

Scoping Document

Application to be a licensing authority

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1 Introduction

This paper was commissioned by the Chief Executive Officer of IPReg and sets out the main requirements for a licensing authority under the Legal Services Act 2007 (LSA) and the elements of a licensing authority (LA) application, together with recommendations for proceeding should the IPReg Board decide to proceed with the application.

Although the report makes extensive reference to the LSA it should not be taken as providing legal advice on the interpretation of the LSA.

Appendix 1 contains a glossary of terms used in this paper.

Sarah Willison

10 November 2011

2 Executive summary

IPReg has been instructed by its approved regulators (ARs) CIPA and ITMA to provide a Scoping Document setting out the work associated with an application for designation as a licensing authority under the LSA.

The key elements of the work are:

- development of the LA application;
- development of the regulatory arrangements (essentially the rules);
- development of operations to support a risk-based approach to authorisation, supervision and enforcement.

This will involve:

- decisions on key policy issues (e.g., as to who can own and manage an ABS licensed by IPReg);
- extensive consultation with stakeholders;
- hiring additional resources both during the development phase and post-implementation;
- additional funding.

The extent to which additional resources are required is in part dependent on the timetable for the LA application. This timetable will need to be discussed with the LSB. In a letter to the LSB dated 9 May 2011 IPReg's Chairman stated that, based on a "full start" in September, the end date (i.e., date of designation) should be March 2013. Given that the project has not yet started, I have revised that timetable. Taking into account the Parliamentary summer recess, the likely designation date would be some time in October 2013. This is an extremely ambitious timetable (see my comments at Appendix 6).

Once the timetable is clearer it will be possible to develop a project plan for the work and a detailed allocation of budget.

Key issues arising from the scoping process are:

- the need to agree a realistic timetable with the LSB for submission of the LA application, that takes account of IPReg's resources and budget;
- the extent to which IPReg's current rules will need to be re-drafted to reflect a more "outcomes-focused" approach, in line with the LSB's stated expectations;
- how IPReg can meet the statutory requirement for compensation arrangements (in addition to indemnity arrangements), given that the PAMIA scheme does not appear to meet in full the requirements of the LSA;
- the additional operations (checks on fitness and propriety of owners, risk-based authorisation and supervision, etc) required for LAs.

The main recommendations of this report are;

- 1 Ensure that the delegation agreement has been revised in accordance with commitments to the LSB;
- 2 Hold discussions with the LSB to discuss timetable for LA application;
- 3 Conduct research on the profession;
- 4 Establish an ABS Working Group and a Reference Group for informal consultation;

- 5 IPReg to determine policy on whether it has one set of rules for all types of firm, adapted where justified on the basis of risk/ result of differences in the underpinning statutory regimes;
- 6 Use external resources to fill internal resource/expertise gaps for preparation of the LA application;
- 7 Use third party supplier(s) to conduct due diligence to support assessment of “fitness to own”;
- 8 Hold meetings with potential appellate bodies to understand fully the advantages and disadvantages of each.

3 Background

3.1 Current regulatory arrangements for patent attorneys and trade mark attorneys

The starting point for understanding the extent of the work that will have to be undertaken to become a LA is the requirements for LAs in the Legal Services Act, together with the associated rules and guidance of the LSB. The extent to which these requirements differ from the current statutory regime for the regulation of trade mark and patent attorneys enables us to identify the “gap” which will need to be addressed in the coming months prior to submission of an LA application. This gap consists of changes to rules, and operational requirements.

The statutory bases for regulating trade mark attorneys and patent attorneys are set out in the Trade Marks Act 1994 and the Copyright, Designs and Patents Act 1988.

Under both Acts, the “person who keeps the register” of Trade Mark Attorneys or Patent Attorneys is given the power to make regulations that regulate:

- (1) the keeping of the register and the registration of persons;
- (2) the carrying on of trade mark attorney/patent attorney work by registered persons.

Section 4.2.2 of this paper sets out what these regulations may cover and how these differ from the LSA.

Appendix 3 sets out the current governance structure for CIPA and ITMA.

3.2 Decision to apply for designation as a licensing authority

In August 2011 the Chairman of IPReg wrote to IPReg entity registrants informing them that CIPA, ITMA and IPReg “consider it both correct in principle and affordable to proceed with the [LA] application”¹.

The key steps in reaching that decision were:

- In June 2010 IPReg invited the LSB to speak to the regulated community about ABSs. IPReg published a summary in the Journals and on its website;
- IPReg issued a preliminary questionnaire in 2010 and a further survey was undertaken by the two Institutes in 2011;
- An ABS working party was formed to consider the issue of trade mark and patent attorney ABSs and who should regulate them. That working party produced a report on 11 April 2011;
- Presentations have been made about the ABS regime to individual firms and feedback received.

The next stage was to examine the scope of work required to apply for, and operate as, a LA.

¹ Letter from Michael Heap to IPReg entity registrants dated 4 August 2011.

4 Key issues (i.e., critical success factors)

4.1 Requirements for application – general

It is important at the outset to bear in mind that the LSB's rules and guidance do not differentiate between licensing authority applicants in terms of their size, specialism, etc. In other words, the same requirements apply to all. (The extent to which, in practice when approving an application, the LSB might have different expectations for smaller applicants needs to be explored with the LSB.) The only exception to this is that the LSB recognise in their guidance that, "...there may be some LAs that will not be competent to regulate all types of ABS, in particular those with complex structures (whether external or lawyer only). A Licensing Authority's licensing rules should set out the type of ABS that can apply to it for a licence. If this places restrictions on the extent or nature of external ownership then this must be fully explained and justified." The quid pro quo for permitting rules with these restrictions is that the applicant must, as an approved regulator, permit the individuals that it regulates to work in an ABS that is regulated by another LA "with a wider range of competencies".

Requirements for licensing authority applications are set out in the LSA and the LSB's Rules for applications to be designated as a LA².

In essence, LA applications must:

- include a commentary saying how the approved regulator will meet the requirements for LAs in the LSA. Supporting "evidence" must be provided. For example, "An applicant must be able to demonstrate how it has prepared properly and thoroughly for its role as a LA and has appropriate arrangements in place to license competently ABS..."³
- attach details of the regulatory arrangements that will apply to licensable bodies. Regulatory arrangements include, but are not limited to, the rules of the LA.

In addition, each LA must issue a policy statement detailing how, in exercising its functions as a LA, the LA will comply with section 28 of the LSA (duty to promote the regulatory objectives⁴).

The LSB's rules for applications set out a detailed list of the matters to be addressed in the application, although the format for the application is not prescribed. It would be useful to explore with the LSB the possibility of submitting the LA application in draft form in order to reduce the risk of rejection on the grounds that it does not meet their requirements (either in form or in substance).

Under the LSB's rules, if the applicant is not an existing licensing authority (i.e., one seeking to extend the list of reserved legal activities in respect of which it is a licensing authority) the

² The LSB has also published guidance on approaches to licensing ABSs.

³ See the Schedule to the LSB's "Rules for applications to be designated as a LA".

⁴ The regulatory objectives are set out in section 1(1) of the LSA and cover protecting and promoting the public interest; supporting the constitutional principle of the rule of law; improving access to justice; protecting and promoting the interests of consumers; promoting competition in the provision of services within subsection (2) (essentially legal services); encouraging an independent, strong, diverse and effective legal profession.

prescribed fee for the application is £22,000. In certain circumstances the Board may impose additional charges.

