

Climbing out of the mire

By **Frank Maher**

Predictions have been rife that there would be an explosion of lender litigation against law firms, mirroring the experiences of the nineties. While the numbers of claims so far are only a small fraction of the deluge that fell on the profession, firms have been uncovering some nasty surprises as they prepare for this year's insurance renewal.

We have seen both large commercial and volume residential firms caught by mortgage frauds, some firms being exposed to hundreds or thousands of possible claims. The situation has been so bad that even mortgage fraudsters themselves have been caught out – in one case, a serial mortgage fraudster committed mortgage fraud to add yet another property to his empire, only to find that he was the victim of an identity fraudster who did not own the property he was purporting to sell. Perhaps there is some justice in the world!

It may just be an unfortunate coincidence of timing, but several firms have had the dreadful experience in the run-up to renewal of discovering that a fee-earner has been involved in wholesale multiple mortgage frauds exposing the firm to the risk that it will be unable to obtain insurance on the open market. That will mean obtaining cover from the Assigned Risks Pool, the cost of which is sufficient to wipe out most firms' profits. Yet even closing a firm down presents serious problems, with the cost of run-off cover and the successor practice issues (see last Risk Focus – June/July 2009).

The firm will then need to consider many issues. Anti-money laundering will be top of the agenda, and considerable care is needed, particularly if there are any transactions that have not yet completed as the firm is then at risk of entering an arrangement and committing an offence under section 328 of the Proceeds of Crime Act 2002, and possibly other provisions too.

The money-laundering reporting officer must consider client privilege, confidentiality and the risk of tipping-off at a time when the facts are far from clear. The firm's anti-money laundering systems and training will doubtless be under the spotlight. How could they have failed to pick up the problem? Bearing in mind the criminal sanctions for failure to comply, some care is needed in dealing with investigations into this.

There is then the question of notifying the current insurers, which needs to be comprehensive. This requires considerable care, because it has to be both thorough and comprehensive if the firm is to have any chance of obtaining insurance for the future *and* of avoiding the risk of exposing partners to future insurers seeking reimbursement of claims

payments due to inadequate disclosure on the proposal form. Remember, too, the ongoing obligation to notify circumstances until the policy expires.

It is also important to remember that, when renewing cover, the obligation to disclose is not limited to claims/circumstances that may give rise to claims, but also anything else that may influence the decision of an insurer to offer cover.

Will the firm have any prospect of obtaining cover from its current insurers, or indeed any others? Firms that have stayed loyal to the same insurer over the years, and have otherwise good claims records, may have a scintilla of hope. In the current economic and insurance climate, they may have little else to fall back on to persuade an insurer, except perhaps the risk of having to close down, leaving the insurer exposed to six years of future cover under their obligation to provide run-off cover.

Other insurance issues that are likely to arise include 'aggregation' – whether multiple claims are treated as one with a single, perhaps inadequate, limit of policy cover (and only one excess), or multiple claims with multiple excesses. The adequacy of disclosure on the last renewal may also come under the spotlight, again raising the spectre of coverage problems.

Rule 20.06 of the Solicitors' Code of Conduct 2007 requires you to notify the Solicitors Regulation Authority (SRA) if you become aware of serious misconduct by a solicitor or employee, or have reason to doubt their integrity. Serious concerns arise if the person concerned is still with the firm. Even if they have left, do you still have any staff that remain loyal to them?

Partners will doubtless be asked by the SRA how they discharged their duty of supervision, as well as investigating the anti-money laundering compliance. Again, great care is needed because disciplinary action may be brought against them as well as the individuals who were complicit in the fraud.

Firms that face this frightening scenario will need to project manage these and many other issues if they are to emerge from it at all. Those involved in the firm's management will need all the help they can get to chart a route through troubled waters. [FDLegal](#)



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