risk and compliance. So I should see everything. I should see all the requests to pitch." EH COLP 5*

*"But anyway those sorts of issues come through the risk management board, but do we have a 'You must submit all OCG or SLAs that you sign to the risk management board'? No. So on the agenda for the next risk management board will be what do we think might work in this regard?" EH COLP 9*

*"So within our firm it has tended to be, that it's down to individual partners, we're getting better at requiring these things to come in centrally and involve some kind of central review. Would that lead to a significant change in how we manage them? Not as things stand, because what is the argument, we say to the client partner 'We need to go back and say no to this', but if we say no we're not on the panel, therefore all the work we invested in getting on the panel is lost and a stream of future income is lost." EH COLP 10*

In addition to terms of engagement being entered into by individual partners beyond the knowledge of the COLP, we also found some evidence of engagement terms being sent midway through a deal out to firms by clients, when they would normally, and should, have been signed upfront as required by the Handbook. Two or three partners raised this practice:

*"It's almost like battle of the forms, so when you get instructed you'll have a conversation with [Bank C], for example, and it's, okay, you'll act for the bank in executing this security*

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<sup>65</sup> Ben W Heineman and David B Wilkins, 'The Lost Generation?' (Corporate Counsel, March 2008)

*and negotiating this loan agreement, and you're very careful about the areas that you know are crossed over or areas that are more risky. But then halfway through after the transaction lands on your desk your formal instructions are coming from somewhere else, which says: 'you'll generally look after the interests of the bank'. You say, 'Hang on a minute, no, we did not agree to do that'. So, it can be a bit tricky. I had on a recent job with [Bank C] actually where I got fed up. I had the more general terms of engagement sent to me. I ended up marking them up and striking out most of it and saying, 'I did not agree to do this'. But you could see someone missing that if they weren't correctly supervised, and the firm being liable in a situation where it perhaps wasn't anticipating it. I think they're quite mischievous in the way they do that."* EH Finance 7

It is not, in and of itself, wrong for a client to be 'mischievous'. But these practices signal a shift in the way in which law firms are engaged – specifically, when that engagement takes place and where the terms of engagement come from – which we would suggest is not reflected in the SRA Handbook.

In Chapter 3 we look at firms signing up to terms with which they know they cannot comply, and taking a 'pragmatic' view of challenging terms. Finally, one partner raised the issue of clients changing terms and conditions of engagement midway through a relationship, particularly in the context of panel terms:

*"What we also get is that clients get taken over and they have new terms, or clients suddenly revise their terms. Historically there's been this huge push from the SRA and everybody to send the client the engagement letter, and we have a beautiful engagement letter, and we do send it out but quite often it comes back and they say 'No, these are the terms on which you're engaging with us'. And even if we've been engaged on our terms for a decade, suddenly it's like this, which they're perfectly at liberty to do, but what I struggle with is most fee-earners don't appreciate that they don't necessarily have to say yes. The other thing we get is a client who's been taken over and is seeking to renegotiate everything, here's the terms, that sort of thing. That comes through quite a lot. And actually our guys are very slow off the mark with that, because usually they're concentrating so hard on maintaining the continuity of contact with the personnel involved that they kind of think, 'Oh, we'll just let that happen'."* EH COLP 11

We mention this because we suspect this was not the only firm to have had this experience, even though the matter was not mentioned by other respondents. It also returns to the theme of the changing nature of engagement terms generally, and the overarching concern about a shifting balance of power that potentially runs counter to the current drafting of the SRA Handbook. These issues cumulate to derive at the question of whether the SRA Handbook adequately reflects modern practice in large law firms.

The three chapters that follow are each set out in three parts. They begin with scene setting: an overview of the relevant laws and regulatory practices. The middle part of these three chapters then sets out our findings from our interviews. The final parts offer up our views on the data – that is whether we think, as a result of the data, that the issues raised are purely commercial matters or whether they have the potential to engage either the regulatory objectives contained in the Legal Services Act 2007 or the professional obligations on lawyers in the SRA Handbook.



## CHAPTER 3 - INFLUENCING ACCESS TO REPRESENTATION

In this chapter, we consider how clients are able to influence who their lawyers represent and do not represent. This is partly about what we might term purely 'legal conflicts' (e.g. Firm X acting for two of its clients, A and B, at the same time on the same matter), but is more largely concerned with what we might term: (i) 'contentious conflicts' (e.g. Firm X acting on a litigation matter opposite one of its clients where that client is represented by another law firm); and (ii) 'commercial conflicts' (e.g. Firm X being asked to act by Client B on a transactional or advisory matter which is adverse to, or against the interests of Client A, even where the firm is not acting for Client A in that matter; or more generally where Firm X acts for Client A and Client B who both operate in the same industry, geographic area etc - what one might usefully think of as the Pepsi-Coke divide).<sup>66</sup> The first part of this chapter discusses how conflicts are regulated by the SRA and wider commentary on conflicts by scholars, before we turn in the second part to what our interviewees told us about conflicts and access to representation.

### CONFLICTS: LEGAL, CONTENTIOUS AND COMMERCIAL

Principle 4 of the SRA's 10 Principles, which, "define the fundamental ethical and professional standards that [the SRA] expects of all firms"<sup>67</sup>, sets out that a lawyer, "must act in the best interests of each client".<sup>68</sup> The guidance to this principle details that a lawyer, "should always act in good faith and do [their] best for each of [their] clients," and goes on to specifically reference a lawyer's, "obligations with regard to conflicts of interest".<sup>69</sup> Conflicts of interest are then further elaborated on in Chapter 3 of the SRA's Code of Conduct.<sup>70</sup> The SRA Code establishes outcomes-focused conduct requirements, and each chapter outlines outcomes to be achieved and a series of linked 'indicative behaviours'. This is a shift in approach from the 2007 Code, which had detailed rules on conflicts of interest, particularly in respect of conveyancing. The SRA says that this new approach places, "greater emphasis on identifying and dealing with conflicts in all types of matters, and having systems and controls to enable [the lawyer] to do so".<sup>71</sup> The current content of the Handbook in relation to conflicts of interest is based very closely on the rules introduced by the SRA in 2006 (found in the Code of Conduct 2007), which were themselves based on wording prepared by a committee set up at the request of the Law Society in 2000.<sup>72</sup> As such, the regulation of conflicts of interest has undergone significant reform in recent years.

The first part of Chapter 3 of the current Code is worth setting out in full:

"This chapter deals with the proper handling of conflicts of interests, which is a critical public protection. It is important to have in place systems that enable you to identify and deal with potential conflicts. Conflicts of interests can arise between:

1. you and current clients ("own interest conflict"); and
2. two or more current clients ("client conflict").

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<sup>66</sup> There are other ways to divide 'conflicts of interest'. For a review of these, see: Janine Griffiths-Baker and Nancy J Moore, 'Regulating Conflicts of Interest in Global Law Firms: Peace in Our Time?' (2012) 80 Fordham Law Review 2541, 2548

<sup>67</sup> <http://www.sra.org.uk/lawyers/handbook/intro/content.page>

<sup>68</sup> <http://www.sra.org.uk/solicitors/handbook/handbookprinciples/content.page>

<sup>69</sup> Ibid, para 2.8

<sup>70</sup> SRA (n 68)

<sup>71</sup> <http://www.sra.org.uk/lawyers/freedom-in-practice/OFR/ofr-quick-guide.page>

<sup>72</sup> For an excellent review and analysis of the history of these reforms, see Loughrey (n 9 above)

You can never act where there is a conflict, or a significant risk of conflict, between you and your client.

If there is a conflict, or a significant risk of a conflict, between two or more current clients, you must not act for all or both of them unless the matter falls within the scope of the limited exceptions set out at Outcomes 3.6 or 3.7. In deciding whether to act in these limited circumstances, the overriding consideration will be the best interests of each of the clients concerned and, in particular, whether the benefits to the clients of you acting for all or both of the clients outweigh the risks.

You should also bear in mind that conflicts of interests may affect your duties of confidentiality and disclosure which are dealt with in Chapter 4. The outcomes in this chapter show how the Principles apply in the context of conflicts of interests.”<sup>73</sup>

As set out above, it is not possible for a lawyer to act where there is an ‘own interest conflict’ or a significant risk of an ‘own interest conflict’.<sup>74</sup> As regards ‘client conflict’, the Code of Conduct requires a law firm to have in place effective systems of identification and controls, such that firms are able to assess the following factors, namely whether: (a) the clients' interests are different; (b) the lawyer’s ability to give independent advice to the clients may be fettered; (c) there is a need to negotiate between the clients; (d) there is an imbalance in bargaining power between the clients; or (e) any client is vulnerable. The SRA sets out that lawyers may act, with appropriate safeguards, where there is a client conflict and those clients have a substantially common interest if, among other matters, the following criteria are met: (a) the lawyer has explained the relevant issues and risks to the clients,<sup>75</sup> and has a reasonable belief that they understand those issues and risks; (b) all the clients have given informed consent in writing to the lawyer; (c) the lawyer is satisfied that it is reasonable for them to act for all the clients and that it is in the clients’ best interests; and (d) the lawyer is satisfied that the benefits to the clients of doing so outweigh the risks.<sup>76</sup>

Similar conditions, although not as strict, apply to where there is a client conflict and lawyers wish to act for multiple clients competing for the same objective.<sup>77</sup> In March 2015, an updated practice note on conflicts of interest was published by the Law Society.<sup>78</sup> It adds very little substance to the SRA Code. The Legal Services Act 2007 does not reference conflicts of interest and, perhaps as a consequence, the LSB does not specifically discuss conflicts in its paper on the meanings behind the regulatory objectives.<sup>79</sup> However, we would suggest that the theory and practice of conflicts goes directly to impacts on access to justice, to the independence of the profession, to competition in the provision of legal services and, arguably, protecting and promoting the public interest. As set out above, the SRA appears to accept the last of these in describing conflicts of interest (in Chapter 3 of the Code) as “a critical public protection”. We come back to these matters in the final section of this chapter.

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<sup>73</sup> See also SRA Handbook outcome O4.2, which states that “any individual who is advising a client makes that client aware of all information material to that retainer of which the individual has personal knowledge”. The duty of confidentiality takes precedence where in conflict with O4.2.

<sup>74</sup> SRA (n 68), O(3.4)

<sup>75</sup> On informed consent in this context, see: *Clarke Boyce v Mouat* [1994] 1 AC 428

<sup>76</sup> SRA (n 68), O(3.6)

<sup>77</sup> SRA (n 68), O(3.7)

<sup>78</sup> <http://www.lawsociety.org.uk/support-services/advice/practice-notes/conflict-of-interests/>

<sup>79</sup> [http://www.legalservicesboard.org.uk/news\\_publications/publications/pdf/regulatory\\_objectives.pdf](http://www.legalservicesboard.org.uk/news_publications/publications/pdf/regulatory_objectives.pdf)

In England and Wales, Canada and the US, lawyers have “lobbied for conflicts rules to be relaxed...and advanced similar arguments for support, namely that reform served client needs and was necessary to reflect the realities of modern practice.”<sup>80</sup> Other studies, in the US, Australia and UK, have found lawyers seeking to find ways around legal conflicts rules, either to increase the firm’s profit and/or to keep an individual lawyer at the firm content.<sup>81</sup> However, our concern with this report lies not in this area. We were not asked to discuss the ‘legal’ conflicts rules, nor did our interviewees raise those rules as matters of concern to them, save in one specific context (where conflicts rules in jurisdiction A conflict with conflicts rules in Jurisdiction B – discussed below).<sup>82</sup>

For lawyers, conflicts of interests can be much wider than is currently envisaged by the conflicts rules. Conflicts as a concept (and not just as a rule) can speak to more amorphous, and thus more challenging (and harder to define),<sup>83</sup> issues in the relationships between lawyers, their firms, their clients, opposite counsel and the regulators. As such, conflicts can more widely concern: who gets paid what and when; how a lawyer is promoted and/or remunerated; the relative importance of any given client to the firm and/or individual lawyer; and the potential for a lawyer to improperly favour one client over another. Legal conflicts and the SRA’s conflicts rules are, in one sense, relatively straightforward. But the wider world of conflicts is, “a rich and subtle area that has a great deal to do with the way in which legal practice is organised”.<sup>84</sup>

Christine Parker and Adrian Evans argue that, “It would be naïve to assume that complete client loyalty in all one’s thinking and acting as a lawyer can be guaranteed, and all conflicts avoided.”<sup>85</sup> On this latter point, it is inherent in the nature of service provision that conflicts exist: the provider wants to be remunerated at X; and the payer wants to pay Y. As such, lawyer conflicts (in the widest sense) go to core issues of independence (discussed in the following Chapter) and loyalty. While this is not the place to rehearse the fiduciary duties that lawyers owe,<sup>86</sup> irrespective of what the SRA’s Code of Conduct says, it is perhaps worthwhile setting out the key passage by Millett LJ on the duty of loyalty from the seminal case in this field *Bristol and West Building Society v Mothew*:

“The principal is entitled to the single-minded loyalty of his fiduciary. This core liability has several facets. A fiduciary must act in good faith; he must not make a profit out of his trust; he must not place himself in a position where his duty and his interest may conflict; he may not act for his own benefit or the benefit of a third person without the informed consent of his principal.”<sup>87</sup>

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<sup>80</sup> Loughrey (n 9 above) 225

<sup>81</sup> Janine Griffiths-Baker, *Serving Two Masters: Conflicts of Interest in the Modern Law Firm* (Hart, 2002); Kimberley Kirkland, ‘Ethical Infrastructures and De Facto Norms at Work in Large US Law Firms: The Role of Ethics Counsel’ (2008) 11 *Legal Ethics* 181; Suzanne le Mire and Christine Parker, ‘Keeping it In-house: Ethics in the Relationship between Large Law Firm Lawyers and Corporate Clients through the Eyes of In-house Counsel’ (2008) 11(2) *Legal Ethics* 201

<sup>82</sup> A matter raised as significant by the International Bar Association. See: IBA, ‘IBA International Principles for the Legal Profession’ (May 2011)

<sup>83</sup> On issues with defining conflicts, see: Donald Nicholson and Julian Webb, ‘Professional Legal Ethics. Critical Interrogations’ (OUP 1999) 129

<sup>84</sup> Richard Epstein, *The Legal Regulation of Lawyers’ Conflicts of Interests* 60 (1992) *Fordham Law Review* 579, 579

<sup>85</sup> Christine Parker and Adrian Evans, *Inside Lawyers’ Ethics* (CUP, 2014) 249

<sup>86</sup> Instead, see: William Flenley and Tom Leech, *Lawyers’ Negligence and Liability* (Bloomsbury Professional, 3<sup>rd</sup> ed, 2012)

<sup>87</sup> *Bristol and West Building Society v Mothew* [1998] EWCA Civ 533 at 18

As Flenley and Leech set out, “The core facet of the duty of loyalty [of a lawyer] is the obligation to act at all times in good faith and in the interests of each client and not to prefer the interests of one client over the interests of the other.”<sup>88</sup> This is a matter to which we return in the final section of this chapter. In 2012, Janine Griffiths-Baker and Nancy Moore wrote that they anticipated that, at some point, a large corporate client would sue a global law firm for damages based on breach of duty, “arising from allegations of impermissible conflicts”.<sup>89</sup> We are not aware of any such case to date.<sup>90</sup> However, one could also imagine the situation, which we discuss below, where a court finds itself obliged to consider the duty of loyalty where a firm declines to act for Client X, an existing client of the firm, because of contractual obligations to Client Y, another existing client, in situations outside the scope of the legal conflict rules. Here, we are drawn to a dictum of Judge Ann Aldrich in a well-known case in the US on conflicts in which the judge observed that, “A firm may not drop a client like a hot potato, especially if it is in order to keep happy a far more lucrative client.”<sup>91</sup> It strikes us that much of the emphasis in the SRA’s conflicts rules is on lawyers’ obligations in relation to given matters rather than the complex relationships between firms and their suite of clients within and without the context of specific matters. Challenges from these complex relationships may, however, be reflected in other Principles found in the Handbook: acting in the best interests of each client (Principle 4 – although we accept this is framed as a matter centric obligation); acting with integrity (Principle 2); and not allowing one’s independence to be compromised (Principle 3).

Much of the previous empirical work has considered situations in which lawyers comment on, or seek to avoid, the *legal* conflict rules.<sup>92</sup> The small scale study of Australian in-house lawyers by Suzanne le Mire and Christine Parker goes beyond this. They found a variety of practice as regards which clients would and would not allow ‘contentious conflicts’ and ‘commercial conflicts’ (as we term them) and concluded that, “Overall, in-house counsel saw dealing with [these sorts of] conflicts appropriately as a matter of the relationship between in-house counsel and external lawyers.”<sup>93</sup> What will be shown below is that, at least for some clients using UK-based law firms, the issue is not one of relationships but of contract.

Joan Loughrey has argued that allowing lawyers to act for multiple clients on unrelated matters, “fails to protect client interests because unrelated matter representation risks lawyers, consciously or unconsciously, failing to do their best for less profitable clients; clients may feel betrayed and thus become less likely to trust their lawyers, which would impair the quality of legal advice they give; and since they may not know of such representation, clients may be deprived of the opportunity to assess and safeguard their interests.”<sup>94</sup> There is the inherent risk, raised by le Mire and Parker, that, “sometimes large law firms might intentionally drop smaller, less powerful clients in order to act for larger, richer clients who they hope will give them more work.”<sup>95</sup> As we will come to see, some clients have afforded themselves, via contract, the power to both prevent firms acting for other entities and also to know who else a firm acts for, or plans to act for (which may breach duties of confidentiality).

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<sup>88</sup> Flenley and Leech (n 86), para 4.30

<sup>89</sup> Griffiths-Baker and Moore (n 66) 2554

<sup>90</sup> The often cited case of *Marks & Spencer v Freshfields* concerned a request for an injunction, not damages. See: *Marks & Spencer Group Plc v Freshfields Bruckhaus Deringer* [2004] EWCA Civ 741 and [2004] EWHC 1337

<sup>91</sup> *Picker International Inc v Varian Associates*, 679 F. Supp. 1362, 1365 (N.D. Ohio 1987). For a review of the run of case law post *Picker*, see: John Leubsdorf, ‘Conflicts of Interest: Slicing the Hot Potato Doctrine’ (2011) 48 *San Diego Law Review* 251

<sup>92</sup> Griffiths-Baker (n 81 above); Kirkland (n 81 above)

<sup>93</sup> Le Mire and Parker (n 79) 215

<sup>94</sup> Loughrey (n 9 above) 226. This point is also made by le Mire and Parker (n 81 above) 217

<sup>95</sup> Le Mire and Parker (n 81) 218

The practical reality of how conflicts play out gives rise to a paradox. Our data, discussed below, will show that clients often want lawyers who have experience. Experience comes, at least in part, from acting for multiple sides and interests on multiple and varied matters in multiple geographic regions. But where conflicts provisions in lawyer terms of engagement restrict for whom that lawyer can act, does this not have an effect, a detrimental effect, on the breadth and depth of expertise that that lawyer can gain? In her study of conflicts in the US in the early 2000s, Susan Shapiro interviewed 128 practising attorneys. She found that some clients in some sectors were willing to be less concerned about conflicts, and were willing to forgo the absolute devotion of a given firm to a given client, if they were getting a lawyer with more experience.<sup>96</sup> Our data seems to suggest that while many clients want lawyers with broad and deep experience, some clients also want (paradoxically) those lawyers to be very restricted in who else, if anyone, they can act for.

