

# Closed Consultation

## *Conflict and confidentiality: Second consultation*

13 February 2010

**A second consultation paper from the Solicitors Regulation Authority on amendments to rule 3 (conflict of interest) and rule 4 (duties of confidentiality and disclosure) of the Solicitors' Code of Conduct 2007.**

- The deadline for submission of responses to this consultation was 12 February
- The information that appears below is for reference purposes only.
- An analysis of responses is available below [\[sra/consultations/consultation-listing/conflict-confidentiality-december-2009/#download\]](#).

### *1. Introduction*

- 1.1 We invite views on draft amendments to rule 3 (conflict of interest) [\[rule3\]](#) and rule 4 (duties of confidentiality and disclosure) [\[rule4\]](#) of the Solicitors' Code of Conduct 2007 ("the Code"). The relevant provisions of the current rules 3 and 4, and guidance, with the proposed changes shown in revision mode, are annexed to the consultation paper [\[#download\]](#). We propose to make these changes now, despite our longer-term plans to re-draft the Code in a more principles-based form and to make changes to accommodate alternative business structures (ABSs).
- 1.2 This consultation follows an earlier consultation [\[sra/consultations/consultation-listing/conflict-confidentiality-rules-proposed-amendments-december-2008\]](#) launched in December 2008. In this consultation, we sought views on proposals put forward by the City of London Law Society (CLLS) suggesting that we relax some of the provisions of rule 3 and rule 4 in circumstances in which the clients are sophisticated users of legal services. Most of the respondents to that consultation supported the proposals, provided that adequate safeguards are put in place.
- 1.3 In light of the responses [\[sra/consultations/consultation-listing/conflict-confidentiality-rules-proposed-amendments-december-2008/#download\]](#), we believe that the current rules are not sufficiently flexible to provide for the needs of sophisticated users of legal services. We think it is possible to draft amendments to the current rules that will meet these needs while continuing to protect the best interests of these clients and the public.
- 1.4 The responses identified some key risk areas that we would like to ensure are minimised. We invite your views on whether the draft rules achieve an appropriate balance between allowing the changes and dealing with the risks so that the clients and public are protected. In particular, we ask for input as to whether the protections are set at the right level. The risks, and how we propose to deal with them, are identified and discussed in section 2.
- 1.5 We hope to hear from respondents to the earlier consultation and from other firms, regulators, academics and, most importantly, users of legal services.
- 1.6 The proposals in relation to rules 3 and 4 will be dealt with separately, as they are not related and pose different levels of risk.

- 1.7 The closing date for the consultation is 13 February 2010. This is shorter than the normal consultation period but has been agreed with the Law Society. We have already consulted on the principles involved, and time is limited before the Code will be replaced with more-principles-based requirements. In deciding to proceed, we have also taken into account the fact that the proposed changes to rule 3 do, to an extent, foreshadow the move to principles-based regulation and would provide a testing ground for this approach.

## 2. Rule 3 (conflict of interest)

### *The changes*

- 2.1. Rule 3 currently prevents solicitors and firms acting for clients with conflicting interests. However, there are two exceptions to this rule. The exceptions permit a firm to act with the informed consent of the clients concerned if the clients
  - (a) have a substantially common interest, or
  - (b) are competing for the same asset.

Both exceptions must satisfy a test of reasonableness. The guidance makes it clear that the second exception is only applicable to specialised areas of legal services and where the clients are sophisticated users of those services.

- 2.2 The proposed amendment will form a third exception that will allow firms to act for sophisticated clients in any situation—excluding litigation in which there is a conflict of interest. This exception will only apply if the clients give informed consent and it is, and remains, in the best interests of each client for the firm to continue to act for them.
- 2.3 Relaxation of rule 3 brings with it certain risks. The main risks, which were identified in the earlier consultation, and how we propose to deal with them in the draft rule and guidance are set out below:

*Risk 1: the firm fails to discharge its obligations under rule 1 to give each client truly independent advice and to act in each client's best interests.*

