

# **Regulation and How this Affects the Professional Indemnity Insurance Arena**

## **Introduction**

Organisers of this conference may have had a rather different vision of what I might cover when they suggested the title for this talk. The 'Regulations' they had in mind were probably those specifically applying to the insurance industries or even particular parts of it, such as the regulation of the Lloyd's market or the reinsurance industry. There will be at least an indirect smattering on that as I skip through the FSA regime; but rather than focusing specifically on what new prison bars are limiting the freedoms of English Insurance companies, I thought this slot might be better filled by drawing together some of the threads of the modern regulatory and professional authority culture insofar as it affects the third party risks of mainstream professional insureds, rather than simply their insurers. As a professional risks Partner in one of the regional offices of a national law firm, I can pass on the dubious benefits of personal experience on this aspect of "The PI Insurance Arena" as much if not more than I'm qualified to explore the more esoteric intricacies of the industry in London.

The dominant model, in place for half a decade now, is the Financial Services Authority (FSA) and the Financial Ombudsman Service (FOS) which is accountable to it, so I'm going to spend a little time summarising those Institutions and also the current and proposed new regulatory and service infrastructures proposed for the legal professions and make some impressionistic comments in light of my own and my firm's experience of dealing with them. I shall then skip through a few recent cases to try to see how they are being treated by the courts; before finishing with a quick round-up of how the professional indemnity insurance industry is responding.

## **Overview**

Until recently, professional regulatory and consumer complaints authorities have been shy to deal with claims for monetary loss, sending petitioners back to their solicitors to pursue actions in the High and County Courts. But, particularly in the legal and financial services sectors, consumer-driven tribunal or ombudsman infrastructures are being developed to operate new jurisdictions parallel to the courts. Some of these are evolving ad hoc, others by legislation, motivated by need to integrate with European trends and designed to address, in the guise of service complaints or regulatory contravention, the need for systems for resolving claims for losses or damages which are quicker, cheaper and therefore more proportionate to smaller claims than traditional civil court professional negligence actions.

The price for this is a high one, not only or so much in terms of cost – which mostly will have to be met by the professions, albeit passed on indirectly to users - but rather in the sacrifice of judicial integrity. Traditional stringencies of

common law tort and contract actions – including rules of precedent, limitation, privilege, evidence, causation, and third-party contributions – are all surrendered, to a greater or lesser degree; and, whatever advocates for the new systems may say, the heavily weighted tactical and political whip hand is held by the consumer.

### The FSA/FOS Model

Regulatory governance of the financial advisory professions operates through the several bodies created, from 1 December 2001, by The Financial Services and Markets Act 2000 (FSMA), the two principal ones, for purposes of this talk, being the Financial Services Authority (FSA), which exercises regulatory and disciplinary functions; and the Financial Ombudsman Service (FOS).

### **The Financial Services Authority**

The FSA became the single regulator for the financial services industry, responsible for supervising banks, building societies, friendly societies, insurance companies and other financial institutions and, through its Code of Market Conduct and Market Abuse Regulations, policing those industries against market abuse or manipulation and insider trading. It is also responsible for regulating credit unions (since 1 July 2002), mortgage providers and advisers (since October 2004), and the sale of general insurance by insurance brokers (since January 2005).

It is a private company limited by guarantee accountable to the public through its annual public meeting. It has a wide range of rule making, investigatory and enforcement powers, its functions being described in the Act in general terms, thus at least in theory flexible to respond to changing markets. It also has power to challenge firms' use of unfair terms in standard form consumer contracts. In all its functions of setting policy, rule-making and enforcement, the FSA is under a duty to act in a way that is compatible with statutory objectives:

- Maintaining market confidence
- Promoting public understanding of the financial markets
- Protecting consumers
- Reducing financial crime

These are supplemented by "*principles of good regulation*", including the need to facilitate innovation and competition and to minimise the anti-competitive effects of regulatory measures.

It is immune from civil actions, but its immunity will not apply to acts of bad faith or breaches of the Human Rights Act.

## Enforcement by FSA

There is a consolidated regime for regulatory and disciplinary investigations; and for other enforcement action, including powers to obtain relevant information from anyone, sometimes from people unconnected with the enquiry; and a wide range of enforcement powers which include the ability to fine individuals and companies, publicly censure both, stop individuals from working in the industry, remove permissions from companies so that they can no longer trade, vary permissions to prevent companies performing certain regulated activities and through other authorities to imprison individuals.

The FSA uses its powers of enforcement advisedly. It will usually only use them where there is a serious breach of rules or principles or where the FSA can get the most bang for its buck! Where it is trying to make a point.

There have been a number of enforcement actions in the insurance industry over the past couple of years (since FSA started to regulate insurance brokers in January 2005). These actions have included:

- Cancelling a firm's permissions (effectively shutting it down) for repeated failures to submit its annual regulatory returns despite requests from the FSA; also where a firm fails to meet the minimum capital requirements (and continues to do so despite repeated requests);
- Cancelling a firm's permissions for failing to pay redress to a complainant following an award made by the Financial Ombudsman Service
- Cancelling a firm's permissions for failing to maintain adequate resources
- Public censure and/or fines for failings in the sales of Payment Protection Insurance (PPI) cover; and
- Prohibition order against an individual for "*knowingly relying on forged documents*", "*recommended lying to an insurance company*" and so on. The case in mind is George Robert Piggott and is a good example of both how serious breaches by an individual are treated - but also how serious the breaches need to be.

