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Picture: Solicitors Indemnity Fund's former office on the market

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Outcomes-Focused Regulation (OFR) and Draft Code of Conduct

The Solicitors Regulation Authority (SRA) consultation on OFR and the new Draft Handbook, including draft Code of Conduct, can be found at <http://path.to/ofr>. Solicitors ignore it at their peril. The consultation closes on 20 August 2010.

The SRA have explained in their roadshows that 'OFR is a regulatory regime that focuses on the high level principles and outcomes that should drive the provision of services for clients. It is backed by firm enforcement action where required.'

The Law Society's summary of the consultation explains that by 6 October 2011 the SRA hopes to:

- put in place a new outcomes-focused Code of Conduct as part of a handbook of all regulatory requirements,
- regulate using a risk-based and outcomes-focused approach, and
- have begun licensing Alternative Business Structures (ABSs).

The SRA plans to shift the supervisory emphasis towards assessing a firm's risk management systems and whether they are achieving the outcomes, rather than a detailed consideration of a firm's processes.

The level of supervision a firm will experience will depend on the perceived risk that it poses to the regulatory objectives. Supervision will also be tailored to take account of factors such as firm size and risk management systems, as well as the firm's previous compliance history and positive engagement with the SRA.

The SRA roadshows explained that their vision is to -

- Concentrate on dealing with firms who pose serious risk;
- Encourage firms to assess and tackle the risks themselves;
- Concentrate on those who cannot –or will not –put things right.

The reality, however, is that achievement of these objectives will depend on the approach to enforcement, on which a further consultation is due in August.

The Draft code contains –

- Principles – which are mandatory. They comprise the six current core principles and four new ones.
- Sections (four), covering
 - You and your client (Chapters 1-6);
 - You and your business (Chapters 7-9)
 - You and your regulator (Chapter 10);
 - You and others (Chapters 11-14).
- Chapters, within each of the above sections.
- Outcomes, which are mandatory. OFR concentrates on providing positive 'outcomes'.
- Indicative behaviours, which are not mandatory but have evidential force. There may however be different ways of achieving the outcomes.
- Guidance, which is available separately.

Three alternative models for a new conflicts rule appear in the Consultation Paper rather than the draft Code of Conduct.

The drafting format will not appeal to all. Lack of structure makes it unnecessarily hard to navigate.

Continued

Outcomes-Focused Regulation (OFR) and Draft Code of Conduct (continued)...

It does not read like a rulebook, perhaps intentionally, but lawyers will doubtless feel uncomfortable with a scheme under which they are judged by results (over which they may not have control) rather than their own actions (over which they should). There are a number of areas where the draft may result in greater regulatory control. The Principles broadly repeat the six core duties in the Rule 1 of the Solicitors' Code of Conduct (SCC) 2007, but add four more, requiring solicitors to -

- Comply with legal and regulatory obligations and co-operate with regulators, possibly undermining defences based on the significant decision in **Connolly v Law Society** [2007] EWHC 1175 (Admin), which held that 'the honest and genuine decision of a solicitor on a question of professional judgment does not give rise to a disciplinary offence';
- Implement effective measures for business management and risk management, with additional emphasis driven in part by the average £60,000 cost of intervention in failed firms;
- Promote diversity – potentially going far beyond not only the current SCC Rule 6, which prohibits discrimination, but also the regulatory objectives in section 1 of the Legal Services Act 2007 of 'encouraging an independent, strong, diverse and effective legal profession' – query whether an over-enthusiastic regulator could require firms to commit significant financial resources to 'promotion' of diversity;
- Protect client money and assets.

Chapter 1, Client care, contains many provisions which resonate with the current SCC Rule 2. However providing the best possible information about the likely overall cost of their matter is mandatory; this is similar to the current SCC Rule 2.03, but significantly it does not include the current proviso in Rule 2.03 (7) - 'If you can demonstrate that it was inappropriate in the circumstances to meet some or all of the requirements in 2.03(1) and (5) above, you will not breach 2.03.' It is therefore more prescriptive than at present.

While the business management provisions in Chapter 7 will require many smaller firms to make significant improvements to their financial controls, the recent events of a large firm foundering may encourage more regulatory intervention in financial and business management across the profession, though it would require a significant change in skill set for the SRA to take on this mantle.

The mandatory outcomes include -

- A 'clear and effective governance structure and reporting lines';
- Appropriate systems and controls for compliance with the Handbook;
- That you 'identify, monitor and manage risks to the achievement of all outcomes, rules, Principles and other requirements in the Handbook...and take steps to address issues identified.' It follows from this that in practice you will need a risk register which helps you track compliance with every provision of the Handbook (not just the Code) – an area where we have been assisting larger UK and overseas firms;
- Systems and controls for monitoring the financial stability of your practice; Indicative behaviours require controlling budgets, expenditure and cashflow – perhaps one should warn against high borrowings, particularly to pay drawings; note too that indicative behaviours in Chapter 10 (You and your regulator) provide for Indicative behaviours which require actively monitoring your financial stability.

