

# Consultation on proposals to amend rule 3 (conflict of interest) and rule 4 (duties of confidentiality and disclosure)

## Analysis of responses

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## Introduction

1. This consultation took place between 18 December 2009 and 12 February 2010. A list of the respondents appears at [Annex 1](#). We would like to thank all those who took the trouble to respond concerning the complex issues attaching to the proposals.
2. Twenty eight responses to the consultation were received which break down as follows:
  - City firms – 11
  - In-house legal teams – 5
  - Large national firms – 1
  - Individual solicitors – members of firms/lecturers/consultants/others – 5
  - Local Law Societies – 2 (City of London (CLLS) and Birmingham)
  - Other groups – 3 (The Law Society/CCBE/others)
  - Barristers - 1
3. The consultation invited views on the detail of draft rules and guidance taking forward changes to rules 3 and 4 which had previously been agreed in principle following an earlier consultation.
4. The proposals in relation to rules 3 and 4 will be dealt with separately as they are not directly related.

## Rule 3

### The proposal

5. Rule 3 currently permits firms to act with the informed consent of the clients concerned where:
  - a) the clients have a “substantially common interest”; or
  - b) the clients are competing for the same asset.

Both exceptions must satisfy various conditions, including a test of reasonableness.

These exceptions form a “carve out” to the general prohibition on acting where there is a conflict.

6. The proposal would extend these exceptions to include a “sophisticated client” exception which would allow firms to act for sophisticated users of legal services in any situation of conflict provided (a) it remained in the best interests of each client to do so and (b) that the firm remained able to give independent advice to each client unaffected by the work it was undertaking for other clients.
7. The consultation was concerned largely with the drafting and asked if the following had properly been dealt with:

- ensuring the core duties relating to independence and best interests of clients were adequately protected – the drafting had focused on the need for firms to be sufficiently resourced to provide each client with proper, independent advice;
  - the risk that clients failed to understand the implications of consenting to the firm acting for them and others – the drafting had focused on the definition of “sophisticated client” and the need for clients to have access to independent legal advice before consenting to the arrangements; and
  - the risk of a client’s confidential information failing to be adequately protected – this was dealt with by the clients being required to agree the arrangements for protecting their confidential information.
8. Other issues covered in the drafting were the definition of “contentious matter”, the exception only applying to non-contentious matters, and the required monitoring and documenting of compliance with the rule. General questions were asked about whether the drafting reflected the right balance between flexibility and protecting the risks to clients and the public and the balance between the requirements in the rule and those in the guidance.

## The responses

### Should the changes be made?

9. Although the consultation invited opinions on the drafting, many chose to express views on the more fundamental issue of whether it is right to make the changes at all with the following result:
- 12 - in favour
  - 13 - against
  - 3 - no view
10. It should be noted that in some instances respondents did not say specifically that they were in favour of the changes because they were not asked to do so but it was nonetheless clear that they did support them. By contrast, those who were opposed to the proposals tended to make this very clear.
11. Fewer large City firms have responded on this occasion than to the earlier consultation and this has clearly had an impact on the outcome. There are also some new respondents who did not reply to the earlier consultation. Significantly, there were five responses from in-house lawyers/ teams of lawyers whereas previously just one responded.
12. Respondents which continued to support the proposals included the CLLS, the Law Society and six of the City firms. Other support came from a professor of law who was a former managing partner of a large firm, a large national firm and an American lawyer (dually admitted) who is a member of a large international firm. One in-house lawyer who responded to the consultation also supported the changes, commenting that: “we have no issues with the proposed amendments to . . . (rule 3). We feel confident that we could manage this appropriately and indeed it accords with our current practice when approached by law firms when conflicts arise.”
13. Of those opposing the changes, four City firms continue to believe that they are not in the best interests of clients, are a threat to the core duties and cannot adequately be

managed. Four of the five representatives of in-house firms responding were not in favour of the responses, making comments such as:

- “I would not support the weakening of the rules as I think firms would exploit them for their own good.”
- “We would always have more than one firm on the panel capable of dealing with each main area of law that is relevant to us so there’s never been a real problem of not having access to a firm that is acceptable to us because of conflict.”
- “We are not convinced the changes are necessary or would ever be “demonstrably to the benefit of all clients involved”.”