4.2 Elements of the Licensing Application:

4.2.1 Who is making the application?

Applications to be designated as a licensing authority must be made by approved regulators⁵. Therefore, any licensing authority application(s) would be submitted by IPReg in the names of CIPA and ITMA. In other words, CIPA and ITMA would each be seeking designation as a licensing authority on the understanding that their regulatory functions were delegated to IPReg. Recent correspondence between IPReg and the LSB suggests that a single application could be jointly made by CIPA and ITMA. The precise mechanics of this will need to be agreed with the LSB.

4.2.2 Licensing rules

Introduction

A key element of the regulatory arrangements that support the LA application will be IPReg's rules for ABSs. These will need to be approved by the LSB by reference to the requirements in the LSA and the LSB's guidance⁶. In this context, IPReg will need to:

- identify any difference between its statutory rule making powers for existing firms and those under the LSA (and also the extent to which those powers differ from the powers granted to other LAs) to determine whether any harmonisation of the legislation is required by an order under section 69 of the LSA;
- decide whether to have one set of rules for all firms or have two sets: one for traditional firms and one for ABSs;
- determine the extent to which the existing approach in the rules needs to be amended to reflect a more outcomes-based approach to regulation as required by the LSB;
- be able to justify its licensing rules by reference to the regulatory objectives contained in the LSA, the Better Regulation Principles (see Appendix 2) and based on the risks that it has identified.

Rule making powers – CPDA, TMA and LSA

The current rules of the PRB and TRB (working jointly together as IPReg) are made under s 275A of the Copyright Designs and Patents Act 1988, s 83A of the Trade Marks Act 1994 and ss 184 and 285 of the LSA.

S275A of the CPDA and S 83A TMA are **permissive** provisions; the “person who keeps the register” of trade mark attorneys/patent attorneys **may** make rules covering the following matters:

⁵ Under section 73 of the LSA a licensing authority means “an approved regulator which is designated as a licensing authority under Part 1 of Schedule 10 and whose rules are approved for the purposes of this Act.”

⁶ Rules must also comply with the Provision of Services Regulations, which implement the EU Services Directive. The Services Directive sets out how the internal market in those services covered by the Directive, which include professional services offered by lawyers, should operate.

- The keeping of the relevant register;
- The carrying on of patent attorney/trade mark agency work;
- Educational, training or other qualifications which must be satisfied prior to registration or for continuation on the register – individuals and bodies;
- Educational, training or other requirements to be met by other regulated persons (i.e., managers and employees of registered bodies that are not individually registered persons);
- Provisions regulating the practice, conduct and discipline of registered and regulated persons;
- Provisions authorising erasure from the register of the registered person or the suspension of registration;
- Provisions requiring the payment of fees specified in/determined in accordance with the regulations;
- Provisions regarding complaint handling in respect of registered persons;
- Provisions about record and account keeping by registered or regulated persons;
- Provisions for the review of decisions/appeals against decisions made under the regulations;
- Provision as to the indemnification of registered persons or regulated persons against losses arising from claims in respect of civil liability incurred by them. This issue is particularly important in the context of ABSs – see below.

The requirements for licensing rules (rules applicable to ABSs) are set out in sections 10 and 83 of, and Schedule 11 to, the LSA. In addition the LSB has issued guidance on its expectations for licensing rules. The provisions in the LSA for ABSs are **mandatory**; licensing authorities **must** make provision for the following matters (although there is some discretion as to what the rules actually say):

- Qualification regulations in respect of licensable bodies to which the licensing authority proposes to issue licences;
- Provision as to how the licensing authority, when considering the regulatory objectives in connection with an application for a licence, should take account of the objective of improving access to justice;
- Appropriate arrangements under which the licensing authority will be able to regulate the conduct of bodies licensed by it (including conduct rules, discipline and practice rules);
- Provision required by sections 52 and 54 (resolution of regulatory conflict);
- Applications for licences;
- Determination of applications;

- Reviews of determinations;
- Periods of licences and renewals;
- Continuity of licences;
- Modification of licences;
- Structural requirements including composition of the management (including permissive power to make additional rules concerning managers and the arrangements for managing licensed bodies);
- Head of Legal Practice (HOLP) – Schedule 11 is **prescriptive** in terms of the provisions that must be made in respect both of the HOLP and the HOFA (see next bullet). These include rules for determining fitness and propriety, reviews of decisions on fitness and propriety; rules for withdrawing approval and reviews of such decisions; rules where a licensed body ceases to have a HOLP;
- Head of Finance and Administration (HOFA) – the provisions of Schedule 11 for HOFAs largely mirror the requirements for HOLPs;
- Practising requirements;
- Licensed activities – rules must be made that state that licensed bodies may only carry on licensed activities through a person who is entitled to carry on the activity;
- Compliance with regulatory arrangements – rules must be made to require licensed bodies and managers and employees of licensed bodies to have suitable arrangements in place to comply with the regulatory arrangements of the approved regulator;
- Disqualified employees – licensing rules must prevent the employment by a licensed body of disqualified persons;
- Indemnification and **compensation arrangements** – under s 83(5) licensing rules must contain appropriate indemnification and compensation arrangements. Sch 11 para 19 states what form such rules may take;
- Accounts – licensing rules must make provision for the handling of client money and money received from other persons (treatment and keeping of accounts);
- Fees – rules must make provision for the payment of periodical fees and may provide for the payment of different fees by different descriptions of licensed body;
- Financial penalties – licensing rules must make provision for acts or omissions in respect of which a financial penalty may be imposed and the criteria and procedure to be applied when determining whether to impose a penalty and the amount of the penalty;
- Disqualifications – licensing rules must make provision for the criteria and procedure to be applied in determining whether a person should be disqualified and for a review of the disqualification decision; for the criteria and procedure for deciding whether a disqualification should remain in force and informing the LSB of decisions in relation to disqualification;

- Suspension and revocation of licence – licensing rules must cover the matters set out in Sch 11 para 24;
- Any other provision required to be contained by virtue of the LSA.

Thus the statutory rule making regimes differ in the following manner:

- the CPDA and TMA are permissive rather than mandatory however this may not be a substantive issue; the important thing is that the power exists;
- the amended CPDA and TMA grant no rule making power in respect of compensation arrangements; they only address indemnification arrangements in respect of civil liability.

As stated above, IPReg will need to decide whether these differences are so significant as to require an order to harmonise the legislation (see 4.2.5 below). The statutory differences will also, of course, impact on the content of the rules. For example, the requirement to have a Head of Legal Practice and a Head of Finance and Administration is specific to ABS.

One additional consideration would be any disparity in powers between the CLC and SRA, when acting in their capacity as a LA, and any other potential LA. The CLC and SRA both sought an order to harmonise their existing powers with those contained in the LSA. In order to achieve parity with the CLC and SRA, IPReg should consider the detail of the order granted to the CLC and SRA. For example, the LSA contains no power to make rules to recover the costs of investigations; the SRA sought an amendment to the LSA to address this, given that it already had an equivalent power in relation to traditional law firms.

General requirements for licensing rules

As stated above, the LSB has issued guidance on licensing rules and an applicant LA will have to justify any deviation from the LSB’s guidance. Within that guidance the LSB state that: “Underpinning the LSB’s approach is our belief that legal services providers should be free to innovate and develop new ways of working to meet consumer needs and demands, whatever their chosen business model. So ABS licensing rules *should not seek to restrict commercial activity* unless there is evidence of consumer detriment that requires regulation.” [My emphasis.]