Key focus areas for the FSA in the insurance sector are currently:

- Sales of PPI
- Call centres and the selling practices used
- Transparency of pricing
- Contract certainty

- Fraud and financial crime
- Handling of client money
- Identification and management of conflicts of interest

#### No PI Cover (save defence costs):

It is important to note that PI cover for the payment of fines or penalty awards from the FSA is prohibited by FSA rules; so there are no direct risks or losses for which professional indemnity insurers can become exposed. But cover is not infrequently offered against the costs of defending an FSA investigation or prosecution; and its regulatory powers and capacity to intrude upon both insureds and insurers, and its 'parent' status in respect of the FOS, have a direct relevance to every firm's professional insurance risks.

#### Regulatory Decisions Committee:

Most FSA decisions to take enforcement action are made by the Regulatory Decisions Committee (RDC) after hearing representations from the firm or individual concerned.

#### The Financial Services and Markets Tribunal:

There is then a channel for appeal to The Financial Services and Markets Tribunal, an independent body which is intended to provide a safeguard for those subject to enforcement action.

#### The Legal & General case:

One case particularly pertinent to the ambit of this talk was a challenge by Legal & General in early 2005 against a decision by the RDC to fine them £1.1million for alleged systemic mis-selling of endowment policies. That decision was based on apparent responses from some 150 out of a sample survey of 250 'low risk' investors which appeared to show that 39% of the respondents had not been properly advised or protected from risk.

Extrapolating those statistics to L&G's total customer base of 40,000 investors, the Board claimed that nearly 40% of its consumers must not be receiving correct advice. The fine was overturned by the Tribunal which found both that the method by which the RDC had reached its conclusions was flawed and that the factual accuracy of the subject cases was unsound.

Notwithstanding this embarrassing result, the concept that the FSA powers extend to the disciplining of firms apparently guilty of systemic wrongdoing without requirement to respond only reactively to expressed complaints, or even to investigate each customer's case individually, remains intact, and continues to receive political support. There are still no published rules, protocols or standards for accumulation and presentation of evidence or

methods of investigation and the risks inherent in such ad hoc and inherently unscientific investigations remain a concern.

### **The Financial Ombudsman Service:**

The Financial Ombudsman Service (FOS) is the Body created by FSMA which is perhaps of most direct financial relevance to professional firms, and hence to their insurers. It is a public body, established as a limited company operating independently of the FSA, but accountable to it. Membership of FOS is compulsory for all authorised firms.

#### Purpose: Quick resolution:

Its purpose is to resolve individual disputes between consumers and financial services firms – fairly, reasonably, quickly and informally. It does not have a regulatory role so cannot fine or punish firms, that being the role of the FSA.

#### Purpose: Guidance:

It also issues guidance on how it handles particular types of complaint, and examples of cases it has handled, which are intended to influence firms in their own complaints handling procedures.

#### Funding - Annual levy:

It is funded by an annual levy on all firms covered by the service.

#### Claimants not usually represented:

Solicitors are rarely employed to assist in FOS claims by the Claimant and legal costs are not awarded.

#### Legacy Ombudsman services:

The FOS encompasses many predecessor Ombudsman bodies including:-

- Banking Ombudsman;
- Building Society Ombudsman;
- Personal Insurance Ombudsman;
- Investment Ombudsman;
- Insurance Ombudsman;
- Personal Investment Ombudsman;
- Securities and Futures Complaints Bureau and Advisory Service;

- Financial Services Authority Direct Regulation Unit and Independent Investigator;

Pensions Ombudsman still separate:

The only important area where the FOS does not have a jurisdiction is in complaints related to mal-administration of occupational pension schemes which are governed by the Pensions Ombudsman (although there are proposals for this to become a division of the FOS).

“Regulated” investments:

Most activities of financial advisers in relation to regulated products will be covered, including advising, selling, managing or purchasing an investment product for an investor. The “regulated” investments are specified in the delegated legislation, but would include the majority of products recommended by an IFA including endowments, precipice bonds, insurance bonds, gilts, unit and investment trusts.

General insurance and mortgage products:

The remit of FOS has been extended to include matters of general insurance and mortgage products.

£100,000 Maximum award:

The statutory maximum award is £100,000, so claims for higher value have to proceed through the courts.

Inadmissible applications:

Other reasons why FOS applications may be disallowed include:

- Lack of merit or reasonable prospects of success, there is no material loss, or a “*fair and reasonable amount*” has been offered;
- Undue complexity or technicality;
- If the complaint is being or has been considered already, or in another appropriate court of disciplinary forum (but the FOS may stay the case while the court hears the matter);
- If the Complainant is a business with an annual turnover in excess of £1m;
- If the Complainant has not been through the firm’s internal complaints procedure;
- If the complaint is solely about poor investment performance; or

- If the Ombudsman is satisfied that there are “*other compelling reasons why it is inappropriate for the complaint to be dealt with by the FOS*”.

#### Firms’ Complaints Protocols:

A regulated firm is expected to have a structured complaints handling process for dealing with complaints, concordant with a timetable leading strictly to a response within 8 weeks, failing which it risks further complaint and/or sanction. This period is absolute and contrasts with the longer 3 month period under the pre-action protocol for professional negligence claims.

#### Initial Adjudication:

Following referral, an admissible complaint is allocated to an Adjudicator, who is not legally qualified but will have basic financial planning qualifications, for investigation, often involving further representations from respective parties, and an initial decision, usually adopting fairly formulaic criteria, either in form of an initial reasoning or a formal adjudication. Oral evidence is rarely considered.

