

Workshop Report prepared by Sue Mawdsley,  
Legal Risk

Thursday, 5th July 2005

## PROTECTING PARTNER ASSETS – LIMITATION OF LIABILITY ISSUES

### Chair:

Richard Turnor,  
Allen & Overy LLP

### Speakers:

Frank Maher,  
Legal Risk  
Alasdair Ritchie,  
Jardine Lloyd Thompson  
Graham Nagus,  
Jardine Lloyd Thompson

### Venue:

Deloitte, Stonecutter Court,  
1 Stonecutter Street,  
London, EC4A 4TR



Sue Mawdsley, Legal Risk

Richard Turnor set the scene by asking members to imagine that they had just been instructed in a major matter worth three times their current professional indemnity insurance cover, and to consider their claims exposure if something went wrong.

Frank Maher outlined current market experience of large professional indemnity claims to try to determine how much of an issue this is in practice. There is an increasing number of claims above or around firms' limits of indemnity. A forthcoming study by the American Bar Association shows that the number of big-ticket suits; (\$2 million or more) against firms has risen dramatically since 1996 and even this figure may be low.

Frank explained that although liability on paid claims exceeding cover is rare (ADT v Binder Hamlin being a notable exception, albeit settled for less pending an appeal), accountants are increasingly exposed to high value claims, mainly audit related, following large corporate failures and press reports refer to a claim against a leading law firm for £600M (albeit said to have been settled for £10M).

Frank then considered how to determine potential exposure on a matter. The size of the transaction is not the only indicator. Interest and costs would be added. The relevant indemnity limit is not the one at the time of the alleged act, but when the claim arises. Firms need to be aware that they may have less cover in future

when the claim comes in. The claim may exceed the value of the transaction many times over. Frank had defended an environmental claim over 100 times the value of the original transaction. Additionally, similar claims may be added together for insurance purposes under the revised 'aggregation rule', meaning that quite small transactions could give rise to issues on indemnity limits.

The growing conversion rate of practices to LLP suggests that fear of the rare but possibly cataclysmic claim is an issue. Whilst recognising it can be important, Frank explained his view that incorporation is only part of the solution and should form part of a wider strategy which identifies the risks faced, enabling firms to take an informed decision whether to eliminate, mitigate, or accept them. The potential collapse of an LLP, would still leave the members with the problem of earning a living, and the possibility of guarantees or other personal liabilities. Even in an LLP, there is some risk of personal liability.

Frank put forward engagement letter terms limiting liability as another important element of this strategy, though again not in themselves a complete answer.

He outlined this planned approach:

- Reduce the risk of error, by identifying high risk areas of work, and implementing systems;

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- Reduce the risk of claims through client care;
- Share the liability with the client;
- Share the liability with another party;
- Avoid gratuitous assumption of risk to third parties;
- Decide what to insure;
- Keep your assets out of reach – common in the United States, but not without problems.

Recent analysis by The St Paul Travelers of claims over £1 Million revealed the differences in claims types for Top 30 firms and the remainder of the Top 100.

Alasdair Ritchie and Graham Nagus then addressed some insurance issues. Asked if cover could be obtained for a single transaction above a firm's limit, they considered it unlikely; there was some experience of it with architects and surveyors but the cost was punitive. Overall cover could be increased in principle – but may be more difficult if you have just faced a major claim.

Looking ahead to this year's renewal, Graham and Alasdair believe that there will be plenty of capacity in the market

with £400million available initially with the Bermuda market for additional top up. Above that may be expensive and specific markets may be available.

Alasdair confirmed his view that US exposure does increase the risk with California being a particular problem. US firms have less cover than here – a large New York law firm carries approximately \$250-300 million cover not on an each and every claim basis.

Alasdair then outlined the 'Lifeboat' cover for insuring LLP members' personal exposure, enabling a trust to buy back the member's assets.

Continuing with the strategic approach, Frank identified properly conducted client due diligence as being of paramount importance.