The LSB also expects that:

- The regulation of ABS should be primarily based on “clear outcomes supplemented by guidance, with rules where there is only one appropriate way to ensure consumer protection and broader public interest.” Both the SRA and the CLC have a set of Principles to which all must adhere supported by a Code of Conduct which defines the outcomes that must be achieved. Experience suggests that the LSB may expect IPReg’s Code to be rewritten in terms of outcomes. In addition, it should be noted that the Legal Services Consumer Panel, argued that the SRA’s new Code of Conduct should be completely re-written as outcomes for clients.
- Consumer confidence in ABSs that are owned by non-lawyers is at least as high as other law firms.

Regulatory regime – one set of requirements or two?

IPReg has two options in developing its regulatory arrangements - and specifically its licensing rules - for licensed bodies:

- (a) amend/enhance its current rules and have one set of rules for all regulated firms and individuals. The advantages of this approach are that it provides a harmonised (within legislative constraints) set of requirements and is easier and less expensive to operate than two sets of rules. In addition, the opportunity could be taken to enhance IPReg's existing regime, for example, in relation to client money. This is not to say that all rules will be the same for both types of body, but rather that the regime will be harmonised so far as possible, except where differences are justified by the risks or where there is no equivalent statutory power (in the absence of a section 69 order).
- (b) develop a separate set of rules for ABSs – the advantage of this approach is that each set of rules can be tailored to the type of regulated body avoiding the possibility of putting additional regulatory burdens on existing firms. One downside of this approach is that firms may switch from one type of regulated body to another and having two sets of rules might hinder this process for both IPReg and the firm.

Having considered the options, I would recommend that option (a) be adopted.

Analysis of current IPReg rules – what needs to change?

Assuming option (a) is taken, IPReg's current rules will need to be adapted/enhanced to address the following issues.

- licensed activities;
- client money;
- disciplinary procedures;
- financial penalties;
- practising requirements;
- fitness and propriety;
- management and ownership of firms;
- compliance with regulatory arrangements;
- non-employment of disqualified employees;
- indemnification and compensation arrangements – see the following section of the report regarding the policy issues;
- withdrawal/suspension of authorisation;
- fees.

Key policy issues associated with the above issues are discussed in section 4.2.3 below.

IPReg's rules will also need to contain "passporting" provisions for existing firms that fall within the definition of a licensable body. Such firms would not need to be "re-authorised" (although their HOLP and HOFA will need to be approved) but the rules will have to accommodate the transfer from their existing status to that of an ABS.

In addition, IPReg will need to review its overall approach to regulation to set the balance between principles, outcomes, rules and guidance. For example, as stated above, I would anticipate that the LSA may argue that the Code of Conduct should be re-drafted to introduce a more outcomes-based approach.

This obviously represents a significant amount of reworking of the existing rules, in addition to which IPReg will need to undertake informal and formal public consultation. In view of the very technical nature of the requirements of the LSA, I would recommend using an external resource to undertake some – if not all – of the re-drafting, based on IPReg's policy decisions (see below).

4.2.3 Policy issues

In the LSA, licensing authorities are granted discretion in relation to certain matters to be addressed in their licensing rules. IPReg will need, therefore, to determine its policy on these issues and to be able to justify its policy approach based on the risks to consumer protection and the public interest, and taking into account the LSB's guidance⁷ and the Better Regulation Principles (see Appendix 2).

These policy issues may have an impact on existing firms that are not licensable bodies, in that ABSs or existing firms may have a competitive advantage, one over the other, depending on the policy decision.

IPReg will also need to be able to demonstrate that, in making its policy decisions, it had considered:

- the impact on the regulatory objectives (positive and negative);
- costs/benefits of policy decisions;
- the Better Regulation Principles;
- whether a decision is merited by reference to the risks that IPReg is seeking to mitigate.

Ownership interests

In Schedule 13, Part 1, the holding of a restricted interest in a body is subject to the approval of the relevant licensing authority⁸. A "material interest" (in very simple terms a 10% interest in a body) will be a "restricted interest", but the licensing authority may also set one or more levels of "controlled interest" (different to the material interest) for which an owner will require approval.

In essence, IPReg would have to decide whether to opt for simplicity (approving material interests) or some form of tiered approach (involving the approval of controlled and material interests).

Adding to the complexity of the approval of restricted interests, are provisions relating to holdings by associates. This is intended to catch situations in which connected persons have

⁷ See section 5.1 of this report regarding research to support the LA application.

⁸ Sch 13, para 1(1).

interests which, taken together, would take them above the level of a restricted interest, therefore requiring approval. Because it is possible for one party to have a number of associates, potentially involving significant numbers of approvals, regulators have the right to set a de minimis to the associate test, so that associates with a holding below a specified limit do not need to be identified and therefore taken into account. The CLC have included a de minimis but the SRA chose not to do so on the basis of the risks to consumers and the public interest generally.

Restriction on holdings – majority owned by Patent/Trade Mark Attorneys?

The current rules of the PRB and TRB contain restrictions on the management and ownership of a body that seeks to be registered on the Register of Patent Attorneys or the Register of Trade Mark Attorneys⁹. IPReg will need to decide whether to seek to apply the same restrictions to licensable bodies (ABS). The SRA, for example, have no such restrictions in their equivalent rules; firms authorised by the SRA (assuming the SRA is designated as a LA) could be 100% owned by non-solicitors.

Any restriction on ownership may be challenged by the LSB as a restriction on competition that is not required by legislation and would need to be justified by IPReg. One justification might be that, as a smaller regulator, IPReg was seeking to restrict ownership and management since its competence to licence bodies was limited to bodies of a specific nature.

Multi-disciplinary practices (MDPs)

Linked to the issue of external ownership and management is that of MDPs. The existence of MDPs has been seen as one of the major benefits of the introduction of the LSA and IPReg will have to determine whether it will permit the bodies that it authorises to provide other professional services such as, e.g., accounting or financial services. These activities will fall outside the jurisdiction of the PRB and TRB (see below) and will of course not be authorised by either, but if IPReg were to decide to prohibit ABSs that it authorised from conducting other activity then this is likely to be challenged since it will impede innovation in terms of new business models.

Professional indemnity insurance and compensation arrangements

Rule 17 of the current Rules of Conduct for Patent Attorneys, Trade Mark Attorneys and Other Regulated Persons states that “each registered person.....must take out and maintain professional indemnity insurance cover....commensurate with the risks at large arising from the extent and size of their practice.” Guidance states that, “It would be expected that PII of at least £1m would be required for all registered persons and their firms unless demonstrably their practice does not warrant a sum that high.”

Both the SRA and the CLC have more stringent requirements in relation to PII in their licensing rules which involve the regulator essentially approving the terms of the insurance. IPReg will have to determine, in discussions with the LSB, the extent to which it needs to amplify the requirements imposed on authorised firms and whether the PII offered by PAMIA is adequate for ABS, bearing in mind IPReg’s jurisdiction (see **Jurisdiction** below).

⁹ See Annex A (A) and (B) of the Patent Attorney and Trade Mark Attorney Registered Bodies Regulations.

A more critical issue is that the LSA requires LAs to have “appropriate compensation arrangements”. Compensation arrangements are defined in s21 LSA as meaning “arrangements to provide for grants or other payments for the purposes of relieving or mitigating losses or hardship suffered by persons in consequence of:

- (a) negligence or fraud or other dishonesty on the part of any persons whom the body has authorised to carry on activities which constitute a reserved legal activity, or employees of theirs, in connection with their activities as authorised persons; and
- (b) failure, on the part of regulated persons, to account for money received by them in connection with their activities as such regulated persons.”