- 2.3.1 We believe that this risk must be minimised by requiring that firms act only if they are properly resourced to do so. Proper resourcing means that the firm must have teams that can operate independently of each other to service all the needs of the different clients in a matter. It also means having an individual or team (of sufficient status) within the firm who can make dispassionate and independent decisions about whether the firm can properly act, and continue to act, for each client. This individual or team must not act for any of the clients in the matter.
- 2.3.2 This is provided for in rule 3.02(3)(d) and (g). Rule 3.02(3)(d),(e) and (f) reinforces this and makes clear that there must be full compliance with rule 1, that no individual acts for, or is responsible for, the supervision of the work of more than one client, and that the firm must have an independent individual or team monitoring compliance with the rule.
- 2.3.3 Situations in which teams must negotiate with each other increase the risk of a breach of rule 1 [rule1]. Some respondents to the consultation highlighted this as particularly difficult

because of the dynamics of relationships within a firm and because it was felt that it may be more uncomfortable to negotiate in an uninhibited manner with your own colleagues than with those outside the firm.

- 2.3.4 Again, we have highlighted in the rule the importance of compliance with rule 1 and the fact that the firm must be satisfied that the interests of one client are not put above the interests of another. In the guidance at note 6(c)(vii), we have flagged the increased risk to clients when negotiations become complex and/or prolonged; it is important that firms carefully monitor this type of situation.

*Risk 2: the client fails to understand what it is agreeing to or the full implications of what is involved when it gives consent.*

- 2.3.5 The main way to minimise this risk is to make sure that the type of client intended to benefit from this exception is properly defined in the rule and guidance.
- 2.3.6 Suggestions from the earlier consultation as to a definition of the type of client intended to benefit from this exception include.
  - a sophisticated or self-certifying client;
  - when the client is a lawyer or has access to an in-house lawyer;
  - to an experienced user of the legal services involved;
  - when the client consults a professional (lawyer, or risk or compliance professional) with understanding of and expertise in the law of conflicts and confidentiality;
  - a sophisticated consumer of legal services;
  - a comprehensive list (e.g. a lawyer, law firm, public company, subsidiary of a public company, large private company, foreign company, liquidator, administrator, trustee of a pension fund, fund manager, etc.).
- 2.3.7 However, none of these suggestions met with majority approval, and we feel there is no perfect or easy definition. Your views are sought on our draft definition, which requires that the client
  - (a) is a lawyer, or
  - (b) has access to an in-house lawyer or other independent advice, and the firm believes the client is capable of understanding the implications of using the exception.

The rule also requires the client to be an experienced user of the type of legal services involved in the matter.

- 2.3.8 The issue of who decides whether the client is sufficiently sophisticated to make the decision about joint representation was also flagged in the earlier consultation. Should it be the client itself, the firm, or a combination of the two? We have drafted the definition in a way that ensures the firm retains some responsibility for the decision. However, input from the client is essential, and we have dealt with this as part of the confirmation required in a written consent. The supporting guidance advises that it may be prudent to check that the client has, in fact, received independent advice.

- 2.3.9. We have also considered the question of the nature of the consent required to be given by the client. Clearly, the client needs to understand that it is agreeing to the firm representing other clients in the matter and that conflict will arise between them, or there is a significant risk that it will do so. The draft rule does not require that consent be "informed" because, due to the constraints of confidentiality, there will always be limits on the information each client can be given. The guidance suggests that as a minimum each client should know the identity of the other clients (see guidance note 6(c)(ii)). The existing "reasonableness test", which must be satisfied in relation to the use of the current exceptions, would require the firm to discuss the nature of the conflict or possible conflict with the client.
- 2.3.10 We propose adopting the requirement that client consent be given in a written form, given the potential impact if something goes wrong. This will serve as a record of the fact that the client is aware of the nature of the risks arising from the retainer. It will also help focus both the firm's and the client's minds on the decisions they are making in agreeing to act/deciding to instruct.

*Risk 3: the firm fails to protect confidential information.*

- 2.3.11 We consider the protection of clients' confidential information to be fundamental (see the professional principles in section 1 of the Legal Services Act 2007); we also consider that safeguards should be incorporated into rule 3 itself. We have done this in the draft by requiring that each client agree, in writing, to the arrangements for protecting their confidential information. This written consent could be given at the same time as the informed consent to acting in a conflict situation is given, or shortly afterwards; the draft makes clear that this must happen before accepting instructions. The guidance suggests, again for consistency, that these arrangements take account of the existing guidance to rule 4 (see guidance note 6(c)(iv)).