14. Significant opposition also came from one of the largest in-house legal teams in Europe and the UK. The grounds of their opposition were many including – the proposals threatened the core duties, they ran counter to the general tightening up on conflicts in the light of the financial crisis, the current rules have not provided them with any problems, relaxed rules can have an impact on transaction integrity (and thus third parties and unrepresented market participants) and the proposals would contribute to a lessening of competition in the market place for legal services which would lead to a concentration of expertise in a smaller number of firms.

15. Others against included a group of risk managers, the CCBE, a barrister (QC) and two individual solicitor respondents.

### **The drafting issues**

16. There were many, often conflicting, views on the drafting. Some thought it was too restrictive and others too lax. Others thought the opportunity should be used to make the conveyancing provisions in the rule consistent with the general provisions. There were many detailed comments on specific issues such as definitions of “sophisticated client” and “contentious matter”, what sort of consent was required and whether the guidance was sufficiently clear as to, for example, the sort of transactions which should never be the subject of the exception. There was also a view expressed by some of the respondents that greater clarity in relation to what was permitted under the existing “substantially common interest” exception would obviate the need for this further relaxation.

## **Rule 4**

### **The proposal**

17. Rule 4 deals with protecting confidential information. The key requirement is that firms must keep the affairs of their clients confidential. The rule includes a duty not to put the confidentiality of one client at risk by acting for another client on a matter in which the first client’s information would be material and where there is adversity between the clients. There are two exceptions to this duty set out in the rule. The first is when the clients give informed consent and agree the measures to protect their confidential information. The second is when it is not possible to get the informed consent of the client whose information needs to be protected but the firm has already started acting for another client when the adversity becomes apparent. In these circumstances, the rule allows the firm to continue acting provided an information barrier that meets the very stringent common law requirements is put in place.

18. The proposed change would extend this second exception to allow firms to accept instructions in the knowledge that it may not be possible to get consent from the client whose information requires protection. This is on the basis that the common law requirements concerning information barriers are complied with. For this reason, this would be an exception which would be restricted to firms large enough to have institutionalised structures and systems for putting these barriers in place.

### **The responses**

19. 14 of the 28 responses failed to comment in any way on rule 4. The proposals in relation to this rule were, to this extent, overlooked. Of the remainder, 10 were in favour and 4 against. There were some minor drafting points made, particularly on the subject of whether it was intended that firms could erect an information barrier when the client whose information was being protected expressly refused consent.

### **How the SRA proposes to proceed**

#### **Rule 3**

20. It is of critical importance that our conflict provisions achieve the correct level of consumer and public protection. In the light of the responses we have received, we have decided not to proceed with the proposals for change. We believe the time has come for a more fundamental, evidence based review of our policy position on conflicts starting from basic principles rather than from the position of the current rule. In taking this forward we will be inviting comments on how conflicts should be regulated in our consultation on the new Code and other regulatory requirements which will form the basis of our move to outcomes-focused regulation and application to be a licensing authority for ABS. This consultation will be published at the end of May.

#### **Rule 4**

21. We have decided to proceed with the proposed changes to rule 4 and the SRA Board will be invited to make these changes in May.

## **Annex 1**

### **Respondents to the consultation on proposals to amend rules 3 and 4**

Philip Lacovara, Mayer Brown, USA

Andrew Benington, SOL

Mike Hughes, Law Lecturer

The Law Society

Berwin Leighton Paisner LLP

Sieglinde Gamssager, CCBE

Chris Hugill, Visiting Professor-Northumbria University

Linklaters

Mayer Brown International

Mark Wyeth QC, Barrister

Birmingham Law Society

Skadden, Arps, Slate, Meagher and Flom

Irwin Mitchell

Addelshaw Goddard

Simmons & Simmons

Denton Wilde Sapte

City of London Law Society

David Middleton, SRA

Benedict O'Halloran, GE Corporate

(Nine other respondents requested that their details be kept confidential)