

**Open Report on behalf of Andrew Crookham, Executive Director - Resources**

Report to:	<b>Executive</b>
Date:	<b>08 May 2019</b>
Subject:	<b>Formation of a Company for Legal Services</b>
Decision Reference:	<b>I017879</b>
Key decision?	<b>No</b>

**Summary:**

This Report sets out the rationale and seeks approval for the creation of a company with a view to the company being licenced by the Solicitor's Regulation Authority (SRA) as an alternative business structure.

**Recommendation(s):**

That the Executive:-

- (1) approves the establishment of a company wholly owned by the County Council with the object of the company being licensed by the Solicitors Regulation Authority for the purpose of providing legal advice and services; and
- (2) delegates to the Executive Director – Resources, in consultation with the Executive Councillor for Community Safety and People Management, authority to determine and approve the final form and constitution of the company and the terms of any accompanying legal documentation including the provision of financial support to the company and the nomination of any directors of the company.

**Alternatives Considered:**

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| 1. | <p>Not to establish a company with a view to it being licensed by the SRA as an alternative business structure.</p> <p>Regulatory issues will limit Legal Services Lincolnshire's (LSL) ability to fully meet the legal needs of its partners as they arrange for the exercise of their functions through new structures such as companies. The ability of LSL to attract external income and thereby contribute to the budget positions of its partner councils will be constrained by the same regulatory considerations.</p> |
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**Reasons for Recommendation:**

The proposal will allow LSL to continue to provide services to its partner Councils when they deliver services through new structures such as companies without risk of it acting contrary to the requirements of the Solicitors Regulation Authority as our professional regulator.

The proposal would also allow LSL to provide services more widely in the future as opportunity arises and capacity allows.

**1. Background****Introduction**

- 1 Legal Services Lincolnshire (LSL) is a shared service between the County Council, Boston Borough Council, East Lindsey District Council, North Kesteven District Council, South Holland District Council and West Lindsey District Council. It was created in 2008 and has been operating on a trading basis since 2010. The service is hosted by the County Council and all staff within the service are employees of the County Council.
- 2 The vast majority of LSL's work is carried out for the County Council and District Partners although some work worth approximately £150,000 is carried out for other external public bodies. Any surplus achieved over and above the costs of the service is distributed back to the partners. There may be opportunities to pursue other external work in future.
- 3 Solicitors are regulated by the Solicitors Regulation Authority and that regulation can impact at two levels. At the level of the individual all solicitors are required to comply with professional codes of conduct. In addition an entity which provides legal services to the public or a section of the public is required to be authorised by the SRA and is regulated by the SRA as an entity.
- 4 As partner councils explore different ways of delivering services, especially through companies, LSL must have regard to the regulatory framework governing it and its solicitors. Guidance issued by the SRA concerning when an in-house team may be required to be licensed as an entity suggests there may be limits to LSL's ability to continue providing services to our partners when they act through other entities such as companies.
- 5 LSL has identified that the creation of an alternative business structure (ABS) would overcome these regulatory concerns and allow LSL to follow its partners work regardless of how they choose to deliver it and to pursue other external work as it arises within a robust regulatory framework. This report explains the background and drivers, briefly identifies and analyses the options, describes how an ABS might work and seeks approval for establishing a company as the first step to progressing an application for a licence to operate as an ABS.

- 6 Partner Councils have indicated their support for the proposals in this Report.

### Drivers

- 7 An ABS is a solicitor's firm generally organised as a limited company licensed by the SRA to provide legal services to the public where the owners of the business include individuals or entities that are not themselves qualified solicitors.
- 8 Under this regime a local authority can own an ABS and there are examples from around the country of local authorities who have pursued this model including Hertfordshire, Warwickshire and Kent County Councils. There have tended to be two drivers for these developments – either to trade commercially to generate income and profit or to manage regulatory risks and enable the Council's in-house teams to continue to provide services to their existing customers as those customers find new ways of delivering their services. There is no inconsistency between these drivers and an entity established to manage regulatory risk can, once created, be used to widen trading activity.
- 9 In the case of LSL both of these drivers are at work. As described above our partner Councils are looking to deliver their services in innovative ways and this is already impacting on our ability to carry out work on their behalf. Equally LSL has traditionally done work for other public bodies as opportunity has arisen and would want to be in a position to continue to do so where that was prudent and sustainable without impacting on the services provided to the partner councils. An ABS would allow LSL to provide its services to a wider range of clients which may enable it to increase the income it achieves to support the budget positions of the partner councils.