*Other points on rule 3*

- 2.4 We have applied the same "reasonableness" requirement to this exception as the rule currently applies to the other exceptions that allow firms to act where there is conflict. This requires that all relevant issues are drawn to the client's attention before a firm agrees to act. Existing guidance makes it clear that the relevant issues in relation to conflict should be discussed with the client and that it would be prudent to set them out in the letter confirming the instructions.
- 2.5 Some respondents to the earlier consultation made the point that, if a firm accepted instructions from two or more clients under this exception, it was important to agree at the outset what would happen if the conflict became such that the firm could no longer act for all of them. The respondents felt that this was important to ensure that the clients were not prejudiced at a critical point in a transaction. Therefore, we have added a requirement that each client's agreement regarding arrangements that will prevail if the firm can no longer continue to represent all the clients in a matter must be given at the outset.
- 2.6 Some respondents also suggested that, if a firm accepted instructions to act in a conflict situation, it should identify the client it regarded as the dominant client. They suggested that this would be the client that the firm would wish to retain in any situation in which it became impossible to act for all the clients. We believe that this might be difficult for a firm to do in all situations; however, if clients all knew what would happen if the firm could no longer act for all

of them, this would prevent prejudice.

- 2.7 Conveyancing conflicts are treated entirely separately under rules 3.07 to 3.22 and do not form part of the present review. The conveyancing conflict rules apply to all types of transactions, whether the clients can be classified as sophisticated or not. Neither the current, nor the proposed, exceptions in the general part of rule 3 apply, or will apply, to such transactions. To avoid confusion, it is proposed to amend the introduction to rule 3 to make this even clearer.
- 2.8 Rule 3.03 will also require amendment to incorporate the three 3.02 exceptions. Small consequential changes to the rest of 3.02 are highlighted in the draft.

#### *Questions on rule 3 changes*

- 2.9 Have we got the balance right between flexibility in relation to the exception and safeguarding against risks to clients and the public?
- 2.10 Does the rule and guidance protect against the three main risks:
  - (a) that the requirements of rule 1 are not adequately met,
  - (b) that the client does not have the knowledge or experience necessary to understand the arrangement fully, and
  - (c) that confidential information leaks.

If not, how could we better protect against these risks?

- 2.11 Have we got the balance right between essential conditions set out in the rule itself, and guidance to assist interpretation?
- 2.12 Are there any aspects of the drafting that could be clearer? If so, please explain.

### *3. Rule 4 (Confidentiality and disclosure)*

#### *The changes*

- 3.1 Rule 4 deals with protecting confidential information. The key requirement here is that firms must keep the affairs of their clients confidential. The rule includes a duty not to put confidentiality at risk by acting for another client on a matter in which such information would be material. This prevents firms accepting instructions from one client if information held for another client is material and if the clients have adverse interests. There are two exceptions to this. 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 problem arises. 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.

- 3.2 We have made the decision to extend this second exception to allow firms to accept instructions in the knowledge that it would not be possible to get consent from the client whose information required protection. This is on the basis, at present with this second exception, that the common law requirements concerning information barriers are complied with. We recognise that only those firms large enough to have institutionalised structures and systems for putting these barriers in place will be able to comply, but that is an inevitable consequence of the common law requirements.
- 3.3 The change to rule 4 will bring the rule into line with the law concerning the use of information barriers. This change appears to require only minimal changes to rule 4.05 as shown in the annex. The minimum protections required for the information barrier are listed in the guidance to rule 4, the relevant parts also being attached.

#### *Questions on rule 4 changes*

- 3.4 Does anything further need to be added to the rule or the guidance to make the position clearer? If so, please explain.
- 3.5 Do you consider there is sufficient emphasis placed on the use of the 4.04 exception? Is it clear that the 4.05 exception is intended to be a last resort?
- 3.6 Do the protections in the rule and guidance remain adequate?

#### *Downloadable documents*

- Consultation paper (PDF 24 pages, 160K) [[globalassets/documents/sra/consultations/conflict-discussion-paper-december-2009.pdf?version=4a1ae5](#)]
- Analysis of responses (PDF 6 pages, 69K) [[globalassets/documents/sra/consultations/conflict\\_and\\_confidentiality\\_second\\_consultation.pdf?version=4a1ae3](#)]