

INDEPENDENCE, REPRESENTATION AND RISK: *Exploring Client Relationships in Large Law Firms*

Steven Vaughan and Claire Coe



‘Our work shows a striking shift in the balance of power from large law firms to their institutional clients, and a number of areas with the potential for lawyers’ independence to be compromised.’

Steven Vaughan, Birmingham Law School

The relationship between large commercial law firms and their clients and the impact of these relationships on professional independence, ethics, standards and risk is of central importance to the effective regulation of the solicitors’ profession. In their report, *Independence, Representation and Risk*, commissioned by the Solicitors Regulation Authority (SRA), Vaughan and Coe show a shift in the balance of power from law firms to clients, represented by the way in which major corporates and financial institutions seek to impose their own terms of engagement on law firms. This shift is not necessarily

reflected in the current SRA approach to regulation, which starts from the position that the law firm is setting its own terms of engagement. Clients’ contractual requirements constitute a form of regulation of the law firm by the client. Vaughan and Coe argue that this private regulation of the corporate and finance practices of large law firms and their corporate finance lawyers via contract has the potential to reduce the distinctiveness of those lawyers as legal professionals. As such, those lawyers may be seen by clients as, perceive themselves to be, and begin to behave like, mere ‘service providers’.

‘The concept of independence in the SRA Handbook does not account for the complexities of modern practice, or the pressures that lawyers in large law firms face. It needs to be reviewed and redrafted.’

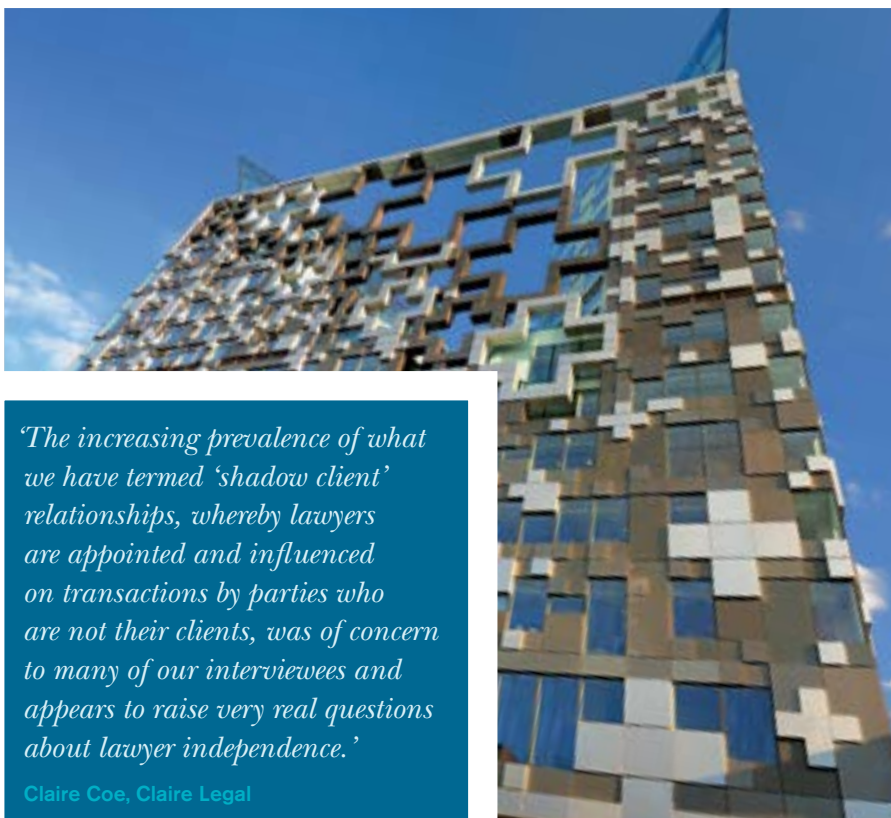
Steven Vaughan,
Birmingham Law School

THE PROJECT

In August 2014, Vaughan and Coe were commissioned by the Solicitors Regulation Authority (SRA), the body responsible for regulating the more than 130,000 solicitors in England & Wales, to conduct, on its behalf, a piece of independent research on lawyer-client relationships in large commercial firms. They focused on three broad questions:

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

Between December 2014 and March 2015 they conducted 53 interviews, speaking with a mix of senior corporate and finance partners (often department heads), Compliance Officers for Legal Practice (COLPs), risk officers and others, from 20 leading English and US law firms.