Who lawyers can and cannot act for influences the market for legal services and, in particular, the shape and size of the litigation market. Whether access to representation might be inhibited as a result of conflicts provisions in client terms of engagement was one of the drivers for the SRA commissioning this research. Access to justice is commonly framed in terms of unmet legal need for the poorest, and perhaps most deserving, members of society. The concept does not guarantee the right to the lawyer of first choice (at any cost and in any situation). The LSB has recognised that ‘access to justice’ is not just a matter for vulnerable consumers:

“Access to justice is relevant to all consumers - individuals, groups, companies and organisations - from the smallest to the largest. It is not restricted by income, scale or importance to the client as it brings a sense of proportionality and fairness to all legal relationships, disputes and proceedings. Thus access to justice matters for small and large business alike, just as it does for the most vulnerable consumer.”<sup>97</sup>

In his report for the government on banks’ lending practices, Lawrence Tomlinson said,

“Any law firm that does business with the banks will have a clause in their contract, preventing them from taking action against the banks. This means that for businesses the pool of lawyers available to give them advice and take their case is extremely limited. When you consider the size of the banks and the amount of work they undertake with a range of legal professionals, it is clear to see the problems businesses have in finding legal advice. Many of the top law firms will be conflicted so even if the business has the resource to pay them, they are not able to access the same class of legal advice that the banks can. For many businesses, finding a suitable lawyer is thus exceedingly difficult. Often their own lawyer, who has helped them and their business for many years, is even unable to help in this situation.”<sup>98</sup>

Our data, discussed in the sections which follow, both supports and challenges this statement.<sup>99</sup> Below, we set out the data from our interviewees on conflicts and representation. As will be seen, the concern of those we spoke to, and our own concern, is focused far more on wider, contentious

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<sup>96</sup> Susan S Shapiro, *Tangled Loyalties: Conflicts of Interest in Legal Practice* (University of Michigan Press, 2002) para 20. See:

[http://www.legalservicesboard.org.uk/news\\_publications/publications/pdf/regulatory\\_objectives.pdf](http://www.legalservicesboard.org.uk/news_publications/publications/pdf/regulatory_objectives.pdf)

<sup>98</sup> Lawrence Tomlinson, ‘Banks’ Lending Practices’ (November 2013) 16. See:

<http://www.tomlinsonreport.com/docs/tomlinsonReport.pdf>

<sup>99</sup> The potential for a client to reduce potential regulation against it by conflicting out the law firms who might take on such work has also been raised by le Mire and Parker – see: (n 81 above) 218

and commercial conflicts, and not so much on the (narrow) framing of legal conflicts of interest covered by the SRA's Handbook.

## **OUR FINDINGS**

In this section we consider the ability of influential clients to dictate to their legal advisers who they may or may not act for in other matters. When we asked our interviewees to give examples of what they considered to be particularly problematic provisions in client terms, provisions on conflicts were almost universally front of mind. As such, we consider here the implications of these client controls, both in terms of their capacity to impact professional obligations, and their potential role in inhibiting access to justice.

### ***No-litigation Clauses***

All of the partners that we spoke to expressed growing concern about the attempts by large clients to limit their capacity to act for other clients, for reasons that go beyond legal conflicts of interest as defined by the SRA. The most common grievance from partners was the 'no litigation' clauses imposed, most frequently through panel terms:

*"Effectively clients are deciding who we can act for. That is fundamentally what it comes down to. Virtually no client will allow us to litigate against them. And, you know, my own view is that this should be our decision."* US COLP 3

*"Obviously sometimes there will be situations where litigation is very far flung and we don't feel there is any connection with the activities we have with them on a normal commercial basis. Then we might not feel constrained by the regulatory conflict procedure to have, say, our Australian arm suing them on an Australian matter whereas we tend to do UK work. So there are situations where the panel would create a constraint that wouldn't probably operate by operation of normal regulation and that can be a concern."* EH Corporate 5

Some framed 'no sue' conflicts clauses in terms of commercial concerns:

*"I do worry, as I'm sure many partners do, that we have a lot of clients who are imposing these restrictions on us, particularly the no litigation or no hostile action restrictions, in circumstances where they don't actually intend to give us much business."* EH Conflicts Officer

There were others who felt that these clauses had the potential to compromise their independence:

*"Clients who simply refuse outright to allow you to act against them on a contentious matter, irrespective of whether or not you seek consent, I think that to my mind does start to potentially compromise professional independence, in that if you have enough clients who are saying that to you, your ability to run a litigation practice, for example, alongside a commercial or transactional practice, is quite difficult. And I think it's one of the reasons why we've seen a number of these boutique litigation firms starting up in the last five years."* US Corporate 1

Of course the decision on whether or not to accept such clauses lies fairly and squarely with the law firm in question, and many of our interviewees – whilst finding the pressure to accept clauses to be significant – agreed that the challenge was a commercial rather than a regulatory one.

Where these 'no litigation' clauses do potentially give rise to concern is on an access point, and this is particularly with regard to large financial institutions. As set out at the start of this chapter, this was a matter that the SRA had specifically asked us to raise with our interviewees. Here, it is possible to advance an argument that corporations that wish to sue large banks and insurers, the vast majority of whom have panel agreements in place with major City law firms, will struggle to find legal representation with sufficient standing or resources to do so. This is particularly the case given that panel terms will often preclude firms from acting "in contentious or potentially contentious matters". This requires firms to predict whether a matter may potentially get acrimonious, and if so, to turn that work away:

*"When we see someone take on a matter on the other side of where the banks are responsible for, we very often ask the partner concerned, 'Is there a dispute here? Do you see a dispute? Is there a possibility of a dispute?' Because from a business perspective we don't want them taking on a job which then escalates into a dispute and causes damage to the relationship."* US Finance 2

It can also lead to firms having to disassociate with clients midway through transactions if a fallout with a banking client looks possible. We were told that this is a particular issue in restructuring work:

A *"I've had a situation recently where something's getting or got a bit ugly and we've had to say, "Look, if it does get litigious or to the stage of grumpy/threatening letters, then we won't be able to act for you because of panel commitments to two or three of the banks involved."*

Q *Do you know what happens to that client or didn't it ever get to that stage?*

A *I had a conversation with one of the guys about half an hour, about 45 minutes ago, so hopefully there'll be a sensible, commercial solution. Because we put our hands up early doors, and said, "Look, just to be completely clear, we can't..." And it's in part because we've just been panelled by a particular bank and the last thing we want to do, having spent 18 months getting panelled, is to then go and, "Yeah, we're suing you now!"* EH Finance 1

We do not have a definitive view on this matter, and our interviewees were broadly split down the middle as to whether or not 'access to justice' was being prejudiced by the banks' insistence on no-litigation clauses (and analogous issues in the insurance market). Around half of the firms that we spoke to were of the opinion that an industry of law firms willing to act adverse to major financial institutions had sprung up in London in the last five to 10 years, and that those firms had sufficient quality, breadth and depth of resources to handle sizeable cases against the large law firms that typically represent the banks. As such, those wishing to sue were represented and represented well. One litigation partner told us:

*"If you look at the market there are a large number of firms out there, the boutiques, who will sue banks. And a lot of people have come into the market. Obviously XX is the stand-out name based off their reputation in the States and they've done very well. We've seen them a lot, we know the guys over there a lot and they've clearly done very well. But there's also a whole list of other firms. So I certainly wouldn't look at it and say it's a market that is under served."* US Litigation 1

Many others were of the view that the banks have panel arrangements with so many of the leading finance firms in the City that it has become difficult for a claimant with a sophisticated derivatives

dispute, for example, to find a law firm with comparable depth of knowledge and resource to bring a case:

*“I think you could always get representation. Frequently you would not get the representation of the same order as the bank. So all the firms with, you know, tonnes and tonnes of lawyers and resources and plenty of facilities to do all the preparations, IT enquiries into disclosure and things like that, they’ve already gone. So you’d be down to firms with maybe one or two partners. And they can put on surprisingly a pretty good show in normal circumstances, but they are not of an equal size or weight to the people on the other side. They don’t have masses of infrastructure and personnel to call on. And that’s one of the ways that litigation, as you know, is done. Especially big litigation. They immediately send out 20 trainees to write letters all day complaining about things, hoping to occupy you answering the letters rather than getting on and doing the work. So that sort of size can impact the sort of justice of the situation.”* EH COLP 3

Two related points were raised, one of which was the fact that there is very little significant litigation against financial institutions in the City, giving rise to debates about cause and effect. Secondly, several partners noted that there is a public perception issue at the heart of this matter, as regards a belief that the major law firms are in the pockets of the big banks. We query whether that in itself prevents more banking litigation getting off the ground:

A *“There’s a public perception issue of the fact that no large city law firm will sue the banks right? And so you, I mean you can draw your own conclusion about how independent we are right?”*

Q *Yeah.*

A *And that’s-, that is well it’s not an issue obviously for me as a partner in this firm, but I think if you take a broader view of the independence of the profession, that is, for me, in the sort of soundbite world of Sky News or something, that in a nutshell is why I think the SRA should be worried, because that doesn’t look good.”* EH Finance 11

A number of law firms raised questions about the behaviour of the banks in this regard, and particularly made reference to the tactical use of instructions by some clients, such that firms are put on panels, or given mandates, precisely to remove the risk of them litigating against the bank in future. We were told:

*“Some years ago we were sent a little bit of litigation by [INVESTMENT BANK X] and three months’ later when we acted against them they said, ‘You can’t, you’ve got a conflict. You’ve acted for us.’ To which we said, ‘Go away! There’s absolutely no connection between the two matters. We don’t have a no sue agreement with you, on your bike!’ It was clear that they had sent us a little bit of work in order to raise that argument and we were having none of it.”* EH COLP 12

*“With some of these companies you get the sense that it is being used tactically. So banks are notorious for doing these tactically but we also get some insurance entities doing this, where they spread their work quite widely but then say to those firms, ‘Of course, you won’t come up against us will you?’ So trying to deprive their opponents of their first choice firms. I think it’s disgraceful, utterly disgraceful, because it looks to us deliberate that they’ve spread their work. They have a lot of work to give so they’ve spread it out and so starve their opponents of the best legal advice.”* EH COLP 13



*“You can be pinned down and stopped from suing them without actually getting any work at all. I feel that’s a kind of a restraint of trade. Obviously, at the end of it, the panel arrangement, you can decide whether or not you want to sign up again, but most law firms are desperate enough to need the work and so sign up and go along with it.”* EH Finance 12

We only have one side of this story - we did not interview clients, nor did we interview litigation experts - and would need to verify if this tactical use of contract is, in fact, occurring and, if it is, who is doing it. However, if there are situations in which in-house lawyers are using contractual provisions solely to deny third parties representation, one might question whether those lawyers are acting in accordance with Principle 1 of the SRA’s Handbook, the obligation to “uphold the rule of law and the proper administration of justice.”

Finally, we feel it is worth noting that this access challenge goes beyond even panel terms, and is in fact in many ways a behavioural rather than simply a contractual challenge. We were told, for example, that many banks will simply not employ law firms that sue banks, thereby discouraging law firms from acting against any financial institution in a contentious scenario, even against those institutions that are not – and never have been – their clients. When combined with the maxim that law firms simply must not sue banks that they wish to work for, whether or not it is explicitly set out in panel terms, we find a significant market challenge:

*“Very, very few law firms in the city will sue an investment bank, because certainly the bigger law firms tend to act for most of the investment banks. But even – and I can’t think of an obscure investment bank, they’re all household or cityhold names! – but if you pick one that we didn’t act for, it is unlikely that we would sue that investment bank, because our other investment bank clients wouldn’t appreciate us taking a position that could be averse or adverse to the investment banking industry as a whole.”* US Corporate 2

*“Even if we weren’t under panel terms, as a relationship issue, if we act for a, you know, a small bank, and we were asked by an individual to have a pop at them, or a small client, we would think very carefully about it. Because of the impact it would have upon our relationship with the other banking clients. If we get a reputation for being free and easy to act against the banks, we fear that the main banks may think the less of us.”* EH COLP 4

### **Commercial Conflict Clauses**

Outside of litigation, we also found many partners to be worried about the use of conflicts provisions to prevent firms acting in commercial matters for their clients’ competitors, or to prevent them acting against a client’s commercial interests.

We were told that stipulations against acting for competitors typically arise in a corporate context, rather than amongst financial institutions, and many of our interviewees referred to the classic argument that a law firm cannot act for both PepsiCo and Coca Cola. One corporate partner said:

*“I think probably the most problematical area in those sorts of scenarios is where clients are requiring that we don’t act for competing businesses in the same, perhaps, geographical area, or the same sector, if you like.”* US Corporate 1

Several interviewees drew a comparison here with conflicts practice in the United States, where clients would typically take a “for us or against us” approach, prohibiting their lawyers from advising their competitors:

*“There is a greater tendency for US clients to say, ‘You are either for us or against us’. And particularly in certain sectors, ‘You can’t act for our competitors’. We would try to avoid that but that is a feature I think that is becoming increasingly common here, because in a number of ways we do tend to slightly follow the US market.”* EH Corporate 5

Of greater concern to many of our respondents, however, was the use of very broadly drafted conflicts provisions in panel agreements, which law firms frequently felt were impossible to comply with. These commercial conflict provision will often prohibit panel firms from acting against the client’s ‘interests’, or from taking a position adverse to the client, on any matter, anywhere in the world. We were told:

*“And the increasing, especially increasing over the last three years, appearance of what I would call the US term, that you won’t take a negative position. I suppose they started out a bit on purely no-suit clauses and they seem to have started to extend to you won’t take a negative position to us as an organisation or our position in the market, even if there’s not even a hint of a direct conflict as regards them being involved in a matter on the other side of another client.”* EH COLP 8

*“We actually said that to a client about a year ago and we’d actually had done a bit of research and said, “Do you know how many subsidiaries we’ve discovered?” They looked at us and said, “No”. “You’ve got 475”. “Wow, we didn’t know we had that many!” And they expect you to be able to track it. That is a real issue. For anyone smaller than us below the top 50/75 firms, it’s going to be hard work. We can’t do it completely but it would be really hard work for anyone to actually keep an eye on that.”* EH COLP 1

*“You sometimes see terms that sort of elliptically refer to positions so you won’t take a position that’s adverse to us. So might that mean that for example if you were acting for Amazon you wouldn’t seek to take a case that talked about enforceability of contract offers made electronically through websites to sell goods? Possibly you could but I don’t think any client ever tries to go that far.”* EH COLP 10

Around a quarter of the firms that we spoke to told us that they simply refuse to sign up to clauses of this kind:

*“So a general requirement not to act for particular entities it is very, very rare that we agree it. It’s much more common for it to be requested. The generalised, you know, ‘You won’t act for people who are contrary to our interests.’ Gosh, we have to watch like hawks for that. And the trouble is all of our partners – well, not all of our partners, a number of our partners – are saying, ‘Look, you know, they’re demanding this, demanding this,’ and we really have to have a very eagle-eyed compliance team, who just says, ‘No. We are not prepared to agree that kind of thing.’ We don’t even understand what it means, let alone anything else.”* EH Corporate 14

More of an issue for the SRA, however, may be the number of firms that reported signing up to these clauses, well aware that they were not capable of monitoring or mitigating the risk of non-compliance but instead taking a “pragmatic” view:

*“There are certain banks that you have to sign up to schedules, which contain terms we would never subscribe to nor would we include in our own forms of engagement letter. But the reality I think in lots of these things is that one has to take a pragmatic view – unless*

*there's something which is known and specific, a situation or something where you just know we can't do that or we can't subscribe to that."* US COLP 1

*"We often take a pragmatic approach to these things, and internally decide, 'Well, is this really something that we think we need to, you know, square away with them?' And that's done very much in consultation with the relationship partners, who know the client very well and over a period of time build up an understanding of the sorts of situations that actually the client is concerned about. But, you know, you do run the risk of not working to the letter of the agreement. Which is sort of perverse."* EH Conflicts Officer

*"What some clients are doing is putting forward a set of terms and conditions with which they know we can't comply and they just say, 'In so doing we are transferring the risk on this from us to them. We know they can't comply, they know they can't comply. Something goes wrong and we either will or will not sue them so.' Putting that into a regulatory context I suppose you could say it is not the right action of a regulated entity to sign up to an agreement with which it knows it cannot reasonably comply."* EH Corporate 2

*"I think one of the other things that always worries me quite a lot is the way terms are written down are often, conflict terms in particular, are often quite imprecise and the partner will say, 'Hey look, I think we are just going to have to take a deep breath and go with this but I've worked with them for years and they have always been really reasonable and everything, and I know they'll interpret this to mean that.' Which is fine while that partner and that lawyer are the people who are in charge of that relationship. If that changes – we had it with a major [XX] company recently, that we had agreed some wording, which wasn't great but you could see how it meant what we thought it meant and it had always been interpreted that way. And someone new turns up and says, 'That's not what it means'."* US COLP 3

Two issues that were brought to our attention with regard to such broadly drafted commercial conflict terms are perhaps more worrisome. First, a couple of interviewees highlighted the rule of law issues that arise from governments asserting that their lawyers cannot act against their interests. For example:

*"I think the whole issue of who you may or may not act for is a big one, and it does worry me the tendency of government clients to begin to request such exclusivity. There I have a real worry. Because I think it does give rise to rule of law issues. If governments start insisting that, as terms of appointment of their lawyers, those lawyers agree that they won't act contrary to the government, bearing in mind the size of governments, you could soon find all the major firms in a particular jurisdiction are not entitled to represent people against the government. And I think that's quite serious from a liberties point of view."* EH Corporate 14

Second, several firms gave examples of offending large financial institutions – with whom they had panel relationships – when acting for other clients on matters where the banks felt the firms were acting against the bank's interests. These so-called 'issue conflicts', where the position taken by a law firm for one client can be detrimental to the position another client would like to take on another unrelated transaction, can be particularly tricky for large law firms to navigate. These matters also have the potential to go to the independence of the lawyer, or firm (which we discuss in the chapter that follows). We were given two examples:

*“We were acting for a XX financial sponsor and it was a big deal. They were new to the [YY] market, so one of the reasons they obviously came to us, is we’ve got experience, expertise in [YY], so they said ‘We want to raise this finance and we want you to do, to help us with the terms’. So we had long conversations with them, what terms do you expect to get, there’s a sort of variety in the [YY] market and they said, ‘We want to be aggressive’. So fine, we go and get a cross-section of deals that are being done in the market, we helped them put together the terms. We were then hauled in to see the arranging banks who we weren’t acting for, who essentially said to us, ‘You are acting against our interests’. To which we said, ‘Well when we’re acting for you, you expect us to do the best we can for you right? Well if we’re not acting for you, we do the best for our other clients,’ but they wanted to kick somebody, they were pretty disappointed. They felt that that was us pushing terms to them that they wouldn’t otherwise have thought about. And that that was contrary to our relationship with the banks. So that definitely goes to the whole independence of the firm because they’re basically saying, on the next one, ‘We don’t want you to do it’. Which of course we said, ‘Well I’m sorry that’s not acceptable.’” EH Finance 11*

*“We have been on the side of the table of a borrower client where we have negotiated a position quite strongly in our client’s interest. Then the relationship partner or even the line partner will get a call from the bank saying, ‘That was too aggressive and you know that’s something that our policies don’t allow us to do’. Sometimes that gets elevated up and sort of they’re saying, ‘We’ve had a call from X at X bank and that you need to tone it down a bit or can’t you persuade your client to change its position for you?’ It’s not just banks that do that, by the way, we have that all-, and particularly some of the sponsors sometimes do that. But there are a couple of banks who do that a bit more than others and they tend to be across the Atlantic.” EH Finance 2*

A final challenge that was noted to us was the increasing convergence of the use of both UK and US conflicts practices, and particularly the growing use of waivers on this side of the Atlantic to deal with commercial conflicts. Interviewees told us that they were being asked to seek waivers where those would not be a requirement under SRA conflict rules, or were being asked to act with a waiver in circumstances where the SRA would deem the conflict to be unwaivable:

*“Sometimes you can’t actually go up to [a client] and say, ‘There’s somebody who wants to sue you’, because you can’t disclose the nature of the party, you can’t disclose the nature of dispute, so you can’t really say anything. If it’s non-contentious it’s not so bad because you say okay, ‘We’re being put on the other side of contract negotiation - which of course they’re aware about - is it okay?’” EH COLP 2*

*“So again, they impose the American style on us. We cannot act against them, unless we get a waiver from them. So that’s the American style, which we have lost work as a result of. Because we’ve had some clients who, for example, were wanting to have a pop at Client X. And that was based in the States. And our client didn’t want – in order for us to act for the client, we would have had to have got a waiver from Client X. The client didn’t want us to give Client X any warning that they were thinking of having a pop at them. So they went elsewhere.” EH COLP 4*

## OUR CONCLUSIONS

The phrase ‘conflicts of interest’ is capable of meaning a number of different things. On one level, we are concerned with ‘legal’ conflicts (i.e. those reflected in the SRA’s Handbook) that seek to prevent lawyers and firms from acting for or against multiple clients on the same matter. On other more amorphous and more complex levels, law firms having multiple clients means that there is the risk that that firm will act against any given client on any given (contentious or non-contentious) matter (where that client has other representation) and/or that that firm will advance arguments which could, in future matters, be to the detriment of any given client (e.g. suggesting a clause be drafted or interpreted in way X for client Y, which would go against the drafting or interpretation they would advance for client Z). These wider contentious and commercial conflicts are not specifically addressed in the SRA’s Principles or the Handbook: the SRA’s conflicts focus appears to us to be on lawyers’ relationships with a ‘matter client’ (i.e. acting for X on Y) rather than their relationships with ‘clients of the firm’ (i.e. X and Z being clients of the firm with potentially competing interests). As a result, in these wider contentious and commercial conflicts situations lawyers and firms will need to juggle acting “with integrity” (Principle 2), not allowing their “independence to be compromised” (Principle 3) and “acting in the best interests of each client” (Principle 4). We explore independence in more depth in the chapter that follows.