The current PAMIA arrangements do not cover all situations in which losses arise in relation to either (a) or (b) above. This is because the insurance would not pay out in the scenario where all partners in a firm were dishonest and, for example, misappropriated client money (insurance cannot cover such a situation since a person cannot insure against his or her own dishonesty). It is in this scenario that compensation arrangements would protect the party suffering the loss.

Unlike the CLC and SRA, IPReg does not operate a compensation scheme and the costs associated with establishing and funding a scheme from scratch would be significant. It may be that PAMIA reserves could be held on trust for specified purposes or alternatively that some form of bond scheme could be established. The LSB previously discussed the idea of clients obtaining their own insurance for such a scenario (i.e., protection against losses not recoverable under the firm’s insurance) although obviously this is likely to be very unattractive to clients, might undermine confidence in attorneys and may be difficult to obtain (even assuming the risk could be assessed in individual cases).

The additional point is that, should compensation arrangements be in place for ABS clients (and other third parties), such persons would have greater protection than for a traditional firm, where such protection currently does not exist (albeit that the scenario is in any event very remote). Should IPReg want to address this disparity, this is a matter which could possibly only be addressed using a section 69 order (see section 4.2.5 below) since the PRB and TRB do not have the statutory power to make rules in relation to compensation arrangements for registrants.

Jurisdiction

This issue arises not so much from a discretion granted to licensing authorities in the LSA but rather from a lack of clarity in the drafting of the Act. If IPReg is to permit the ABSs that it licenses to be multi-disciplinary practices, then it will need to define its jurisdiction, i.e., the extent to which its rules apply to a body that conducts activities other than intellectual property work. This is required for a number of reasons:

- i) a licensing authority will not have the vires to make rules in relation to activities outside the licensing authority’s legal jurisdiction; to do so would be ultra vires. Therefore, in order to mitigate the risk of acting ultra vires, the licensing authority needs to determine for its purposes the extent of its jurisdiction;
- ii) for the purposes of indemnification and compensation arrangements it is necessary to be clear about the circumstances in which regulated firms’ acts and omissions (and those of their managers and employees) would/would not be covered by indemnity insurance and compensation arrangements;
- iii) IPReg will need to determine its regulatory reach in terms of activities conducted overseas or for overseas clients.

Registration/domicile

Under the LSA (Schedule 11, Part 3) licensing rules must require a licensed body (other than LLPs and companies, whose registered office is situated in England and Wales) to have a practising address in England and Wales, i.e., an address from which the body provides the reserved legal activities. LLPs and companies with a registered office in England and Wales need not, under the LSA, have such a practising address and IPReg will need to decide whether to impose such a requirement within its rules.

Owners, by contrast, are under no legal obligation to be registered, etc in England and Wales. For example, under the SRA's rules an owner can be based/registered anywhere in the world. This, of course, carries with it potentially quite a heavy burden in terms of assessing the fitness and propriety of the potential owner since it may be necessary to take overseas legal advice and engage other third parties (assuming they are intending to take a restricted interest in a firm and therefore require approval). IPReg will need to decide whether it wishes to take a more restrictive approach.

Fitness and propriety – what will the test cover?

Licensing authorities have to have rules concerning the criteria to be applied by the LA when determining whether an individual is fit and proper. Currently IPReg approves individuals to be managers of a registered body and it is likely that the test contained in the Patent Attorney and Trade Mark Attorney Registered Bodies Regulations could be adapted for this purpose, although it may be that the test should be extended to cover other aspects of character and suitability.

IPReg will need to decide whether to outsource (elements of) the assessment of fitness and propriety since this may involve a significant increase in the workload of staff. The actual decision to approve a role holder (e.g. a HOLP) cannot, of course, be outsourced since it is a regulatory decision. As a first step, I would recommend that potential suppliers of these services be identified to enable IPReg to consider the merits and costs of using a third party supplier.

Period of licences

IPReg has to determine the term (i.e., period) of the licences that it grants. At the moment, IPReg's licences are annually renewable but it could move to licences that are not limited in time. The advantage of this approach is that the regulator does not have to "re-authorise" all firms on an annual basis; rather, firms would submit an annual return (see **Reporting and Notification** below) enabling IPReg to identify any high risk firms and determine appropriate regulatory action.

Appeals

The rules of LAs must make provision for appeals, specifying the circumstances in which appeals can be made (this is already covered in the current rules although the provisions may need to be amplified).

The more significant decision for IPReg is the identity of the appellate body to which appeals from the decisions of the PRB and TRB can be made. LA applications must specify the appellate body to be used for these purposes. The appellate body for decisions of the CLC is the General Regulatory Chamber of the First Tier Tribunal, and for decisions of the SRA will

be the Solicitors Disciplinary Tribunal. There are advantages and disadvantages associated with both the GRC and the SDT:

- The SDT has a long track record in hearing appeals relating to solicitors but has in the past been criticised for the length of time taken to make decisions. In addition, there was a concern that the SDT might unconsciously favour more traditional firms;
- The GRC, on the other hand, lacks experience of the legal services market. The main objection raised by the SRA was, however, not this lack of experience but rather its ability to recover the costs of appeals (the SDT, by contrast, can make an order for costs in favour of the decision making body).

It is recommended that discussions be held with both the GRC and the SDT to explore further the advantages and disadvantages of each body.

Reporting and notification

Reporting and notification requirements are an essential element of a risk-based regulatory regime. IPReg will need to seek information from firms and individuals on an annual basis. These reporting requirements will enable IPReg to:

- demonstrate to the LSB that it understands its regulated community and the risks to the regulatory objectives associated with that community;
- risk assess the regulated community, individual firms and indeed individuals (e.g. owners);
- justify more effectively its policy, based on an informed understanding of risks.

IPReg's rules will need to make provision for the submission of this information. In addition, IPReg will need to consider the resource implications of analysing the additional information from firms¹⁰.

Grounds for refusal/revocation/suspension (firms and role holders)

IPReg will need to set its policy on refusing, revoking and suspending the authorisation of firms and the approval of role holders (e.g., the HOLP and HOFA). This can be developed from IPReg's existing rules which provide grounds for revocation.

Approach to disciplinary action and fining

IPReg will need to determine its policy towards disciplining firms and individuals and explain what approach it will take to financial penalties. As yet, IPReg does not have rules relating to the discipline of firms and an associated enforcement and fining policy.

Fees

The rules of LAs must make provisions relating to the payment of fees for both the initial application for authorisation and throughout the period of authorisation. The basis on which fees have been calculated will need to be explained and the LSB may require disclosure of the actual cost of the fee for the initial application for authorisation. Where other fees are to be charged (e.g., to change a term of a licence), rules need to make provision for the fees.

¹⁰ See 5.4 below.

IPReg will need to decide whether to charge fees on the same basis for all firms, or whether a different approach should be adopted for ABSs on the basis of perceived risks and the additional costs associated with authorising an ABS.

IPReg will already have had some experience of dealing with the LSB in relation to fees and their requirements for understanding how fees are calculated.

Supplemental consideration – section 15 LSA

The Rules of Conduct for Patent Attorneys, Trade Mark Attorneys and Other Regulated Persons (see Guidance note 2.3) currently contain provisions for in-house practice. Whilst not strictly a matter relating to the LA application, this guidance may need to be reviewed to ensure that it accurately reflects section 15 of the LSA, which basically explains the circumstances in which persons may carry on reserved legal activities without the need for authorisation under the LSA), on the basis that they are acting for their employer.

