Axiom Ince, SLAPPs, Dixit Shah…who would be a regulator?

Regulating the legal services industry is not an easy job, as John Gould explains

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One of the key challenges faced by legal regulators is how to apply limited resources to achieve the best outcomes in the public interest. Recently two controversies have brought the question of how regulatory risks are prioritised into sharp focus.

Any risk management professional will tell you that the threat posed by a risk is a combination of how likely it is to occur and the impact of the consequences. A nuclear meltdown is less likely to occur than a late running train, but the impact is much greater. Setting priorities must take both into account.

Inevitably different regulatory stakeholders have different priorities but, conventionally, the key interests are those of the regulated profession and the consumers of their services. Each group's collective interests should largely overlap because both have an interest in ensuring that regulation is cost-effective and maintains high levels of confidence in the regulated profession. But there are other interests in play. Governments and campaigners have broader political and social interests and objectives and, inevitably, politicians respond to issues which attract media interest. A good story can often be made out of a connection between worrying social issues and the activities of lawyers.

Two current controversies illustrate the choices that have to be made: the collapse of Axiom Ince and the approach to so called strategic lawsuits against public participation (SLAPPs).

£60m & a profession-wide levy

I don't think it would be an exaggeration to describe the reported regulatory consequences of the Axiom Ince collapse as a nuclear event. It has been suggested that more than £60,000,000 may have been lost and that a special levy on the profession to bolster the Solicitors Regulation Authority's (SRA's) compensation fund will be required. The impact on very large numbers of clients and employees is likely to be substantial and the damage to public confidence, severe.

On 25 October, SRA chair Anna Bradley, published her reflections following the SRA Board's discussion of this catastrophic collapse: 'We also need to learn from the recent failures of larger firms, so we discussed what we know about why this happened. We are reviewing what actions we could take to reduce the probability of similar failures in the future. We take a risk-based approach to regulation, so we would need to make sure that any changes in our approach are well targeted and do not result in unjustified burdens on the sector.'

The SRA board is currently reviewing the risks posed by 'accumulator' firms and it is undoubtedly wise to do so. The SRA has a good record of clearing up the mess left by collapsed law firms and protecting clients using the solicitors' compensation fund. It has dealt with complex fraudulent investment funds involving tens of millions of pounds and dishonest consolidators absconding with millions of pounds of clients' money. It has protected tens of thousands of clients left unrepresented in many hundreds of law firms. The compensation fund has traditionally underpinned the solicitors' brand and given levels of protection to clients unmatched in other sectors.

The system, however, was designed to underpin confidence in small practices. Larger practices provided financial support partly because it was in their interest to ensure that confidence in the solicitors' brand was maintained and partly as part of the public interest price of the statutory protection of title and reserved activities.

The overwhelming majority of claims on the compensation fund related to dishonest sole practitioners and occasionally small partnerships where all the partners were implicated or uninsured. It was always very unlikely that every individual in, say, a 20-partner practice would be implicated in dishonesty or allow an uninsured failure to account for client money with which it was entrusted. Even where there were claims, it was unusual for a dishonest sole practitioner to have access to levy-changing amounts of client money.

Where larger losses did arise they were often associated with a single powerful individual who controlled an entity which was an agglomeration of many small and often financially unstable firms. As long ago as 2000 more than £10m was stolen from client accounts by a criminal solicitor called Dixit Shah from a consolidation of around a dozen firms under the name of Brandons. He escaped abroad.

Following the Legal Services Act in 2007, the regulatory framework has encouraged not only alternative business structures but also a more business-orientated approach to the provision of legal services. Consolidation and external investment have been seen as a path to financial success and a better legal services market. An entrepreneurial and innovative culture, where risks are seen as simply a natural incident of doing business, was encouraged in the hope of obtaining benefits for consumers. Crucially, however, these experiments took place within the bell jar of the solicitors' brand. This meant that to an extent some risks were collectivised between traditional firms and more

entrepreneurial styles of practice.

