

# 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

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

were anonymous. The SRA did not, and does not, know which law firms we contacted and/or which 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 matters between firms with (on the face of it) equally well-qualified and equally well-educated

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

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

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 interests of, other clients of a firm. For example, there could be an asymmetry of

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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.

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”.

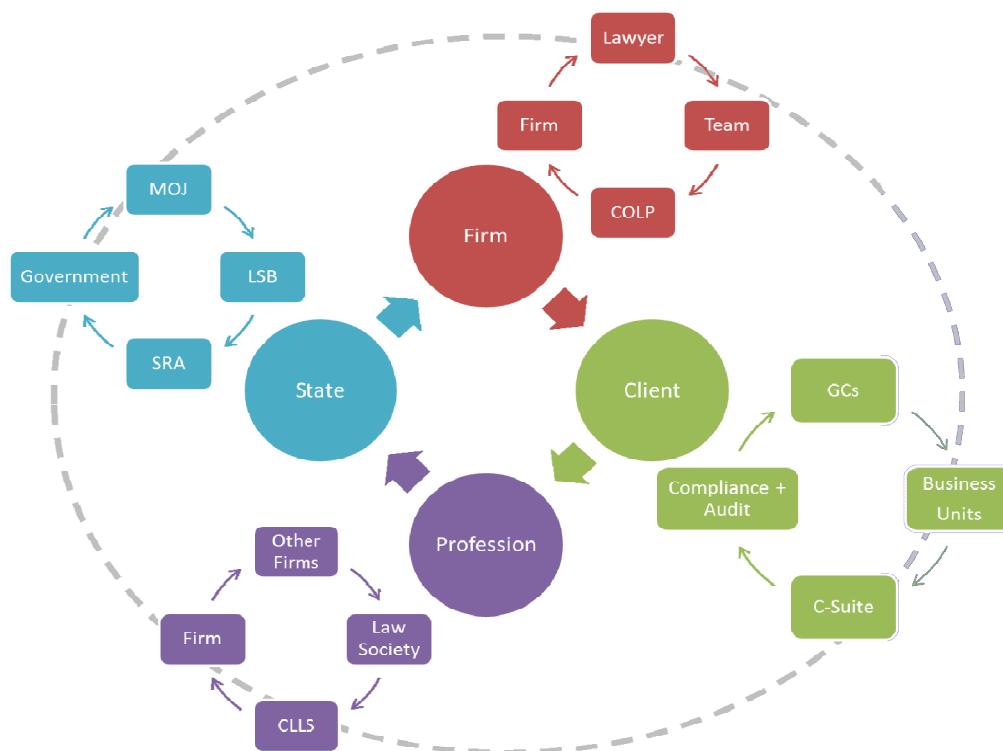
<sup>9</sup> Joan Loughrey, ‘Large Law Firms, Sophisticated Clients, and the Regulation of Conflicts of Interest in England and Wales’, (2011) 14(2) *Legal Ethics* 215, 230; SRA Code of Conduct, Chapter 3

<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>**



**Key:**

- C-Suite: Board/Senior Executives/Chief Executive Suite'
- CLLS: City of London Law Society
- COLP: Compliance Officer for Legal Practice
- GCs: General Counsel
- LSB: Legal Services Board
- MOJ: Ministry of Justice
- SRA: Solicitors Regulation Authority

<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, “sound financial and risk management principles.” It might be thought irresponsible for a firm to act

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

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>

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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>

(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.