What our data also shows is that lawyers and firms, in these situations, need to be mindful of contractual promises they have made to clients on conflicts in their terms of engagement. The seeking by clients to restrict, via contract, who a lawyer and a firm can and cannot act for was of almost universal concern to our interviewees, and the first matter they raised when we asked them to talk to us about particularly challenging provisions in terms of engagement. Where these clauses restrict the ability of firms to sue their clients (on matters where those clients are represented by another firm), this gives rise to potential issues of access for third parties who may not be able to secure representation from their first choice of lawyer or firm. This has been raised previously by the Tomlinson Report as of specific concern in the context of financial institutions, and the same theme comes out from our data. What is less clear, however, is whether these practices (i.e. ‘no sue’ clauses) and their consequences (i.e. a reshaping of the field in terms of who is willing to sue whom) give rise to regulatory issues with which the Financial Conduct Authority (FCA), Competition and Markets Authority (CMA) or the SRA should concern themselves. Access to justice and access to representation are related, and intertwined, but access to justice does not necessarily mean having access to your first lawyer of choice.

Half of our interviewees were of the view that these practices have led to boutique litigation firms opening up that have cornered a niche in the market and offer representation where needed. The other half, while accepting these niche firms had opened, questioned the quality of representation at those niche firms (primarily because of their view that, say, complex, specialist financial litigation requires the claimant firm to also have a complex, specialist finance practice in addition to a litigation practice). Quality in legal services is, however, another challenging concept, and we might debate the indicators of quality in these sorts of contentious matters between firms with (on the face of it) equally qualified and educated partners. We also accept there is some self-interest in those who raised questions of quality relating to the boutique litigation practices.

What seems clear to us is that the market for litigation has been reshaped as a result of contractual provisions on conflicts of interest. What concerns us are certain comments from some of our interviewees that these contractual provisions were introduced strategically by some clients to deny claimants representation from a tier of firms and in situations where firms are appointed to panels (and made to sign up to these ‘no sue’ clauses) where the panel client has no intention of giving that

firm much, or any, work. If (and this is a big 'if') SRA-regulated in-house lawyers are active in these practices, we might question whether they are really in compliance with Principle 1, a lawyer's obligation to 'uphold the rule of law and the proper administration of justice'. This matter needs further exploration. It is equally possible that some of these practices arose via clients without any internal lawyer involvement. Where this is the case, this may be a matter of interest and concern to the FCA or CMA. Relatedly, Richard Moorhead has suggested that, "In theory, lawyers' firms entering into contracts which restrain them from acting against banks which is broader than professional conflict rules might be criticised for compromising their independence (a core principle)."<sup>100</sup> While we would agree with this possibility (that criticism might be so directed), we accept that others feel differently. There is no set answer to this matter at present.

These concerns go not only to 'no sue' clauses but are equally relevant (if harder to pin down) in the context of commercial conflicts provisions introduced by clients into lawyer terms of engagement. We were told that these clauses seek to prevent lawyers from acting adverse to clients on transactional matters (where those clients have other representation) and extend to the more amorphous 'thou shalt not act adverse to our interests' clauses, which include denying firms the ability to advance issues (e.g. the drafting or interpretation of a clause in a contract) which might, in future, be prejudicial to a given client. A number of the firms we spoke to routinely push back on these sorts of clauses. We would suggest that this must be the right approach and that accepting such clauses poses serious potential risks to lawyers and firms of compromising their independence (Principle 3) and/or not acting in the best interests of each client (Principle 4).

We are unclear, and have been unable to find clarity elsewhere, on the extent to which the professional obligations on lawyers and regulated entities restrict the ability of those lawyers and firms to enter into contracts with their clients.<sup>101</sup> One view might be that such contracts are permissible save where they are in tension with the Principles and Handbook. However, such would assume (wrongly) that there are neat answers to the complex questions we raise in this chapter on conflicts of interest.

At the same time, a number of firms told us that they have signed up to contractual provisions on conflicts with their clients where the firms are not sure they are able to comply with those provisions (for example because the provisions are so vast and the client has hundreds of subsidiaries operating in multiple jurisdictions). Is this a question of those firms really acting 'in the best interests of each client' (Principle 4), or is this simply a commercial matter (a risk decision) for firms to decide as they see fit (and not a matter for the SRA)? Lawyers, and firms, need to also be alive to the relevance of Principle 8 to these matters, which is an obligation to, "run your business or carry out your role in the business effectively and in accordance with proper governance and sound financial and risk management principles."

Joan Loughrey has suggested that if we see default regulatory conflicts rules as something to contract out of then we see conflicts as "purely private" matters and we fail to acknowledge, as the SRA itself acknowledges, the importance of conflicts to the public interest.<sup>102</sup> Similarly, we might argue that firms accepting to widen their conflicts obligations via contract also frames conflicts in terms of the private and ignores the public. A potential counter to this may lie in how the common law has historically understood conflicts in terms of "undivided loyalty" to clients.<sup>103</sup> Do we then see

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<sup>100</sup> <https://lawyerwatch.wordpress.com/2013/11/28/independence-matters-banking-and-big-law-in-the-news/>

<sup>101</sup> We note that Outcomes 3.4 and 3.5 of the SRA Handbook cannot be waived.

<sup>102</sup> Loughrey (n 9 above) 230

<sup>103</sup> *Clark Boyce v Mouat* [1994] 1 AC 428, 435; *Farrington v Rowe McBride & Partners* [1985] 1 NZLR 83, 90

contractual provisions on conflicts being used as a self-correcting mechanism to the matter-focused approach to 'legal' conflicts regulation introduced by the SRA? This is unlikely, we would suggest, to have been the driving reason behind the provisions on conflicts in some lawyer terms of engagement, but the end result may well be the same.

## CHAPTER 4 - INDEPENDENCE

In this section of the report we explore the concept of lawyer independence, framed in the context of the changing nature of what clients demand from their external counsel (discussed in Chapter 2). The first part of this chapter explores the meaning of independence, as set out by the LSB and SRA, in case law and by academics working in this area. This part, compared to the introductions to other chapters in this report, is somewhat lengthy and reflects the fact that lawyer independence is a complex, contested and nuanced concept. The second part of the chapter sets out what our interviewees told us about how they understand independence, and draws on a number of examples given to us of situations in which the independence of corporate and finance lawyers may be challenged.

In the third part of the chapter, we set out our views as to whether, as a result of the changes in lawyer-client representation (discussed in Chapter 2), and the influence clients have over representation (discussed in Chapter 3), the independence of lawyers in large firms is, or has the potential to be, compromised.

### WHAT IS INDEPENDENCE?

Independence is referred to in the regulatory objectives set out in the Legal Services Act 2007. Section 1(1)(f) states that one of the objectives is to, “encourage[e] an independent, strong, diverse and effective legal profession.” One of the ‘professional principles’ in the Act is that “authorised persons should act with independence and integrity”.<sup>104</sup> In 2010 the LSB published a paper setting out what it understood to be the meanings of the LSA’s regulatory objectives. On independence, the LSB said,

“Independent primarily means independent from government and other unwarranted influence. A client should be confident that his/her lawyer will advise and act without fear that the state will penalise through regulation. Similarly, a client should be confident that his/her lawyer will advise and act without being prejudiced by other factors or interests other than the overriding professional responsibility to the Court – their advice should be independent of inappropriate influence. (Similarly, lawyers should be confident that their independence as officers of the Court is not constrained by their relationship with their client). But we must all recognise that the overwhelming majority of legal services are delivered for profit: the regulatory objectives serve to protect consumers from lawyers acting in their own financial interests over those of the consumer. An independent profession serves to promote the principle that legal service providers should be free from inappropriate influence (financial or institutional) to act as an agent of the client, in their best interests. Regardless of the structure within which legal services are delivered, we expect lawyers to be mindful of the source of payment for their services (be it legal aid, after the event insurance, before the event insurance, third party funding or any other

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<sup>104</sup> Section 1(3)(a). The ‘Joint Committee on the Draft Legal Services Bill’ was responsible for the inclusion of the word ‘independent’ into the LSA. In its first report, the Committee commented at paragraph 119: ‘We heard much evidence on the need for independence—the independence of the legal profession from Government, the independence of the regulatory framework from the influence of the regulated professions and the independence of the legal profession from market or economic pressures.’ – see: <http://www.publications.parliament.uk/pa/jt/jtlegal.htm>



source) so that they can identify and manage the potential threat to their independence.”<sup>105</sup>

This is a useful, and rich, starting point for understanding independence. Principle 3 of the SRA Handbook states that a lawyer should, “not allow [his/her] independence to be compromised.”<sup>106</sup> The guidance to this Principle states that,

““Independence” means your own and your firm's independence, and not merely your ability to give independent advice to a client. You should avoid situations which might put your independence at risk - e.g. giving control of your practice to a third party which is beyond the regulatory reach of the SRA or other approved regulator.”

From the first line of this guidance, we take it that independence has two core aspects: the ability to give legal advice to clients independent of state or regulatory interference; and the independence of lawyers and firms from their clients.<sup>107</sup> Scholars who write in this area also acknowledge the two core aspects: independence from state; and independence from clients.<sup>108</sup> The latter has been characterised as lawyer autonomy and/or ‘client capture’ in some recent academic work in this area,<sup>109</sup> which draws on earlier work about the power balance between lawyers and their clients.<sup>110</sup> Kevin Leicht and Mary Fennell first suggested that ‘client capture’ may occur where, “the consumers of professional work gain the ability to control the activities, timing, and costs of professional work. In effect the ‘consumer becomes sovereign’ much as consumers search for (and price) other consumer goods and services.”<sup>111</sup> This may lead lawyers to:

“render advice which has less to do with professional standards but which is more closely related to the commercial interest of both the client and the professional. Professionals who are ‘captured’ by their clients cannot then be relied upon to provide the advice their profession requires of them. That is not to say that the advice may necessarily encourage the client to break laws or otherwise behave unethically.”<sup>112</sup>

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<sup>105</sup> LSB, ‘The Regulatory Objectives – Legal Services Act 2007’ (p11) – see:

[http://www.legalservicesboard.org.uk/news\\_publications/publications/pdf/regulatory\\_objectives.pdf](http://www.legalservicesboard.org.uk/news_publications/publications/pdf/regulatory_objectives.pdf)

<sup>106</sup> <http://www.sra.org.uk/lawyers/handbook/handbookprinciples/content.page>

<sup>107</sup> We also take it, from the use of ‘not merely’, that the SRA believes that its lawyers could prioritise, or would (if able) prioritise, the ability to give independent advice to a client over forms of independence.

<sup>108</sup> See, for example, Bruce A. Green, ‘Lawyers' Professional Independence: Overrated or Undervalued’ (2013) 46(3) Akron Law Review 599; and Elanor W. Myers ‘Examining Independence and Loyalty’ (1999) 72(4) Temple Law Review 857. Robert Gordon, in his leading 1988 article, suggests that the word ‘independence’ has multiple meanings in the context of legal services: it could mean independence in the form of corporate self-regulation; independence as to control over the condition of work, and ultimately clients’ and third parties’ influence; and independence in the form of political independence and freedom from regulation from regulators – see: Robert Gordon, ‘The Independence of Lawyers’ (Faculty Scholarship Series. Paper 1361, 1988).

<sup>109</sup> Ronit Dinovitzer, Hugh Gunz and Sally Gunz, ‘Unpacking client capture: evidence from corporate law firms’ (2014a) 1 Journal of Professions and Organization 99; Ronit Dinovitzer, Hugh Gunz and Sally Gunz, ‘Reconsidering Lawyer Autonomy: The Nexus Between Firm, Lawyer, and Client in Large Commercial Practice’ (2014b) 51(3) American Business Law Journal 661

<sup>110</sup> John Heinz, ‘The Power of Lawyers’ (1982) 17 Georgia Law Review 981

<sup>111</sup> Kevin T Leicht and Mary L Fennell, *Professional Work: A Sociological Approach* (Blackwell 2001) 105-106

<sup>112</sup> Dinovitzer, Gunz and Gunz, (2014a) (n 109 above) 100

Concerns about lawyer independence are not new, either in general or in the specific context of commercial practice.<sup>113</sup> However, such concerns may be becoming increasingly important due to changes in the way in which legal work is awarded and rewarded, because client relationships move between firms, and due to increasing numbers of City firms moving away from pure lockstep. In their recent study of 106 Canadian corporate lawyers, Ronit Dinovitzer, Hugh Gunz and Sally Gunz found complex and nuanced, direct and indirect, examples of client capture from those they interviewed. Their empirical findings also highlight,

“...a number of personal characteristics and organisational contexts which may increase the risks for CC [client capture]. For example our interviews tapped into considerable concern about the perceived changes to practice—primarily focused on commercialism—that have heightened the negative pressures felt by practitioners. Senior lawyers in particular were fearful of the impact on their more junior colleagues. Taken together, our results suggest that factors such as a firm’s compensation system, lateral mobility, an individual’s seniority and the qualities they value in their clients may have an influence on how professionals respond to CC.”<sup>114</sup>

We return to these characteristics and contexts later in this chapter. Importantly, independence is also linked to the rule of law.<sup>115</sup> In the 2012 Upjohn Lecture, Lord Neuberger, President of the Supreme Court, commented as follows on the ‘purpose’ of the legal profession:

“A vibrant, independent legal profession is an essential element of any democratic society committed to the rule of law. It is not merely another form of business, solely aimed at maximising profit whilst providing a competitive service to consumers. I am far from suggesting that lawyers ought not seek to maximise their profits, or ought not provide a competitive service. What I am saying is that lawyers also owe overriding specific duties to the court and to society, duties which go beyond the maximisation of profit and which may require lawyers to act to their own detriment, and to that of their clients.”<sup>116</sup>

The use of ‘overriding’ and ‘detriment’ in this speech are powerful signals. However, it is not entirely clear, from the above statement, or elsewhere, whether independence is, or should, vary depending on the sort of legal work a lawyer is engaged in: does independence mean something different, or matter more, in, say, litigation contexts over transactional lawyering? We would suggest not, and return to this below.

It is worth setting this out explicitly. Independence, and Principle 3 from the SRA’s Handbook, applies (in principle) equally to lawyers working in-house as it does to lawyers working in private practice. In a recent empirical study by Richard Moorhead and Steven Vaughan, into how in-house lawyers perceived and managed legal risk, the following insights were drawn into the notion of in-house independence,

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<sup>113</sup> Dinovitzer, Gunz and Gunz, (2014b) (n 109 above) 672; Wayne K. Hobson, ‘Symbol of the New Profession: Emergence of the Large Law Firm 1870–1915’, in Gerard W. Gawalt (ed.) *The New High Priests: Lawyers in Post Civil War America* (Praeger, 1984)

<sup>114</sup> Dinovitzer, Gunz and Gunz, (2014a) (n 109 above) 115

<sup>115</sup> This has also been acknowledged by David Middleton of the SRA in a paper prepared by him for the SRA Board in 2010. See: [http://governance.lawsociety.org.uk/secure/meeting/188745/2010-10-](http://governance.lawsociety.org.uk/secure/meeting/188745/2010-10-15)

[15](http://governance.lawsociety.org.uk/secure/meeting/188745/2010-10-15) Item 6 Public Preparation for ABSs.pdf

<sup>116</sup> Lord Neuberger, ‘Reforming Legal Education’ (Association of Law Teachers Lord Upjohn Lecture, November 2012) 7 – see: <https://www.supremecourt.uk/docs/lord-neuberger-121115-speech.pdf>

“Professional claims to independence by our interviewees were subtle and not naïve. Independence did not either exist or not exist – it manifested along a continuum and could be weaker or stronger, in the same person, at different times and in different contexts. Our interviewees understood that professional independence was (sometimes) in tension with their need to serve, and be seen to serve, the business. Conversely, professional independence could be reinforced by the business (e.g. sometimes respondents reported a deliberate attempt to align the professional claim to independence with a leadership desire to do, and be seen to do, the right thing within their businesses).”<sup>117</sup>

In a later part of this chapter, we discuss the extent to which the above findings on in-house lawyers align with what we were told by our private practice interviewees.

#### JUDICIAL UNDERSTANDINGS OF LAWYER INDEPENDENCE

We have been unable to find many cases which speak directly to, or comment on, the concept of private practice lawyer independence.<sup>118</sup> Four rulings from the Lawyers Disciplinary Tribunal (SDT) have relevance. In the first, a case concerning a lawyer and fraudulent investment schemes, the SDT commented that,

"A lawyer is independent of his client and having regard to his wider responsibilities and the need to maintain the profession's reputation, [he/she] must and should on occasion be prepared to say to [his/her] client 'What you seek to do may be legal but I am not prepared to help you do it'".<sup>119</sup>

In the second, a case before the SDT concerning the pursuit by a law firm of those it suspected of being involved with illegal broadband ISP file-sharing, there is the following comment:

“[T]he Tribunal found that the Respondents had lost their focus on fulfilling their role as lawyers. They became in thrall to the scheme [during which 6,113 letters were sent out alleging copyright breaches] and what they perceived to be the driving imperative to make it profitable for themselves and their Firm. Their judgement became distorted and they pursued the scheme regardless of the interests of their clients and the impact upon those whom they identified as potential defendants among the general public. The Tribunal felt that the Respondents’ independence had been compromised to a significant degree.”<sup>120</sup>

In the third, a SDT ruling concerning a firm taking loans from a client, the Tribunal commented as follows,

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<sup>117</sup> Moorhead and Vaughan (n 1 above)

<sup>118</sup> In *Akzo Nobel*, the ECJ ruled that privilege only protects communications with independent lawyers and that an in-house lawyer does not enjoy the same degree of independence from his employer as an external lawyer – see: *Akzo Nobel Chemicals Ltd and Akros Chemicals Ltd v European Commission* Case C-550/07 P ECLI:EU:C:2010:512 For a review by Richard Moorhead of a Court of Appeal decision on the independence of barristers (*Farooqi & Others* [2013] EWCA Crim 1649) see: <https://lawyerwatch.wordpress.com/2013/10/02/court-of-appeal-criticism-of-advocate-extends-beyond-the-man-himself/>

<sup>119</sup> *In the matter of Paul Francis Simms*, Lawyers Disciplinary Tribunal, 2 February 2004, para 76

<sup>120</sup> *SRA v Brian Laurence Miller and David Joel Gore*, SDT Case No. 10619-2010, 3 October 2011, para 178. We are grateful to Peter Steel of Bevan Brittan for bringing this case to our attention.

“Raleys [the firm] had had a long (over 100 years) association with the NUM [the client]. They were rightly proud of having served the Mining Community over many years and were proud to be the nominated NUM Lawyers. The difficulty which that situation created was that the lawyers become too close to their client and too reliant upon it. That kind of situation eats away at the independence of the lawyers and blinds them to their duties under the Professional Rules of Conduct of the Profession, especially towards their individual clients.”<sup>121</sup>

In the fourth case, concerning a law firm that was dependent on an accountancy firm for 65% of its business, the SDT ruled that the lawyer’s independence had been compromised and referenced the “level of control” exerted by the accountants over the law firm, and the “interwoven nature of the relationship” between the two firms.<sup>122</sup>

In a fifth case, in the High Court on appeal from a ruling of the SDT and concerning a lawyer accepting referral fees for personal injury claims, the trial judge, May J, commented that,

“Referral fees were seen as objectionable because they tended to forge a commercial link of reliance between the lawyer and the referrer which was seen as inimical to the lawyer’s independence and integrity; to the client’s freedom to instruct a lawyer of his or her choice; and the lawyer’s duty to act in the client’s best interest.”<sup>123</sup>

The court went on to find that the lawyer “became over-reliant on a single client to the detriment of her independence.”<sup>124</sup> In *Crown Dilmun v Sutton*,<sup>125</sup> a case concerning the fiduciary duties of directors, Smith J found that the director’s lawyer had been reckless (as to whether consent for the underlying transaction had been obtained) because,

“...she was too far wedded to this big contract, which the deal maker Mr Sutton [the director] was bringing to her firm. CD [Mr Sutton’s company] was becoming history and the future lay with Mr Sutton. She was not going to harm the firm as she saw it by creating problems. To fall out with Mr Sutton at this late stage would jeopardise the contract and would lead to him going elsewhere.”<sup>126</sup>

From these six cases, we take independence to be comprised of (at least) three facets: (i) a lawyer being prepared to say no to their client;<sup>127</sup> (ii) an acceptance that independence may, in some situations, mean taking decisions that have negative financial consequences for the lawyer; and (iii) a need for a lawyer to avoid becoming overly reliant or overly close to any given client.<sup>128</sup> While

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<sup>121</sup> *In the matter of David Peter Barber and Others*, SDT Case 9698-2007, 21 July 2009, para 273. We are grateful to Iain Miller of Bevan Brittan for bringing this case to our attention.

