

# Risk Update



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## The renewal

It is that time of year again. General expectations this time are that rates across the board may rise a little, 5 to 10 per cent has been suggested. However, we suspect it may be a little more complex than that, because it is unlikely that risk has diminished for firms with falling fee levels and they should not expect that premiums will therefore go down. We have not yet seen the full impact of credit crunch related claims, particularly those brought by lenders, which may be symptomatic of the property market in itself, as lenders have been unable to sell properties and crystallise their losses.

More than ever before, there is a need to manage the renewal process carefully. If you go about it the wrong way, it may not be possible to put it right later.

We expect that, as last year, there will be a noticeable but still relatively small proportion of firms with real problems obtaining cover. After the experience many firms had last year, we think it unwise to delay renewal in the hope of a cheaper deal emerging. There is generally no excuse for delaying the start of the renewal process beyond July.

Firms should take heed of the **Law Society's Practice Note on Professional Indemnity Insurance – the revised version dated 28 April 2009**, rather than the original version (which contained errors in relation to successor practices).

For most firms there will only be three or four insurers potentially interested in their business. Unless you know who the broker will approach and with whom they have relationships, you cannot be sure whether some opportunities will be untapped, whether they will be given proper consideration by a particular underwriter, and whether instruction of multiple brokers may simply lead to duplication of effort which will help no one when there are over 9,000 firms seeking to renew cover on the same day.

Particular problem areas we envisage arising are as follows.

- **Claims histories** – either specific (particularly large claims), or general, including lender claims and other multiple claim issues;
- **Dishonesty claims** (which may overlap with lender claims);
- **Solicitors Regulation Authority investigations** – it is critical to distinguish between routine Practice Standards visits, which will not be a concern provided they reveal nothing untoward, and Forensic Investigations which will be a cause for concern;
- **Failure to pay excesses**, which can be fatal to renewal prospects;
- **'Successor practice' problems** – where firms have, perhaps inadvertently, assumed the liability to insure a prior practice with inadequately considered liabilities.

So far as the last point is concerned, successor practice liability is a particular feature of the compulsory Minimum Terms and Conditions of Insurance in England and Wales. We are not saying that firms should never assume such risk, but it is a business decision requiring careful planning. It may arise when taking on teams or individuals. We have advised on over 70 successor practice issues, including transatlantic and other cross-border mergers.

Further guidance and free materials on successor practices can be found on the dedicated Successor Practice page on our website. [www.legalrisk.co.uk/Pages/Article.aspx?id=226](http://www.legalrisk.co.uk/Pages/Article.aspx?id=226)

There may be solutions for firms with problems such as those outlined above, but it can take time and firms with potential renewal issues should ensure they prioritise their renewal efforts.

Issues to consider are disclosure of material facts (which is a more onerous requirement than merely disclosing claims and circumstances) and the potential personal liability of principals for excesses and run off premiums (for which insurers may contend even in the case of incorporated practices).

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***The renewal (continued)...***

For those who have had enough of private practice, care is also needed in relation to insurance issues whether you are closing the practice or selling it. While the latter may obviate the need to buy compulsory (and perhaps additional) expensive run-off cover, it is not without issues, because take over by a larger practice in particular may expose you to large uninsured excesses and loss of control over limits of cover.

If you are the person entrusted with the responsibility of protecting the firm by complying with the insuring provisions in a professional indemnity insurance, you are required to perform your duty to exercise reasonable skill and care, and that duty requires compliance to an objective standard. So ruled Bernard Livesey QC sitting as a deputy High Court judge in **Tann v Herrington** [2009] EWHC 445 (Ch).

In the case in question, the partner in question delayed in making a notification of a claim to the insurers, because he believed the claim was spurious or, as he put it, a "dinner party claim". He said he thought he was acting in the best interests of the firm. As the insurance market hardens, insurers can be expected to take more policy points on issues such as late notification. The person in the firm responsible for the insurance arrangements has an onerous responsibility. We can provide advice and help on how to fulfil that responsibility.

***We advise on renewal-related issues, coverage disputes, professional liability and successor practices - contact [info@legalrisk.co.uk](mailto:info@legalrisk.co.uk)***

**Anti money laundering**

The Law Society's Practice Note on Anti Money Laundering is still being considered for Treasury approval, a process which appears to have become more drawn out than might have been expected.

The Practice Note on Mortgage Fraud was revised on 15 April 2009. [http://www.lawsociety.org.uk/productsandservices/practicenotes/mortgagefraud/2607\\_article](http://www.lawsociety.org.uk/productsandservices/practicenotes/mortgagefraud/2607_article) Firms should train relevant staff in this as it may be checked by the SRA when investigating firms with problems. We are aware of enquiries about compliance with the Money Laundering Regulations 2007 in relation to firms under investigation over mortgage fraud matters prior to the implementation of the Regulations.