#### Referral to Ombudsman (either party):

If either party is unhappy with the result, they can insist upon referral to the Ombudsman, who will be legally qualified, and whose decisions can be expected to conform more with lawyers’ expectations. If the Adjudicator’s decision is upheld, the Ombudsman’s decision will be issued; but if not, the decision remains provisional pending further comments from the parties before a final decision is issued.

#### Confirmation of acceptance by Complainant:

The Ombudsman’s final Decision is not binding until the Complainant confirms in writing that he accepts it. There is a significant imbalance between the position of the firm and the Complainant since the Complainant can simply choose to ignore the decision and take the matter to court, whereas if the Complainant accepts it then there is nothing the firm can do.

#### No appeal:

There is no right of appeal and the only legal option left is Judicial Review, which is confined to a focus upon the process by which the decision was reached.

#### Ombudsman’s subjective discretion; “fair and reasonable”:

The courts will not normally interfere with the Ombudsman’s very broad discretion, which is to “*determine the complaint by reference to what is, in his opinion, fair and reasonable in all the circumstances of the case*” taking into account “*the relevant law, regulations, regulatory rules, guidance and standards, relevant*

*codes of practice and, where appropriate, what he considers to have been good industry practice at the relevant time”.*

No necessary adherence to common law principles:

Whilst the basic test of common law negligence - the standard of conduct to be expected of the reasonably competent professional giving advice at that particular time - may be heeded more often than not, there is no rule of precedent, and adherence to principles of causation, evidential uncertainty and disregard of hindsight is, by anecdote of colleagues who deal regularly with this work, inconsistent. Causation in particular is an area which adjudicators can have trouble with, especially points as to how the complainant would have alternatively spent his money and what would have happened to it then.

Case comparison: Beary v PMI:

Two recent legal cases deserve comparison. In **Beary v Pall Mall Investments [2005] EWCA Civ 415**, Pall Mall conceded that, in breach of duty, it had failed to advise Mr Beary on alternative methods of dealing with his pension fund, in particular, the possibility of buying an immediate annuity. However, the Judge found that if Pall Mall had explained the possibility of purchasing an immediate annuity, Mr Beary would not have done so. Causation was, therefore, not established and this part of the claim failed.

Case comparison: IFG v FOS (Ombudsman not fettered by legal doctrines):

Compare that then with **IFG Financial Services Ltd v FOS [2005]. EWHC 1153**, a Judicial Review application which raised the question whether the Ombudsman is obliged to follow normal English law in deciding what is ‘fair and reasonable’; and if not, whether the Ombudsman is ‘above the law’. IFG were IFAs who advised their clients, Mr & Mrs Jenkins, on investments. Two problems emerged: first, the Jenkins’ requirement was for medium risk investment but IFG wrongfully invested in high risk investments - currencies and derivatives funds. Second, the fund had a fraudulent investment manager, which could not reasonably have been foreseen, nor could IFG have taken steps to protect the investors. The FOS made an award for IFG to pay the investors the whole of their loss from their investment in the fund, including the loss resulting from the fund managers’ dishonesty. It was common ground that IFG would not have been legally liable in a civil court for the fraud if the investors had sued, and IFG’s insurers accordingly sought a judicial review. Their application was dismissed on the basis that the award was not ‘irrational’; the Ombudsman had considered the position in law, although chose not to follow it in deciding what was ‘fair and reasonable’. FOS awards form a different liability regime to legal liability, in which the Ombudsman has wide scope to come to subjective decisions.

This result has produced many objections from legal commentators, not so much that the FOS should have the power to apply his own interpretation of reasonableness, but rather that insofar as there is a clear common law



principle - that professionals should not bear losses which fall outside the scope of their legal duties (Lord Hoffman in **Banque Bruxelles v Eagle Star HL, 1997 aka SAAMCO**), which itself was premised on what the Lawlords considered “fair and reasonable” (yes those very words), it comes rather rich that the Ombudsman should purport to know better.

An interesting angle in the story, however, is that the man in charge at IFG went on record to say that the decision to run the JR challenge was entirely the insurers’ and that he did not take undue exception to the Ombudsman’s approach.

I expect the insurers among you to be muttering already that that’s all very well, but it’s a far cry from proving the requisite elements of duty of care, breach, causation and loss in a professional negligence claim; how are we to understand and underwrite professional risks if we can’t even be sure that FOS will follow the law?

#### Scope for speculative claims:

Perhaps the bigger worry is that this decision will encourage people to bring speculative or legally unwinnable claims to FOS with optimism that they don’t have to prove their suit against legal principles, and it is likely to influence the outcome of cases leading to more decisions in Claimants’ favour. The FOS have made attempts to cork that bottle by describing the IFG case as unique to its rare facts, but notwithstanding that absent any rules of precedent future adjudicators don’t have to have regard to it, the seeds of doubt are well sewn among those who have to contemplate the risks.

#### Other ‘sidelined’ legal concepts:

Other steadfast legal concepts are also sidelined in the FOS arena. Rather than the 6 year limitation period of civil law, the deadline for a FOS complaint is 15 years and even that safeguard against exposure may be undone by the “fair and reasonable” principle.

Thus for purist common lawyers raised on the strategies of tightly regulated adversarial process, this is a whole new game; and for member firms the criteria for risk and claims avoidance have evolved a long way from where they were only a few years ago.

