# Consultation feedback on proposals to amend Rule 3 (conflicts of interest) and Rule 4 (duties of confidentiality and disclosure)

# Introduction

This paper provides feedback on the results of the SRA's consultation paper dealing with proposals put forward by the City of London Law Society (CLLS) to amend rule 3 (conflicts of interest) and rule 4 (duties of confidentiality and disclosure). The consultation was published on the SRA's website in December 2008 and the consultation period closed on 31 March 2009. We received 38 responses. We would like to thank all those who took the trouble to respond, many providing detailed information on how they saw the proposals applying to their businesses and the associated benefits and risks. Others provided helpful information on how conflicts are regulated in other jurisdictions. Because some respondents requested that their details be kept confidential a full list of respondents is not being published.

# A breakdown of the responses

We received 38 responses which break down as follows:

- Solicitors' firms - 18
- In-house legal departments – 1
- Legal Services Ombudsman
- Representative groups:
    - The Law Society
    - City of London Law Society (CLLS)
    - Association of Personal Injury Lawyers (APIL)
    - Sole Practitioner's Group
    - Bristol Risk Managers' Group
    - Delegation des Barreaux de France
- Local law societies – 2
- Other individual lawyers, including overseas - 10

The majority of the respondents were large city and international firms providing significant support for the proposals in relation to both rules 3 and 4. There were, however, dissenting voices even amongst the city respondents. Disappointingly, only one large in-house legal department responded. Outside the City, two local law societies responded, both relatively small, but both supporting the proposals.

The risks identified by both those that supported the proposals and those that did not were similar, with those in support believing that the benefits outweighed the risks and that the risks could be managed. The dissenters took the reverse view. Sometimes it was a little unclear as to whether respondents were actually opposing the proposals because they seemed to indicate that with very clear guidelines they could perhaps be beneficial and the risks successfully managed. Some also made

the point that without seeing a draft rule and any proposed supporting guidance it was difficult to reach a firm view.

Because the proposals in relation to rules 3 and 4 were dealt with separately in the consultation they will be treated separately in this document.

## Rule 3

### The proposal

The proposal would allow firms to act for sophisticated clients in any situation, excluding litigation, where there is conflict between them, provided the clients give informed consent.

### An analysis of the responses to this proposal

#### The benefits identified

Twenty four of the thirty-eight respondents thought the benefits outweighed the risks. The CLLS said the benefits will "give greater freedom to sophisticated clients to make informed decisions about how and on what terms they obtain legal advice, it will reduce costs, it will enable transactions to be completed more quickly and it will make England and Wales more competitive". Other respondents echoed this and have added that clients should not be unnecessarily prevented from instructing a firm that knows their business, particularly in specialised business sectors where the choice of solicitors with the appropriate level of expertise is limited.

The Law Society commented that "a potential client should not be deprived of his or her choice without good cause" and that "if the clients' freedom to instruct the firm of their choice and the benefits this brings, outweighs the risk which arises from the same firm acting for multiple parties, then it would be disproportionate to prevent it". Network Rail's in-house legal advisers, the only in-house legal department to respond, whilst conceding the potential benefits, also added: "The proposal also allows a firm to earn two (or more) sets of fees for one transaction. It is difficult to see how this is a benefit for anyone other than the firm and its partners".

Other respondents, in talking about the benefits, also outlined the type of transaction where they see the ability to act for multiple clients being particularly beneficial. These included project work involving multiple clients, asset finance and derivatives and structured products.

#### The Risks

The main risks which have been identified are these:

- A failure to protect confidential information through the breach of an information barrier. Most respondents identify this as one of the key risks, including the CLLS. Network Rail say the risk goes beyond just the risk of confidential information leaking to more subtle nuances of behaviour which give clues within an office as to, for example, what work on a project another team are prioritising or not.