<sup>122</sup> *SRA v Tax and Legal Consultancy Limited*, SDT Case No. 10722-2011, 11 October 2011, para 39.86

<sup>123</sup> *Reed v George Marriott* [2009] EWHC 1183 (Admin) para 46

<sup>124</sup> *ibid*, para 51

<sup>125</sup> [2004] 1 BCLC 468. We are grateful to Joan Loughrey for bringing this case to our attention.

<sup>126</sup> *Ibid*, para 118

<sup>127</sup> This facet is by no means a modern phenomenon. In the 1960s Talcott Parsons argued that lawyers’, “function in relation to clients is by no means only to “give them what they want” but often to resist their pressures and get them to realise some of the hard facts of their situations, not only with reference to what they can, even with clever legal help, expect to “get away with” but with reference to what the law will permit them to do.” – Talcott Parsons, ‘A Sociologist Looks at the Legal Profession’ in Talcott Parsons (ed) *Essays in Sociological Theory* (Free Press, 1964)

<sup>128</sup> We accept that ‘overly’ may not be a particularly helpful term, but the case law does not allow for further, more specific delineation in this regard. In their work in this area, Dinovitzer, Gunz and Gunz comment that,

these facets are interesting, and important, we would suggest, on the basis of our data, that they do not capture the full spectrum of challenges to lawyer independence in large commercial firms.

### THE CHALLENGES IN UNDERSTANDING INDEPENDENCE

The SRA Handbook guidance, set out above, does not significantly amplify or expand on Principle 3. It does not, for example, say whether the ability to give free and independent legal advice to clients is more or less important than being independent from those clients. This is important as the guidance in the Handbook that ‘the public interest’ should determine the way forward for lawyers in challenging situations *only* operates when there is conflict *between* the ten Principles and not, as here, where any single Principle might have multiple meanings in tension with each other.<sup>129</sup> Gordon Turriff argues that the meaning of ‘lawyer independence’ is not clear.<sup>130</sup> We would agree. The LSA regulatory objectives and the SRA Handbook Principles are not given as a hierarchy. There are those who argue that client loyalty trumps any notion of independence.<sup>131</sup> Indeed, some of the emphasis on lawyer independence seems to suggest that independence from the state is of prime importance. Robert Rosen argues that as lawyers become more embedded in their clients’ businesses, the more likely they are to see independence as being about insulating their clients from state oversight (and less about acting as a gatekeeper/shepherding those clients to comply with the letter and spirit of the law).<sup>132</sup> In *The Rule of Law*, Lord Bingham commented that,

‘Scarcely less important than an independent judiciary is an independent legal profession, fearless in its representation of those who cannot represent themselves, however unpopular or distasteful their case may be.’<sup>133</sup>

We accept that Lord Bingham’s comment may equally go to the importance of lawyers being independent of popular opinion. As noted in the Introduction to this report, a lack of independence was one of the risks set out in the SRA’s 2014/2015 Risk Outlook. The SRA said:

“Promotion of a client's interests, or a desire to maximise commercial return, should not override wider obligations to the public interest and the proper administration of justice. We acknowledge that the professional principles can, and do, come into conflict with each other. However, when professional principles come into conflict, the one that best serves the public interest, in the particular circumstances, prevails. There is an increasing trend towards corporate buyers of legal services, such as financial institutions and large multinational businesses, having sophisticated in-house legal departments. This can change the balance of power between the client and their legal advisor. Those we regulate must ensure they prioritise their obligations to act in the public interest, in accordance

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“there exists the risk that the relationship between lawyer and corporate counsel might become of sufficient comfort or familiarity as to detract from the appropriate level of professional autonomy or skepticism on the part of lawyer” - ((2014b) (n 109 above) 697). This may be a better, and more nuanced, way of understanding closeness.

<sup>129</sup> SRA Principles 2011, para 2.2: “Where two or more Principles come into 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>130</sup> Gordon Turriff, ‘The Importance of Being Earnestly Independent’, (2012) 2 Michigan State Law 281

<sup>131</sup> Evan A Davis, ‘The Meaning of Professional Independence’ (2003) 103 Columbia Law Review 1281, 1291

<sup>132</sup> Rosen (n 42 above)

<sup>133</sup> Tom Bingham, *The Rule of Law* (Penguin 2010) 92-3

with their duties to court, and must resist client pressure which may adversely compromise their professional independence.”<sup>134</sup>

Later in the Risk Outlook, the SRA comments that,

“[A lack of independence] may also be significant when a firm is reliant on a single or limited number of clients. Maintaining independence is also relevant to in-house lawyers, who may come under pressure from their employers.”<sup>135</sup>

These are much richer statements from the SRA on independence than the guidance to Principle 3. Two matters strike us as particularly interesting. First, in the context of better understanding the concept of independence, five issues seem to be identified as important (which align with, but go further than, the principles we drew from the case law in this area):

- (i) the balance of power between firms and their clients;
- (ii) the reliance of a firm on any given client;
- (iii) the extent to which lawyers are willing to promote clients’, or a client’s, interests;
- (iv) the ability for in-house lawyers to stand apart from their employers;
- (v) and the role of incentives.<sup>136</sup>

From the data we have gathered, set out in Chapters 2 and 3 and discussed below, we would agree with these. Second, the statements by the SRA in the Risk Outlook make it clear that independence (and Principle 3) can, and does, come into conflict with some of the other Principles to which lawyers are also subject (for example, the requirements to act in the best interests of each client,<sup>137</sup> and/or to provide a proper standard of service to one’s clients).<sup>138</sup> In its recent report on lawyers balancing duties in litigation, the SRA comments that,

“In walking the line between their duties to clients, the court, third parties and to the public interest, lawyers’ surest guides are their integrity and independence.”<sup>139</sup>

There seems no good reason why this argument should not also apply to transactional lawyers. Indeed, such may be more important in situations that lack a neutral third party arbiter, such as a judge.<sup>140</sup> Here, Richard Painter argues that, in the case of corporate representation, lawyers cannot always be easily distinguished from their clients,<sup>141</sup> and are instead morally interdependent such that it is hard to distinguish actions of lawyers and actions of clients.<sup>142</sup> The challenge, however, is in having independence as a guide when independence can mean multiple and many contradictory things at the same time.

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<sup>134</sup> <http://www.sra.org.uk/risk/outlook/risk-outlook-2014-2015.page>

<sup>135</sup> *ibid*

<sup>136</sup> See the general discussion in the following on culture, organisation and the framing of biases: Richard Moorhead, Victoria Hinchly, Christine Parker, Soren Holm and David Kershaw, ‘Designing Ethics Indicators for Legal Services Provision’ (Report for the Legal Services Board, 2012) - [http://www.legalservicesboard.org.uk/what\\_we\\_do/research/Publications/pdf/designing\\_ethics\\_indicators\\_for\\_legal\\_services\\_provision\\_lsb\\_report\\_sep\\_2012.pdf](http://www.legalservicesboard.org.uk/what_we_do/research/Publications/pdf/designing_ethics_indicators_for_legal_services_provision_lsb_report_sep_2012.pdf)

<sup>137</sup> Principle 4

<sup>138</sup> Principle 5

<sup>139</sup> <http://www.sra.org.uk/risk/resources/balancing-duties-litigation.page#notes5>

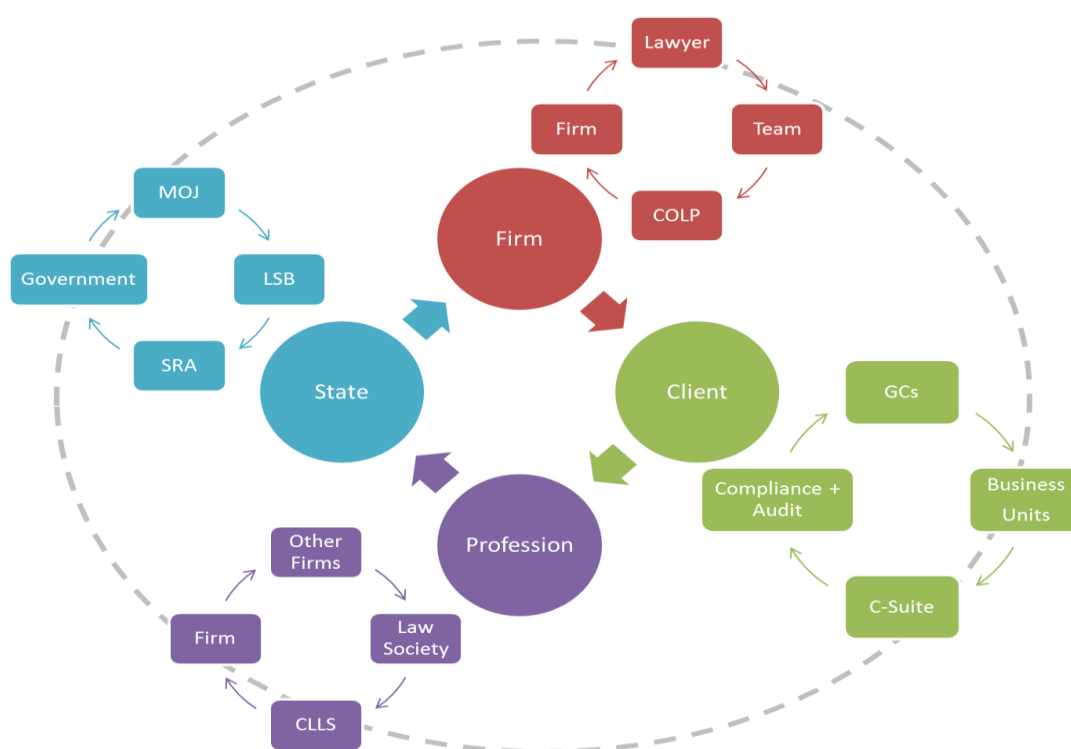
<sup>140</sup> John C Coffee, ‘The Acquiescent Gatekeeper: Reputational Intermediaries, Auditor Independence and the Governance of Accounting’ (Columbia Law and Economics Working Paper No. 191, May 2001)

<sup>141</sup> Richard W. Painter, ‘The Moral Interdependence of Corporate Lawyers and Their Clients’, (1994) 67 S. CAL. L. REV.507

<sup>142</sup> *ibid.* 512

As is evident from Chapters 2 and 3, tension and conflict between and within the Principles are recurrent themes. We would also suggest that such opens up the space to better understand the complex issue of independence. Independence is not just a simply tripartite relationship (client – lawyer – state). Instead, there are multiple, interlinking relationships, and organisational factors, which may impact on independence – for example, a lawyer’s relationship with her firm; the firm’s relationship with the SRA; the power and influence held by a COLP; the connection between any given lawyer and any given in-house lawyer; how an in-house lawyer is accepted or perceived by her organisation’s business units; the impact of representative bodies etc.<sup>143</sup> We try to capture some of this complexity in the diagram below.

FIGURE 4.1 – THE INTERCONNECTED NATURE OF LAWYER INDEPENDENCE<sup>144</sup>



<sup>143</sup> This complexity has been accepted by others writing in this area but we would suggest that their alternative nuanced account is still lacking – “While the traditional notion of client capture focuses on the two-party relationship, that of the lawyer and client, our findings emphasise that we must consider it in the context of the complexity of a large law firm. Individual lawyers may feel pressure exerted not only directly by the client, but more subtly and indirectly from the relationship partner or other lawyers in the firm with whom they share client work (Type 2 client capture).” – Dinovitzer, Gunz and Gunz (2014b) (n 109 above) 715

<sup>144</sup> We accept that it is possible to push this figure further and to include other actors. Richard Moorhead has helpfully suggested that these other actors might include, say, insurers and other State regulatory bodies. Moorhead uses the work of Andrew Abbott to discuss the interconnected nature of professionalism in his piece on ‘Precarious Professionalism’ – see: Moorhead (n 12 above)

## OUR FINDINGS

On the following pages we outline our findings based on what interviewees told us about independence. More specifically, when speaking with COLPs and senior partners about independence, we sought to establish their views on what the term “professional independence” meant to them; how they felt their clients understood the term; whether they had seen situations where independence had been compromised by peer firms, or where clients had sought to exert undue pressure on external lawyers; and how their firms sought to identify and mitigate risks to independence arising from client pressure on fee earners at all levels.

In this section, a number of structural pressures on independence are raised, such as fee arrangements, law firm compensation models, and individual partners becoming overly reliant on any one given client. Two specific threats to independence were brought to our attention (unprompted) by interviewees, namely the risks arising from clients seeking to put pressure on the way legal opinions are drafted, and third-party payers seeking, in some contexts, to influence the behaviour of advisers to other parties on a transaction. Finally, we consider here the way in which firms mitigate independence risks at more junior levels within their organisations, and the role of the COLP as the ‘holder’ of professional values for the firm.

### ***Our Interviewees’ Definition of Independence***

It quickly became apparent during the interview process that the senior lawyers that we were speaking with had a limited understanding of the concept of professional independence. The majority of interviewees struggled or failed to define the term, with a handful very clear that they were not independent and that it was not their role to be so. Indeed some felt their clients considered them, and wanted them to be a, “member of the family” [EH Corporate 15]. As we set out above, lawyer independence is complex and nuanced, and so a failure to articulate what independence meant, or could mean, is perhaps understandable. Some of the responses to our request for a definition of the term are set out below. Several partners expressed complete ignorance of the concept:

Q        *“How you would describe professional independence?”*

A        *Crikey, I’ve never even heard the expression. Is that as an individual or a practice?”*  
EH Finance 4

Others felt the concept was simply anathema to modern legal practice:

*“I don’t know if I’d ever... how often I would think of myself as being independent as a strong part of my offering and it is not something that you ever, ever use in a pitch. You actually go more the other way and say we would like to be part of the team, we want to understand your business. If there is a commercial term that they can win at the expense of the other party, then absolutely it’s my, you know, in my interests to act in their best interests, my obligation to act in their best interests and win that point and is that independence? That’s not, that’s fighting their corner isn’t it?”* EH Corporate 15

This viewpoint is perhaps suggestive of an approach to professional values which are framed almost exclusively in terms of the best interests of the client (over other interests).<sup>145</sup>

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<sup>145</sup> This has been picked up in other work. see: Moorhead (n 12 above)



When pushed, however, most would accept that independence from clients is important, and one or two made reference to the American concept of ‘zealous advocacy’ as providing more clarity:

*“Not being beholden I think is a good way of putting it. If you're beholden to someone then you can't exercise your independent judgement. Beholden can be anything from literally being a bit of a crook to just being too dependent on a big client, having someone who's too much of a mate. If you've got someone who's a really good friend who works for a client you'd probably want to try and make sure that somebody else gives your instructions.”*  
EH COLP 1

*“With these really big clients you've always got to make sure that you're dealing with them eye to eye rather than on your knees.”* EH COLP 9

*“I mean I suppose professional independence means that you advise on the basis of what you consider to be the relevant aspects and you resist attempts by your client to push you into a particular conclusion.”* EH Finance 10

We asked interviewees how they felt their clients viewed independence, and whether private practice lawyers felt that their clients expected their advisers to exhibit ‘independence of mind’ and ‘in appearance’,<sup>146</sup> including from clients. We went further, asking senior partners to consider how clients’ expectations in this regard had changed over time.

The majority felt that there had been a shift in the perception of external legal advisers over time, and that they are increasingly expected to act as ‘part of the team’, rather than to challenge. But very few thought their clients were entirely ignorant of the concept of professional independence, or that they were consistently making unreasonable demands that brought these issues to the fore. We accept this may seem somewhat contradictory: our interviewees were, generally, poor at articulating what independence was, or could be, while at the same time they accepted, when pushed, the importance of independence and told us they would resist challenges to their independence wherever those challenges presented themselves. Most felt that they needed to resist challenges to their independence, and that protecting the independence of the profession was important:

*“I think you've got to be independent. Being a service, you've got to understand the commercial work that your client does to understand the nature of their business, so you can give some constructive and meaningful advice to them in the situation that they're in. I think maybe clients thought, ‘Well, if they're a service industry, they'd better get on and serve’, which is a different perspective. I've not agreed with that. Some clients think, you know, ‘Who pays the piper calls the tune’”, that sort of thing. Which is something you do have to resist.”*  
EH COLP 3

*“We are here to give commercial legal advice and if one was to think that commercial legal advice could be in some way altered because of the proximity of a relationship, that wouldn't be right. That said, the proximity of a relationship on a commercial level, and understanding*

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<sup>146</sup> These terms had been given to us by the SRA to put to our interviewees, and come from the IFAC Code of Ethics for accountants. See: <https://www.icaew.com/~media/corporate/files/technical/ethics/ifac%20code%20of%20ethics%20the%20final%20destination%20icaew.ashx>

*your client, is extremely important, because that does help you to shape the commerciality of the advice that you are giving.” EH Corporate 3*

### **Client Pressure**

The SRA was curious to know whether senior lawyers in private practice had ever felt uncomfortable about the closeness of the relationship between a colleague, or a competitor, and their client.<sup>147</sup> We also sought to find out whether interviewees had ever witnessed individuals employed by clients putting pressure on external lawyers.

The majority of those that we spoke to could not point to specific instances of independence being compromised. The following four quotes present a range of views of how our interviewees conceptualised independence:

*“Most grown up law firms behave in an appropriate way with their clients and I don’t see even with [the firm], even our top ten global clients who are very important to our firm, I can’t think of a single incident where the undue influence of one of those clients put the firm in a position where we were not complying with our general professional duties.” US COLP 1*

*“I think we’ve always been independent in the sense that I don’t think it’s any more possible now to buy advice that you want than it was previously, but it’s certainly possible to get much better economic terms than you ever could as a client.” EH Corporate 11*

*“It’s hugely important and I think we all regard it as hugely important to be able to say no to a client. I’m struggling to think of a situation where I’ve felt under pressure to take on a piece of work that I hadn’t wanted to take on and certainly I’ve never been asked to do anything improper.” EH Corporate 12*

Despite this broad sense of proper behaviour, when prompted most respondents were able to point to situations where their independence might be put under pressure, or where challenges might arise. Often these were in the context of day-to-day working relationships, and once again several interviewees made reference here to a shift in the balance of power over time, such that clients are now more able to dictate the behaviour of their legal advisers:

*“More broadly, more nebulously, the sort of day-to-day working relationship can give rise to requests to do things that we might not be happy with. Specific things on a case. Or to accept certain sort of – a power relationship between the two firms. I think that’s probably more insidious rather than overtly saying they don’t like clause whatever of your terms of business. It’s sort of day to day working relationships, I think, where things can be more concerning.” EH COLP 3*

Most agreed that there had been a shift in the dynamics of law firm/client relationships, in the context of independence, over time:

*“I think lawyers are regarded as being part of the service industry. And with most service industries the client can dictate the speed and the scope of what they want to be delivered. So, I think it has much moved towards the client specifying what they want out of their*

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<sup>147</sup> The question was phrased in this way because previous research suggests that asking interviewees to talk about their own potential failings bears little fruit.