Priority was given by government to increasing competition in the provision of legal services. This might have been done by taking new styles of provider outside of solicitors' regulation while permitting reserved activity on the basis of some other title and form of authorisation. It was, however, considered that the solicitors' brand was too entrenched and that new entrants would not be able to compete if they could not also present themselves as solicitors.

This led to a combined system in which consumers could not easily differentiate new types or models of provider from traditional practices. It also meant that traditional providers were effectively required to underwrite businesses which looked very different from the great majority of the existing profession.

It was appreciated from the outset that new challenges would have to be met. Greater supervision of higher risk service providers and more emphasis on financial stability would be required. All providers were brought within a compliance regime modelled on financial services which outsourced and grew compliance activity by forcing law firms to internalise it through, for example, the introduction of compliance officers.

The risks are not much to do with whether a business has external ownership but rather about the concentration of control and the level of financial risk taking. Quality of management and financial strength also really matter in these kind of businesses. Mitigation of such risks relies very heavily on the quality of the SRA's supervision of centralised, and often speculative, large commercial businesses which are not adequately capitalised or managed and are attempting bulk provision. This was always likely to involve higher levels of risk however diligently SRA personnel approached their task. Complex structures and rapid change further increased the level of difficulty.

So when the SRA board comes to consider the three large cases mentioned by Bradley what are some of the facts they will be looking at?

Three cases

Axiom Ince

The SRA intervened into Axiom Ince Ltd on 3 October 2023. On 10 August 2023 there had been interventions into three individuals, one of whom, Pragnesh Modhwadia, has been reported as being its sole shareholder.

Axiom Ince Ltd was not a conventional firm of solicitors. Modhwadia became the company's founding director in its previous existence in 2015. The last accounts it filed, for the period to 31 March 2022, were truncated on the basis of a claim to the small companies' exemption. The accounts do not inspire confidence that the company was a solid foundation for the rapid consolidation of a large group. They describe themselves as 'unaudited filleted financial statements'. The accountant preparing them confirms he has neither audited, reviewed nor verified them. He is clear that he expresses no opinion about them.

Had he been asked to comment, he might have observed that the company had net current liabilities of £2,307,487, that it had made a loss of £199,650 in the last year and that it had creditors falling due within one year of £9,948,409. Its assets included goodwill, of unstated provenance, valued at £3,600,786 and a debt of £1,571,100 stated as owing to it by Modhwadia himself who was also the director who signed off the accounts.

> *"The overwhelming majority of claims on the compensation fund related to dishonest sole practitioners"*

The company changed its name to Axiom Ince Limited on 5 May 2023 following the acquisition of the insolvent Ince Group out of administration. The Ince Group was a consolidation of a number of firms including Ince & Co and Gordon Dadds based on investment through a PLC group. The Ince CEO, in welcoming the deal commented: 'After taking over the management of the PLC group, it quickly became apparent we needed to address a series of poorly structured and executed transactions and expansions.' The acquisition and brief ownership of Plexus, a bulk provider, followed.

Metamorph

The second of the three significant failures was Metamorph.

Metamorph Group was a consolidator of high street legal practices and was launched in 2016. It had made eight acquisitions by 30 June 2020. Metamorph sought 'to build a substantial national professional services business by helping a fragmented market consolidate'.

Metamorph's strategy was to acquire businesses and retain the individual brands of the acquired firms. The client base was comprised, predominantly, of private clients and, rather ironically, it was claimed that this created a more stable income stream for the Group. External ownership of a portfolio of conventionally operating and established law firms does not, of itself, increase regulatory risk but unreliable management and lack of resources does.

By early November 2022 it had 11 firms which appeared to be substantially loss making and to be suffering from unstable leadership with the sudden departure of its accountant founder. MLL Ltd, BPL Solicitors Ltd, Beaumont ABS Ltd & Atray Ltd were closed by the SRA on 14 December 2022. Separately, Knowles Benning LLP & Knight Polson Limited were closed by the SRA on 19 December 2022, Browns Solicitors (Buckinghamshire) Limited on 20 January 2023 and Parrott & Coales LLP on 29 September 2023. The total financial cost to the profession is not yet known but it will be some millions of pounds.