#### Reducing the FOS risks: ‘Fact find’ records:

So, what are the new benchmarks for inhibiting risks of an FOS exposure? The most important thing is the preservation of good records that the investor client has been properly advised ahead of the investment commitment. Unless there is a clear ‘fact find’ record on the adviser’s file recording the personal and financial circumstances of the client, preferably signed by them, it is very easy for the Adjudicator and the complainant to assert that proper consideration has not been given to the personal financial circumstances of the Complainant and therefore the advice was unsuitable.

### Reducing the FOS risks - "Reasons Why" letters:

Likewise, the absence of a "reasons why" or "suitability" letter on the file, explaining the recommendations and the risks of the products, can leave an open goal for complainants. To defend a complaint successfully, the adviser needs to show the Complainant understood the investment or transaction, and often also that it was suitable to their subjective circumstances, the size of the investment relative to total resources, and attitude to risk.

### Reducing the FOS risks: Contemporary evidence:

Contemporary evidence of the qualities and value of the investment product comparable to others as perceived by the market is also important, not least to discourage subservience to hindsight if the investment subsequently fails.

### Contentious Issues:

There are several other contentious issues to complicate the prediction and management of FOS risks:

*"Treating Customers Fairly"*: The TCF regime implemented by the FSA is intended to provide a set of values that will ensure that all customers are treated equally. However, as no FSA guidance has been issued in relation to exactly what TCF is this issue is the subject of much speculation.

*Increase in the £100,000 maximum award*: There have already been proposals to increase the maximum award available to FOS to £200k, but it has recently been decided that the current £100k limit will remain until 2009, on the basis that the majority of complaints reviewed by FOS currently fall under the £100k mark. The concerns for insurers would be two-fold: as well as the consequent uplift of the amounts of risk exposed to the uncertainties of the summary system, more complaints will be referred to FOS, thereby increasing their caseload and the delay before matters are dealt with, adding longer tails to claims and tying up capacity.

*Claims for unrecovered balances through the courts*: we can expect a growing number of claims where the value of the claim exceeds £100k but, for commercial or tactical reasons, the consumer still goes to FOS, where a favourable outcome will provide useful tactical advantage in the court action. An attempt to run a sequential claim to a Northern Ireland court was thrown out recently, but the rationale of that decision has not been considered yet in England and may not withstand scrutiny.

*Uncertain quantum decisions*: A growing tendency to impose formulaic methods for calculation of loss, where FOS is reluctant or unable to fix upon a decisive figure, is creating unease that this may be a handy back-door to recoveries in excess of £100,000.

*Insurance consequences of supra-£100k awards:* Most policies covering FOS exposures limit the indemnity to the official maximum, creating tactical and commercial dilemmas for insureds when their exposure runs above it.

*Ombudsman News:* Although there is no strict principle of precedent, that has not stopped FOS publishing its decisions on a monthly basis as demonstrations or illustrations of prevailing rationales; and these indisputably carry heavy influence on subsequent decisions. Thus once again it gets to have its cake and eat it.

*Claims Management Companies:* Claims companies provide formulaic, standard letters of claim which encompass a whole range of issues and invariably these issues do not all apply to every Claimant; but FOS is rarely cynical enough when it comes to testing the evidence provided by them. FOS says that statistically the involvement of Management companies is having no impact on the proportion of successful claims, but that may be because ineffectual scrutiny of evidence is endemic to most cases.

*Unfair Consumer Bias:* The uneven right of the Complainant to ignore an FOS decision if he chooses, but the professional adviser is bound by it, is the primary tactical advantage for the consumer; closely followed by the fact that his risks are minimal because the process is free, whereas the adviser not only pays dues towards the costs of the service but also has to bear the price of investigating and responding to often spurious complaints. But that is not to say that the system doesn't work, or that it is inherently disadvantageous to the professional industries. On the contrary, were the total cost of the system to be analysed and counted – it probably has been, but I haven't located any published review – the speedy recourse to justice, rough and ready though it may be, has produced many advantages and it has not been the experience of my firm that our professional clients are getting a consistently raw deal. ...That said..

*Public confidence:* For all that politicians and government advocates clamour their approval, especially in context of promoting the FOS as a model for the legal professions, the service is still regarded with sceptical caution among the general public and the media.

The concern above all is that the FOS system inherently lacks legal integrity and must therefore undermine justice and ultimately the social and commercial stability stemming from it. To an extent the fairly widespread suspicion or outright hostility among lawyers is driven by chagrin that so much potential business has been taken from them; but there are many who share real concerns, myself among them, that the FOS is a cheap device which is bound to deliver a cheap return for financial clients and service providers alike.

### Disparity with Legal principles:

I have already discussed some of the stark disparities between the respective civil court and FOS systems, but it is relevant to summarise some of the key distinctions.

*Evidence* - the FOS will make a decision in most cases based entirely upon written evidence produced by the parties, which is often flimsy and frequently unorganised. Where the Complainant is unable to produce detailed evidence, the FOS will substitute or construct a case by piecing together the information to aid the Complainant. Evidently this leads to a lack of scrutiny and often to the FOS accepting a Complainant's version of events despite inherent flaws.

*Privilege* – the FOS is a scarce respecter of privilege or even confidential documents; refusal or failure to produce key material will be construed against the Insured. There are no rules of evidence to assist the Insured as there would be in Court. Conversely if a Complainant fails to produce documents this will not be construed against them.