The requirements of Chapter 9 on Fee sharing and Referrals are less prescriptive than at present, save that they are extended to overseas offices.

Chapter 10 'is about co-operation with your regulators and ombudsmen, primarily the SRA and the Legal Ombudsman.' It requires you to provide sufficient information to enable the SRA to decide whether to issue with a practising certificate/registration etc and to notify changes, including being in serious financial difficulty.

There is a need for an equivalent to SCC Rule 20, guidance note 34, which provides -

'Unless you are required by law to report a matter, 20.06 does not apply to confidential and/or privileged information another lawyer discloses to you:

- (a) as your client or the client of your firm; or
- (b) when seeking advice from a confidential helpline, such as the Solicitors' Assistance Scheme or Lawcare.'

Otherwise changes from SCC Rule 20 are few, apart from the requirement mentioned above for actively monitoring your financial stability.

Continued ...

Outcomes-Focused Regulation (OFR) and Draft Code of Conduct (continued)...

Chapter 11, Relations with third parties, is largely unchanged but the provision relating to undertakings is concerning, because the effect of the definition in Chapter 14 does not limit its application to undertakings given in the course of practice and could, for example, extend to undertakings to discharge loans for partnership capital. The provisions on undertakings in overseas offices are wider too.

International firms will be concerned at the increasing claim to extra-territorial jurisdiction in several areas, including Client care, Diversity, Management and Referrals. Chapter 13 allows overseas laws to take precedence in the relevant jurisdiction - but not rules of ethics or conduct. The consumer-focus of the drafting will sit uncomfortably with the relationship between solicitors and commercial clients.

Space does not permit a more detailed review. Solicitors should consider the consultation paper and the Draft Code with care and respond to the SRA. They should also start planning for the new regime, even though the detail of the Code may not yet be final.

For advice on the new Draft Code of Conduct or on risk registers contact frank.maher@legalrisk.co.uk

The Renewal



Solicitors in England and Wales are required to renew their primary insurance on 1 October 2010, and all indications are that this may be the most barbaric renewal since the demise of the Solicitors Indemnity Fund. Larger firms should escape relatively unscathed, except perhaps for a number who have had some adverse claims experience and rogue partner or employee issues in recent times.

For the smaller firms, life may be far more difficult, particularly with the absence from the market of Quinn and, less significantly, Hiscox; other insurers who have traditionally covered smaller firms may also be limiting their appetite for covering them this time. There may be hundreds of firms unable to obtain cover in the open market.

While we can but exhort all firms to submit their proposal forms early, as we have done for some years, there will be no guarantee of an early quotation, nor that when received, it will be one the firms can afford.

The spectre of the Assigned Risks Pool (ARP) looms large for hundreds of firms who are unable to obtain affordable cover in the commercial market, but real concerns remain that the record of the ARP in premium collection will pass a massive burden onto the rest of the profession – with premiums received of £7.2 million, and paid and reserved claims totalling £43.5 million. The £7.2 million premiums received over nine years will not even cover the paid and reserved claims total for the 2000-01 year, which amount to £9.5 million. The profession voted to end the Solicitors Indemnity Fund because they perceived that the good were subsidising the bad, and we have now replaced it with what masquerades as an open market scheme - under which, broadly, the good firms subsidise the bad. With perhaps one in 12 firms about to enter the ARP this is unsustainable.

The picture might be very different if the scope of cover were reduced, but there appears to be a perception that having the widest cover of any profession in the world (and by a significant margin) is incontrovertibly in the public interest. If the effect of the breadth of cover is to make it simply unavailable to a significant portion of the profession, forcing firms out of business, it is doubtful that the public interest is being well served.

We recognise that firms who are unable to obtain cover are not invariably bad firms, though doubtless some are, but may be victims of the limited appetite of the insurance market for covering small firms with particular practice areas and the almost unlimited cover afforded by the Minimum Terms and Conditions. The removal for this renewal of cover for disciplinary defence costs is not even scratching the surface. A summary of this and other rule changes (awaiting approval by the Legal Services Board) can be found at www.lawsociety.org.uk/newsandevents/news/view=newsarticle.law?NEWSID=428835.

Removing the requirement for qualifying insurers to pay claimants where firms have failed to pay the excess would enable insurers to underwrite risks properly. That may reduce the protection for the public, but it is a level of protection far in excess of anything they enjoy from any other profession.

Continued ...

The Renewal (continued)...

Despite the gloomy outlook, we have helped many firms with insurance difficulties. Although we are solicitors, not insurance brokers, there are many legal issues on which firms seek advice – block notifications, coverage and successor practices to name a few, and our extensive knowledge of the insurance market has made a real difference for many firms over the years.

