

Risk Update



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No rest.....

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No rest for the wicked: regulatory changes

Readers may recall, amidst the packing of buckets and spades, the introduction of rule 2.08 as an emergency addition to rule 2, which came into effect on 11 August 2009, following the scrapping of the remuneration certifying procedure. This required wholesale amendment of the notice to be given on invoices.


28 December 2009 was the date chosen to bring into force the Provision of Services Regulations 2009. They too required solicitors to make changes to the information they provide to clients, on (1) complaints procedure, (2) disclosure of professional indemnity insurance, and (3) European Economic Area in which professional title granted.

And now the Solicitors Regulation Authority (SRA) is replacing the emergency rule 2.08 with amendments to rule 2.05 which come into effect on 1 March 2010, and which will require further changes to Terms of Business/client engagement letters. The client care letter and complaints management practice notes have been updated to reflect changes.

In the meantime, following the SRA's decision in principle to amend rules 3 (conflicts) and 4 (confidentiality) to allow waivers for 'sophisticated clients', they issued their second consultation on the wording of the amended rules on 18 December 2009. The consultation period closes on 12 February 2010.

See www.sra.org.uk/sra/consultations/conflict-confidentiality-december-2009.page. Failure to understand the conflicts rules is still prevalent in the profession, and we have assisted many firms on this with helpline advice on a variety of issues, including cross-border conflicts, and workshops for senior partners in city firms.

A consultation has also opened on replacing the Code of Conduct with a more principles-based system of regulation – see page 2.

Subscribers to our  **Helpline** (fixed price, or pay as you go) receive advice on what changes are needed to make their Terms of Business comply with regulatory changes as they are introduced, whichever holiday period they arrive in.

For advice on regulatory issues, contact frank.maher@legalrisk.co.uk

SRA's Practice Standards monitoring visits: would you be among the 28%?

The Law Society's 2009 Regulatory performance survey findings, indicate that 28% of firms visited by the Practice Standards Unit found they were adversarial in their approach. 23% felt the PSU did not have a good understanding of their firm, and almost 20% found that the emphasis was on enforcement rather than on preventing problems. Even 31% of the PSU staff who conducted the visits acknowledged that their approach was more rules-based than principles-based.

We specialise in advising firms on compliance with the Solicitors' Code of Conduct 2007. We represent firms in their dealings with the SRA on a multitude of regulatory and practice issues. We have gathered a detailed insight into the way the PSU conduct their monitoring visits.

We have assisted a number of practices, including both major city firms and smaller ones, with their preparations. For some firms this has been by carrying out a dry run SRA type visit, mirroring the way the SRA have conducted them, and in other cases a workshop with their risk committee.

Continued

SRA's Practice Standards monitoring visits (continued)...

We provide a range of checks, which can include:

- Review of compliance with the Code of Conduct and other regulatory/statutory requirements.
- Review of existing risk management strategy, systems, policies and procedures.
- Online questionnaire to test for compliance with key regulatory requirements, e.g. Referrals.
- Interviews with key personnel.
- Debrief interview.
- Written findings.

Contact us for further details: sue.mawdsley@legalrisk.co.uk

All Change?

The current Solicitors' Code of Conduct came into force on 1 July 2007. Less than 3 years later, the SRA has published a consultation "Achieving the Right Outcomes" (20 January 2010) which runs until 6 March 2010 - www.sra.org.uk/consultations/achieving-right-outcomes/. This seeks views on the SRA's proposals to rewrite the Code of Conduct, replacing it with an outcomes-focused rulebook that could be applied to ABS's as well as traditional law firms. It would represent a further shift towards principles-based regulation (see above as to the SRA's own employees' continuing rule-based approach). To a greater extent, firms would be "...empowered to decide for themselves the most appropriate way to achieve the outcomes and comply with the new core duties/principles..." The SRA contemplates an approach to supervision which involves:

"...less 'ticking of boxes' and more discussion of the effectiveness of the firm's risk management systems."

For advice on risk management systems, contact francis.dingwall@legalrisk.co.uk

£500,000 fines

The Information Commissioner's Office will be able to issue fines of up to £500,000 for serious data security breaches, under new powers expected to come into force on 6 April 2010. Guidance can be downloaded from the ICO website at www.ico.gov.uk/upload/documents/library/data_protection/detailed_specialist_guides/ico_guidance_monetary_penalties.pdf. In addition, solicitors could expect the SRA to take action for breach of rule 4 (confidentiality) in relation to clients. Handheld devices, laptops and emails remain the weak link in security for many firms.