4.2.4 Structural requirements

In order to support the new provisions in its regulatory arrangements for ABSs, IPReg will have to develop policies and procedures in relation to the following matters:

- The authorisation and supervision of firms and individuals using a risk-based approach;
- The development of a methodology for risk assessing firms and individuals to support the authorisation and supervisory activities;
- The collection and analysis of information from firms and other stakeholders such as clients and potential consumers;
- The assessment of fitness and propriety for those intending to hold a restricted interest in a body and for the HOLP and HOFA;
- The hearing of internal appeals and arrangements for applicants to make external appeals to the appellate body;
- The handling of investigations and the disciplining of firms and individuals;
- Amendments to the PII arrangements and development of a solution in relation to compensation arrangements;
- Consumer engagement;
- The maintenance of public records in relation to authorised persons (building on the current arrangements).

4.2.5 Secondary legislation to support designation and regulatory arrangements

Another significant area of work relates to secondary legislation that will support the LA application. The need for some secondary legislation will only become clear when IPReg has made its decisions on certain policy matters. Below is a (non-exhaustive) list of the secondary legislation that may be required:

Order	Function	Required
Designation Order	Designates the body as a licensing authority	Yes
Section 69 Order	Amends legislation where a case is made that there is a necessity to do so	Possibly – in part this depends on the decision made in relation to certain

		policy matters including compensation arrangements. IPReg is likely to need such an order if it intends to recover the costs of investigations from firms.
Section 80 Order	Order specifies the appellate body for decisions made by the LA	Probably
Rehabilitation of Offenders (Exceptions) Order	Permits bodies in relation to specified matters to require from individuals details of spent offences	May not be necessary given the exceptions made to accommodate the CLC and the SRA
Consequential amendments (s 208) Order	Amends legislation for the purpose of implementing the LSA	Unlikely – would need to be discussed with the MoJ

Secondary legislation is one of the most protracted elements of an LA application. Once IPReg is in a position to identify whether, for example, a section 69 order or further exceptions to the Rehabilitation of Offenders Act is required, it will need to raise the matter at the earliest opportunity with the LSB.

5 Development process for LA application

The overall LA application process is set out in Appendix 4. I have set out below the key elements of the development process.

5.1 Basis for LA application and regulatory arrangement – research on risks

It will be clear from what has already been said that one of the critical elements of an LA application is the justification of policy and of regulatory arrangements. Currently, IPReg has only limited information on its regulated community and this may prove to be an obstacle in discussions with the LSB. For example, IPReg's policy is driven by a view that its regulated community represents a low risk to the regulatory objectives in the LSA, and on that basis some of its rules are less stringent than those, say, of the SRA or CLC. IPReg will need to be able to justify that policy based on, for example, data about the low percentage of private clients and the small numbers of complaints and claims.

This information can be obtained from a number of sources, e.g., the Legal Ombudsman and PAMIA. However, I would also recommend that IPReg conducts its own research amongst firms. Such research would have significant benefits for IPReg irrespective of whether an LA application is made in terms of deepening IPReg's understanding of the regulated community. IPReg might also consider engagement with consumer groups and potentially the large commercial clients to hear the perspective of the client or potential client.

5.2 Consultation

5.2.1 Public consultations

IPReg will need to decide how many public consultations it will need to undertake in order to be in a position to submit its LA application. Matters to be consulted upon include:

1. changes to existing rules;
2. new rules;
3. approach to fees;
4. approach to authorising, supervising and disciplining firms;
5. handling of appeals.

On the basis of the above, although there is nothing preventing IPReg from publishing a single consultation paper covering all of these issues, it might well seem overly ambitious to proceed on that basis, since it would:

- (a) potentially reduce the quality of responses due to the large volume of material being consulted upon; and
- (b) leave no room for further consideration of contentious matters.

Appendix 6 sets out the possible timetable for the LA application including public consultations.

Consultations should include some form of impact assessment of new rules and policy and IPReg will need to be in a position to demonstrate that it has taken into account competition law, Human Rights Act requirements, equality and diversity legislation and potential costs and benefits.

5.2.2 Informal consultation

In view of the wide ranging requirements for regulatory arrangements (see sections 4.2.2-4.2.4 above) and the relatively short time frame, it would be advisable to establish a reference group of key stakeholders for the purpose of informal consultation. The disadvantage of this would be the additional time taken to establish and run such a group, but experience suggests that the advantage of having such a group in terms of gauging opinion on key policy issues would outweigh the disadvantage.

I would suggest that the informal reference group consist of:

- members of the original ABS working group;
- non-council members of the AR forum;
- a representative from PAMIA.

5.3 Working party

The development of the LA application together with associated policy, rules and operations will involve significant resources. It will also be necessary to identify efficient ways of working since there will be significant time pressures, whatever the eventual timetable.

I would recommend that a Working Party be established to facilitate work on the LA application. This Working Party could consist of

- Michael Heap – IPReg Chairman;
- Ann Wright – IPReg CEO;
- One member of the Patent Regulation Board;
- One member of the Trade Mark Regulation Board;
- Sarah Willison – external consultant.

5.4 Resourcing the development process and use of third party suppliers

Precise resource requirements are difficult to estimate at this stage. Resource requirements fall into two categories:

- resources required to undertake the development of the LA application, the rules and new operations (legal, research, additional Board time, etc);
- resources required to operate as an LA. These will need to be assessed since IPReg will have to demonstrate that it has the resources to operate effectively as a LA.

The detail of additional resource requirements will need to be worked out once the timetable has been agreed with the LSB but, in my professional opinion, IPReg's current resources would not be sufficient to undertake the work to develop the LA application. Further analysis will be required of the longer term resource needs to operate as a LA.

This paper does not address business as usual resource requirements for IPReg; these will be covered in a separate paper from the IPReg Chief Executive.

5.5 Governance of development process – decision-making

In accordance with the terms of the delegation agreement, decisions on the LA application will be made by the Trade Marks Regulation Board and the Patent Regulation Board, together sitting as the Intellectual Property Regulation Board.

5.6 Engagement with LSB and other stakeholders

5.6.1 Legal Services Board

IPReg currently holds regular meeting with the Legal Services Board. In the period leading up to the submission of the licensing authority application it will be necessary to continue these meetings to update the LSB on progress and discuss key policy issues in order to identify and resolve (so far as possible) any differences of opinion over policy prior to submission of the formal application.

An immediate priority is to seek a meeting with the LSB to agree the timetable for the application.

5.6.2 Mandatory consultees

Under Schedule 9, paragraph 3 to the LSA, the LSB has a duty to seek the views of the following parties following the submission of a licensing authority application:

- (i) the Office of Fair Trading (whose primary focus will be competition);
- (ii) the Legal Services Consumer Panel (self-evidently concerned with protecting the interests of consumers);
- (iii) the Lord Chief Justice; and
- (iv) any other party as the Board considers it reasonable to consult. The Board did not choose to exercise this right in relation to the applications of the CLC and SRA but it would be as well to discuss with them whether the LSB is likely to do so.

As part of the development process it would be sensible to seek meetings with the OFT, LSCP and LCJ (the “mandatory consultees”) to gauge any concerns that they may have with the application. This is particularly important because the mandatory consultees will not necessarily agree with one another on key policy issues and this can be borne in mind when drafting the LA application.

5.6.3 Other regulators – regulatory conflict

Under section 52 LSA the regulatory arrangements of an approved regulator must make such provision:

- as is reasonably practicable to prevent regulatory conflicts between their regulatory arrangements and those of another approved regulator such as the SRA, CLC or BSB¹¹; and

¹¹ Where a conflict exists between the entity regulator of a body conducting reserved legal activity and the requirements of another approved regulator in relation to an employee or manager of the body, the entity requirement prevails over the individual requirement (section 52(4) LSA).