The Serious Organised Crime Agency is reviewing the way professional bodies act as supervisors, which could in due course lead to a more proactive role by the Solicitors Regulation Authority in monitoring compliance in law firms. This emphasises the need for firms to be able to demonstrate compliance with the Money Laundering Regulations 2007, with documentary evidence in support, to show that that they have –

- (a) kept their systems under review;
- (b) revised and updated their systems as necessary;
- (c) ensured all relevant staff are trained;
- (d) undertaken ongoing monitoring where required by the Regulations (broadly non-face to face clients, Politically Exposed Persons);
- (e) reported matters to SOCA where appropriate (paying due regard to privilege and confidentiality).

One issue we have noticed is solicitors failing adequately to elevate their concerns and actions when another firm's client who is a party to a transaction is subject to criminal investigation or charges.

***We advise on systems, procedures, compliance audit, notification issues including privilege and confidentiality, and training. Contact [sue.mawdsley@legalrisk.co.uk](mailto:sue.mawdsley@legalrisk.co.uk)***

**Sham partnerships**

In **Hodson v Hodson** [2009] EWHC 430 (Ch), the Court had to decide whether there was a genuine partnership between two solicitors. When the firm was sued, one of them claimed she was not a true partner. The Claimant made no allegation that she was liable as having been held out as a partner, but alleged that she was a true partner. The reluctant partner was entitled to 1% of the profits (which she waived), and hardly had any involvement in the firm. For an initial period, she was the supervising partner for the purposes of rule 13 (which left her exposed under the decision in **M Young Legal Associates Ltd v Zahid** [2006] EWCA Civ 613), but she claimed she did not fulfil her responsibilities. In a subsequent period, she no longer had the rule 13 function.

The judge ruled that the reluctant partner did discharge her duties under rule 13, and therefore had some involvement in the management of the partnership during the initial period. She was entitled to a share of profit, even if it was only 1% and she waived it, and she derived other benefits, in that she obtained professional indemnity insurance and was able to use the firm's client account. The judge concluded that she was a true partner throughout. It is understood that the decision is under appeal.

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## Review of regulation – Smedley and Lord Hunt

The *Review of the Regulation of Corporate Legal Work* [www.legalregulationreview.org.uk/files/report\\_smedleyfinal.pdf](http://www.legalregulationreview.org.uk/files/report_smedleyfinal.pdf) by Nick Smedley (in relation to large city firms) and the Initial Response to Evidence by Lord Hunt [www.legalregulationreview.com/files/Initial%20Response%20to%20Evidence%20FINAL.pdf](http://www.legalregulationreview.com/files/Initial%20Response%20to%20Evidence%20FINAL.pdf) have been published.



A key issue, if it is in due course enacted, will be the requirement for large firms regulated by a discrete part of the Solicitors Regulation Authority to certify their own compliance on a regular basis. We can see this becoming onerous. At present, few firms have internal procedures requiring partners to self-certify their compliance. It can be effective, and we know of cases where it is, but many will find it a formidable challenge and the large city firms should not see it as an easy way out of the current regulatory regime - 'The regulator is not there to give these powerful firms an easy ride' (paragraph 3.41).

The Smedley report comments that the proposed 'style of regulation moves the SRA towards a combination of self-assessment by the firms (along the lines of the 'ethical infrastructure' approach pioneered in New South Wales), segmentation (as practised by such other regulators as the FSA and the ICA), expert advice by the regulator, and an overall model of supervision which is closer to engagement and partnership.' (Paragraph 4.10). For more information on the New South Wales experience see the November 2008 edition of Risk Update.

The following extracts are also illuminating –

- 4.12 When it comes to investigations, the SRA will want to develop something new in its repertoire. This must be faster and sharper than long, drawn-out investigations of alleged malpractice, based on extensive trawling of the files.
- 4.13 The firms will be required to co-operate with this new regime, and to commit to openness and transparency in their dealings with the regulator. Sanctions for failure to do so will be severe.
- 4.18 ...The regime I propose would not be 'light touch', nor 'hands-off'. It would demand of the firms the best corporate practices, and appropriate investment in management, governance, training and technology.

The requirement for openness and transparency will presumably involve a new self-reporting regime.

## Amendments to the Solicitors' Code of Conduct 2007

The Code was amended on 31 March 2009, primarily to make provision for Legal Disciplinary Practices but the opportunity was taken to make other changes too.

Note the amended guidance note 7 to rule 1.03, the core duty of independence [www.sra.org.uk/rule1](http://www.sra.org.uk/rule1) –

“ 'Independence' means your own and your firm's independence, and not merely your ability to give independent advice to a client.”

The note then lists examples which may cause consternation because, although we suspect they have been introduced to challenge firms 'jumping the gun' on the provisions of the Legal Services Act 2007 which will in due course permit external investment in legal practices, they may equally be said to apply to conventional lending by high street banks which may seek to exert some control over the way a practice is run. The wording is surprisingly loose in parts, with one example being 'finance agreements/loans to your firm with particular strings attached'.