*Remit* – the test of what is “*fair and reasonable in the circumstances of the case*” is an exceptionally wide remit and allows for a wide variety of decisions to fall within a reasonable decision, hence the virtual impossibility of judicially reviewing an Ombudsman's decision. The Court, on the other hand, is required to follow precedent case law and set out detailed reasons as to why it has reached the decision it has, otherwise an appeal may be forthcoming by the losing party.

*Formulaic Response* – the lack of expertise of the Adjudicators and overall caseload of FOS personnel means that example cases are used for others to follow where facts are similar. Such formulaic responses can result in cases not being viewed as individually as they would be in Court and there is abundant scope for claims to be wrongly decided because the Adjudicator lacked the ability or simply the time to assess the accuracy with which the facts matched the precedent example case.

*Imbalance* – whereas a complainant can bind the firm by accepting the FOS decision, or choose to reject the decision and refer the matter to Court, the firm has no such power.

*Informality* – the FOS system is a lot less formal than the Court system which means less scrutiny of the evidence and relevant issues.

*Subjectivity* – another symptom of the different systems is the Ombudsman's liberty to tailor decisions according to the subjective dispositions of the parties and other factors which courts are prone or obliged to ignore.

*Consumer bias* - as already discussed; Claimants enjoy inherent procedural and evidential advantages.

*Mitigation* – FOS seldom addresses counter-allegations of failure to mitigate.

*Third Party Contribution* – Insofar as an FOS award is not a liability as such, there is minimal scope to pursue a contribution claim against another party who in a civil law context might be partly to blame.

*Precedent* – FOS has no rule of precedent and referral to other cases is consultative rather than compulsory.

The vital point to remember in this, however, is that complex, technical or multiple-party cases, ill-suited to summary adjudication, will not be taken up by FOS in the first place. FOS is a course for the simpler horses. There may be quite a lot to tackle on quantum issues, often with contested expert evidence, but intricate issues of law matter less in these circumstances than the need to get to a figure which stands up to scrutiny.

Advantages for professionals or their Insurers:

There are some areas where the FOS system can be used to a Defendant firm's advantage.

*Tighter timeframe:* There is just a 6 month time period for referring a matter to the FOS once a final letter of response is received from the firm, which is of course much shorter than the limitation period for a claim in the Courts and, if used correctly, can enable firms to close their files a lot quicker; the FOS complaints process is a lot quicker than the pre-action protocol and is therefore more economical for Defendant firms who do not have to spend a significant amount of time investigating the complaint and responding to a formal letter of claim.

*Mediation/Offers:* FOS encourages offers to be made and has sometimes acted as conciliator. Firms just need to be aware that if they make an offer to the Complainant usually the FOS will take it upon themselves to advise the Complainant as to the reasonableness of the offer. The FOS is likely then to assist in negotiating a settlement between the Claimant and the firm.

*Issues for Insurers:* I have touched on the majority of these issues already, but lets summarise:

*Limits to cover:* Specified maximums can sometimes be exceeded where a formula for calculation, rather than an explicit figure is awarded. If the FOS statutory maximum award limit is raised in 2009, Insurers will need to review their policies.

*'Faits accomplis':* Due to the informality of the FOS system, Insureds often provide a final response to the Complainant or even further correspond with the FOS before alerting Insurers to the existence of a claim.

*Expense:* Although cheaper, the FOS system is not entirely without cost to the firm (although not to the Complainant). There is case fee of £360.00 for the third complaint onwards whether the complaint has merit or not. Further, if

calculation is required, for example in pension cases, an expert will need to be instructed at the Defendant firm's expense (or its Insurer's).

*Quantum uncertainty:* With its unpredictability, reserves for FOS claims can be expected to be higher, albeit usefully balanced but the much lower costs and absence of adverse costs risks to the Complainant.

## **The Legal Professions:**

So... Is the FSA/FOS model to be copied for other professional advisers? Indeed it is. The legal professions are next on the list. Even now the Legal Services Bill is making its way through Parliament, not without controversy, but with a seemingly inevitable destiny to the Statute book. The FSA/FOS model was referred to with some enthusiasm in the Clementi Report, which has spawned the current Bill and the new proposed infrastructures for regulations and resolution of claims and disputes against the professions broadly follow it.

They will include:

### **In Prospect: Legal Services Board (LSB)**

There are currently eight regulators of legal services, seven of whose powers will be affected by the draft Bill. Each operates under its own guidelines and procedures. The aim is to establish a single LSB of between 9-12 members, appointed by the Secretary of State (possibly in conjunction with the Lord Chief Justice, if Amendments tabled in the Lords are not overturned by the Commons, as the Government has threatened to do), which will simplify the existing structures by providing a single oversight body to, in effect, regulate the regulators, operating in cooperation with them; including the Bar Council and the Law Society's Solicitors Regulation Authority. But it will also have power of its own to set performance targets, issue directions for action, publish statements of censure, impose financial penalties, issue intervention directions and recommend to the Secretary of State the cancellation of a body's status as an approved regulator or authorise new regulators as necessary.

The LSB will be funded by a levy from the professions.

### **In Prospect: Office for Legal Complaints (OLC)**

*Current complaints systems:* At present, each of the existing regulators manages their own complaints handling and disciplinary arrangements. The Law Society in particular has suffered a lot of critical press about its complaints handling; and following its own reorganisation at the turn of the year, effectively hived off the Consumer Complaints Service, renamed the Legal Complaints Service (LCS), which now operates independently with its own Board and Chief Executive from Leamington Spa. It is promoting itself

aggressively as a pro-consumer complaints agency. The current Offices of the Legal Services Complaints Commissioner, together with the Legal Services Ombudsman, will be abolished. For reasons I am about to talk about, I have clients who will bid them good riddance.