- as is reasonably practicable and in all the circumstances appropriate, to prevent regulatory conflicts between their arrangements and those of an external regulatory body (i.e., not an approved regulator, for example the FSA).

As approved regulators, both ITMA and CIPA are already obliged to comply with section 52. By extension, this would apply to an approved regulator seeking designation as a licensing authority.

Both the SRA and CLC have bilateral memoranda of understanding (MoUs) with some regulators. In addition, at the request of the Legal Services Board, the SRA established a Working Group of approved and other regulators with a view to agreeing a draft Framework Memorandum of Understanding (FMOU) and providing a forum for resolution of regulatory conflict. Although the FMOU is not yet signed by the parties, IPReg's LA application will need to annex this FMOU in order to demonstrate compliance with section 52. IPReg will need to decide whether any additional MoUs are required with particular third parties, either to address in greater detail than is set out in the FMOU any specific matter, or by virtue of the fact that the party is not a signatory to the FMOU.

5.7 Other considerations – the Smedley report on smaller approved regulators

The Smedley Report impacts on IPReg and the licensing authority application process in two ways:

(1) the two approaches that it suggests for the LSB in relation to the future of the smaller approved regulators may impact on the manner in which the LSB responds to a licensing authority application by CIPA and ITMA. I have no doubt that discussions with the LSB concerning the response to Smedley are ongoing and it would be helpful to have a meeting with the LSB, as part of that process, to seek an update on their current thinking and how it might influence their view on a licensing authority application.

(2) the licensing authority application will need to address the concerns raised in the Smedley report and provide the necessary assurance, whether or not the concerns are accepted as having substance. This is not, of course, to say that the LSB are in full agreement with Smedley's comments. Smedley raised concerns about the approved regulators generally and the report also has some specific comments on IPReg. These, together with suggestions as to how they might be managed in the LA application, are set out in Appendix 5.

6 Recommendations, dependencies and risks

Recommendations

The main recommendations of this report are listed below:

No.	Recommendation	Intended outcome(s)	Priority
1	Ensure that the delegation agreement has been revised	Compliance with requirements of LSB Internal Governance Rules facilitates LA application process.	H
2	Hold discussions with the LSB to discuss timetable for LA application	<ul style="list-style-type: none"> • Agreement of realistic timetable for LA application; • Common understanding of key milestones. 	H
3	Conduct research on the profession	<ul style="list-style-type: none"> • IPReg is better able to justify policy decisions in relation to its regulatory arrangements based on evidence from research; • Research, together with existing data, informs the develop of the risk model . 	H
4	Establish an ABS Working Group and Reference Group for informal consultation	Development work on the LA application and the operational requirements for a licensing authority is efficient and effective.	M
5	IPReg to determine policy on whether it has one set of rules for all types of firm, adapted where justified on the basis of risk/ result of differences in the underpinning statutory regimes	<ul style="list-style-type: none"> • Common standard of client protection; • Facilitation of competition in the market place. 	M
6	Use external resources to fill resource/expertise gaps for preparation of the LA application	<ul style="list-style-type: none"> • Agreed deadlines are met; • LSB has confidence in IPReg development team. 	H
7	Use third party supplier(s) to conduct due diligence to support assessment of “fitness to own”	IPReg obtains specialist services in the most efficient and flexible manner.	M
8	Hold meetings with potential appellate	IPReg is able to determine	H

	bodies to understand fully the advantages and disadvantages of each	which appellate body it would be in the public interest to appoint	
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Dependencies

Key dependencies for the success of this project are:

- Full co-operation between the parties (CIPA, ITMA, etc);
- IPReg understand the LSB's intended response to the Smedley report and how it will impact on the LA application process.

Risks

The main risks to the project, together with an explanation of how these will be mitigated, are set out below. These risks should be monitored throughout the progress of the project:

Risk	H/M/L	Mitigation
LSB impose unrealistic deadline for submission of LA application	H	Hold discussions with the LSB as soon as possible to agree a realistic timetable for submission of the LA application.
Lack of buy in from parties impedes progress on the LA application	H	Agree amendments to the Delegation Agreement; Ensure full and positive engagement of all parties through the proposed Reference Group.
Solution cannot be found to requirement for compensation arrangements	H	Continue urgent discussions with PAMIA and other advisers to identify potential solutions; Discuss possible solutions with the LSB.
Lack of internal resource and expertise to develop LA application and supporting processes	M	Once the timetable has been clarified with the LSB, assess likely resource needs and how these can be supplemented, e.g., through use of external lawyers to draft/redraft rules.
Lack of external consultancy resource (NB experience of LA applications is very limited due to the fact that to date on two applications have been submitted.)	M	Identify clear milestones and carefully manage any delay

7 Timetable

Appendix 6 addresses the timetable for the LA application.

Appendix 1 – Glossary of abbreviations

AR – approved regulator – approved regulators are named in the LSA and include CIPA and ITMA;

ABS – alternative business structure (known in the LSA as a licensed body);

LA – licensing authority – an approved regulator that has been designated as a licensing authority for ABSs;

LSA – Legal Services Act 2007;

LSB – Legal Services Board;

MoJ – Ministry of Justice;

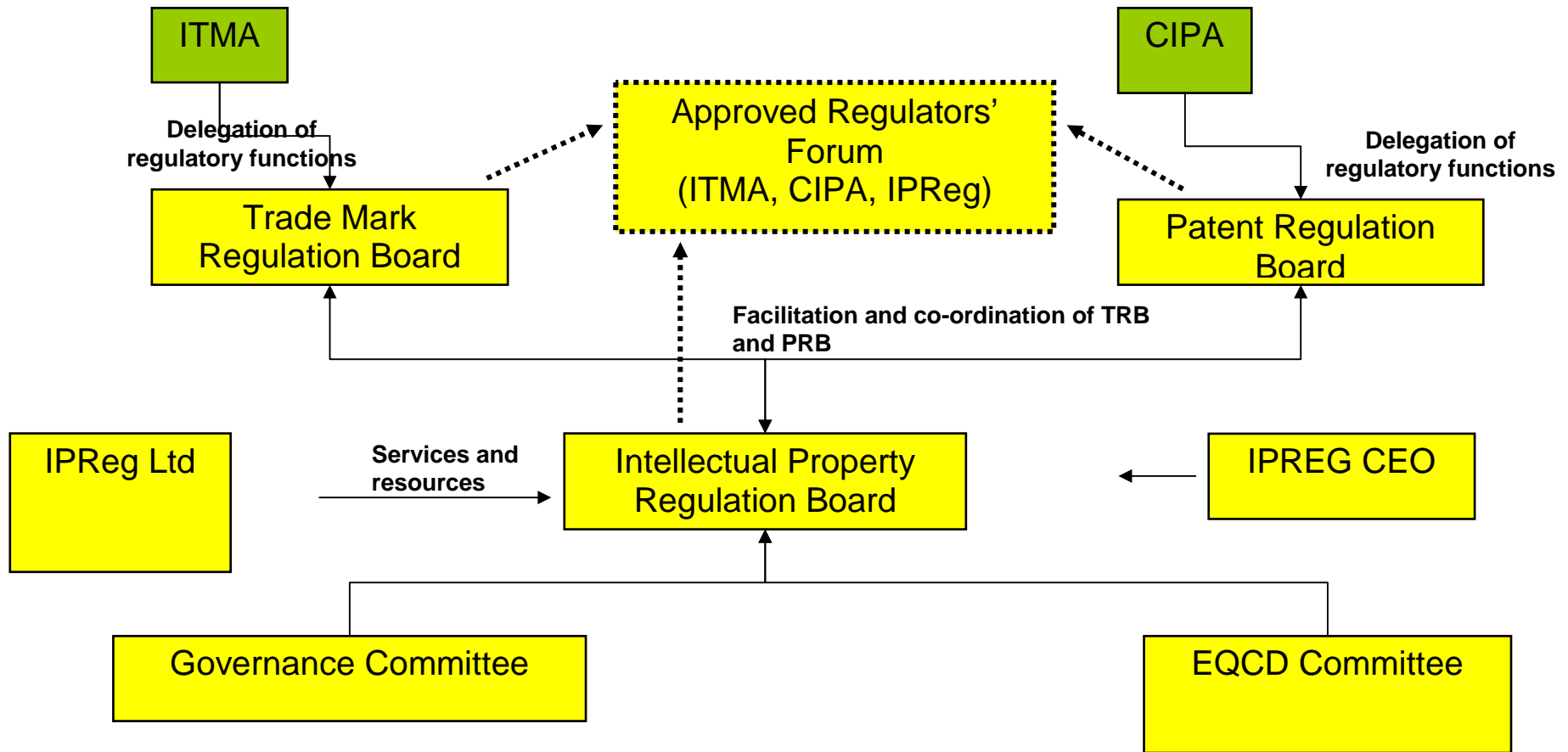
Section 69 order – an order made under s 69 LSA to amend legislation.