*lawyers and managing the whole process; rather than saying to the lawyers, 'Can you give me some advice because I'm consulting you as a professional?'"* EH Corporate 13

While this may in many ways be a sensible and innocuous development, there was some indication that it might on occasion be more problematic:

A *"It feels to me 20 years ago you gave your advice and your advice was what it was, rather than you were compelled by some business imperative that the advice should be a certain way.*

Q *So, that happens now?*

A *Hm. Not too much, but I certainly see instances of it."* EH Finance 8

Many interviewees speak of the power of the large financial institutions in this regard, and their ability to make demands of law firms where there is limited room for negotiation. Many told us that if they do not behave in a certain way when acting for a bank, their client will simply go elsewhere. And yet a quarter of the firms that we interviewed took a much more robust adversarial approach and spoke about routinely pushing back against challenging (or, as they perceived them, unreasonable) requests from clients. One corporate partner said:

*"If you stand up to clients, they normally back off. You know? They may be very angry, but they don't come to [the firm] for shonky non-independent advice. If they want shonky non-independent advice, they generally go somewhere else."* EH Corporate 14

### ***Structural Pressures on Independence***

A number of structural pressures on independence were raised by our interviewees, most notably fee arrangements, law firm compensation systems, and the tendency for individual partners and/or teams to become reliant on one particular client.

With regards to fee arrangements, several partners raised concerns about firms signing up to contingent fees, or success fees, which meant they had "too much skin in the game" (EH COLP 7) and were no longer acting independently. There is a general consensus that clients increasingly favour a move away from hourly rates for transactional work, so that they can better manage tight legal budgets, and whilst this is understandable from the buy-side, private practice lawyers need to be mindful of the potential impact on independence. These fee arrangements can lead to a risk that partners become motivated less by their client's best interests and more by getting the deal done at any cost so as to better remunerate the firm.<sup>148</sup> However, it would be possible for partners, and firms, to adapt to new fee arrangements in ways that seek to reduce the risk of challenges to their independence.

*"It's not so much that anyone would be stupid enough to advise on something that was clearly technically not correct as a lawyer – well maybe there is someone who's stupid enough to do that, but I think that would be a little unlikely. It's more just you start to step away from just wanting to advocate for your client to a point where what you're advocating for is for the deal to get done. And that could result in your client not getting as good an outcome from the risk allocation, for example, as they might otherwise get, because you feel*

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<sup>148</sup> For a discussion of the ethics of different billing practices among lawyers, see: Christine Parker, Adrian Evans, Linda Haller, Suzanne Le Mire and Reid Mortensen, 'The Ethical Infrastructure of Legal Practice in Larger Firms: Values, Policies and Behaviour' (2008) 31(1) UNSW Law Journal 158; Donald Massey, 'Ethical Considerations of Alternative Fee Billing', (2001) 28(2) Southern University Law Review 111.

*that it's a deal that should be done, everyone's a winner, and actually I'm particularly a winner because I get my fees paid. And you start to advocate the deal rather than advocating your client's case or your client's position for the deal."* US Corporate 1

What is notable here is that while four or five other interviewees raised similar concerns, many more spoke about having themselves working on a contingent fee basis, or a success fee, and did not feel that such gave rise to independence issues.

Secondly, and with regard to partner compensation, we were told by several firms that the models by which they and their colleagues were remunerated had some impact on their ability, and willingness, to push back on client demands that made them feel uncomfortable. For example, several lockstep firms felt that lockstep compensation – whereby partners are rewarded according to seniority rather than according to their contribution – served to support them in maintaining their independence from powerful clients.

*"We're a rigid lockstep, which I think actually helps in a funny kind of way because there's less individual pressure on people and it also means that you've got a greater sense of not doing anything wrong for the wider partnership."* EH Finance 5

*"We do have a merit-based remuneration system, so it can be quite painful if we've had to walk away from something."* EH Corporate 12

One partner gave an example of his firm opting to walk away from a relationship with a major client because it was uncomfortable about the panel terms:

*"It wasn't a difficult decision at all. I mean there were line partners who when they go into work, 60% or 70% of their daily lives for many years have been working for that one bank, who were obviously extremely worried about it and were not particularly happy about it. But you know, as a firm we're lockstep, so we don't... not too difficult a conversation to sort of say 'Look, don't worry, there's plenty of other things that we can support you in, and put you into other relationships etc.' We've lived with that arrangement for several years now, it's worked well."* EH Finance 2

One COLP cautioned about assumptions concerning the role of the compensation system in influencing partner behaviour, and many others felt the compensation system to be irrelevant:<sup>149</sup>

*"I think one has to be very careful to say that remuneration systems necessarily produce a particular culture, because I don't think they do... or I can think of very, very good firms which are very merit-based in terms of the way they distribute profit, but which seem to have very good strong cultures, which wouldn't accept people doing things outside the culture of the firm."* EH COLP 6

A final matter that was raised with regard to structural challenges to independence centred on the issues that arise out of reliance on a single client. Many of the individuals that we spoke to identified this as a concern at firm level, often in the context of comments that suggested only firms where large clients contributed a significant amount to overall turnover might have independence issues:

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<sup>149</sup> This issue was also found by Richard Moorhead and Victoria Hinchly in their study of ethics with 21 in-house and private practice lawyers (n 23 above)

*“I think perhaps [independence] is less of an issue for large law firms. I suspect it’s more of an issue for smaller law firms. It’s around who’s your biggest client;”* EH Finance 7

*“So, to turn your question slightly on its head: how would one feel about a relationship with any client – again, nothing to do with banks – but any client whose continued patronage, if that’s the right word, was germane to the future of survival of the firm? I don’t know. I think that would be, certainly if I was a senior partner, managing partner in that firm, I would see it as fundamental to actually ensure that that reliance was not a long-term proposition for the firm; that we would be looking to spread that risk, as it were.”* EH Finance 6

*“It’s partly professional principles but also this firm doesn’t have a client that is worth more than about 3% of its annual turnover. Its reputation, brand and goodwill are worth far more to it than the interests of any client in any situation. I think if you were in a smaller firm with a dominant client who dictated the financial performance of the firm it would be more of a worry.”* US Finance 2

Several partners referred to potential problems arising if a client accounted for more than around 3% of the firm’s turnover, but said that that was not an issue at their firm, where no one client was dominant. We were unclear, and remain unclear, why 3% was seen as the magic number. When we pushed the point further, exploring issues of reliance at an individual partner or team level, references to percentages were less useful, and most partners accepted that challenges to independence can and do arise:

*“I think people do get pressurised to compromise their independence sometimes, because the revenue coming from a particular client is so significant that the partner would be very concerned about losing that.”* EH Corporate 13

*“There might be an issue of – and again to personalities – the pressure coming not at a firm level but on an individual level, where the client relationship partner might be a sort of deputy or whatever, that work has been and is the mainstay of that partner, or that team’s revenue generation. And so therefore decision making that that team makes, or wants the firm to make, is driven by that client relationship.”* EH COLP 8

## **MARKET PRACTICE AND PRESSURES ON INDEPENDENCE**

Two areas where market practice has developed in such a way as to give rise to concern about professional independence were raised by our interviewees. These areas, concerning client influence over opinions and the role of what we have termed “shadow clients”, were raised repeatedly by interviewees without our prompting. When we asked partners about areas where they felt that professional independence might be challenged, these were the two issues most frequently raised.

### ***The Giving of Opinions***

First, with regard to the giving of legal opinions, we found several law firms telling us that clients were exerting undue influence over law firms to shape their opinions in a certain way. The giving of an opinion by a firm, as with any work product, involves elements of negotiation as to form, content and format. Such discussions may be perfectly acceptable. What we have found some evidence of,

however, is pressure by clients on opinion writing that goes beyond the bounds of acceptable negotiation, and lawyers telling us that they are being pushed to give opinions that they do not feel comfortable with. The leading US legal ethics scholar William Simon has previously suggested that there is now a “market for bad legal advice” in which clients prefer lawyers who are willing to give them the opinions they want.<sup>150</sup>

One corporate partner referred to a blurring of the line such that external legal advisers are becoming facilitators on deals, rather than independent advisers:

*“Something I think lawyers have to be careful of is where they can be pushed to give views the client wants them to express, rather than those being views that they would naturally express themselves. So, I think that’s probably the biggest risk, that what ordinarily, or a few years ago, would have been the professional independence has suddenly become a bit more blurred, because the client wants to achieve a particular business objective, and the lawyer becomes a facilitator of that rather than an advisor. That is probably the main distinction: facilitator versus advisor.”* EH Corporate 13

Several other partners talked of being put under pressure to deliver opinions that they were not happy about. For example:

*“Now, one can understand the bank’s desire to have consistency amongst its panel firms in terms of how legal opinions are given in relation to financing or security documents. Because if some banker in some branch wants a legal opinion in relation to a security package, you don’t want to find that Firm A is giving a wildly different opinion to Firm B.*

*“The problem with that, of course, is that if firms are required to give opinion wording, which ideally they would not agree to, or if it’s going beyond what they consider normal and reasonable, but they are told by the client, ‘Well, all other firms are willing to do it. If these firms are willing to do it, why aren’t you?’ You again may have to assume the risk; and it may be a limited risk, but there are some provisions of legal opinions where you would want to give a certain qualification or caveat or whatever. That certainly arose where a client, a banking client, was asking, it was in relation to real estate financing transactions, that firms agree to a standard format.”* EH COLP 12

This begs the question: if Firm X is unwilling to give an opinion in a form that Firm Y is happy to give, why does the client not just ask Firm Y to give the opinion? This strikes us as a subtle, but potentially invidious practice on the part of some clients. Is it possible that Firm Y is not used because Firm Y is a less good ‘reputational intermediary’ than Firm X? Work in this area suggests that lawyers act as reputational intermediaries where they reduce uncertainty by using their professional reputation as a bond – or form of insurance – to guarantee the veracity of their client’s representations.<sup>151</sup> Here, choosing Firm X may not be about quality (or not all about quality) but may rather concern the signal that using Firm X sends. If true, lack of independence from the client has the potential to undermine the public interest by enabling clients to use compromised lawyers and firms to send misleading market signals (for example when firms issue opinions).

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<sup>150</sup> William H Simon, ‘The Market for Bad Legal Advice: Academic Professional Responsibility Counselling as an Example’ (2008) 60 Stanford Law Review 1556

<sup>151</sup> Ronald J. Gilson, ‘Value creation by business lawyers: Legal skills and asset pricing.’ (1984) Yale Law Journal, 239; KS Okamoto, ‘Reputation and the Value of Lawyers’ (1995) Or. L. Rev. 74

Several of the largest firms now have opinion committees to try to mitigate the risk of client pressure being exerted and leading to poor opinions practice. Those committees are commonplace in the United States but we were not able to establish how widespread their use is on this side of the Atlantic. One partner said:

*“I mean obviously in a more general way clients quite like you to say things that they want to hear, but that’s an old problem. If it’s not what they want to hear then they challenge us to say it in the most palatable way and, but perhaps we particularly get that in opinions. They are a bit like, ‘Can you shade your opinion so it looks a bit more like this?’ And the answer is either yes or no and we get round that by having an opinions panel so no one gets put under too much pressure.”* US COLP 3

Many of the firms we spoke to do not have such committees in place, however, and find this area worrying.

### **Shadow Clients**

A second, and much larger topic of concern, is around third-party payers, and more specifically what we have termed ‘shadow clients’. Here we are referring to another age-old practice whereby, particularly in leveraged finance but also elsewhere, borrowers dictate who their lending banks can use for legal advice. This situation arises because the borrowers are typically paying the banks’ legal fees, and as such feel justified in influencing the decision over which law firm is instructed for the banks. In this situation, the borrower becomes a law firm’s ‘shadow client’,<sup>152</sup> with significant influence over its appointment, remuneration, and potentially the scope of its work, but without directly instructing it.

This gives rise to a number of issues, both on a practical level in terms of a law firm’s ability to recover its fees from the other side, but also with regard to independence. Case law would also seem to suggest that where a third party, over the course of a series of transactions, reposes trust and confidence in a lawyer, that might give rise to a fiduciary duty without a retainer.<sup>153</sup> Critically, we were told that it is becoming increasingly common practice for the sponsor on a private equity transaction to appoint the law firm that will advise the lender *before* that lender bank has been chosen. As a consequence, the scope of that law firm’s role and the terms of its engagement are agreed with the sponsor, instead of with the bank that will ultimately be the law firm’s client.<sup>154</sup>

While banks will often have some room to challenge the appointment – and the law firm chosen by the borrower will typically be one that is on most of the banks’ panels – the bank will essentially be told not only which firm it has to use, but also the scope of the legal work that the borrower is willing to pay for. That means that the law firm acting for the bank is potentially motivated more by satisfying the borrower on the other side of the table – because that is where the next deal will come from – than by satisfying his or her client. There is also the potential that the firm will be taking instructions on which pieces of advice to give, and which points of law to take, from the other side. We were told in this context:

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<sup>152</sup> We draw here on the notion of a ‘shadow director’ from company law. This term is defined in Section 251(1) of the Companies Act 2006 as, “means a person in accordance with whose directions or instructions the directors of the company are accustomed to act.”

<sup>153</sup> *Bolkiah v KPMG* [1999] 2 A.C. 222; *Longstaff v Birtles* [2001] EWCA Civ 1219

<sup>154</sup> For those unfamiliar with the world of private equity, this article is useful starting point which explains the role of the sponsor: <http://apps.americanbar.org/buslaw/blt/2008-01-02/blomberg.shtml>

*“Basically the lender and the sponsor clients are not actually getting the best advice because one or the other of the lawyers is concerned about a view that the sponsor or lender client will have of them in taking particular positions on points. So, actually on both sides of the table I’ve had sponsor clients saying to me and I’ve had lender clients saying into me, ‘Hang on, what on earth is this lawyer doing? These are points that I do not want to give’. But it’s because – cahoots is an emotive word – but it’s almost like they’re in cahoots because they’re frightened to damage their reputation with someone who might be on the other side of the table who they perceive is perhaps a better work bringer. So, actually their advice is being coloured. In that particular situation I mentioned it was the lender who in their view was being prejudiced because the sponsor was calling the shots.” EH Finance 7*

*“I think there is a genuine potential, I only say a potential, for ethical conflict if your fees are being paid by a third party.” EH Corporate 2*

*“I think its unfortunate banks have allowed themselves to get into a situation where this happened. Ironically, the fact that the borrower was paying is probably one of the main reasons why borrowers have been able to assert so much control over these costs, because ultimately they're paying for them. Their argument to the banks is, if they're a strong borrower they'll say, ‘If you want to use lawyers, if you expect us to pay for them, then we want to have a say. We want to choose them or have a strong say in who you choose, because it's our problem; it's our fees.’ It can give rise to challenging pressures for an individual partner or a law firm's deal flow and income to be determined by whether the people on the other side of the table, whose interests aren't aligned with their own client's, like them. There's always a suspicion or the fear that some lawyers in the market will gain market share by not really doing the best job for their client but by being over-accommodating to the borrower's side.” US Finance 2*

*“So the panels are definitely important, but actually it’s more the fact that the financial sponsor is even more important. And some people perceive a risk to independence through the strength of that financial sponsor relationship. Because if they are the one that’s paying you, and dictating your appointments, then that I think sometimes creates a perception that you are more in their pocket than -, you are more on their side than you are your client’s side, which is the bank.” EH Finance 11*

*“I think the point about the fees being paid by the other side and us being appointed by the other side is probably the main professional area of interest at the moment. It doesn’t necessarily work to our disadvantage, but there is that concern, especially with very powerful sponsors who have maybe got themselves too much leverage with the banks. Some might go a bit too far in terms of accommodating them.” US Finance 2*

The following conversation between the interviewer and the respondent is typical of the discussions we had with regard to the implications of this behaviour, which many partners describe as standard market practice:

- Q *“And what about taking that a step further where borrowers... how common is it that you might be put into the transaction for the bank by the borrower, if you see what I mean?*
- A *Yeah that’s very common, very common that the issuer – this is very common in capital markets as well. I mean for example we have one very significant client, well they’re actually not a client, we have one institution in our capital markets practice*



*which always requires us to act for the underwriters so they're never our client but our relationship is they always refer they always say to the underwriters "you've got to use XXX".*

*Q Does that present any professional issues or how can you make sure it doesn't?*

*A I'm not sure it presents any professional issues.*

*Q Independence issues?*

*A I think it can get a bit awkward sometimes, if you've got a really difficult issue on a deal and particularly if the borrower or originator, issuer, doesn't see it as a difficult issue and just thinks you're being difficult or if one of the underwriters or one of the lenders raises a particular issue, which may be totally unreasonable, but because you're their counsel you've got to represent it and fight for it. Yeah that can be awkward. I suppose it might cross your mind that unless you handle it properly you're not going to get a referral in the future but I don't think it changes the way we do it."*

US Finance 3

Many of the partners that we spoke to were at pains to point out that the phenomena of third-party payers, and by extension shadow clients, was not a new one, and that firms behave reputably in the vast majority of circumstances:

*"It genuinely doesn't change our legal advice, I can say that hand on heart. I know that's the right answer, but it's genuinely the right answer as well."* EH Finance 5

Nevertheless, we were told that the power of the sponsors in these situations has grown in the wake of the credit crisis, and the tendency for banks to come into deals with their legal advisers having already been appointed for them has increased. Many advisers to the banks told us that the banks were not happy with this arrangement:

*"On the vast majority of the banking deals that I work on, the borrower pays the bank's legal fees, and it's been like that since time immemorial really. But what the powerful sponsors now do, or even the big borrowers, corporate borrowers, they say, 'If we are paying the bank's lawyers' fees, we want to choose who the bank's lawyers are.' And of course that creates some very odd dynamics because they're never going to choose a law firm that's going to give them a bloody nose. So who really is your client? And anecdotally, there are lots of stories where the banks feel pretty hacked off that the people that are meant to be batting for them seem to be conceding much more to the sponsor than you would expect. And I don't think that's good for the profession."* EH Finance 3

This issue was also the only example of a threat to advisers' independence that was raised, unprompted, at the GC Roundtable, outlined in Chapter 6 of this report.

While appreciating that the banks are sophisticated purchasers of legal services, and that the terms are being dictated to them by the sponsors on these transactions (with the law firms merely bystanders), we would suggest that these arrangements do appear to put the independence of lawyers at risk and therefore raise challenges for the legal profession and the SRA. We would also suggest that these 'shadow client' situations do not engage the conflicts rules as set out in the SRA Handbook because the borrower/sponsor is never, at least technically, a client of the firm on the matter.

## **MITIGATION OF THREATS TO INDEPENDENCE**

When it comes to mitigating threats to the firm's, or any given lawyer's, independence, we asked our interviewees whether they felt that their firms had effective systems and controls in place to identify and mitigate risks arising from client pressure on fee earners at all levels. We found evidence of a rather concerning lack of systems and controls at the non-partner level within firms, below partner, where many partners struggled to explain any meaningful procedures in place.

Very few firms were able to point to regular, and in many cases any, professional ethics or professionalism training programmes for associates that covered matters such as the principle of lawyer independence. Often these existed 'on day one of joining', and were not repeated. In only two or three cases were there established ethics training schemes running on an annual basis, or every two years. Instead, many partners pointed to the firm's culture as the chief mitigation against threats to independence below partner level:<sup>155</sup>

*"I think the culture here is that associates should feel comfortable to come to a more senior associate on the matter, or a partner and say, I'm being asked to do something and I'm not comfortable. Can I talk it through with you? Just in the way a partner would feel able to go and talk to the office of general counsel. So I don't think there's a formal process, but I think it's a cultural thing."* US COLP 4

*"I think that actually finding people that work at the firm who have integrity and common sense as to what's honest and what's not is actually far more important than some box ticking exercise."* US Finance 1<sup>156</sup>

*"Well I guess there's no explicit training-, I don't think there's any explicit training on that particular point, because I guess we're trained for all of our career to know where the lines are."* EH Finance 11

*"I suppose it comes down to communication and I'm not sure there's a very sophisticated answer to this, but of course aspects of deals or smaller deals get done with very little partner involvement for economic reasons if nothing else, but we try to absolutely imbue in all the associates that if they feel they're being pushed or compromised they need to get a partner involved."* EH finance 10

Others pointed to informal procedural measures, often the domain of individual partners, such as insisting that partners be copied in to every email conversation with a client, or making associates share rooms with more senior lawyers so that they could be more closely monitored. The overwhelming consensus, however, was that mitigation is purely informal for fee earners:

*"I don't have a particular sense of how that's done on a formal basis. I know that partners are certainly told, we know that one of our responsibilities is to monitor what our associates are doing with clients and to make it easy for them to raise any concerns that they have. So an open door policy, all that kind of stuff."* US Corporate 1

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<sup>155</sup> The importance of culture was also found in Richard Moorhead and Victoria Hinchly's study – see: Moorhead and Hinchly (n 23 above)

<sup>156</sup> We note here that there is some evidence from the field of social psychology that thinking of oneself as a professional increases the likelihood of unethical behaviour. See: Maryam Kouchaki, 'Professionalism and Moral Behavior: Does a Professional Self-Conception Make One More Unethical?' (Edmond J. Safra Working Papers, No. 4, 2013); and Andrew M. Perlman, 'A Behavioral Theory of Legal Ethics' (Suffolk University Law School Research Paper No. 13-31, 2013) 22. We are grateful to Joan Loughrey for raising this point with us.