### Options

- 10 An options appraisal has been carried out in terms of different ways of setting up an ABS model. The options that have been considered together with brief discussion of their pros and cons, are:-

- a) *No change. Retain solely a local authority shared services partnership structured as an in-house trading unit of Lincolnshire County Council.*

This does not manage the regulatory risk of acting for other entities. This could lead to LSL losing the ability to provide partners with support as they potentially move core work into new ways of working. This would impact on the income capable of being attracted to LCC.

- b) *Create an ABS alongside the in-house trading unit to act for non-partner clients. Staff would be made available to the ABS where*

*necessary to work for clients who can only be provided with services through the ABS.*

This would provide a solution to the regulatory risks of acting for other partner-created entities and enable LSL to manage the wider regulatory risks around existing partners pursuing their activities through new structures and ways of working. This would secure existing income and potentially enable the attraction of additional income from partners. The solution is also scalable, forming a basis on which the Council could pursue wider trading activity where appropriate.

- c) *Create an ABS instead of an existing in-house trading unit as a non-Teckal trading company owned by the Council. All services including those to existing Partners would be delivered through the ABS and all staff would transfer into the ABS and be employed by it. Partner entitlement to surplus shares would need to be secured through the constitution of the company – probably through dividends on shareholdings.*

This would potentially enable an entirely separate legal entity to operate outside local authority pay structures as a means of addressing recruitment and retention difficulties. It would, however, be a significant undertaking, would probably increase costs to the County Council and partners and create procurement issues for the County Council and partners in purchasing legal services from the company. The access of the County Council to legal advice would be dependent on contract rather than direct control and the specialist public sector focus of the service may be lost over time as the ABS responds to commercial pressures and opportunities.

- d) *Create an ABS instead of an existing in-house trading unit as a Teckal trading company owned by the Partners.*

This model and is the same as Option c) except the Partners would exert sufficient control over the company for it to qualify for the Teckal procurement exception so the Partners' own work could be awarded to it without competition. Only 20% of the turnover of the company could be traded activity so the loss of public sector focus referred to in c) above would be minimised. However the capacity of the ABS to respond to opportunities to provide services to third parties would be limited. In order to take advantage of the Teckal exemption all Partners would need to be owners which would increase the complexity of establishing and running the ABS (see below).

- e) *Partner with an existing local authority ABS. Under this option LSL could become a local branch of a wider local authority ABS with ambitions outside its immediate area.*

This would require a period of negotiation and alignment of objectives and appetite for risk which is likely to take time and may not be successful. Such an entity is likely to be one that is driven by commercial, trading objectives with the potential loss of focus referred to in c) above. To deal with the regulatory risk some form of formal shared service arrangement would be necessary or LCC would need to take a share of ownership in the ABS.

11 On the basis of a consideration of these options it is recommended that the Council pursue the establishment of an ABS on the model of option b) above for the following reasons:-

- The priority should be to secure in-house capacity for the County Council and existing Partners rather than to pursue external income for its own sake.
- The model needs to ensure regulatory problems do not prevent LSL providing services expected by the Partners both to them and any new entities they establish.
- The attraction of external income is welcome insofar as it is consistent with the sustainability of the service.
- There are concerns about the capacity of the existing service to accommodate additional external work and about its ability to attract the additional capacity that would be needed to enable trading on any scale.
- While a trading ABS might be able to offer higher pay, such additional costs will either have to be passed on to the Partners in higher rates or covered by new external work. There is no evidence of a widespread market from which those additional costs could be covered by new work.
- Disruption to existing services and the resources required to give effect to any proposal should be minimised. A full trading model would require most resource and be most disruptive.

### **Establishing a Future Model**

12 The precise nature of the model to be established will be subject to detailed discussion with the SRA who will need to be satisfied that any model meets its regulatory requirements before it will licence the entity to provide legal services.