Kingly

A third ugly sibling was Kingly Solicitors Ltd. Its last pre-liquidation accounts were filed on 26 March 2020. It described itself for the purpose of filing as a 'micro-entity'. It boasted capital and reserves of minus £119,520. According to its statement of affairs in liquidation, filed on 29 September 2020, it had by then an estimated deficiency as regards creditors of £16,585,377.20. The cost to the profession was reported as being in excess of £10m.

The aftermath

The consequences of the collapse of these three businesses are undoubtedly serious. Many clients and staff will have suffered severely; confidence in the solicitors' profession and its regulation will have been undermined and the profession's costs will be increased by compensation fund contributions and increased professional indemnity costs in the future. These costs will in due course feed through to consumers of legal services.

One must be careful to avoid hindsight and the monitoring of solvency and management competence of complex businesses is challenging. Events move quickly and although insolvency can be a trigger for dishonesty, there is no automatic relationship. The difference between survival and collapse may come down to a lender's or investor's decision which could go either way. It might be suggested that these problems are structural by combining within a single regulatory system low risk traditional practices, well managed and resourced businesses and under-capitalised, risky and speculative ventures.

How then are these risks to be managed? It may be that some firms are simply too

risky to practise under the umbrella of what are effectively mutualised client protection arrangements. Logically this should involve the withdrawal or refusal of recognition or licensing. The reward to the public or the profession of their existence may not justify the risk that the regulator seems to have taken in the past. The profession and consumers should not be underwriting a speculator's roll of the dice.

Professional indemnity insurance already covers losses of client funds unless all the insured principals are dishonest but the minimum fixed cover is only £3m. For these types of enterprise the standard minimum cover doesn't look appropriate. An insurance-based approach would be likely to allow premiums to be weighted according to the risk attaching to the insured firm in a way that compensation fund contributions are not.

It seems difficult to imagine the regulators will not adjust their priorities and consider how the regime itself needs to change.

In its corporate report 2021/22 published on 20 July 2023 the SRA listed its key enforcement themes. The themes listed were, in order: SLAPPs; Post Office Horizon IT scandal; sexual misconduct; non-disclosure agreements; money laundering; dubious investment schemes; health of respondents and solicitor wellbeing; workplace bullying and harassment; publishing key consumer information on law firm websites and acting in compensation claims. The first of these themes is the second controversy.

SLAPPs

On 27 October the Society of Media Lawyers wrote to the President of the Law Society saying it was 'deeply concerned' the Law Society was attaching a disproportionate importance to SLAPPs, having succumbed to media and political pressure. The letter argued that despite a thematic review by the SRA of 25 media firms and it undertaking 40 SLAPP investigations, there remained no evidence of actual examples of abusive litigation, no disciplinary findings and no judicial criticism. It alleged there were merely assertions that cases existed and that harm was being caused. Even, the letter continued, the Coalition Against SLAPPs in Europe, whose statements were often repeated in the media and by politicians, state that there have only been 24 documented SLAPP lawsuits in the UK since 2010 out of the thousands of defamation and privacy cases over that period.

Abusive litigation has long been recognised as an area of potential misconduct. It is wrong for a solicitor to use proceedings to harass or bully particularly against under-resourced or unrepresented opponents. It is wrong to use proceedings which lack any arguable merit to achieve collateral effects such as delaying deportations. The question is not whether it is important that abusive litigation is deterred but rather how that importance compares with other areas warranting the regulator's attention. The SRA cannot be criticised for listening and responding to pressure from its various constituencies about issues which matter to them, but the challenge is prioritisation and focus.

Even with hindsight these are not easy choices and Bradley is right that time and consultation will be required to develop answers. Yet, if an event calls into question the sustainability of the compensation fund, which has long been an outstanding example of client protection and how to maintain public confidence at a reasonable cost, lowering the risk of another regulatory Chernobyl seems like a priority beyond all others. **NLJ**

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