Q “Do you do things like ethics training for junior law firm associates?”

A “No, we don’t. I think there used to be an induction process which included things like that. That’s not happening at the moment, but it’s something that we’re looking to re-introduce when the next set of trainees arrive in September. Because I had that when I was a trainee and I found it very useful.” EH Corporate 13

We were struck by the lack of focus in the majority of those firms we spoke with on regular ethics training, by the reliance on law firm culture as the guiding light for a firm’s lawyers, and by the lack of formal procedural measures in place to mitigate threats to independence. The SRA has identified ethics as core to competence (and indeed it is the first competency on the SRA’s new ‘Competence Statement’) but they are not stipulating that ethics (or any other training) form part of continuing professional development. Given the findings in this report we recommend that firms and their professional bodies give serious consideration to developing ethics training as part of their ongoing training programmes.

#### **INTERNAL OWNERSHIP OF RISK AND THE ROLE OF THE COLP**

Within the law firms that we spoke to, a debate emerged about the ownership of compliance and risk, with COLPs increasingly taking on responsibility for supporting partners should they come under pressure from clients to behave in a way in which they feel uncomfortable. COLPs tell us that this has changed over time, in part since COLPs formally took up their roles on 1 January 2013. Often COLPs will be tasked with having the difficult conversations with clients that partners choose not to have, though several COLPs told us they prefer to leave as much responsibility with the partners as possible, so that they are forced to “win the argument” (EH COLP 9) with difficult clients, rather than simply passing the buck.

COLPs told us they were often taking on the role of standing up to clients from partners that felt under pressure:

*“In terms of issues arising during the matter, I think things have changed since I became GC. When I first started most people tried to sort them out themselves, unless they thought it was a money laundering issue, in which case they’d come and talk to me. Now more and more people come and talk to me when they’ve got a problem that they’re uncomfortable about and that they’re not sure they can solve themselves. Which is as it should be, that’s what I’m here for partly. So although it’s not a formal process or procedure I think I can trust most of my partners to recognise a problem. Some of them are prepared to accept more risk than others, inevitably, but I don’t think any of them are accepting the sort of risks that would actually cause me to have sleepless nights.”* EH COLP 1

*“The fundamental trigger will be the partner or the lawyer believing that there may be an issue here. And to some extent what’s happening is that that individual partner or that individual lawyer, in a way, is covering off the risk by coming to me. Sometimes they want to be able to say to the client, ‘Look, I understand you’re not necessarily going to like what we’re going to say here, or the position we’re taking on our terms of engagement, but I’ve run this past our General Counsel,’ and occasionally I’ll be dragged in to deal with the client direct. So that would be where the lawyer here or the partner here accepts in a way that what is being said from a risk and compliance point of view is correct but they’d rather I was the person delivering it, or I was the reason for it rather than them.”* EH COLP 9

Some COLPs felt that law firms still have a long way to go in recognising and mitigating the risks that arise from client relationships:

*“The Big Four I think are better at it than we are. Law firms generally – it would be interesting to know what other law firms say about that. But having systems in place to spot a team’s struggling, are they likely to make bad decisions, well no-one on earth can be doing this amount of work by themselves without cutting corners or doing something, so what on earth are they doing. So that’s something which we could be better at.”* EH COLP 8

A number of COLPs felt that by assuming responsibility for difficult client conversations, they were disempowering partners and allowing them to become even more compliant with the wishes of clients, because they no longer assumed ownership of challenging situations. This delegation of responsibility issue is perhaps not new, but may be a downside of the advent of the COLP position in law firms:

*“I do think you have to win the argument, or persuade them. And I think the challenge is to have a rational explanation as to why you’re saying what you’re saying. That’s why actually, although I don’t mind being used as cover for a partner that’s got problems with a client in this area, I think it’s much better that the client partner wins the debate or persuades the client, because that’s again dealing with the client eye-to-eye rather than on your knees. You know, ‘I’m just a client partner, please don’t... I’ll hand it over to our General Counsel’.”* EH COLP 9

*“They tend to find their way to me I suppose and then I would counsel them and mentor them and may front it with them as well. So quite often the very difficult conflict conversations come my way as a representative of the firm. I would always try and get the client partner to deal with it if possible, because I think that creates a better dynamic longer term in terms of that relationship, because I think client partners do need to learn to be able to say no. Managing a relationship is not all about saying yes, but if it is tense or difficult and/or important then again I will get involved.”* EH COLP 10

On the other hand, one can view this rise of the COLP as having a positive impact, enabling compliance and risk managers with regulatory clout to push back against client demands in circumstances where partners carrying the commercial relationship find this difficult or impossible.

## **OUR CONCLUSIONS**

Independence in the legal profession is a complex and nuanced concept. At its most basic, it suggests that lawyers should stand apart from client and/or state influence. However, and as represented earlier in this chapter in Figure 4.1, we would suggest that influence is better understood as a series of interconnected and multiple relationships which each have the potential to impact on the role of, and advice given by, any individual lawyer or any law firm. Independence is the practice of advising and acting free from inappropriate influence. We would also suggest that, in the context of the lawyer-client relationship, the following matters have the potential to influence the independence of any given lawyer: (i) the balance of power between lawyer, firm, client relationship partner and client; (ii) the reliance of the lawyer and/or firm on the client for business; (iii) the willingness and potential for lawyers and firms to say ‘no’ to clients; (iv) the acceptance by lawyers and firms that affirming independence may have negative financial consequences; (v) the closeness of the lawyer and/or firm to the client; (vi) law firm culture; and (vii) the ways in which firms structure and distribute incentives.

Our view is that the current definition and exposition of independence in the SRA Handbook does not account for these nuances. At the same time, it is not in any way clear to us how ‘the public interest’ acts as a meaningful decider in situations of conflict – for example (and we accept this is a very simplistic, binary example), is the public interest in effecting client wishes and undertaking transactions that contribute to the economy more or less than the public interest in lawyers standing up to their clients and declining, on occasion, to effect their wishes? We would argue that our evidence shows that weakened independence influences the objectivity with which law is interpreted and acted upon. There is a public interest in the law being advised and acted upon objectively. If a lawyer is being asked to say the law is less X than she believes, or that the risk in doing Y is less than she believes, or that the law should be described in these terms (when the lawyer believes it is best described in other terms), then that is compromising her independence and weakening the rule of law and compromising the administration of justice.

Our interviewees were, in general, unable to clearly articulate what the principle of independence meant. However, when pushed, most could understand the importance of lawyer independence, although a minority were of the fixed view that they were not independent, and were not appointed by clients to be independent. We were told by our interviewees of a number of structural pressures on independence, such as fee arrangements, law firm compensation models, and individual partners becoming overly reliant on any one given client. Two specific threats to independence were brought to our attention (unprompted) by interviewees, namely the risks arising from clients seeking to put pressure on the way opinions are drafted, and third-party payers seeking, in some contexts, to influence the behaviour of advisers to other parties on a transaction (starting by dictating who those lawyer advisers could be). The second matter strikes us as problematic and less amenable to resolution by a simple reaffirmation of the SRA Handbook Principles. We have coined the term “shadow client” to denote the power that these third parties (commonly borrowers or private equity sponsors) have to choose which law firms act on which transactions. While we were not given any specific examples of this practice resulting in tangible violations of the Handbook, many of our interviewees were concerned by the potential for lawyers appointed by third parties to possibly act, in ways subtle and refined, in the interests of those third parties over the interests of their clients. We would agree, and this point was also raised (unprompted) by a member of the GC Roundtable.

Finally, we were struck by the lack of sophistication as to the ways in which a number of our participating firms mitigate independence risks at more junior levels within their organisations. This may or may not be reflective of the wider market. We were also struck by the view of the role of the COLP as the ‘holder’ or arbiter of professional values for the firm, and raise the question of whether such has the potential for individual lawyers to become less aware of, and less interested in, their own professionalism, professional identity and professional obligations.

## CHAPTER 5 – RISK TRANSFERS

In this chapter we explore ways in which risk is, or may be, transferred to large law firms, and other ways in which the liability of firms may be negotiated or increased through their relationships with their clients. The SRA asked us to specifically discuss three matters with our interviewees: (i) law firms accepting liability for the work of third-party law firms (or other advisers); (ii) law firms indemnifying clients; and (iii) the extent to which law firms are able to cap their liability. A fourth matter, the use of reliance letters, was raised to us by the firms we spoke to.

The second part of this chapter sets out what our interviewees told us about their experiences of these matters. In the third part of the chapter, we set out our views as to whether, as a result of law firms accepting risk or otherwise reshaping their liability profile, there may be challenges to some of the regulatory objectives contained in the Legal Services Act 2007, in particular s1(f) which sets out the requirement to, “encourage[e] an independent, strong, diverse and effective legal profession.” The LSB primarily understands ‘strength’ in this context to mean the ability of the profession to “speak authoritatively on matters of relevance”, and sees ‘effective’ in terms of meeting the needs of consumers.<sup>157</sup> We would suggest that while these are some possible facets of s1(f), they ignore the importance of a strong and effective profession in terms of one which is financially healthy and which has a strong international brand. We return to these matters at the end of this chapter.

### THE REGULATORY CONTEXT

Law firms, and individual lawyers, have a responsibility under Principle 8 of the SRA Handbook to run their businesses, “effectively and in accordance with proper governance and sound financial and risk management principles”. The guidance to this Principle in the Handbook says that, “Whether you are a manager or an employee, you have a part to play in helping to ensure that your business is well run for the benefit of your clients and, e.g. in meeting the outcomes in Chapter 7 (Management of your business) of the Code.”<sup>158</sup> The linked mandatory outcomes in Chapter 7 include an obligation to have “effective systems and controls in place” to achieve and comply with the Principles (O(7.2)), an obligation to, “identify, monitor and manage risks to compliance with all the Principles” (O7.3)), and an obligation to, “train individuals working in the firm to maintain a level of competence appropriate to their work and level of responsibility” (O(7.6)). We wonder whether, and as highlighted below, some of the firms that we spoke with are undertaking appropriate due diligence and risk management (sufficient to evidence compliance with Principle 8) in relation to risk transfer by their clients.

### LAWYER LIABILITY

As a basic starting point, law firms, and their individual lawyers,<sup>159</sup> may be liable to their clients where they are negligent and/or where they are in breach of their contractual terms of engagement.<sup>160</sup> The contractual and tortious duties overlap. Case law in this area suggests that, in terms of contractual liability, clients need to be specific in setting out exactly what their lawyers will be liable for. Lord Woolf, in *Midland Bank plc v Cox McQueen*, commented that, “If commercial

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<sup>157</sup> LSB, ‘The Regulatory Objectives’ (2010) paras 41 and 44 – see:

[http://www.legalservicesboard.org.uk/news\\_publications/publications/pdf/regulatory\\_objectives.pdf](http://www.legalservicesboard.org.uk/news_publications/publications/pdf/regulatory_objectives.pdf)

<sup>158</sup> <http://www.sra.org.uk/solicitors/handbook/handbookprinciples/content.page>

<sup>159</sup> *Merrett v Babb* [2001] EWCA Civ 214

<sup>160</sup> *Hilton v Barker Booth Eastwood* [2005] UKHL 8 at [28]

institutions such as banks wish to impose an absolute liability on members of a profession they should do so in clear terms so that the lawyers can appreciate the extent of their obligation which they are accepting.”<sup>161</sup> The courts have so far been relatively unwilling to impose on lawyers an obligation (and corresponding liability) for matters outside of the scope of their engagement.<sup>162</sup> We come later in this chapter to discuss a shift in practice in how lawyers or their clients draft the scope of their work.

Where a lawyer does, however, give advice outside the retainer, there may well be liability in Tort.<sup>163</sup> Whether or not a firm or lawyer will generally be liable in Tort depends on a variety of factors, as set out in *Duncan v Cuelenaere*: the experience and training of the lawyer; the form and nature of the client’s instructions; the specificity of those instructions; the nature of the action or the legal assignment; the precautions one would expect a lawyer, acting prudently and competently, to take; and the influence of other factors beyond the control of the client and the adviser.<sup>164</sup> The duty of care owed by any given firm or lawyer to any given client is variable,<sup>165</sup> and lawyers do not, in general, owe duties at common law to third parties.

On matters where a client is getting advice from multiple advisors, there is generally no liability for Adviser A as a result of advice given by Adviser B to Client C.<sup>166</sup> Indeed, it is possible for firms to carve out, via contract, the proportion of liability for which they may be responsible in situations where a client has multiple advisers.<sup>167</sup> Vicarious liability, however, refers to a situation where someone is held responsible for the actions or omissions of another person. In the legal services field, this is commonly discussed in situations where Partner A is held responsible for the actions of Partner B where both work in the same law firm;<sup>168</sup> and/or where a law firm is held vicariously liable for the acts of one of its employees.<sup>169</sup> It is established that some relationships can give rise to vicarious liability (for example, employment, partnership and membership of an LLP). Similarly, there are other situations in which it will be clear that there is no vicarious liability (for example, where the alleged wrongdoer is plainly an independent contractor). However, there are more complex, and uncertain situations.

In the situation where Law Firm X co-ordinates advice by Law Firm Y to Client A, as part of a larger matter on which Law Firm X is also advising, could Law Firm X be vicariously liable for defective advice given by Law Firm Y?<sup>170</sup> In *JGE v Trustees of Portsmouth Roman Catholic Diocesan Trust*,<sup>171</sup> the

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<sup>161</sup> *Midland Bank plc v Cox McQueen* [1999] Lloyd’s Rep PN 223

<sup>162</sup> *Midland Bank Co Ltd v Hett, Stubbs & Kemp* [1979] Ch 384

<sup>163</sup> *Holt v Payne Skillington* (1996) 77 BLR 51

<sup>164</sup> *Duncan v Cuelenaere, Beaubier, Walters, Kendall & Fisher* [1987] 2 WWR 379 at 382

<sup>165</sup> *Pickersgill v Riley* [2004] UKPC 14 at [7] (Lord Scott)

<sup>166</sup> There are, however, some interesting cases about risk and the obligations of lawyers to warn their clients about risk. As a starting point, see: *Credit Lyonnais SA v Russell Jones & Walker* [2002] EWCH 1310 at [28] (Laddie J)

<sup>167</sup> *West v Ian Finlay & Associates* [2014] EWCA Civ 316

<sup>168</sup> Section 10, Partnership Act 1890; *Dubai Aluminium Co Ltd v Salaam and others* [2002] UKHL 48. For an interesting discussion of how this works in the US, see: Douglas Richmond, ‘Law Firm Partners as Their Brothers’ Keepers’ (2008) 96 Kentucky Law Journal 231

<sup>169</sup> *Lloyd v Grace, Smith & Co* [1912] AC 716; *Bernard v AG of Jamaica* [2004] UKPC 47

<sup>170</sup> A recent Supreme Court case definitively sets out the law on vicarious liability in secondment style arrangements – where the test asks whether it is just and reasonable in all the circumstances to impose vicarious liability, having regard to all the circumstances, including in particular the degree of integration of the individual into the host’s business – but does not answer this question directly: *Catholic Child Welfare Society and others v Various Claimants and others* [2012] UKSC 56

<sup>171</sup> [2012] EWCA Civ 938; [2012] IRLR 846 (CA)

Court of Appeal (by a majority) concluded that vicarious liability could be applied to relationships outside the existing recognised categories where, "the relationship ... is so close in character to one of employer/employee that it is just and fair to hold the employer vicariously liable."<sup>172</sup> One, however, might take the view that, in the example used above, Law Firm Y is purely, and wholly, an independent contractor (such that vicarious liability would be impossible) and the relationship is wholly different to that of employer/employee.<sup>173</sup> Despite this, we could imagine situations in which the degree of control exercised by Law Firm X over Law Firm Y, and the degree of integration of Law Firm Y into Law Firm X's business (multiple 'best friend' referrals; secondments between the two firms etc), was such that imposing liability might be fair, just and reasonable. In the alternative, one might argue that Law Firm X had a non-delegable duty to Client A (to provide legal advice on the relevant matter in a situation where they could not contract out that advice) and, as such, would be liable for Law Firm Y's advice.<sup>174</sup> We accept that this discussion is largely academic, but it strikes us as interesting, important and worthy of further exploration when, as set out below, firms are commonly accepting the potential liability in contract for advice given to their clients by other advisers.

As noted above, we were asked by the SRA to ask our interviewees about the extent to which their clients sought indemnities from them. Indemnities offer the beneficiaries much wider recourse to large quanta of damages (i.e. more money). This is because, with an indemnity claim and unlike a standard breach of contract claim, there is no need on the claimant to show fault or negligence. Instead, it suffices to show that the 'trigger' for the indemnity has occurred. Equally, there may be an ability to recover all loss which causally flows from such trigger event, no matter how remote or indirect it may seem to have been. Finally, there is no requirement for the indemnified party to show that it has mitigated (sought to reduce or minimise) its loss, nor is it possible to argue contributory negligence of that indemnified party.

## OUR FINDINGS

In the following we outline our findings based on what interviewees told us about risk transfers. When speaking with COLPs and senior partners about risk transfers, we sought to establish their views on how client relationships might be giving rise to a transfer of risk; we discussed their views on their firms' abilities to identify, monitor and mitigate risks arising from client relationships; and we asked about the firms' willingness to accept risk and liability transfers sought by clients.

### ***The General Transfer of Risk***

Many of those that we spoke to talked about clients seeking generally to transfer risk on to their legal advisers. For example:

*"One of the terms that I really disliked and we wouldn't take, but it took about three months for the client to back down on it, was, "You are expected to raise any legal or commercial issues that are relevant even if they fall outside the ambit of our instructions". EH COLP 5*

We wonder whether this particular request may actually be a reflection of the common law, as discussed above, such that lawyers are obliged to warn their clients of risks of which they become aware, even where such falls outside the scope of the agreed retainer. Others told us:

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<sup>172</sup> Ibid, para 73

<sup>173</sup> *D & F Estates Ltd v Church Commissioners for England* [1989] AC 177

<sup>174</sup> *Woodland v Essex County Council* [2013] UKSC 66



*“It’s well known that lawyers have deep pockets through professional indemnity insurance. I think the profession has been absolutely disgracefully hopeless in not following the lead of other professional services firms, like the accountants, and managing limited liability.”* EH Finance 8

*“They do sometimes ask questions where you sort of get the impression that, well, are you just a cheaper form of insurance by them trying to get you to confirm things, which quite often are as much to do with commercial judgement as any particular legal point.”* EH Corporate 1

*“There are a number of clients who view us like an insurance policy which is something I hate. But sometimes they don’t care too much what you say as long as they get an opinion letter at the end, which they can stick on the file and sue you on if it doesn’t work out.”* EH Finance 10

*“You know very well that half the time people instruct you because they want your insurance policy to back them up.”* EH corporate 9

*“You get actually get large in-house legal teams that try and do the work for themselves, quite often they’ll prepare something and then they’ll just last minute send it to you to review it. And that is I think a clear attempt to try and transfer liability for a job that you haven’t done onto you and your insurers.”* EH Corporate 13

One finance partner took the view that large organisations, and particularly large financial institutions, are less concerned about transferring risk to their law firms, so much as transferring the risk away from themselves; perhaps a somewhat subtle distinction. A key point is that, to date, law firms have not experienced any significant resistance from their professional indemnity insurers on these points. Most interviewees said that they regularly checked their position with their insurers, and were confident they could get coverage for their exposures. It is this softness in the insurance market, driven by capacity, which is further fuelling the perception of the profession having deep pockets. That argument is encapsulated by the following corporate partner:

*“The market for us for insurance is still comparatively soft because there is lots of capacity. If you were to see a series of big, i.e. more than £100 million, claims come through against big law firms, I think the whole situation would change. You would find the market would harden really quickly and then it would be you either cap or you don’t get cover. So we are still operating in a relatively soft insurance market. But that could all change. It wouldn’t take more than a few really big claims to get at that.”* EH Corporate 2

### **How Client Relationships Transfer Risk**

Every one of the partners that we interviewed told us that the clients that they are working for are increasingly expecting their legal advisers to accept more risk, either through the use of more sophisticated outside counsel guidelines, panel arrangements or engagement terms. Some of these risk transfers are presented to law firms as non-negotiable, and most partners say that they cannot routinely push back on risk transfers being imposed on the profession, though around a quarter of the firms spoken to have successfully pushed back on risk transfers in some way.