13 The SRA approval process for licensing an ABS is rigorous and wide ranging. In particular the SRA will need to approve:-

- Each owner of the company (i.e. the County Council).
- Each individual who exercises any degree of control over the ABS on behalf of the owner – i.e. any member or officer with decision-making responsibility on behalf of the Council as owner.
- Each individual who acts as a director of the company.
- Each compliance officer of the company – one is required for professional practice and one for finance (they will also be directors).

- Arrangements in place to manage conflict and otherwise to ensure separation between the work carried out on behalf of the ABS and work carried out direct for the County Council and Partners.
- 14 Subject to discussion with the SRA, however, we know that the SRA has licensed an arrangement which would have many of the characteristics we would be looking to implement. In particular, the model operates without the need for existing staff to transfer to the ABS and therefore all staff would remain employed by LSL (Lincolnshire County Council). Suitable arrangements would be put in place between the ABS and the Council so that the ABS could call on the services of the staff within LSL to provide services to the clients of the ABS. This kind of model would be a proportionate response to the drivers identified in this paper which revolve principally around following the work of our existing partners whilst they would also enable appropriate expansion of the services provided by the Council.
- 15 A lot of the work necessary to meet SRA requirements is already in place. In particular a conflict protocol is already followed and case management systems allow files to be restricted to particular lawyers. However, further work will be needed to document this to SRA satisfaction. Specialist input will be needed to ensure compliance with SRA accounting rules and tax issues. Work and conflicts would need to be managed carefully to ensure that work for the County Council and existing partners is not jeopardised.

### **Establishing a Company**

- 16 Although the Council will be the sole owner of the proposed ABS, it is not the Council but the company which must apply to the ABS for a licence to provide legal services. The establishment of a company is therefore the first stage in progressing this matter. This Report therefore seeks approval for the establishment of the company with a view to the company making application for a licence as an ABS.
- 17 To progress this draft Articles of Association and a draft Shareholders Agreement are being developed. A copy of the Articles of Association is attached at Appendix A. These are fairly standard Articles with few issues of principle involved. They have been developed with a view to addressing the issues that are likely to be of concern to the SRA.
- 18 With this in mind it is proposed that there are only two Directors of the company (three at most), one of which will be the Chief legal Officer who will also be the Compliance Officer for Legal Practice (COLP) and the other a suitable person with the necessary financial background to act as the Compliance Officer for Finance and Administration (COFA).
- 19 The Shareholders Agreement will govern the relationship between the Council as owner of the company and the company itself. As is usual with such agreements the main issue of principle relates to the extent of control the Council should exercise over the company as against the Directors. In

relation to the ABS it is proposed that the degree of control would be relatively limited because the ABS is a trading company rather than a Teckal company and because the SRA is likely to be more concerned the more the Council seeks to exercise control over what is a regulated and licensed legal practice.

- 20 Nevertheless some degree of control is appropriate and the Shareholders Agreement will contain reserved matters which would be subject to approval by the Council as owner. The main areas where control will be exercised are set out in Appendix B. As can be seen, the principal area where control is exercised is in approval of the annual business plan and budget supplemented by some specific controls over financial, constitutional and administrative decisions. One of these proposed controls relates to the nature of the clients that the ABS might act for with any decision to act for anything other than public sector bodies being reserved to the Council as shareholder.
- 21 Given that the County Council will be the sole owner of the company it will be a regulated company within the meaning of the Local Authorities (Companies) Order 1995 and Part V of the Local Government and Housing Act 1989. This requires such companies to comply with certain administrative responsibilities relating, for example to the identification of the County Council as owner of the company on its letter head, the provision of information, the appointment of auditors and the remuneration of directors. These requirements will be complied with.
- 22 Financially, the ABS is expected to require very little funding from the Council. This is because the ABS itself is envisaged as having no employment costs although it will need to arrange its own professional indemnity insurance cover and will need to pay its way in relation to any property or support services costs to ensure that there is no State Aid. The principal issue for the ABS is likely to be cash flow caused by any issues with recovery of fees from its clients. This may be alleviated by the provision of a loan facility at commercial rates. The extent to which any such facility may be required will be determined moving forward.