Appendix 2 – Better Regulation Principles

The Better Regulation Executive's Principles of Better Regulation state that any regulation should be:

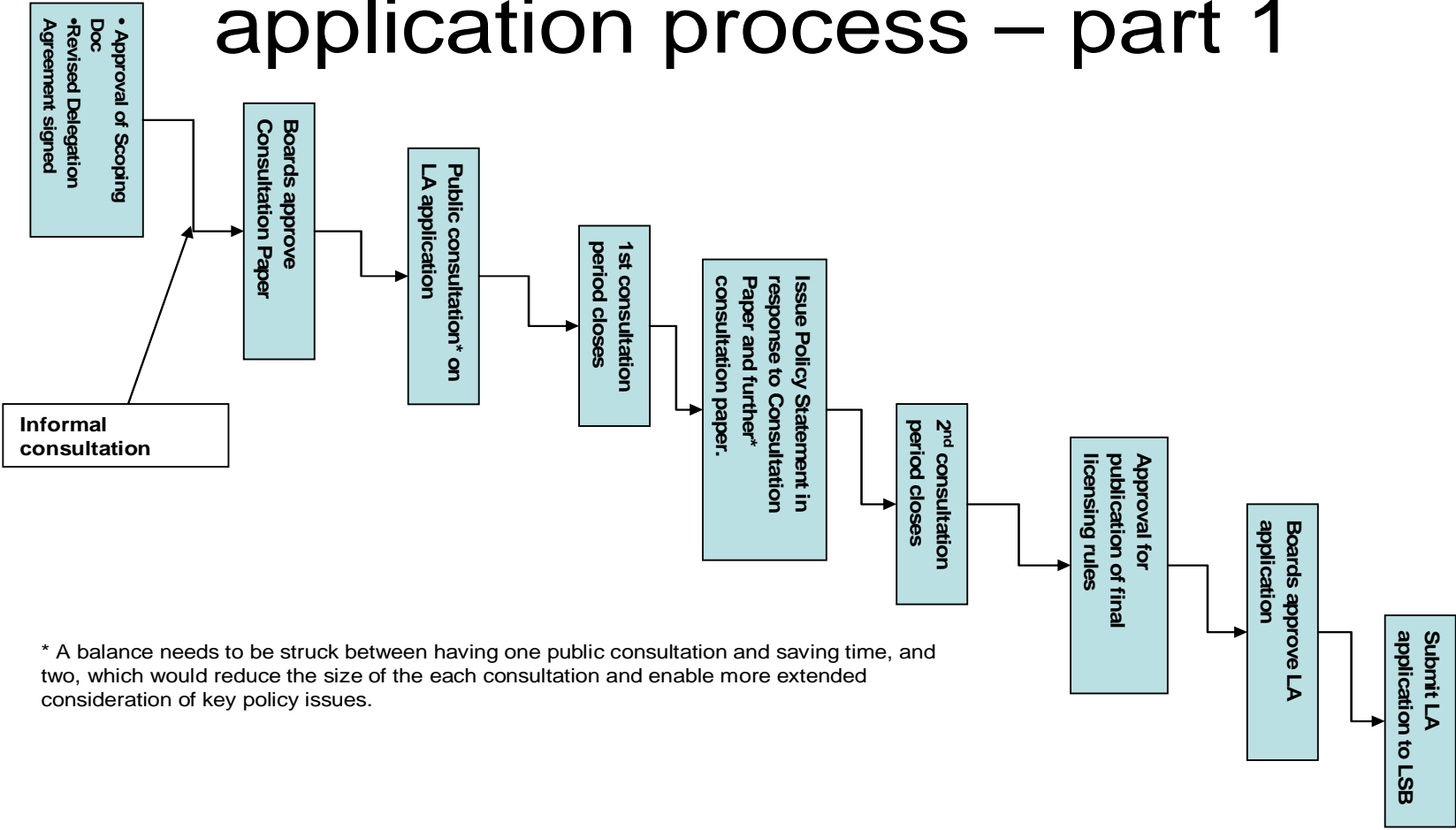
- transparent;
- accountable;
- proportionate;
- consistent;
- targeted – only at cases where action is needed.

