

LEGAL SERVICES ACT 2007

EXPLANATORY NOTES

COMMENTARY ON SECTIONS

Part 5: Alternative Business Structures

Background

Section 89: Ownership of licensed bodies

226. **Schedule 13**, introduced by this section, deals with the ownership of licensed bodies. Section 105 provides that this Schedule does not apply to trade unions.
227. **Schedule 13** imposes restrictions on the holding of certain types of interests in licensed bodies (restricted interests) by non-authorised persons. Any non-authorised persons holding, or seeking to hold, restricted interests, must be approved by the licensing authority before the body can be licensed. Once the body is licensed any further acquisition or holding of restricted interests by non-authorised persons must also be approved.
228. The main type of restricted interest is a material interest (Schedule 13, paragraph 3), which arises when a person:
- has an interest in at least 10% or more of the shares in it or in its parent company;
 - can exercise or control the exercise of 10% of the voting rights in (or, in some cases, has power to direct the policy of) it or its parent company; or
 - can exercise significant influence over the management of the company or its parent company by virtue of their shareholding or voting power in it.
229. If they wish, licensing authorities can make licensing rules specifying a lower proportion than 10% for defining material interest (sub-paragraph (2) of paragraph 3).
230. Licensing rules may provide for a second type of restricted interest, a “controlled interest”. This is a shareholding in the licensed body or a parent undertaking of a percentage specified in licensing rules, or an entitlement to exercise or control the exercise of voting power in a licensed body or parent undertaking of a percentage specified in licensing rules. Licensing rules may only specify a percentage which exceeds the percentage which constitutes a material interest.
231. For the purposes of deciding whether a person has material interest or a controlled interest in a licensed body, account may be taken of interests held by a person’s associates, who are defined in paragraph 5. The Lord Chancellor has power in paragraph 9 to change the definitions of “material interest” and “associate”, on the Board’s recommendation.
232. **Paragraph 6** sets out the approval requirements. A non-authorised person’s holding of a restricted interest will be approved if the licensing authority is satisfied that it would not compromise the regulatory objectives or compliance by the licensed body and such of

its managers and employees who are authorised persons with the duties in section 176. The licensing authority must also be satisfied that the person is a fit and proper person to hold the interest. Licensing rules must include criteria and procedure for making this decision.

233. [Paragraph 7](#) provides that if a person holds a restricted interest by virtue of holding a certain percentage of a body's shares or controlling a certain percentage of the voting power in a body, any restricted interest held by virtue of a lesser percentage of shares (where the approved interest is in the form of shares) or voting power (where the approved interest is in the form of voting power) is also treated as being approved by the licensing authority. For example, if the material interest threshold is a 10% shareholding and the controlled interest threshold is a 20% shareholding, a person who is approved to hold a controlled interest will also be approved in relation to the material interest.
234. [Part 2](#) covers the identification to licensing authorities of non-authorised persons, and the approval of those persons. At the initial licensing stage, a body seeking a licence must identify any person that it knows holds a restricted interest or expects to hold one when the licence is issued, (sub-paragraphs (1) and (2) of paragraph 10). This includes telling the licensing authority if the identities of such people change after the application has been made (sub-paragraph (2) of paragraph 10). Failing to do so is an offence, punishable on summary conviction by a fine up to level 5 on the standard scale.
235. Under paragraph 13, the applicant body must also notify the non-authorised persons whom it has identified to the licensing authority. Failure to do this is also an offence, punishable in the same way. The notification must explain the effect of paragraph 14, which enables the licensing authority to seek more information from non-authorised persons who have been identified. The deliberate provision of false or misleading information is an offence, punishable by a fine not exceeding the statutory maximum on summary conviction or by a fine and/or two years in prison on conviction on indictment.
236. If the licensing authority is satisfied that the non-authorised person meets the approval requirements in paragraph 6, and that the person has not been disqualified, it may grant the application for a licence. The licensing authority may also approve the holding of the interest subject to conditions (paragraphs 17 and 18), or it may object to the holding of the interest (paragraphs 19 and 20).
237. After a licence has been granted, the acquisition of interests by non-authorised persons is still regulated in the manner set out in part 3 of the Schedule. Under paragraph 21, if an investor intends to take steps to acquire an interest in a licensed body that would give the investor a restricted interest in it, the investor must notify both the licensed body and the licensing authority. Where the investor acquires an interest without taking steps to do so – for instance, by inheriting it – the investor must give the notifications within a time limit set by the Lord Chancellor on the Board's recommendation. Under paragraphs 22 and 23, failure to give notification is an offence, punishable on summary conviction by a fine of level 5 on the standard scale. Taking a proposed acquisition step without obtaining approval from a licensing authority is also an offence, punishable by a fine not exceeding the statutory maximum on summary conviction or by an unlimited fine and/or two years in prison on conviction on indictment (paragraph 24).
238. Again, the licensing authority may approve the holding of the interest, approve it subject to conditions, or object to it. The procedure and criteria for this are set out in paragraphs 25 to 32. Where the licensing authority approves a proposed interest (with or without conditions) it may specify a period within which the investor must acquire it. If it does not, the period is automatically one year from the date of the approval notice. If the investor does not acquire the interest by the deadline, the approval lapses (paragraph 30).
239. The licensing authority also has power to impose conditions on, or object to the holding of an interest after it has been acquired. The procedure and criteria for this are set out in paragraphs 33 to 37.