Frank referred to the results of the PWC Financial Management in Law Firms Survey 2004 which suggest that client engagement letters are not standard practice in 10% of firms. Due diligence includes financial and credit risk, reputational issues, conflict checking and money laundering checks. The basic question; 'why are they instructing us?' should always be posed. New clients are a risk recognised by insurers. Firms need to avoid dabbling, which can affect large firms as well as small.

People risk is a further issue, lateral hires and overdependence on one client being two particular aspects. Work done in multiple offices or in the early hours of the morning too can present problems.

Frank then drilled down further into limitation of liability. The Unfair Contract Terms Act 1977, establishes a requirement of reasonableness for such terms, the resources available to meet a liability and insurance cover forming part of the determination. There are additional restrictions for solicitors in paragraph 12.11, Guide Professional Conduct which precludes limitation by contract below the minimum level of cover and section 60(5) Solicitors Act 1974 which prevents solicitors from excluding liability for negligence within a contentious business agreement. There is a view that section 60 (5) does not apply to all contentious matters.

Scope of duty, and making clear in terms of engagement what the firm will and will not be doing, are key to a protection strategy. Frank outlined a recent example of a corporate claim he had defended to illustrate the point.

Firms may instruct counsel to obtain a measure of protection but Frank pointed out, that many counsel have low levels of insurance cover and it is rare to obtain full indemnity from them in practice.

Frank concluded by pointing to the US experience of doctors where due to adverse claims experience they have developed complicated means of divesting themselves of their assets. This may be something we see developing.

The floor was then opened for questions. The first was about levels of cover under Lifeboat policies. An insurance broker member had secured £25 Million for one firm and thought £30 Million would be the likely maximum. Cost was £4,000 - £7,000 per million pounds cover.

Richard Turnor identified the difficulty of establishing that trustees could have an insurable interest. There were further concerns regarding creditors being able to claw back the funds as an asset of the business. The view was that it came down to drafting and the funds providing for dependents, spouse and family, and not coming into the LLP members' hands.

Another question was whether firms reduced their insurance cover on conversion to LLP; general opinion was not. Cover was no cheaper for LLPs and insurers are becoming more aware of their own exposure when covering LLPs too.

Graham Nagus referred to the potential vertical exposure introduced by the

changes to the Solicitors' Indemnity Insurance Rules 2005 in relation to 'similar' claims under the 'aggregation rule', which firms should address with their brokers. Frank Maher made the point that it was not just an issue for small practices, but for larger ones too.

Another member added that in his experience, the most common question asked by clients is are you doing this to reduce your premiums and insurance cover?

Richard Turnor asked to what extent do insurers look at client due diligence? Graham Nagus confirmed that they do and expect risk management to be in place. Firms should meet their insurers.

A member asked whether pension funds were available to creditors, another member replying that that overpayments could be clawed back.

Engagement letters, or lack of them, were the next topic. Richard Turnor thought it was a cultural issue in countries like Belgium where written terms are rare. Frank commented that another global firm experienced the same issue there. There was discussion on whether clients were in a stronger position if they did not try and negotiate standard terms but challenged them later instead. Practice varied on whether to

insist on client signing terms, or having a 'deemed acceptance' provision in them. Scope of duty was identified as a key issue, though Frank warned of the risk of 'engagement creep'. Richard added that careful drafting of scope could restrict conflict issues.

Richard Turnor asked about audience experience of client reaction to liability caps. Frank Maher believed there is very little client resistance apart from institutional client panels, though the large accountancy practices have more success here. He thought liability caps were more likely to be effective where firms had drawn clients' attention to them in a covering letter, and given the opportunity to discuss them. He was unhappy about fee multipliers unless there was also a minimum amount. He also identified the risks of limiting liability to the full amount of indemnity cover which may not be available in the future.

Frank Maher made one final point for solicitors in relation to the Law Society minimum, cautioning that there needed to be provision covering this where other provisions were excluding liability.

**Slides from this workshop can be found on the members' side of the APP website under "Workshop Reports".**

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