Some of the terms that firms are being asked to sign up to significantly broaden the scope of their engagement with the effect of transferring risk. For example, one COLP reported refusal by a client

to sign the firm's standard engagement terms that set out that the firm was not advising on the tax and commercial implications of the transaction in question. The client insisted that tax advice be wrapped in to the engagement terms. Another COLP told us that large clients now expect his firm to check, as part of the background to ordinary service, whether the client is breaching sanctions by making payments: "That is something we are reluctant to do because, of course, this is taking on potentially substantial risk" [EH COLP 13]. A third COLP described some American corporations insisting that their law firms provide anti-corruption undertakings, and saying that firms will not get the work unless they undertake not to assist any individual in the organisation with the breaching of the company's procurement programme. Others talked about clients attempting to pass on some of their obligations with regard to anti-bribery or anti-money laundering on to the law firm.

### **Reliance Letters**

One specific issue with regard to risk transfers that was raised by around a quarter of the 20 law firms questioned, without our prompting, was the use of reliance letters. These are demanded by non-clients of the firm – typically lenders to a firm's borrower client – and require the firm to permit that non-client to rely on the advice given to its client, and accept liability for that advice. The use of reliance letters has grown in recent years because they are typically demanded by non-bank lenders, such as insurance companies and funds, who have increased in number and become more significant market participants since traditional bank lending reduced in the wake of the credit crisis.

Our interviewees tell us they are not comfortable signing such letters, but often have limited ability to say no because their borrower clients are under pressure to get their lawyers to do so. For example:

*"We actually had a situation about three weeks ago with a non-bank lender lending to our client, who presented to us two days before the facility was meant to be completed with a six-page reliance letter covering both things like money laundering and also the work we had done, and giving warranties as to whom we'd spoken, warranties about the advice we'd given, not in detail but on what subjects we'd provided advice. We just took one look at it and said we're not going to sign it. So they rang the client and said unless your lawyers sign this we're not going to give you the money. That's a true story. We went back to their lawyers and said, "Did you advise your clients to do that? Unless you assure us that you did not, and what's more that you've told them that they can't, we're going to report you", and we ended up signing a one-line letter. It's just outrageous the way these people behave, and it's getting worse and worse." EH COLP 1*

Some of the US lawyers interviewed pointed out that the practice of giving reliance letters to other parties on a transaction is far more widespread in the States and does not give cause for concern. In the UK, however, lawyers told us they were worried about their exposure as a result:

*"So, for example your client has asked you to do a piece of work and asked you for some advice, and wants one of their investors to be able to rely on it. So, they're trying to extend; they want to get more for their money. So, rather than telling investors, 'You've got to assess this yourself' they would like to rely on our advice. And of course we didn't do the work for their investors; we did the work for the client. It's chipping away and extending the scope of the work I think, which is one of the main concerns. And the type of loss which that investor may face may be very different from the type of loss that you had in mind when you were doing the work advising your own client." EH corporate 13*

There is the potential that where a non-client of the firm is to rely on an opinion or advice given by the firm, that non-client may also seek to influence the content of the opinion or advice (i.e. what is and is not covered). Here, there is a real risk that the firm may come to accept a duty of care to the non-client and for it, as a result, to then become a client of the firm.

### **Wrapping Liability**

One area where we were told that insurance companies have so far been willing to stand behind firms is in wrapping liability – that is, the practice of firms coordinating or giving advice with input from other law firms (or other advisers) and agreeing to accept liability for the advice or work of that other firm. Many of our interviewees told us that they are now regularly expected to wrap liability for the work of other firms. Only a very small minority reported pushing back routinely and successfully on that requirement, though around half said that they accepted such conditions rarely and “*tried to resist it*”. The following was a typical comment:

*“You can’t avoid there being an overseas law firm involved in many transactions, so if we’re advising on English law, and we don’t advise, or a part of our firm doesn’t advise, on the relevant foreign law, we have to go to somebody else. Unless the client instructs those people directly we tend to have to pick up liability. Touch wood, it hasn’t been a major problem, but it is at least a theoretical problem.”* EH Corporate 9

The COLP at one of the firms that would not accept liability wrapping said:

*“I don’t see why we should take responsibility for advice in jurisdictions where we know nothing about, you know, about the advice. So no, it would be very rare for us to do that.”*  
US COLP 3

Where the practice of wrapping liability was accepted, most firms were well aware of the risk transfer issues that arose as a result, and most reported speaking to their insurers to confirm their position. Typically the risk was mitigated through due diligence on the foreign law firm involved, with an English-qualified lawyer reviewing things produced by the foreign law firm before passing them to the client, and with the use of back-to-back engagement letters.

Only one firm gave an example of a bad experience where something had gone wrong with a third-party law firm that they had engaged on a deal on a client’s behalf. The client was a large financial institution using a panel of legal advisers. The law firm in question had not agreed to accept liability for the advice of the foreign law firm, but was nevertheless in the firing line when mistakes were made:

*“Interestingly when that firm did cock up - this organisation knocked on our door and said just to let you know this has all happened, we expect you to indemnify us. They were out of pocket by about 150 grand or thereabouts, and we said no. They came back and said ‘well look, as a relationship firm we need something,’ and we ended doing a one-off payment to them for 20 grand. It’s quite clear if we hadn’t of done that we wouldn’t have been on the panel. But it wasn’t our liability.”* EH Finance 5

## **Indemnities**

We asked interviewees in what circumstances their firm might agree to indemnify clients. In a small number of cases, we were told that indemnities were not something that clients were requesting, though for a majority of firms they were becoming commonplace, and a growing issue. Respondents told us that US financial institutions and public sector clients increasingly ask law firms for wide-ranging indemnities, while most panel terms would include indemnities in bespoke areas such as confidentiality and data protection.<sup>175</sup> In this regard, the vast majority of the lawyers that we spoke to reported pushing back quite hard when asked to sign, particularly wide-ranging, indemnities, but many firms were ultimately agreeing to them. As with wrapping liability, a small (and almost identical) minority of firms refused outright to sign indemnities.

An interesting question arose around the firms that reported never seeing, and never being asked to sign, indemnities. The majority of firms, who say such terms are now widespread in panel agreements, suggested that competitors who said they were not seeing them must be inadvertently agreeing to indemnity clauses without properly reviewing terms. There was a sense that indemnities were unfair:

*“So we can have given correct advice. But if the client suffers a loss, we’re still liable. It just seems so wrong.”* EH COLP 7

Another interviewee explained the range of topics being covered by indemnity clauses:

*“One of the other big trends that we’ve noticed is indemnities, and sometimes very wide-ranging indemnities. That’s relatively new. Essentially some of them are not unreasonable. Some of them are, ‘We expect you to indemnify us against any breach by you, the law firm, of anti-bribery or corruption rules and regulations’, or, ‘Your breach of someone else’s IP rights’ or something like that. Which is kind of a pointless thing to say to a law firm, but fine. But when they’re essentially seeking our indemnity in relation to our advice, and any loss whatsoever that might flow from that, essentially we’ve become their insurer.”*  
EH Conflicts Officer

The lawyers that we spoke to suggested that indemnity clauses may be another example of the types of terms being introduced by procurement departments, where legal services providers are being treated as akin to other suppliers of goods and services, and therefore being asked to sign similar clauses. We were told that insurers do not have a problem with law firms signing up to indemnities. Despite this, most firms are trying to resist them, with varying degrees of success:

*“One doesn’t like giving indemnities at all. And we try and argue it’s not necessary, because they’ve got the contractual requirement that we provide services to a proper and reasonable level. If we don’t, there’ll be a breach of contract, and if we have breached it, then they’ve got the PI cover to go against. So we don’t need a primary obligation of an indemnity to protect them. It doesn’t go down well with American banks particularly, and particularly XX. They accepted our points philosophically, but commercially XX said, ‘We are going to get indemnities from everybody.’ And so if we want the work, we give the indemnity.”* EH COLP 4

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<sup>175</sup> See, for example, the indemnities in the government’s Legal Services Framework Agreement: <http://ccs-agreements.cabinetoffice.gov.uk/contracts/rm919>

*“Something that I find much more objectionable is the indemnity provisions that [clients] insist on, sometimes on a non-negotiable basis. Sometimes we are able to negotiate amendments, but it’s just a pure shifting of risk. I find it just unacceptable that the indemnity provisions just appear to shift all risk, if you read them literally – and that’s what the contract says – it’s just shifting all risk on the project onto us. I can see from a client’s perspective why that’s a marvellous idea, because we’ve got deep pockets and a big insurance policy. But it doesn’t seem right.”* EH COLP 7

*“In previous firms I had a much stronger rule to say no, here we tend to think about it and quite often do it. I don’t like indemnities but that’s a really quite technical argument. I mean the reason why I don’t like them is that they can be broader than what you can be responsible for, or they can give you issues with your insurance, they can remove the duty to mitigate, all those sorts of things. But I view them more of an ‘also ran’ in the context of the issues.”* EH COLP 10

*“The examples that come to my mind are government contracts, where they tend to have a sort of general indemnity for anything that their service provider or their legal service provider might cause. I haven’t noticed it so much recently in private sector terms. But actually on the government side we have found, once where we’ve got into the position where we’ve got terms agreed, they’ll see sense on some of those terms and we’ll manage through using compliance as well to get some adjustments to things like that so they are not completely immovable.”* EH Corporate 5

Most of the partners that we spoke to were uncomfortable with their firm being pushed to give indemnities to clients, because of the related exposure, and routinely resisted with varying degrees of success. Several seemed relatively dismissive of indemnities as an issue, regarding them as routine, particularly in the context of confidentiality or data protection, and several others were surprisingly relaxed about signing them.

As a procedural point, most firms expect partners to refer decisions on the signing of indemnities up a chain of command within the business, typically going first to the COLP and/or risk team, and then often elevating acceptance of an indemnity up to a committee of partners tasked with taking such decisions. Still, as with other areas of outside counsel terms, most law firms admit there remains potential for individual partners to sign up to indemnities, either without realising they are doing so, or without involving other members of the firm in the decision-making process.

### ***Capping Liability***

All of the firms that we interviewed include limits on liability in their standard engagement terms. Equally all reported pushback on caps, most notably from financial institutions and government bodies. These purchasers of legal services typically refuse all caps on liability. We were told that other clients are more willing to accept caps and, as such, many firms still do a majority of their work on some sort of capped basis.

Most interviewees felt that the refusal by the banks to allow law firms and individual partners to impose caps on their liability, particularly on very large transactions, was unfair:

*“One of the things obviously is that sometimes we’re dealing with some pretty chunky transactions. So when you’re dealing with something, we closed one the other day which was £[X-hundred million]. So its big numbers and they’re significant enough numbers that if you*

*make a world-class whoopsie in your documents or whatever, it would have implications for the wider firm because the PI cover doesn't go that far."* EH Finance 1

*"The typical thing of banks is that they never want your cap on liability. And that is quite an aggressive position to take. But they demand it and they always get it. So on the scale of sort of risks that you might be exposed to as a law firm, which the SRA is keen to know about, that is quite a big risk. Obviously if you're talking about huge cases where the sort of headline figures may be billions, that is quite a major risk to absorb."* EH COLP 3

*"I think [not allowing] limits on liability are completely unfair. Those directors in banks we know were not putting any of their money at risk when they were behaving in an entirely reckless fashion. So why should my assets, my personal assets, be at risk? And not just in relation to limits on liability, but I think I find even more offensive, their lack of engagement in 'sue the firm, not the individual' type provisions that we would have in our limits. At times you can get them to see reason on stuff like that; but their general position is, 'We don't accept limits on liability, and this is a limit on liability'."* EH Finance 8

Some partners at law firms believe that caps on liability are a hard argument for law firms to run, given that it can be seen as an admission that mistakes may be made. But others draw the comparison with the accounting firms, where it is routinely accepted that the Big Four will be able to cap their liability on transactions<sup>176</sup>:

*"I wouldn't bother a UK clearer asking about caps on liability now, I just wouldn't bother, I probably haven't asked for the last three/four years. It's clearly ridiculous on a transaction to have no liability cap. They can't say it's that important because if it was they'd insist the accountancy firms do it."* EH Finance 5

The fact that large accounting firms are able to work with capped liability gives rise to debates about apportioning liability, because in an uncapped environment law firms and accounting firms would both pick up their fair shares of liability should anything go wrong on a deal where both could be blamed. But if accounting firms have been able to agree a cap on a transaction, and law firms have been unable to do so, clients have often insisted that law firms pick up all the responsibility, including the accounting firm's liability above and beyond the firm's cap, in a situation where both were liable. A number of firms told us they included proportionate liability clauses in their terms to counter such arguments, but that clients resisted them. One said:

*"We have a proportionate liability clause in our agreements. Now some clients resist that. And I actually get very tough with them about it. In fact I said to one client, 'I'll tell you what, you write me a memorandum explaining why that's fair, and if you succeed, I'll agree it.' And in the end they said, 'Alright,' and they'd accept it."* EH Corporate 14

A couple of law firms raised similar issues with regard to instructions that they accept from syndicates of banks, where one of the banks in the syndicate has a panel relationship with the firm and has refused a cap on liability. While the syndicate terms may allow for a cap on liability, that one bank with the broader relationship will continue to insist that it has a side arrangement whereby the law firm's liability is uncapped. Two partners, from the firms that raised the syndication issue with us, commented as follows:

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<sup>176</sup> The British Venture Capital Association (BVCA), for example, signed a memorandum of understanding in 1998 with the then Big Five accounting firms that allowed for them to cap liability on private equity deals, with £25 million the agreed cap on deals worth more than £55 million.

*“That creates difficulties, because if we’re advising the syndicate, do we have to tell them that there’s a sort of a side arrangements with one of the banks that actually, yeah, our liability to them is unlimited, because of the panel terms, notwithstanding the fact that the syndication agreement says that it is on a limited basis.” EH COLP 4*

A *“What we are trying to do is come to an arrangement with bank A unilaterally, to say that ‘We will limit our liability to all four of you on the face of the report. But for you, Bank 1, it’s a matter of a separate contracting arrangement between just you and us, and if there were to be a problem then we would treat you as uncapped.’*

Q *And the other three banks know about that?*

A *No.” EH Finance 3*

## **IDENTIFYING, MONITORING AND MITIGATING TRANSFERS OF RISK**

While our conversations demonstrate some evidence of a build-up of risk in the legal profession, particularly as a result of the financial services industry focusing attention on its own risk management and mitigation, we also found firms growing more sophisticated in their own methods of risk identification and management.

Lawyers tended to describe their firm’s ability to identify, monitor and mitigate risks arising from client relationships as good, or at least sufficient. That they would be so positive is perhaps unsurprising. Most rated their firm’s willingness to accept risk and liability transfers sought by clients as medium to low (although one might argue that our findings demonstrate otherwise), but noted that their ability to stand up to client demands was sometimes challenged by clients saying the firm would not get the work if it did not agree to certain terms.

Critically, all firms were able to demonstrate new and constantly evolving methods for identifying and mitigating risk transfers, usually through client acceptance processes that had been developed in recent years and were becoming increasingly sophisticated. Most firms were cognisant of room for improvement, and significant areas of risk remaining and arising from client pressure, with this partner’s response being typical:

*“I think there are specific areas where there are processes in place for doing that, for example reviewing terms and conditions. So, provided people follow those processes the risks there can be mitigated. But I think more generally, because of business pressures, there are some risks of powerful clients dictating terms to us. And I don’t think the firm is very good at managing that because that requires you to make long-term decisions, and the outcomes will affect some partners adversely and benefit others. And that is something that I think firms aren’t very good at managing. I think that requires quite a lot of senior management involvement, because you both need to make the decision but also mitigate the effects of that with the partners that have lost out. And as I say, I don’t think this firm is very good at doing that at all.” EH Corporate 13*

The mitigation of the risks set out in this chapter was most typically achieved through better processes for reviewing and monitoring client terms; for referring terms on liability caps, liability wrapping and indemnities to specifically-tasked people within the organisation; and for recording terms accepted in prior arrangements.

When considering more general transfers of risk, mitigation typically focuses on better scoping of law firm obligations (i.e. narrowing the scope of engagement), and resultant liabilities. This is an area where nearly all firms told us they were working hard to up their game:

*“You apply different limitations onto the scale and you look very carefully at what it is you want to expose yourself to from a liability perspective. This is a difficult one – it is a fine balance between clients feeling that their lawyers are trying to just sort of limit all their liability because at the end of the day we are paid very well to identify risk for them. But at the same time, if you are being asked to do something very quickly for which you are not being paid a great deal of money, you need to be very careful about describing what it is that you’ve done. I’ll give you a very simple example. A client might have an annual report or prospectus or some kind of public document that it is going to send out and it is fifty pages long. They ping it to you and they say, ‘I’ve just got a couple of specific questions in relation to that statement on page 13 and are we able to say what we are saying on page 25?’ Now, unless you are very clear that you have not read the rest of the document and that you are not advising on the rest of the document, there could be a risk that if there was something else in there that you had not read, they could come back afterwards and say, well come on, you’re a highly paid, sophisticated law firm, you ought to have read the whole thing, surely, and pointed out any risks to me? Notwithstanding the fact that is not what they specifically asked you to do when they sent it to you. And there are clients out there who will take advantage of that kind of event if it was to happen.”* EH Corporate 3

*“I’m thinking of one instance where, either in the engagement letter, or the partner concerned saw the issue arising and said “You know there is a big, big area here we’re not advising on it, we assume you’re getting help from insert name here, but you need to.” And that was one of 10,000 emails sent on the file, but was critical when push came to shove.”* EH Finance 2

*“If a client comes up to you and says ‘we’ve got this really complicated lease unwind and we want you to cap your fees to confirm whether we can or can’t at £3,000 or whatever,’ I’m afraid to say we have historically taken that sort of responsibility, which is crazy. So we’re more and more aware of the fact that if a client comes up to us and says they want to cap the fees, we’re very clear about the fine scope and very clear about limitation of liability.”* EH COLP 2

## **OUR CONCLUSIONS**

The picture painted by this chapter is relatively clear: we find an increase in risks accepted by firms, on an individual and systemic basis, with some (but not many) firms being robust in their push back against these practices. While this is interesting, it is perfectly possible to see these changes as simply an allocation, or reallocation, of power and risk between sophisticated parties – a matter of contract and negotiation (which in turn shapes the nature and extent of tortious obligations). As such, the developments in risk transfer of which we were made aware would be of no proper regulatory interest to the SRA (and might instead be better taken forward by the relevant representative bodies). However, we think there is an equally valid argument that sets out that these risk transfer practices operate to build up systemic risk in the legal profession,<sup>177</sup> which could, in due course, lead to significant liability, the risk of law firm collapse, and a resultant undermining of

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<sup>177</sup> There is, somewhat surprisingly, little literature on systemic risk in the legal profession. A number of commentators have looked at the role of law firms in relation to systemic risk in financial services sector, but not on systemic risk per se in the legal profession. This is, perhaps, worthy of further exploration.



the strength of the profession (in terms of brand and perception) on the international stage. Equally, one might frame these practices in the context of Principle 8 of the SRA Handbook and question the extent to which firms are engaging in sound and effective financial and risk management. It might be thought irresponsible for a firm to act on a matter which could give rise to liability greater than the firm could sustain, unless the firm also caps such liability at the amount of its insurance (or lower).<sup>178</sup>

Finally, we were struck, in our interviews, by the role of the insurance sector in these matters and the seeming willingness of those insurers to accept their insureds taking on a variety of forms of potential liability. We would suggest that this is worthy of further exploration.

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<sup>178</sup> We are aware that Bar associations in New South Wales and Western Australia encourage firms to participate in schemes which cap liability at AUS \$10m.