*These notes refer to the Legal Services Act 2007 (c.29)
which received Royal Assent on 30th October 2007*

240. Conditions imposed under either paragraph 28 or paragraph 33 may be varied or waived on application by the investor, (sub-paragraph (1) of paragraph 35). In addition, the licensing authority may cancel a condition on its own initiative, (sub-paragraph (2) of paragraph 35).
241. **Part 4** of the Schedule enables licensing rules to be made specifying an upper “ceiling” limit for the holders of shares in licensed bodies by a non-authorised person. If such a limit is imposed, no non-authorised person may exceed it, regardless of whether or not they meet the approval requirements at paragraph 6.
242. **Part 5** of the Schedule deals with enforcement. The “divestiture” provisions enable the court, on application of a licensing authority, to order the sale of shares held by a person who holds an interest in a licensed body. This may be done in the following circumstances:
- where an investor has taken steps to obtain an interest without the licensing authority’s approval – this can lead to divestiture even if the investor has not been charged with or convicted of the offence under paragraph 24;
 - where an investor holds a restricted interest in breach of conditions imposed under paragraphs 17, 28 or 33; and
 - where an investor holds an interest to which the licensing authority has objected under paragraphs 31 or 36.
243. The court may also order the sale of shares where a non-authorised person’s shareholding exceeds any ceiling imposed by licensing rules made under Part 4 of the Schedule.
244. Divestiture is limited by paragraph 41 to licensed bodies that are companies with shares. The number of shares the court may order to be sold is limited – essentially only as many as necessary to ensure that the person is no longer in breach of the requirements of the Schedule (sub-paragraphs (2) and (3) of paragraph 45). If the court orders shares to be sold, it may make whatever other orders it sees fit as to the sale or transfer of the shares (sub-paragraph (6) of paragraph 45). The proceeds of sale have to be paid into court for the benefit of whomever is beneficially interested in them – usually the investor – and any such person may apply for part or all of the proceeds. The cost of conducting the sale is first deducted from the proceeds (sub-paragraph (7) of paragraph 45).
245. Where the conditions for divestiture are satisfied, paragraph 44 allows the licensing authority to issue a restriction notice imposing certain restrictions on the shares. It is expected that a restriction notice will be issued when the licensing authority believes that it must act as a matter of urgency before an application for divestiture to the High Court. The restrictions which may be imposed are:
- any transfer of the shares or agreement to transfer them is void (including transfer of the right to receive unissued shares),
 - the shares’ voting rights cannot be exercised,
 - no further shares can be issued to the investor, or
 - the investor cannot be paid any sums due on the shares (dividends etc), unless the company goes into liquidation.
246. A restriction notice ceases to have effect after a High Court order (the court may make such an order on an application for sale of the shares); if no application has been made to the court for divestiture within a prescribed time limit on the expiry of that time limit, or when the licensed body ceases to be licensed.
247. The court may also remove any restrictions imposed under paragraph 45, set out in sub-paragraph (4) of paragraph 46.

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248. Divestiture will not always be possible. Paragraph 46 provides an alternative mechanism for enforcement in a case where a person holds a restricted interest in breach of any conditions imposed on the holding of that interest. The licensing authority may apply to the High Court for an order enforcing the conditions.
249. [Paragraphs 47 to 50](#) provide for the Board to be notified of decisions under this Schedule to object to a person holding an interest, or to impose conditions on their holding it. Paragraph 51 requires the Board to maintain lists of persons who have been subject to objections and conditions, which will be available to licensing authorities and, will enable them to make informed regulatory decisions.