Uncertainty and the Jackson review

The new ISO 31000 International Standard for Risk Management (published Nov 2009) defines risk as "the effect of uncertainty on objectives". In the short term – and possibly medium term – Lord Justice Jackson's recommendations inject an extra dose of risk into litigation, because of the uncertainties surrounding their implementation. His Review of Civil Litigation Costs: Final Report (published on 14 January) proposes a 'coherent package of interlocking reforms'. Some can be implemented without legislative changes, but some require changes to secondary and even primary legislation. Civil litigation costs are unlikely to be high on the agenda of an incoming government this summer.

Under the recommendations, professional indemnity claimants and their solicitors would cease to recover ATE premiums and success fees, but would gain 'one way costs shifting' and contingency fees payable out of damages. The effect in the short term could be to accelerate claims, as claimants' solicitors take advantage of the current arrangements while they last, leading to a worsening of the claims spike inevitable in a recession. Anecdotally, even firms which have been claims free appear to be facing increased claims, no doubt recession-led.

For advice on defending professional liability claims and indemnity cover, contact francis.dingwall@legalrisk.co.uk

If not then, when? Perpetuities and errors of law

Aficionados of the Rule against Perpetuities will be aware that the remaining provisions of the Perpetuities and Accumulations Act 2009 come into force on 6 April 2010 (sections 1 to 21, and the Schedule). The Act provides a single statutory perpetuity period of 125 years, replacing the various existing common law and statutory perpetuity periods in most cases. Among the number of changes enacted, there may be a small reduction in risk for property lawyers because the rule will no longer apply to instruments creating options exercisable in the future, easements which will come into existence in the future, or in overage agreements.

Continued ...

If not then, when? Perpetuities and errors of law (continued)...

There may be uncertainty as to whether the new provisions apply to a codicil executed after the commencement date referring to a will executed before that date, so caution is needed, and perhaps a new will (executed on or after 6 April 2010) for the avoidance of doubt and future litigation risk.

Pensions advice has been a growing source of claims for some time. Some interesting issues are covered in an article entitled 'Perpetuity Periods in the context of Trusts Receiving Pension Death Benefits: A Wealth of Uncertainty', Private Client Business P.C.B. (2009) No.4 Pages 269-275, and issues which arise when occupational pension scheme administrators exercise powers to transfer death benefits held on discretionary trusts to the trustees of a new trust following death of a member.

The California Supreme Court held in **Lucas v. Hamm**, 364 P.2d 685 (Cal. 1961), that the failure of a will-drafting attorney to navigate the Rule Against Perpetuities was outside the scope of the duty of care as a matter of law. While traditional wisdom has been that most law firm claims arose from procedural error rather than errors of law, insurers have noted an increase in errors of law as a cause of claims in recent times, being the underlying cause of incorrect advice, particularly for larger City firms. Recession-driven pressures could exacerbate this.

Although the issue on liability for negligence and the standard of care is in principle the same as for any other mistake, in practice a solicitor's ignorance of the law will usually be found to be negligent. (See for example **Ridehalgh v Horsefield** [1994] Ch 205 at 240-245, and the analysis of the issue in Jackson & Powell on Professional Liability at 11-084 to 11-085.)

A glimpse into the future of law?

Reuters reported (9 December 2009) that accountants Tenon Group plc were acquiring RSM Bentley Jennison, a top 20 accountancy firm, for c. £76 million to boost their geographical reach. They funded the acquisition partly by the issue of shares. They saw synergies of at least £6.3 million.

Once ABS's are introduced, might we expect such news reports in the world of legal services? See Managing Partner's report on The Future of Legal Services which features a collection of views and predictions on how market trends and regulatory changes are shaping the future of legal services, including a contribution from Frank Maher alongside Lord Hunt, Robert Heslett and other luminaries.

We have advised major corporations and law firms on outside ownership issues, and are advising firms under investigation by the SRA for alleged breaches of the existing rules.