‘The increasing prevalence of what we have termed ‘shadow client’ relationships, whereby lawyers are appointed and influenced on transactions by parties who are not their clients, was of concern to many of our interviewees and appears to raise very real questions about lawyer independence.’

Claire Coe, Claire Legal

The findings

25,600 LAWYERS

BETWEEN 2000 AND 2012, THE
IN-HOUSE LAWYER POPULATION
DOUBLED TO 25,600 OR 18% OF
THE TOTAL LAWYER POPULATION

LAWYER-CLIENT RELATIONSHIPS

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

Vaughan and Coe found a significant perceived shift in the balance of power from law firms to clients. This manifests in part in how major corporates and financial institutions seek to impose their own terms of engagement on law firms. A number of clients engage law firms via panels; a competitive process whereby law firms pitch to be one of a number of dedicated lawyers for the client. One of the conditions of these panel processes is often the acceptance of detailed, mandatory sets of terms and conditions (also often known as 'outside counsel guidelines'). These guidelines cover a variety of matters, from fee arrangements to secondments, IT security, conflicts of interest and much more.

Despite around three quarters of the interviewees outlining a scenario whereby they are being forced to accept more and more onerous terms of engagement with little room for negotiation, Vaughan and Coe found that four or five of the firms interviewed said that they routinely pushed back on terms that they deemed unacceptable. Crucially, these firms continued to receive instructions, including where they refused to accept positions on panels because of terms that they could not get comfortable with. This suggests a dynamism and complexity to lawyer-client relationships in large firms.

INFLUENCING ACCESS TO REPRESENTATION

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

An almost universal concern to interviewees was the seeking by clients to restrict, via contract, who a lawyer and a firm can act for. It was the first issue raised when interviewees were asked to talk about particularly challenging contractual clauses in their terms of engagement. Where these clauses restrict the ability of firms to sue their clients (on matters where those clients are represented by another law firm), this gives rise to potential issues for third parties who may not be able to

secure representation from their first choice of lawyer or firm. This practice has been raised previously by the Tomlinson Report (2013) as of specific concern in the context of financial institutions, and the same theme comes out from this data.

The interviewees split down the middle when asked whether their clients imposing 'no sue' clauses impacted on the ability of third parties to gain effective legal representation. Half of the interviewees were of the view that these practices have led to the opening of boutique litigation firms and firms developing bank litigation practices that have cornered a niche in the market and offer representation where needed. The other half, while accepting these niche firms had opened, questioned the quality of representation at those niche firms. What seems clear is that the market for litigation has been reshaped as a result of contractual provisions on conflicts of interest.

LAWYER INDEPENDENCE

Q *'How you would describe professional independence?'*

A *'Crikey, I've never even heard the expression'* **EH Finance 4**

Independence in the legal profession is a complex and nuanced concept. At its most basic, it is the practice of advising and acting free from inappropriate influence and is commonly understood as a tripartite relationship between the client, the lawyer and the state. Interviewees were asked what they understood by the term 'lawyer independence' and whether they had encountered situations in which their independence, or the



THE TOP 196 LAW FIRMS THAT THE SRA CATEGORISES AS 'HIGH IMPACT' FIRMS EMPLOY ONE THIRD OF PRACTISING LAWYERS REGISTERED AS OF MARCH 2015

- HIGH IMPACT FIRMS
- PRACTISING LAYERS

independence of other lawyers, had been challenged. They were, in general, unable to clearly articulate what the principle of independence meant. However, when pushed, most could understand the importance of lawyer independence, although a minority were of the fixed view that they were not independent, and were not appointed by clients to be independent. This is a concerning lack of understanding of the SRA Handbook, which states that a solicitor and law firm must, "not allow [their] independence to be compromised" (Principle 3). This is one of the ten core principles with which every solicitor and firm must comply. One particularly concerning example of a challenge to independence arises in the context of what Vaughan and Coe term 'shadow clients.'

'SHADOW CLIENTS'

'I think there is a genuine potential, I only say a potential, for ethical conflict if your fees are being paid by a third party'

EH Corporate 2

In leveraged finance deals, but also elsewhere, borrowers often dictate which law firms their lender banks can use for legal advice. This situation arises because the borrowers are typically paying the banks' legal fees, and as such feel justified in influencing the decision over which law firm is instructed for the banks. In this situation, the borrower becomes a law firm's 'shadow client' (as Vaughan and Coe call them), with significant influence over the law firm's appointment, remuneration, and potentially the scope of its work, but without directly instructing it. Critically, interviewees

reported that it is becoming increasingly common practice for the sponsor on a private equity transaction to appoint the law firm that will advise the lender before that lender bank has been chosen.