*Independent; covering all legal businesses:* If/when the Bill goes through, it will establish the OLC, as an independent complaints-handling body with responsibility to establish a scheme for handling complaints consistently across the industry.

*Broad powers:* The OLC will have power to order an apology to the claimant, order the rectification of any error or admission (at the respondent's cost), limit the costs to which the respondent is entitled (in respect of the services to which the complaint relates), award compensation to a complainant for loss, inconvenience or distress caused, or make any other direction for action it sees fit.

*£20k award limit:* At least initially there will be a £20,000 limit on the value of any orders made by the OLC, but critics expect this to be lifted much closer to parity with the FOS before too long (not that there has been any sign of that in official communications).

*2 – stage process:* Probably following exhaustion of firms' own complaints protocols, the OLC complaints procedure is intended to be an internal 2-tier process: (1) a caseworker will first look at a complaint and make a recommendation; the recommendation will not be binding to either party and either can ask for the complaint to be considered by an ombudsman; (2) an ombudsman can consider the complaint and make a binding award; the complainant can reject the award and take it to court. The Bill does not allow for any further appeal mechanism.

*Funded by Professions:* It is intended that the OLC should be funded by the legal professions, and its projected cost has already generated a lot of controversy. Additionally, the OLC will be given wide powers to raise funding and will be obliged to make rules requiring firms to pay fees in respect of complaints made against them, probably even if the complaint is not upheld.

*Accountable to LSB:* The OLC will be accountable to the LSB which has the power to set performance targets for it.

Parliamentary debate:

The independence of the OLC, its appointment and structure and its powers, have been an issue for keen Parliamentary debate, with Government making some small concessions but not really relinquishing ultimate control by the Secretary of State, through the LSB.

## **The Legal Complaints Service (LCS) and Legal Services Ombudsman (LSO):**

*IPS complaints jurisdiction up to £15,000:* Current LCS process is not too dissimilar to the FOS. Complainants are required to exhaust firms' internal complaints procedures before making formal complaint of Inadequate Professional Service (IPS) to the LCS within a six month timeframe, whereupon a Caseworker is assigned to conduct what is normally an exclusively paper exercise of investigation and preliminary adjudication in the form of recommendations for resolution. After further submissions from the parties, and failing agreement or conciliation, the case is referred to a senior Adjudicator who makes a decision and, if he upholds the complaint, a financial award up to a current limit raised in January 2006 from £5000 to £15,000.

At that point, similarities with the FOS process end.

*Purely IPS or Negligence too?* Ostensibly Claims for negligence or breach of duty are still the preserve of the courts. The LCS Chief Executive was quoted in the Law Gazette only last week (21 June) as confirming that 'negligence matters' are "currently outside the scope and powers of the LCS". But that has not stopped the LCS from involving itself in an ever increasing number of complaints and enquiries arising solely because financial deficit has been suffered by the Complainant; or from making awards of 'compensation' on the basis of rationales indistinguishable from those of a court damages award.

*Referral to LSO:* Complainants still dissatisfied with their award, or the reasoning or process of the LCS decision, can refer to the Legal Services Ombudsman who has power to make recommendations, or directions if necessary, to the LCS to re-visit the matter.

*LCS awards are not legally enforceable:* The Adjudication has no legal status as a binding document. Accordingly...

*Formalisation by SDT:* In order to enforce an award, a rather artificial application is made to the Solicitors Disciplinary Tribunal, which is an independent Statutory tribunal nowadays linked to the Solicitors Regulation Authority (the second of the three-way split of the Law Society's corpus, the third constituent being the Society itself, which continues to represent members' interests) and empowered by Schedule 1A of the Solicitors Act 1974 to hear disciplinary applications. The order sought is that the respondent has misconducted himself to the disrepute of the profession by failing to comply with the LCS adjudication and that the LCS Decision should therefore carry force as if it were a High Court Order. This leaves open an avenue for entry of a civil Judgment against the respondent with conventional sanctions upon default; but it also creates a route for appeal and substantive review of the IPS award to the courts, which probably have a rather broader discretion to review the background reasoning than a judge on Judicial Review of a FOS award; but in reality a positive decision by a Judge to meddle with the discretionary reasoning of the caseworker, adjudicator and/or Tribunal will be rare.



*IPS awards now on Insurers' radar:*

One of the consequences of the uplift of the compensatory limit from £1,000, when the 'jurisdiction' was introduced by the Courts & Legal Services Act 1990, to £15,000 from January 2006, probably not really bargained for by the LCS, is that awards at that level may exceed the insurance excesses of smaller firms' professional indemnity policies, so that insurers can be expected to take an active interest in the process.

*Are they covered?*

I say 'may' because there is still some uncertainty whether IPS awards are excluded from cover under solicitors' policies as 'fines or penalties'; but the persuasive analysis in my view is that they are covered, falling within an express stipulation in the Solicitors Indemnity Insurance Rules Minimum Terms for compulsory PI insurance:

*1.8 The insurance must indemnify each Insured against any amount paid or payable in accordance with the recommendation of the Legal Services Ombudsman or any other regulatory authority to the same extent as it indemnifies the Insured against civil liability.*

If the issue is that the LCS is not a 'regulatory authority', insofar as its function is not regulation but complaints resolution, that does not work for me; the LCS is specifically the body which the Ombudsman oversees. There are insurers who agree with me because they have instructed me.