Top 100 survey

Our Top 100 Law Firm Professional Indemnity and Risk Management Survey is in course of final preparation. There is still time for any final responses to be taken into account. Contact: info@legalrisk.co.uk

Perils for employers, and for employees

The risk to the employer: vicarious liability

The reported decision in **Nayyar v Denton Wilde Sapte** [2009] EWHC 3218 (QB) highlights the importance of a rigorous approach to client engagement. This was a remarkable failed aviation contract claim against DWS and their assistant, Ms Advani, who was found to be negligent but acting outside the scope of her employment in arranging a £2.4 million deal in India with a £400,000 bribe. The claim against Ms Advani herself was defeated by the application of the doctrine *ex turpi causa*.

DWS were able to demonstrate that Ms Advani did not follow any of the firm's client engagement procedures. Where a firm does not have any proper procedures, or does not apply them uniformly, they will be more exposed to this kind of claim than DWS was.

Furthermore, the judge reminded the parties that even where no formal solicitor/client relationship is established, a solicitor and/or his firm may well assume a duty of care to a potential client before that stage is reached:

"For example, it would be by no means uncommon for legal advice and assistance to be given to a potential client for the purpose of seeking to persuade him or her to become a client."

This is a risk that firms need to guard against. We have recently advised the London office of a major US firm on its client engagement procedures.

As to the employer's exposure to its partners' activities, see Frank Maher's article "A Rogue in your Midst", in FD Legal January 2010, which can be found at www.legalrisk.co.uk/FileUploads/201018_FD_Legal_Risk_Focus_Decr09-Jan10.pdf

Continued ...

Perils for employers, and for employees (continued)...

The risk to the employee: rule 23.01 as amended

Few employees will expose themselves to risk to the extent that Ms Advani did. But all employees, support staff as well as fee-earners, now have exposure to regulatory risk, following the introduction of entity regulation. The Code of Conduct and Accounts Rules extend regulation to all employees of firms, as well as the recognised body itself and its managers: see rule 23.01(1)(d) of the Solicitors Code of Conduct 2007. Direct regulatory action can be taken against any employee. Firms should let their employees know, and should train them on the relevant rules, e.g. rule 4 (confidentiality) which would be relevant to secretaries and receptionists.

We have recently provided training on the Code of Conduct to the support staff at a top 100 firm, to help the partners fulfil their rule 5 (business management) responsibilities.

Policy coverage disputes: sham partnerships

The surge in professional indemnity insurers taking policy coverage disputes against solicitors on the Minimum Terms & Conditions, appears to be continuing. It no doubt reflects the hardening of the market, and the adverse claims experience. The scope for dispute is narrow. Establishing that a partnership is a sham can be a vital element, because it enables an insurer to deny cover to a firm altogether where there is a dishonest principal (against whom the insurer can invoke the dishonesty exclusion) who appears on the face of it to have one or more innocent partners. The Court of Appeal's decision in **Rowlands v Hodson** [2009] EWCA Civ 1042 has probably narrowed the availability of the point.

As in **M Young Legal Associates v Zahid Solicitors** [2006] EWCA Civ 613, the putative partner came on board to fulfil the supervision requirements, and made a similarly miniscule contribution to partnership affairs. She then gave up her supervision role, but there was no express or implied dissolution of the partnership. Rimer LJ found that she remained a true partner for the next two years, even though her continued activity in the partnership was no more than nominal.

We are arguing the point on sham partnerships both as between insured and insurer, and between insurers on a successor practice issue.

For advice on litigating and arbitrating policy coverage issues, contact francis.dingwall@legalrisk.co.uk

Anti-Money Laundering

The Joint Money Laundering Steering Group published final amendments to its December 2007 guidance and is seeking Treasury approval. See www.jmlsg.org/bba/jsp/polopoly.jsp?d=754&a=16974

For advice on anti-money laundering compliance, systems, audits and training contact sue.mawdsley@legalrisk.co.uk

Conferences

- Sue Mawdsley will be chairing the Conference on **Anti-Money Laundering Compliance** 23 February 2010, Ark Group.
- Francis Dingwall will be presenting a paper on Risk Management issues at the Ark Group conference on **Constructing Strategic Risk Assessment Frameworks** on 14-15 April 2010. His recent article "Lawyers, Surgeons, Pilots and Error-tolerant Systems of Work", published in *Managing Partner* magazine, can be found at www.legalrisk.co.uk/FileUploads/20091215_MPLexis_Nexis_supplementPart_2_Francis_Dingwall_1209.pdf

Judicial appointment

We are sure our readers will join us in congratulating our consultant, Tony Summers, on his appointment as the Principal Judge, Tribunals – Criminal Injuries Compensation.



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