- The clients do not receive wholly independent or impartial advice and the core duties are, therefore, put at risk. There are also a series of subsets of this concern. These include:
    - insufficient large departments or teams to ensure both/all clients receive truly independent advice;
    - internal firm dynamics leading to pressure being placed on compliance teams;
    - subtle favouring of the dominant client;
    - the embarrassment for internal teams of negotiating with each other ;
    - the natural inhibitions of one team in complaining about the conduct of another team in the same office;
    - the possible economic pressures on firms to maintain the client relationship with each of the clients involved in a matter;
    - conflicts between the firm's commercial interests and the interests of its clients;
    - "The inherent conflict between the proposed (amendment) and …rule 1, particularly with regard to independence and the best interests of each client" (comments of a member firm of the CLLS); and
    - loss of client confidence/ failure of public confidence through the failure of a high profile transaction.
- The difficulty in policing the arrangements for the regulator and this includes the difficulty of going behind any pro-forma check list which might be added as a condition to the proposed relaxation to check whether, for example, informed consent is, in fact, transparent and informed.
- Client choice could ultimately be reduced by specialised work being retained within a small circle of firms.
- The difficulty of defining "sophisticated client".
- Widely differing interpretations and/or a risk of liberal interpretations of the proposed amendment.

**Can these risks be managed?**

Two large City firms believe that the risks are too great, mainly because they believe that the ability of a firm to discharge its core duties of independence and acting in the best interests of each client will inevitably be put under too much strain and, as a result, compromised where teams are negotiating with each other. Another City firm makes the point that the current exception to rule 3 which allows firms to act for competing bidders works satisfactorily because the teams acting on behalf of the

different clients are not negotiating with each other but with a third party. It goes on to say that "any circumstance in which substantive negotiation needs to be done between parties who are in a directly "adversarial" (which does not mean confrontational) relationship…must mean that any law firm representing both of them must have difficulty in discharging its duty of undivided loyalty". Other respondents expressed similar views. Network Rail's lawyers have concerns about the use of information barriers and the more subtle ways in which information can be deduced from the way people within a firm behave.

The vast majority of City firms do, however, believe they can be managed. The thrust of what many of them are saying is that the big firms with their own risk and compliance departments already make, and can be trusted to make, proper independent decisions about when they can act in situations of conflict or potential conflict for the benefit of the clients. Furthermore, it would be totally contrary to the interests of the firms to act where this was not the case for reputational reasons and because of the loss of client trust.

## Rule 4

### The proposal

The proposal would allow firms ***to accept*** instructions using information barriers where the duty of confidentiality might be put at risk where the interests of two or more clients are adverse. At present firms can only act in this situation to complete instructions after the adversity has become apparent.

### An analysis of the responses to this proposal

In relation to this proposal, 24 of the 38 respondents favoured the proposal and 4 were against. Some respondents did not comment at all on rule 4, focusing entirely on rule 3. Generally, the risks were considered lower. There was also a level of acceptance that the change would align the rule with the law concerning the use of information barriers.

Network Rail's legal team was one of the few that did not favour the change. Their view was that a firm should be required to obtain the consent of the old client. They commented:

> "We consider that the best protection for clients is to require that where the firm no longer act for the old client that there has been a period of time between ceasing to act for the old client and starting to act for the new one."

One of the City firms made some specific comments which captured the views of most of those that supported the change. These were:

> "We think it illogical to distinguish between existing and new clients as the existing rules do. Even if, as the SRA's paper suggests, it may be more inconvenient for an existing client to have to instruct fresh solicitors than for a new client to be unable to instruct the solicitor of its choice, that is not a reason by itself to require consent in the latter but not the former case. To require consent in either case there needs first to be a significant problem for which the requirement of consent is an appropriate solution. We are not aware of such a problem and nor is one envisaged under the general law, which does not make a distinction between existing and new clients. As,

indicated in our answer to question 1 above, we think it wrong in principle for professional conduct rules to be more restrictive than the general law in the absence of some compelling reason.

In our experience, clients can be unfairly disadvantaged by the current requirement for consent under the rules. In particular, it is often not possible to seek consent on grounds of confidentiality. Moreover, where it is possible to seek consent, we are aware of examples of such consent being withheld for tactical reasons rather than ones based on genuine conflict concerns. Indeed the rule in its current form can be said to encourage the tactical imparting by a client of confidential information in order to prevent its solicitor subsequently accepting instructions from another client."

## The SRA's conclusions on the outcome of the consultation

The SRA has considered the benefits and risks revealed by the responses to the consultation against the new regulatory framework set out in the Legal Services Act 2007. In particular, the proposals have been considered in the light of the regulatory objectives and professional principles set out in section 1. The Smedley report, and its proposals for reform of the way the legal market for sophisticated clients is regulated, has also been taken into account.

Overall, the SRA has concluded that the risks can be properly managed through rules and guidance and that it is appropriate to proceed with the proposals. The SRA, therefore, will prepare draft rules and guidance and publish these for consultation in the autumn.