It is accepted that banks are sophisticated users of legal services, and that borrowers have the market power to dictate terms to their banks (with the law firms acting as bystanders to these interactions). However, Vaughan and Coe express concern that these 'shadow client' arrangements put the independence of lawyers at risk and therefore raise challenges for the legal profession and the SRA. These situations were of significant concern to interviewees, a number of whom raised them (unprompted) as instances where a lawyer's professional obligations might be challenged in practice.

RISK TRANSFERS

'You know very well that half the time people instruct you because they want your insurance policy to back them up' EH Corporate 9

Interviewees were asked about the extent to which they are willing to accept liability for advice given to their clients by other advisers (e.g. by law firms based in jurisdictions where the initial firm did not have an office). They were also asked whether clients sought indemnities from them, and the extent to which clients expected them to work on the basis of uncapped liability. The data suggests an increase in the risks accepted by firms, on an individual and systemic basis, with some (but not many) firms being robust in their push back against these three practices. While this is

interesting, it is perfectly possible to see these changes as simply an allocation, or reallocation, of power between sophisticated parties. However, Vaughan and Coe suggest there is an equally valid argument that sets out that these risk transfer practices operate to build up systemic risk in the legal profession, which could, in due course, lead to significant liability, the risk of law firm collapse, and a resultant undermining of the strength of the profession (in terms of brand and perception) on the international stage.

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

EH Finance 10

50%
TURNOVER
FROM THE 196 'HIGH IMPACT'
FIRMS REPRESENTS AROUND
HALF OF THE TURNOVER OF THE
ENTIRE LEGAL SERVICES SECTOR

RESEARCH SPOTLIGHT

OCTOBER 2015



ABOUT THE AUTHORS

Dr Steven Vaughan: Steven practised as a lawyer in the City for nine years, first with Freshfields Bruckhaus Deringer and then with Latham & Watkins, before making the move into academia. He is a Senior Lecturer at Birmingham Law School and the Director of Education in its Centre for Professional Legal Education and Research. A part of Steven's time on this project was paid for via his ESRC grant (reference ES/K00834X/1).

✉ s.vaughan@bham.ac.uk

🐦 @lawvaughan

Claire Coe Smith: Claire has more than 15 years' experience working with City and International law firms, analysing their businesses and the strategic issues they face. Claire is a former Editor of *Legal Business* and a regular writer for *Financial News*, *Private Equity International*, *The Times* and *City AM*. She now has her own consultancy, conducting writing and research work in the legal and professional services industry.

✉ claire.coe@clairelegal.com

Recommendations

The SRA, as regulator, has a challenging task of deciding when, and how, a matter is of regulatory concern, compared with when and how a matter is only (or primarily) a market issue. The SRA did not ask Vaughan and Coe for recommendations of next steps in the research report. However, Vaughan and Coe are of the view that:

- 1 the principle of 'independence', as currently set out in the SRA Handbook and associated guidance, does not well match the realities of practice in large law firms and could be better framed;
- 2 the long standing practice of 'shadow clients', an area of growing prominence where law firms (and their banking clients) are unable to resist what have become market norms, is an area of real concern and should be addressed; and
- 3 the build up of risk across the largest firms, and the potential for significant impacts from uncapped liability is striking.

References

Coe, C and Vaughan, S (2015) 'Independence, Representation and Risk: An Empirical Exploration of the Management of Client Relationships by Large Law Firms' (October 2015, Solicitors Regulation Authority)

Suggested Spotlight Citation

Vaughan, S and Coe, C (2015) 'Independence, Representation and Risk: Exploring Client Relationships in Large Law Firms', Birmingham Law School Research Spotlight, University of Birmingham.

Acknowledgements

Vaughan and Coe are very grateful to the SRA for the opportunity to undertake this research and, all importantly, to the partners, COLPs, risk officers and others who gave their time to talk. Siu Wong, a final-year law undergraduate at the University of Birmingham, acted as research assistant in the early stages of this project and they are very grateful for all the work he did. The research was undertaken on an independent basis for, and on behalf of, the Solicitors Regulation Authority but does not necessarily represent its views.

UNIVERSITY OF
BIRMINGHAM

Birmingham Law School
Edgbaston, Birmingham,
B15 2TT, United Kingdom
www.birmingham.ac.uk



@BLSresearch
#BLSwhoweare