## CHAPTER 6 – THE (INITIAL) VIEW FROM IN-HOUSE LAWYERS AT FINANCIAL INSTITUTIONS

Having concluded our extensive interview process with private practice partners and COLPs, we felt it important to seek out an in-house perspective on the issues raised by our interviewees. As a result, with the support of the SRA, a meeting with five (in total) general counsel and other senior in-house lawyers was convened, all of whom worked at major financial institutions, to discuss our topics of independence, representation and risk on a non-attributable basis during a two-hour meeting at the start of May 2015. What follows is a summary of that conversation.

We conducted our research among private practice lawyers in a structured and comprehensive way (as set out in the Executive Summary and Appendix 2), so as to satisfy ourselves that those interviewed represented a good sample of opinion within the cohort of large law firms in which we were interested. This section on in-house lawyers is not intended in any way to offer up a comparable representation of in-house counsel views. Instead, we hoped to elicit a small sample of views on our key themes; to give general counsel room to respond to some of the issues raised by private practice lawyers; and to open a dialogue with a section of the in-house community that the SRA may wish to broaden and continue.

### OUR FINDINGS

As a general point, the general counsel and senior in-house lawyers were grateful to have been invited to participate in the process and were keen to put forward their views on the issues under discussion. It was noted that the number of lawyers now practising in house has increased, and that the SRA Handbook in its current form does not necessarily take that into consideration. We would agree. As presently framed, the Handbook sets out, at the end of each chapter, different outcomes that apply to the in-house community. However, the core Principles, and associated guidance, does not account for any differences between those employed in-house and those in private practice.<sup>179</sup> The significant shift in the number of in-house lawyers in the last decade (a doubling of numbers between 2002 and 2012) may well be sufficient justification for the current approach in the Handbook to be revisited. The vast majority of in-house solicitors (60%) work in the private sector and are most concentrated in the financial services sector.<sup>180</sup>

### *Engaging External Advisers*

All attendees at the roundtable worked at financial institutions, but not all used panels to manage relationships with external legal advisers. All accepted that the terms of engagement that they now expect law firms to sign up to on receipt of instructions have become lengthier, but they did not see that as an issue. Nor did they think it an issue that private practice lawyers felt there was little room to negotiate on the terms of business. One lawyer present said: “We have standard contract terms, have these master agreements; why should we deviate from that?”

Panels have been used to reduce costs and institutionalise relationships between financial institutions and their advisers: “We now have a panel, and we have maybe had it four years,” said

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<sup>179</sup> Slaughter and May have published an in-house lawyer guide to the SRA Handbook, which has the backing of the GC100. See: <http://slaughterandmay.com/media/1805055/sra-handbook-2011-in-house-lawyer-guide.pdf>

<sup>180</sup> Oxera, ‘The Role of In-House Solicitors’ (February 2014), 22. 32% of 1,037 in-house respondents to an online survey said they worked in financial services.

one attendee. “We have found we have generated significant savings. In the last five years we have been cutting costs, and rather than cutting people from our teams, where we can really generate more savings is on some of those relationships. Ten years ago the relationship was at desk level; now we institutionalise the relationships, and we have more pulling power through that.”

Alongside the pressure to cut costs, in-house lawyers told us their role is increasingly focused on managing risk for their employer, rather than executing transactions, and this has changed the relationship with external counsel. “The in-house world has moved into a very different direction over the last five or six years, which is more about risk management,” said one lawyer present. “The job of in-house lawyers is very different to what it was seven or eight years ago. Our job is risk management: legal, compliance, reputational and other risk management. The role of external counsel has changed too, and has to change, not necessarily as fast as we have. Through this institutionalisation of relationships, what we expect from external counsel, and why we can’t have hundreds of firms, is that we expect risk management from them too. They need to understand our risks and our appetite for risk – which, by the way, is moving – and be able to manage it.”

This focus on managing risk, reducing cost, and institutionalising relationships leads to the greater use of panels: “When you link this risk management with the savings we are all trying to achieve,” an attendee said, “Then we have to have very clear relationships with outside counsel, we have to give them processes, clear guidelines on our legal risk appetite, and every other type of risk, for the bank or the desk, at any point in time, and get some value for that. They haven’t changed their models and they should be. Law firms are stuck in the twentieth century.”

It was further explained that legal departments, at the five banks represented, now no longer sit within investment banking, but are instead part of the central corporate function, alongside IT, HR, Compliance and other non-fee generating teams. That changes the dynamic of engaging external law firms, and removes some of that power from general counsel: “Traditionally it’s been general counsel deciding what happens in relationships; now it’s more legal COOs [Chief Operating Officers] who, in terms of cost, make those decisions on fee arrangements etc,” said one attendee.

### ***Influencing Representation***

The representatives of financial institutions that were present felt strongly that their legal advisers should not be permitted to sue them on behalf of other clients, and their terms of engagement include no-litigation clauses. One said: “We don’t allow panel firms to sue us, they know that if they do it will have an effect. That’s why at the end of the day there are bank firms and then non-bank firms.”

Those present had very limited experience of being on the receiving end of lawsuits, and when those had occurred, they had ordinarily involved employment matters – handled by niche employment law firms. Some had seen litigation boutiques on the other side of non-employment lawsuits, but there was no consensus on the quality or availability of alternative advisers that could, should they wish to, sue banks on behalf of clients.

The in-house counsel did not make use of wider conflict clauses that suggest their advisers should not act against their commercial interests, arguing instead that it is useful to have advisers with experience of working for other players in the market. One said: “All those firms act on transactions on the other side, it’s helpful when they do so. Often they take very aggressive positions, and I don’t think we would take a view that they shouldn’t.” Another added: “One of the benefits of going to

outside counsel is that you get the market view, so you need them to be acting for buy-side firms as well as sell-side firms; it's helpful."

### ***Independence***

We asked in-house lawyers to define what they expected in terms of professional independence from their advisers, and they struggled to articulate their expectations. Separately, however, when discussing how non-panel firms might start to get work from the bank, one general counsel said: "We tell firms that if we see a firm acting for an issuer on a particular transaction across from us, and we like the work that you do, and you don't behave in a way that's going to upset us, then we are more likely to use you as our counsel next time around. We are very open with law firms trying to get into the tent, we say start off by not acting unreasonably when you're in a position against us." This line of argument, which went unchallenged by other roundtable participants, might require law firms seeking to win work by such means to consider whether they are acting in the best interests of their client in those circumstances. This possibility was not raised by our law firm interviewees.

With regard to the other matters raised by private practice lawyers in the context of independence, the in-house roundtable lawyers told us that they like to receive opinions in standard format, and they like to be able to discuss them. "It doesn't feel wrong to push it and make sure they have gone as far as they can," said one lawyer. The use of opinions committees at some law firms was raised as a mitigating factor employed to prevent lawyers giving opinions that the firm did not support.

As with private practice lawyers, we asked the in-house lawyers if there were any situations that they had come across where they had concerns about independence. Without prompting from us, the one issue that was raised was that of 'shadow clients' (our term) and third-party appointers. One said: "There are some situations that worry me on the independence side, for example in leveraged finance, where the sponsor says all the banks are going to use X, for example. We have all the bidding banks with different interests required to use a law firm, and I think there's a question of independence. You have sometimes got the option to appoint your own counsel, but usually that's either not possible from a cost perspective, or sometimes you are just discouraged from doing so in any event by the sponsor. I don't think that happens often, and I don't think it's a massive problem, but elements of the way the market works – where certain parties to transactions have a lot of power and tell the rest of the parties how it's going to work, including respective counsel – do cause concern."

The concept of the law firm acting as "structuring counsel", before the banks are brought in, was raised, and the way in which the decision was taken subsequently on who the firm would act for, whether borrower-side or lender, should be "monitored pretty carefully", we were told.

### ***Risk Transfers***

Finally, we asked the roundtable attendees about risk transfers, and particularly the issues of wrapping liability, indemnities, and liability caps. Those present did occasionally, but not always, ask their law firms to accept liability for the advice of third-party law firms on transactions. They did not use indemnities in their standard terms (or were not aware of them if they did).

They all felt strongly that law firms should not be able to cap their liability, and further pushed back hard on firms trying to introduce liability caps under the radar, for example by sending engagement

letters midway through deals that included caps on liability.<sup>181</sup> The consensus view was best summarised by this comment: “Why shouldn’t lawyers stand behind their advice? We can’t cap our liability, so we turn and say, ‘Why should they?’”

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<sup>181</sup> We believe that, in the US, practice varies between States as to whether law firms are permitted to cap their liability. This document provides a short overview:  
<http://apps.americanbar.org/buslaw/newsletter/0065/materials/pp8.pdf>

## APPENDIX 1 – THE TOPIC GUIDE

The below interview topic guide sets out the wide range of matters of interest to the SRA as a series of questions and prompts. Not all issues were discussed in all interviews and, as is common in interviews of this nature, new issues not considered below which were raised by our interviewees were then rolled forward to future interviews. We have put asterisks at the end of the questions that the SRA asked us to prioritise.

### A. BACKGROUND & INTRODUCTIONS

### B. YOU AND YOUR FIRM

- What is your main practice area?
- How long have you been in practice?
- How long have you practised at the firm?
- Are panel relationships with clients significant to your practice, or firm?
- Which of the following best describes your firm - "English heritage", "US heritage", "English/US heritage"

### C. CLIENT RELATIONSHIPS

- What sorts of requests do clients make of you that may impact your professional obligations? What professional obligations are affected? \*\*\*
  - o What about your duties not to allow your independence to be compromised; to treat all clients fairly; to act with integrity; to uphold the rule of law?
- How have client requests and their impact on professional obligations changed over your time in practice? What factors do you think have influenced this change? \*\*\*
  - o International competition; emphasis on client service; greater use of panels; use of client procurement functions to engage external lawyers; growth of in house legal departments; client pressure to reduce legal costs; firm pressure to maximise billings; growth of merit based partner compensation systems; other?
- Do particular types of client make particularly challenging requests? \*\*\*
  - o Banks; PE houses; corporate clients in particular sectors; US clients; Other?
- Where your firm has a panel relationship with a client is it easier or harder to manage risks arising from that client relationship? \*\*\*
- Where your firm manages a client relationship through a client relationship partner (or team) is it easier or harder to manage risks arising from that client relationship? \*\*\*
  - o Do you think your client relationship partners are effective at mitigating the risk that incentives to preserve and develop the client relationship adversely impact professional obligations? Is this risk monitored by the firm?
  - o How often do clients or client relationship partners say “this is a relationship issue”? How do you or your colleagues respond when client relationships impact professional obligations?

o Do you ever act "opposite" panel or other clients? How does this affect your independence or approach?

- Have you ever felt uncomfortable about the closeness of the relationship between a competitor firm or a peer and their client? Why? \*\*\*

o If possible, please provide examples.

- Have you ever felt uncomfortable about the closeness of the relationship between your firm or colleague and a client of your firm? Why? \*\*\*

o If possible, please provide examples.

#### D. **PRESERVING PROFESSIONALISM**

- What does "professional independence" mean to you?

o Do you - and do you think your clients - expect lawyers to have "independence of mind" and "in appearance" including from their clients?

o Has this changed during your time in practice? How?

- Have you ever witnessed a non lawyer or lawyer employed by a client putting pressure on his/her in house or external lawyers?

o To take a course of action you thought conflicted with professional obligations? To take legal or other risk you thought imprudent? Please expand

- Have you ever been in a situation where you thought the individual instructing you was not acting in the best interests of the client, or unethically?

o What did you do?

o Did you escalate it to another person higher up in the client's organisation? If so, how was that received?

- How does your firm support its lawyers when professional duties require them to act against a client's or the firm's interests, e.g. to turn work away or cease to act? \*\*\*

o Has this ever happened to you or a colleague?

- Do you think your firm has effective systems and controls in place to identify and mitigate risks arising from client pressure on fee earners at all levels across the firm? \*\*\*

o What are these systems and controls?

- Do you think that the SRA is effective at regulating professionalism and ensuring lawyers at large law firms retain their professional independence from their clients and their firms?

- Do you think that the SRA is effective at regulating professionalism and ensuring in house lawyers retain their professional independence from their employers?

o How could the SRA be more effective in these regards?

o Have you ever considered reporting misconduct to the SRA? If you decided not to report it, why?

- In what circumstances do you think a lawyer should "whistle-blow" either "up" or "out" of his or her organisation?

- o To avert serious harm to a client's shareholders, for example?

- If you encounter malfeasance or misconduct by a client how do you ensure the appropriate person in the client organisation is made aware - especially where you are concerned that the person instructing you may not be acting properly?

- If your duties to your client come into conflict with other professional duties which takes precedence?

- o Under the SRA's 2011 Code of Conduct the principle that best serves the public interest in the particular circumstances takes precedence. Do you agree with this principle?

- o Do you think your clients are familiar with and would agree with this principle?

#### **E. RISKS ARISING UNDER OUTSIDE COUNSEL GUIDELINES ("OCGs") /TERMS OF ENGAGEMENT MANDATED BY CLIENTS**

- Have clients ever asked you to agree their OCGs or Relationship Agreements or other terms of engagement (each "Client Terms") without (or with limited) negotiation? \*\*\*

- o If so, how often does this happen and with what types of client?

- o What terms cause you anxiety?

- Do you have a process for vetting/approving Client Terms or do individual partners have the discretion to agree them? \*\*\*

- o Are you aware of partners trying to circumvent these processes when trying to "win" work?

- o Do you periodically review and compare Client Terms across the firm?

- Can you give examples of particularly problematic provisions in Client Terms? \*\*\*

- o Do Clients Terms transfer risk or liability to your firm?

- Do you ever contact your insurers about provisions in Client Terms? If so, how often? What do they say when you contact them?

- o Have you ever discovered that Client Terms exposed the firm to potential liability of which you were unaware?

- Do Client Terms impact duties to other clients? \*\*\*

- o Do clients ask you to take secondees for example? How do you protect the confidential information of your other clients when you take in client secondees?

- o Do clients ask to audit your IT systems? Do you allow it? How do you protect the confidential information of other clients?

- o Do clients ask you to complete security questionnaires? Who completes them? Would some of those questions, if answered, compromise security?



- Do you think that clients make tougher demands of firms when it comes to conflicts of interest than are demanded by professional rules and the law?
- When a client or potential client seeks to bar your firm from taking any adversarial position against it, or from acting for its competitors, how do you respond to these "client controls"? \*\*\*
- Are you aware of any situation in which an SME, financial market counterparty, or individual in a regulatory investigation has been unable to secure legal representation with sufficient standing or resources as a consequence of these "client controls"? \*\*\*

#### F. MITIGATING LIABILITY

- Where your firm is coordinating or giving advice with input from another law firm do you ever agree to accept liability for the advice or work of that firm? \*\*\*
  - o If so, how do you mitigate the risk of potential liability?
- In what circumstances does your firm agree to indemnify clients? \*\*\*
  - o Which types of client request indemnities?
  - o In what context/types of work?
  - o Would your firm agree to indemnify a client in respect of negligence?
- If your firm were instructed to review a large volume of documents, and the client asked for the review to be limited because of cost or time constraints, what would you do?
  - o Would you seek to cap the firm's liability?
  - o Where you are not able to cap liability how do you mitigate the risk of potential liability?
- How would you rate your firm's ability to identify, monitor and mitigate risks arising from client relationships - good, sufficient, poor? \*\*\*
  - o Why?
  - o How do you think this compares with your competitors?
- How would you rate your firm's willingness to accept risk and liability transfers sought by clients - high, medium, low? \*\*\*
  - o Why?
  - o How do you think this compares with your competitors?
- How often do you need to contact your insurers about indemnities sought by clients or other client risk transfer mechanisms? What do they say when you do contact them?
- How do you think clients' and firms' attitudes to risk and liability transfer have changed during your time in practice? Does this cause you concern? \*\*\*

#### G. SUMMING UP

- Are there any other comments that you would like to make? Are there other questions you think we should be asking?

## APPENDIX 2 – METHODOLOGY

The interest of the SRA, because of the concerns shared with it, lies for this project in large law firms conducting significant non-reserved legal services through their corporate and finance practices. To be clear, this is not to say that the SRA is not also interested in professional standards in other areas of the legal services sector.

Our starting point for this project was the cohort constituting the 196 firms that the SRA then categorised as ‘High Impact’ firms.<sup>182</sup> Under the SRA’s risk scoring methodology, ‘High Impact’ firms present the greatest ‘impact’ risk because they are the most significant legal services businesses regulated by the SRA. Whether a firm is ranked as ‘High Impact’, and where it appears in the SRA’s ranking changes from time to time and depends on various factors: the firm’s gross fees from regulated activities undertaken from offices in England & Wales (“turnover”); and the number of SRA-regulated professionals working at the firm being the most significant.

At the time the project was initiated, the SRA’s ‘High Impact’ cohort comprised a wide variety of firms and ABSs. Some of these firms conduct little or no international corporate or finance work (for example, large personal injury practices). To narrow the cohort, we took data from *Chambers & Partners*, a directory of leading law firms, to identify firms from the initial list of 196 ‘High Impact’ practices that are regarded as leaders in the field of either corporate and/or finance work.

Our use of *Chambers & Partners* led to a population of 40 English or English heritage firms (‘EH’ firms) and 22 US/US heritage firms (‘US’ firms). Some of the US firms did not appear in the SRA’s ‘High Impact’ list, but were ranked highly for corporate and/or finance work by *Chambers & Partners*. As one of the SRA’s research interests was the potential difference between UK and US firms, these US firms were added in to our population and form part of the total of 20 firms interviewed.

Each list, of 40 EH firms and 22 US firms, was put into alphabetical order. We then used a random sequence generator to create two random sequences: one sequence for the numbers 1-40; and the second sequence for the numbers 1-22. We then approached the first 15 EH firms from the first random sequence (i.e. if ‘17’ was the first random number in the first random sequence, we contacted the firm at number 17 on our EH list, and then moved on to the second random number in the sequence). Where a firm declined to participate in the research, we moved down the random sequence until we had reached 15 participant UK firms. The same approach was taken to derive a sample of five US firms. In total, we approached 37 firms with a request to participate; of which 17 failed to reply or declined to participate (for a variety of reasons). This is a high response rate and reflects, we would suggest, the importance firms placed on the subjects under discussion.<sup>183</sup> Ethical approval for the project was given by the University of Birmingham.

We worked with the SRA and several members of the ERG to design an interview questionnaire that set out the topics of interest to the regulator. This is attached as Appendix 1 to this report. The questionnaire is broad and deep: after an initial set of interviews, it became clear that we would not be able to cover all the questions in all of the interviews. Given this, we asked the SRA to highlight to us those questions of most importance. We then took forward those prioritised questions – and set out our data on them in this report – and additionally raised with our interviewees as many of the

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<sup>182</sup> The initial cohort comprised 203 High Impact firms but some of these firms closed between the start and finish of this research project.

<sup>183</sup> In the social sciences, a response rate about 50% is considered very good indeed. See: Yehuda Baruch and Brooks C. Holtom, ‘Survey response rate levels and trends in organizational research’ (2008) *Human Relations* 1139

other matters as was possible in the time. We were also keen to give interviewees the time and space to raise any concerns of their own not raised via the topic guide. We then took those new issues forward with other interviewees.

In total, 53 interviews were conducted. Of these, 11 interviews were conducted by Claire and Steven together; a further seven by Steven; and the remaining 35 by Claire. The longest lasted 63 minutes and the shortest 36 minutes. The vast majority were between 45 and 55 minutes long. In terms of interviewees, we talked to:

- EH COLPS = 13
- EH Conflicts Officer = 1
- US COLPS = 5
- EH Corporate Partners = 15
- US Corporate Partners = 2
- EH Finance Partners = 12
- US Finance Partners = 4
- US Litigation Partner = 1

The interviews were anonymous. The SRA did not, and does not, know which law firms we contacted and/or which partners, COLPs and others participated. This report uses identifiers ('EH Corporate 6', for example) when we quote from the interviews, which were professionally transcribed and then redacted, to give the reader a sense of the breadth of comments we received.<sup>184</sup> We had, in total, almost 1,000 pages of transcribed data. The transcriptions are held on a password-protected network drive at the University of Birmingham that is only accessible on campus. The original audio files have now been destroyed.

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<sup>184</sup> We have conducted some very light editing of some of the quotes to make them more readable and/or to remove certain sympathetic circularities and/or to avoid interviewees being potentially identified.