## **2. Legal Issues:**

### Equality Act 2010

Under section 149 of the Equality Act 2010, the Council must, in the exercise of its functions, have due regard to the need to:

- \* Eliminate discrimination, harassment, victimisation and any other conduct that is prohibited by or under the Act
- \* Advance equality of opportunity between persons who share a relevant protected characteristic and persons who do not share it
- \* Foster good relations between persons who share a relevant protected characteristic and persons who do not share it.

The relevant protected characteristics are age; disability; gender reassignment; pregnancy and maternity; race; religion or belief; sex; and sexual orientation

Having due regard to the need to advance equality of opportunity involves having due regard, in particular, to the need to:

- \* Remove or minimise disadvantages suffered by persons who share a relevant protected characteristic that are connected to that characteristic
- \* Take steps to meet the needs of persons who share a relevant protected characteristic that are different from the needs of persons who do not share it
- \* Encourage persons who share a relevant protected characteristic to participate in public life or in any other activity in which participation by such persons is disproportionately low

The steps involved in meeting the needs of disabled persons that are different from the needs of persons who are not disabled include, in particular, steps to take account of disabled persons' disabilities

Having due regard to the need to foster good relations between persons who share a relevant protected characteristic and persons who do not share it involves having due regard, in particular, to the need to tackle prejudice, and promote understanding

Compliance with the duties in section 149 may involve treating some persons more favourably than others

The duty cannot be delegated and must be discharged by the decision-maker. To discharge the statutory duty the decision-maker must analyse all the relevant material with the specific statutory obligations in mind. If a risk of adverse impact is identified consideration must be given to measures to avoid that impact as part of the decision making process

The proposal in this Report is not considered to have any implications for equality and diversity.

### Joint Strategic Needs Analysis (JSNA) and the Joint Health and Wellbeing Strategy (JHWS)

The Council must have regard to the Joint Strategic Needs Assessment (JSNA) and the Joint Health & Well Being Strategy (JHWS) in coming to a decision

The proposal in this Report has no direct impact on the Joint Health and Wellbeing Strategy

### Crime and Disorder

Under section 17 of the Crime and Disorder Act 1998, the Council must exercise its various functions with due regard to the likely effect of the exercise of those functions on, and the need to do all that it reasonably can to prevent crime and disorder in its area (including anti-social and other behaviour adversely affecting the local environment), the misuse of drugs, alcohol and other substances in its area and re-offending in its area

The proposal in this Report has no direct impact on crime and disorder matters.

### **3. Conclusion**

Overall, it is considered that the proposal in this Report provides a proportionate, response to the emerging regulatory issues which would allow LSL to continue with its current scope of work as Partners pursue alternative means of delivering their services. It would also provide a basis for gradually widening the clients LSL can work for.

### **4. Legal Comments:**

The Council has power under section 1 of the Localism Act 2011 to provide legal services as envisaged but must do so through a company if it is acting for a commercial purpose.

The more detailed legal issues to be taken into account in reaching a decision are referred to in the Report.

The decision is consistent with the Policy Framework and within the remit of the Executive.

### **5. Resource Comments:**

Establishing an ABS company as per the report recommendation will have little direct impact on the budgets of the Council.

Implications for financial administration and accounting of the company will need to be kept under review as the proposal progresses and prior to a final decision being taken under delegated authority by the Executive Director - Resources in consultation with the Executive Councillor for Community Safety and People Management.

### **6. Consultation**

#### **a) Has Local Member Been Consulted?**

N/A

#### **b) Has Executive Councillor Been Consulted?**

Yes

#### **c) Scrutiny Comments**

The decision will be considered by the Overview and Scrutiny Management Board at its meeting on 25 April 2019 and the comments of the Board will be reported to the Executive.

**d) Have Risks and Impact Analysis been carried out?**

Yes

**e) Risks and Impact Analysis**

See the body of the Report

**7. Appendices**

These are listed below and attached at the back of the report	
Appendix A	Draft Articles of Association
Appendix B	Draft Reserved Matters

**8. Background Papers**

No Background Papers within the meaning of section 100D of the Local Government Act 1972 have been used in the preparation of this Report.

This report was written by David Coleman, Chief Legal Officer, who can be contacted on 01522 552134 or [david.coleman@lincolnshire.gov.uk](mailto:david.coleman@lincolnshire.gov.uk) .