*A particular multiple-case experience:* One such engagement, involving politically driven multiple complaints by clients dissatisfied by a specific systemic aspect of my client's practice, has given me fairly extensive first hand experience both of the process and the developing characteristics of the LCS; and opportunity to compare, over time, LCS performance in a number of broadly similar, but rarely identical situations.

Comparisons with the FOS model are close, both in the procedural order of things and the variations in apparent calibre of caseworker assigned to the case. This appearance may be misleading, because workloads can be intense and political pressures and infrastructural upheavals have made their tasks very difficult. In earlier days, three or four years ago, cases were addressed individually and a variety of conclusions were arrived at through a variety of different reasoning processes; but there was at least a consistency in their attempts to apply principles of duty, breach, causation and loss and to fit them to the available evidence. Naturally those reports which most impressed me were the ones which agreed with my clients' case, usually for the same reasons that I would expect a court to have applied. The volume of cases however led to delays, followed by shortcut compromises and a most critical scrutiny by the Legal Services Ombudsman.

On their face, her comments were focused primarily upon procedural issues:

i.e. the delays and aspects of dealing with complainants which she perceived to be inattentive to the primary purpose of the CCS – now – LCS, which was, and nowadays is even more so, to be seen to be alleviating disappointment among consumers. In her endeavours to convey those cultural messages, a clear impression came across in her reports, at least to me, that the facts, and issues of law or evidence, are secondary and should not be allowed to get in the way of a desired result.

Caseworkers' reports and decisions since then have been much more consistent, but they are following a formulaic template which bears scant heed either to what the complainant would have done if differently advised, or indeed whether they have really suffered any loss.

The next chapter in this illuminating adventure is likely to be perhaps the most intriguing: the referral of the firm to the SDT, to decide, as I have touched on already, whether the solicitors' disobedience to the IPS awards (with their insurer's agreement) should be upheld as misconduct and the awards treated as having force of High Court Orders. As the matter is ongoing, further comment or speculation on that would be inappropriate.

### **Problems of the FSA/FOS Model for Legal Businesses**

Returning to general observation, there are several inherent tensions and obstacles of principle to either adapting the current complaints structures, or passing laws to build new ones, for legal businesses which emulate the model now well established for professions in the financial sector.

#### *Why are Lawyers different?*

The legal professional industries are simply not the same as the financial advisers, or most other professions for that matter, in several key respects:

*Product:* The commodity which financial advisers deal with is money. Often ethereal or transitory, it is the stuff of many peoples' dreams and the measure of many others; but it has dimensions in space and time, as a vegetable on a market stall. Lawyers deal with, and in, the protection of people's rights, with honour and reputation also in the shop window. Like health, once lost they are rarely completely recovered.

*Value:* Losses of money from an ill-advised investment, safety in a defective building, or an injury from a medical mistreatment are all broadly quantifiable. So are many civil contract or tort rights; but what price liberty, reputation or honour?

*Culture:* There are always counterpoints to every generalisation but I hope it's safe to suggest that people tend to gravitate to the professions dealing with what they most like or are best at handling themselves. The best – but not necessarily the richest – lawyers become so because they set high store by the intangible things they deal in.

With these factors in mind it is much harder to envisage at least some sections of the legal professions tolerating patterns of *'rough and ready justice'* to the same extent, if at all, as some other professions. Unlike the financial advisers, lawyers are less obvious horses for this course. Whereas legal complexities play a lesser part in most financial advice cases, the proportion of lawyer-negligence matters where technical issues arise, especially causation or attribution or apportionment of blame, is much greater.

Of the many emotions felt by my clients towards the IPS process in light of their experiences, hurt and outrage are among the most prominent, in stark contrast to the gentleman from IFG Financial Services Ltd.

### **Recent Cases**

It is relevant now to look at a few more cases reflecting how the courts have been treating decisions by professional authorities in recent times. I have already referred to the Pall Mall Investments and IFG decisions. There have been at least a dozen I could mention even in the last year, most concerning appeals made by health professionals or solicitors, but I'm going to look at just four, one of them involving a firm of architects.

They fall broadly into two divisions: Those in which the court has interfered with the professional body's decision and those where it hasn't.

*DID interfere:* **Meadow v GMC [2006] EWCA Civ1390**; This well publicised case concerned the paediatrician whose expert testimony in several cot-death murder trials was subsequently discredited, leading to his being struck –off by the Fitness to Practise Panel (FPP) of the General Medical Council for serious professional misconduct. His appeal to the High Court was allowed and the GMC order quashed. The GMC appealed. The CA held (i) that Meadow did not enjoy immunity from disciplinary proceedings, whatever the rules of /in civil Courts about the immunity from suit for expert witnesses: *"It would be wrong in principle for the court to cut across or impliedly to limit the powers of an FPP by extending immunity from civil suit to Fitness To Practise proceedings"*; but (ii) Although the CA did not wholly endorse the High Court Judge's criticisms that the FPP had been driven by the publicity to be over zealous in its condemnation of Meadow, it nevertheless acquitted him of serious misconduct in that he had given his evidence in a genuine belief as to its validity.