Rule 5 (a) has been amended to require 'proper' (previously 'adequate') supervision; query if much flows from this however. Note also the requirement in rule 7.07 [www.sra.org.uk/rule7](http://www.sra.org.uk/rule7) for all emails (which will include replies) to include the words "regulated by the Solicitors Regulation Authority", and either (a) the firm's registered name and number if it is an LLP or company, or (b) if the firm is a partnership or sole practitioner, the name under which it is recognised by the Solicitors Regulation Authority, and the number allocated to it by the Authority.

The major changes are in rules 12 to 14, addressing the new forms of business structure.

## Supervision

Rule 5 of the Solicitors' Code of Conduct 2007 requires the managers of a practice to make arrangements for supervision and management. You are required to put in place – and monitor – sound systems to check untrustworthy staff – and partners – in the firm. Failure to do so may make the principals liable to be disciplined, when their staff are dishonest. See our "Practical Guide to Rule 5" for a full commentary on the responsibilities the principals in a firm bear. **To obtain a copy (price £10) contact [info@legalrisk.co.uk](mailto:info@legalrisk.co.uk)**



## MasterCigars: the saga continues

In Morgan J's latest judgment [2009] EWHC 651 (Ch), having sounded the alarm over satellite litigation over costs estimates, he goes on to give further very useful guidance. He spells out the legal process to be followed where a solicitor exceeds his estimate (cf paragraph 54). Essentially, the judge must determine whether, and if so how, the client relied on the estimate, before making deductions that reflect the impact that the erroneous estimate had on the client's conduct. He consigns the '20% margin' approach to history (except for use as a formula where it happens to express the result of the legal process to be followed).

Morgan J stresses that "...it is not the proper function of the court to punish the solicitor for providing a wrong estimate...". Practitioners should, however, bear in mind that they may still have to bear the consequences of non-compliance at the hands of the SRA or the Legal Complaints Service.

Estimates will continue to present difficulties, because costs are hard to predict. Morgan J's judgment provides some clues as to how to tackle those difficulties. First, make sure your terms of business make it clear the estimate is not a fixed price. Beyond that, a continuing dialogue with the client over the costs is the key. Make sure the estimate is detailed (itemising the work it covers, with a price against each item if possible), and inform the client of progress on each of those items of work and its cost as they unfold, and on further items of work as they arise, so that the client cannot say he relied on the estimate.

***We have developed an online audit questionnaire to enable firms to check the level of their compliance with rule 2 of the Solicitors' Code of Conduct 2007, available for £350.00 plus VAT. For more information, contact [info@legalrisk.co.uk](mailto:info@legalrisk.co.uk)***

## Limiting liability by contract

Limiting liability is becoming far more common, with all 64 firms responding to Legal Risk LLP's Top 100 Professional Indemnity and Risk Management Survey 2008 limiting liability at least some of the time. Our 2008 and 2009 surveys can be found at <http://www.legalrisk.co.uk/Pages/Resources.aspx?id=259>.

This will inevitably result in more decisions on the effect of such terms. So far we have **Marplace v Chaffe Street** [2006] EWHC 1919 (Ch), though the defendants won on liability, and the issue also arose in **Nationwide v Dunlop Hayward** [2009] EWHC 254 (Comm). The judge held that the provisions of the Civil Liability (Contribution) Act 1978 meant that a defendant could be liable to contribute to the amount the claimant was entitled to recover from another defendant without reference to a contractual limitation of liability. Addressing this contractually will be the next challenge.

An important aspect of limiting liability is to define the scope of the retainer and to avoid 'engagement creep'. Practitioners should note the decision in **Cobbetts LLP and anor v Hodge** [2009] EWHC 786 (Ch), though Floyd J, who decided this case, might not have expected to see it discussed in this context. The problem he was addressing was whether a salaried partner owed the firm he worked for a fiduciary duty, having determined that he was not a true partner and therefore owed no such duty in that capacity. In the course of his retainer, Mr Hodge negotiated for himself an equity stake in his client's business, a reward for seeking and finding other investors. On a narrow reading of the letter of instruction, his retainer "...might be said not to include the obtaining of investors". But the solicitor was "not straitjacketed by the letter of instruction. He was aware of the [firm]'s policy of adding value for clients...". It was therefore within the scope of his retainer to assist in finding investors.

The result may have been just in the circumstances of the case. But in another case, a commercial client may argue that the scope of a solicitor's duty extended beyond legal advice to other activities from which the firm would want to dissociate itself, where the firm advertises itself as providing 'commercial advice' or 'adding value'. Firms should take particular care to limit the services they advertise to legal services unless they really do provide wider commercial services, and make clear in their terms of business and/or client engagement letter the limits to the scope of their retainer (and prevent it being extended by staff without the written authority of a partner). Promotional material may extend the boundaries of the firm's duties.

***We have drafted terms limiting liability for ten of the top 100 UK firms and many others, including some in other jurisdictions. Contact [info@legalrisk.co.uk](mailto:info@legalrisk.co.uk)***

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