Appendix 3 - Governance

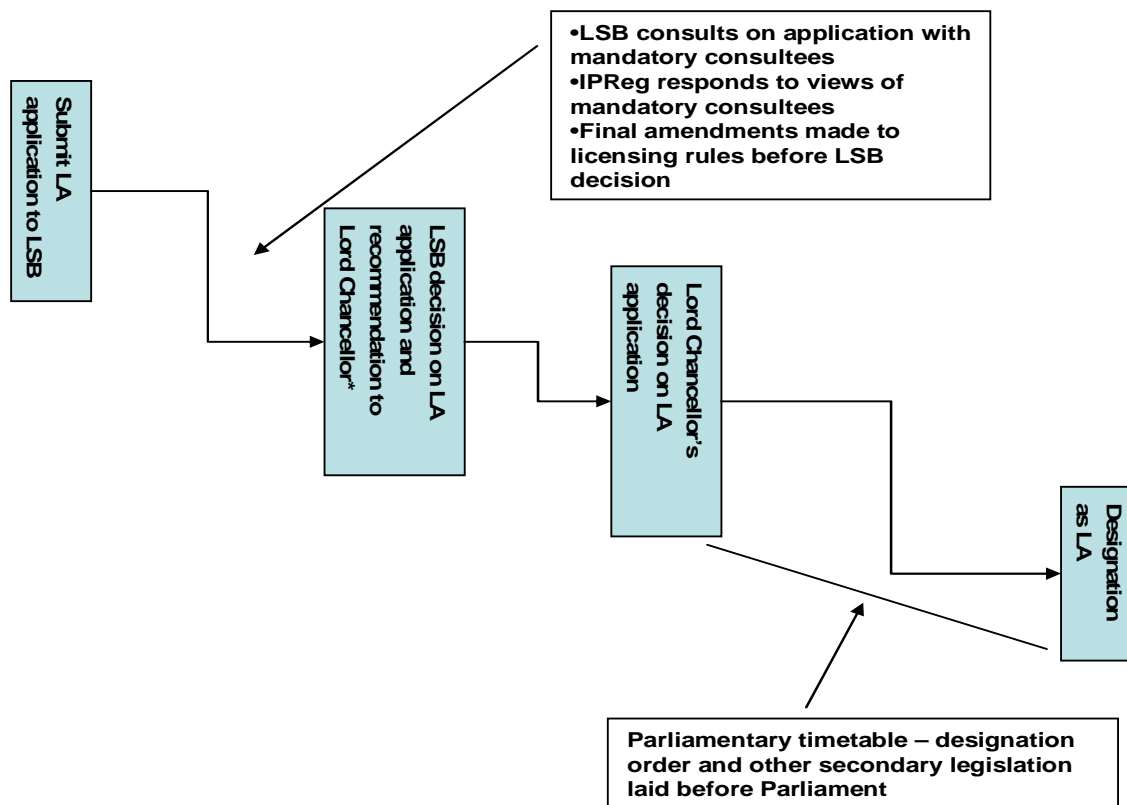


- Representative function
- Regulatory function

Appendix 4 - Overview of application process – part 1



Appendix 4 - Overview of application process – part 2



Appendix 5 – comments in Smedley report

No.	Comment	Specific to IPReg	Suggested approach in LA application
1	Regulated community is being subject to “a wider regulatory scheme than is required by legislation”	Yes	The LSA determines which bodies are “licensable”. IPReg will have to, in its rules, explain its jurisdiction in relation to licensable bodies. The SRA, for example, take the view that their jurisdiction for ABS covers reserved legal activities, legal activities and matters subject to a licence condition (i.e., beyond the reserved legal activities), based on their interpretation of the LSA. It is unclear whether Smedley is referring to the need to be registered (in current terminology) or the extent of the jurisdiction of IPReg should a body be registered.
2	Lack of information on the number of unregulated practitioners in the field	Yes	See section 5.1 of this report and the recommendation to conduct research on regulated community. This will enable IPReg to demonstrate within its LA application a stronger understanding of that community and therefore to justify its approach on key policy issues as being in the public interest, in furtherance of the regulatory principles and proportionate to the identified risks.
3	“Given that most practitioners could offer the full range of services (short of rights of audience) without being registered or otherwise regulated, there is a risk that any unduly expensive or burdensome regime will drive practitioners off the register and into the unregulated environment.”	Yes	In relation to ABSs, it would not be within a licensing authority’s power to force a body to be authorised. Bodies need only be authorised if they fall within the definition of being a licensable body (specifically, if they are conducting or intending to conduct a reserved legal activity). Therefore, whether the body needs to be authorised is determined by the legislation, not IPReg. It is open to any body to decide to conduct only unreserved activity and that is a commercial decision. This risk should not, however, be the determining factor in deciding what IPReg’s regulatory arrangements for ABSs should be; these must reflect the regulatory objectives and meet the requirements of the Better Regulation

			Principles.
4	Potential for friction between the membership bodies and IPReg	Yes	The main way that this issue can be addressed is through the Delegation Agreement.
5	Lack of information concerning the extent of regulated activity in their domain and associated risks	Yes	See 2.
6	No current restrictions on business ownership and mixed practices but this will need to be reviewed in the light of the LSA.	Yes	Statement is incorrect. IPReg's proposed regulatory regime for ABSs will be set out in the LA application.
7	Short track record of IPReg	Yes	Whilst it is true that IPReg has only been in existence for a relatively short period of time, those involved at Board level are drawing on considerable experience of the regulated community in CIPA and ITMA. The main concerns are likely to be with the experience of risk-based and outcomes-focused regulation. See also 11 below.
8	Need to verify perceived low level of regulatory risks		See 2 above.
9	Lack of information on consumers of legal services leading to a risk that regulatory arrangements may not be sufficiently consumer focused	No	See 2 above. In addition, the LA application will need to explain how IPReg has considered the needs of all types of client. Research amongst firms should provide more data on numbers of commercial clients and "Fred's in the shed" and the rules will need to address particular client needs based on that understanding of the client base.
10	Lack of information on regulatory overlaps	No	See 2.
11	Capacity and capability to meet the demands of the new regulatory environment given size and limited resources	No	In some respects the quality of the LA application and the dialogue with the LSB in the run up to the application should be a means of convincing the LSB of the capability of IPReg. The LA application will need to: <ul style="list-style-type: none"> • demonstrate an understanding of the required resources both in terms of levels of resources and capabilities; • estimate levels of resources. These estimates will need to be grounded in the number of firms and individuals to be

			<p>authorised and the amount of time required to fulfil the responsibilities of an LA in relation to those firms and individuals. Additional resources can be provided through the use of external suppliers.</p> <ul style="list-style-type: none"> • In terms of the skills base, IPReg will need to demonstrate at all levels that it has an understanding of its regulated community and of risk-based/outcomes-focused regulation. Again, some specialist skills can be bought in through the use of third party suppliers.
12	Ability to handle complaints as part of a “robust investigatory and disciplinary infrastructure”	No	IPReg already has a process in place for investigating firms and rules for withdrawing registration. These may need to be enhanced to provide the necessary assurance to the LSB and the regulatory arrangements, in terms of IPReg’s rules, will need to cover disciplinary procedures ¹² .
13	Culture and willingness to “embrace a changed style of regulation”	No	In the main this will be answered through the design of the regulatory arrangements and the extent to which these mirror the desired approach of the LSB.
14	Need for those working within the SRA to be “skilled and knowledgeable about regulation and risk management”	No	See 12 above.

¹² See section 4.2.2 of this report.

Appendix 6 – Timetable notes and assumptions

Timings under LSA and LSB Rules

1 Under the LSA, the Board has 12 months from the date of the application to give its decision to the applicant and its recommendation to the Lord Chancellor. This period may be extended up to a maximum of 16 months. Under the LSB's rules, the Board will aim to deal with an application in 6 months from the date of submission (or final submission if additional information is required).

2 Under the LSB's rules for applications to be designated as a LA, the LSB will specify a time limit for responses from the mandatory consultees, following which the applicant has 28 days to respond to comments from the mandatory consultees (or such longer period as the Board may specify).

3 The Lord Chancellor has 90 days from the date of the recommendation of the LSB to notify the applicant of whether or not he will make an order in accordance with the recommendation.

Timetable

I have set out the LA application timetable on the following page. In a letter to the LSB dated 9 May 2011, IPReg's Chairman stated that the date of designation should be March 2013, based on a "full start" in September 2011. Given that work did not commence in September, I have revised that estimated timetable. Taking into account the Parliamentary summer recess, the likely designation date would be October 2013. This is almost the same timetable as that set for the CLC and SRA. Although both met the timetable for submission of their LA applications (the SRA's designation has been delayed), they did so with the use of considerable resources and expenditure. It would be advisable to agree a more realistic timetable, which was appropriate for IPReg in terms of budget and resources. The timetable will also need to be agreed with the Ministry of Justice, recognising that it will be subject to the constraints of the Parliamentary timetable.

The timetable is based on the following assumptions:

- IPREG will publish two public consultations on its proposed approach for licensing ABSs;
- the LSB will make a decision on IPReg's LA application to an agreed deadline (ie, less than the 12 months provided for in the LSB's rules or indeed its stated aim of 6 months);
- the secondary legislation required is limited to that listed in this Scoping Document;
- CIPA and ITMA will make best endeavours to facilitate the LA application process.

Appendix 6 - Timetable