*DID interfere:* **Brown v General Dental Council [2006] EWHC 1576**; The professional conduct committee of the GDC struck off the Appellant dentist for running his practice for 21 months without indemnity insurance, rejecting his explanation that he believed he had obtained it and had never been informed that his application for cover had been rejected. The High Court overturned the GDC decision as disproportionate, drawing distinction between unwitting

and deliberate misconduct, and noting that the dentist had made urgent efforts to seek insurance as soon as he became aware of the problem.

*DID NOT interfere: Raschid v GMC; Fatnani v GMC [2007] All ER 47;* Two High Court decisions reducing respective 'sentences' by the FPP of 12 months suspension and striking-off to one month and 12 months suspension respectively were appealed by the GMC. CA reinstated the original FPP decisions, stating the necessity to respect the expertise of the Panel in deciding what was necessary to maintain the standards and reputation of the profession.

*DID NOT interfere: Vranicki v Architects Registration Board [2007] EWCH.* Vranicki was charged and found guilty by the professional conduct committee on two counts of serious professional incompetence, namely she failed to provide clients with adequate protection with the contractors, and that she did not properly administer the project. Her appeal was dismissed by the court on the basis that it would not interfere with the standard set by the committee unless it was unreasonable to conclude that the standard had not been set properly. Moreover, the Committee were entitled to find that V had failed to retain proper control of the project thus causing subsequent difficulties.

These decisions reflect the continuing general disinclination of the courts to interfere with the decisions of professional tribunals save where they are clearly flawed or disproportionate. To that extent there is not much change in the judicial climate as reflected by the IFG case, and many others.

However, we have yet to see a case where a High Court, never mind the Court of Appeal, is asked to review a professional disciplinary tribunal decision on a solicitors IPS case, or similar matter where the 'sentence' is monetary or compensatory for substandard service rather than serious misconduct. That said, the Vranicki matter does come worryingly close. Her offence does appear to have been one of failure to fulfil her professional service commitments, through incompetence rather than pure misconduct. If this is signaling a trend towards using disciplinary bodies to exact sanction or leverage by aggrieved third party clients or traders, then, especially if there are loss exposures for which the risks are shared by or transferred to insurers, it is a trend which I hope the courts will recognise and be prepared to be more actively involved in how these matters are dealt with by the tribunals.

## **Insurance Products Compared**

Cover in respect of compensatory awards by professional bodies seems not to be consistent across all professions, reflecting the varying extents to which the respective professions have developed their compensatory cultures. I have had opportunity to speak with a couple of the larger firms of professional indemnity brokers, and to compare some of the policies under which my firm has been instructed in recent times.

## **Consistencies:**

*PI, not PL:* Where cover for compensatory awards is to be obtained, it is in claims-made professional indemnity products. It is rarely construable under public liability or product liability policies.

*Legal liability risks only:* Most PI policies provide cover in respect of “a Claim”, which carries a definition elsewhere in the policy. Whilst the precise wordings vary, most are along lines of “a demand for, or an assertion of a right to, civil compensation or civil damages” which as a rule cannot encompass awards by professional bodies because they do not have the force of legal or civil court orders.

*Usually by tack-on:* Non-civil third party cover is usually available as extra: Save in respect of solicitors, for whom the Minimum Terms, as already discussed, make cover against awards by “the Legal Services Ombudsman or any other regulatory authority” compulsory, protection against third party payments under professional-body awards usually has to be by way of a tack-on to the primary civil liability risks being insured, and is not always on offer, save to those professions who have developed service-compensatory infrastructures or ombudsmen.

*Fines and penalties:* Cover for a fine or penalty, normally including punitive or exemplary damages, is usually excluded and for many professions their statutory or professional rules expressly forbid such insurance. That is so, as I have already said, for firms regulated by the FSA.

*“Away” Costs:* orders or agreements to pay the costs of a complainant, regulator, investigator or prosecutor of professional conduct complaints are also usually forbidden or contractually excluded from cover. ...But

*“Home” costs:* Own-side or defence costs are often indemnified, even in respect of purely disciplinary or misconduct exposures, whether in respect of specified statutory offences (eg contraventions of the Property Misdescriptions Act 1991 by estate agents) or professional regulations. But the cover is rarely unconditional, usually being subject to insurers’ consent subjective to the circumstances, and/or objective standards of reasonableness.

## **Inconsistencies:**

*Coverage limits.* Whilst the range of insurance products seems still to be fairly narrow, falling within quite tight indemnity parameters on a claims-made basis, there is always scope to tailor these to subjective requirements, at least for larger firms, in terms of minimum and maximum indemnity, excess provisions, costs coverage, transference of control of defence strategies, percentage sharing of the exposure between insured and insurer, and so on.

*Culture /Awareness.* The extent to which different professions have developed their complaints, client care and service standards cultures, and attendant

regulatory infrastructures, has varied considerably both in terms of pace, and the thickness of their skin. For some, the priorities have been entirely commercial and driven by their home and international markets, especially in Europe; but others, especially where they have been under political or media spotlights, have had to respond to ever more powerful consumer and regulatory lobbies.

*Range:* Likewise the volume of regulations, their sophistication, and range of quantum tariffs or other sanctions also vary considerably according to 'product' and profile.

*Interpretation:* Perhaps if there is one overriding consistency among all the professions, it is that there rarely is consistency, either between different professional institutions or between cases within the same professional sector. Slavery to precedent seems generally to be regarded with suspicion at present, in tune with the overriding objectives of subjective proportionality, public or political profile, and international synchrony.

Mike Willis  
25 June 2007