Many practices are contemplating closure, and we have had several recent instructions on successor practice issues from firms seeking to close while maintaining opportunities for employment and client retention. In the current economic climate, this is far from being only a small firm issue.

There has been a revival of interest in captives, which can help the larger firms manage their risk and exposure to the availability and cost of insurance cover. As an incidental side effect, they may also insulate partners from some of the personal exposure to excesses in the event of failure of the practice.

For advice on insurance coverage and renewal, insurance issues on law firm insolvency, successor practices, partner liabilities and captives contact frank.maher@legalrisk.co.uk

Quinn Direct v The Law Society [2010] EWCA Civ 805

Quinn's appeal has been dismissed, but as if there were not enough insurance problems for solicitors already, the Court of Appeal's judgment has worrying implications on an issue which did not manifest itself in the first instance decision – highlighting a solicitor-client conflict www.bailii.org/ew/cases/EWCA/Civ/2010/805.html.

Note in particular the following extract –

23. ... I do not accept that an insured solicitor under any form of "claims made" policy is either entitled or bound to disclose to his insurer, either on inception, renewal or notification, confidential and privileged documents or information of the client without the client's consent. The documents and information are held by the solicitor subject to the right and privilege of the client requiring them to be kept confidential. The privilege of the client has been described as "a fundamental human right long established in the common law" by Lord Hoffmann in **R (Morgan Grenfell Ltd) v Special Commissioners of Income Tax** [2003] 1 AC 563. Any claim to its relaxation should be approached with the greatest circumspection, see **R v Derbyshire Justices** [1996] AC 487, 512. If the client will not waive his privilege to enable a proper notification to be made by the solicitor either before inception or during the currency of the policy then the solicitor will no doubt so inform the qualifying insurer. The solicitor is not entitled to ignore the client's privilege.
24. Second, no doubt the solicitor/insured owes duties of good faith to the insurer. He cannot justify any concealment of a material matter on the ground that he, personally, is privileged from disclosing it (see **March Cabaret Club & Casino Ltd v The London Assurance** [1975] 2 L.L.R. 169, 177) nor, perhaps, on the ground that the information he failed to disclose was confidential (see **Blackburn Low & Co. v Haslam** (1888) 21 QBD 144, 153/4). Nevertheless the privilege is that of his client and cannot be broken or waived without the client's consent. It may be that, if the client will not waive his privilege to enable proper disclosure to be made, the consequence of the resulting conflict of interest will be that the insurance is vitiated or the notification inadequate but that is the problem of the solicitor not the client, **Hilton v Barker Booth & Eastwood** [2005] UKHL 8. The solicitor's duty of disclosure cannot override the entitlement of the client.

Great care will be needed in completing proposal forms, and notifications of circumstances to insurers. Terms of business will need to be reviewed, but this will not help with past matters and the SRA's disapproval of solicitors seeking waiver of confidentiality and privilege through general terms of business is an added hurdle.

For advice on notifying insurers, terms of business (including limitation of liability), conflicts and confidentiality contact frank.maher@legalrisk.co.uk

Law Society Practice Notes

Practice Notes have been published on Insolvency of Qualifying Insurers and an updated one on Professional Indemnity. See www.lawsociety.org.uk/productsandservices/practicenotes.page?=#home

Continued ...

More POEMs

Our March 2008 newsletter mentioned a challenge by HM Revenue and Customs to the offshore status of a trust, where the Place Of Effective Management (POEM) was held to be in the UK, in **Smallwood v Revenue and Customs Commissioners**. Although an appeal to Mann J was successful, that has now been reversed by the Court of Appeal, leaving the taxpayer to face a substantial tax bill. See [2010] EWCA Civ 778 www.bailii.org/ew/cases/EWCA/Civ/2010/778.html.

There will often be interaction between law firms and accountants on schemes for high net worth individuals. We have advised a number of high net worth firms on their terms of business, their relationships with accountants and on limitation of liability.

Legal ombudsman service

The new legal ombudsman service will open on 6 October this year. Established by the Office for Legal Complaints and based in Birmingham, the service will replace the Legal Complaints Service based in Leamington Spa. We should expect a customer-friendly approach to compensation, which may in turn make the insurance market even more unfriendly for law firms, particularly those with a consumer client-base. The ombudsman's ability to award compensation will not be bound by inconvenient doctrines of law, such as scope of duty or limitation - see **R (on the application of Heather Moore & Edgecomb Ltd) v Financial Ombudsman Service** [2008] EWCA Civ 642. www.bailii.org/ew/cases/EWCA/Civ/2008/643.html

The ombudsman's jurisdiction to award compensation will be £30,000, but is widely predicted to increase to £100,000. Equally significant is the jurisdiction to reduce or disallow costs, particularly now that the Remuneration Certificate procedure has been scrapped.

Firms should use the run-up to 6 October as an opportunity to check that they are fully complying with SCC Rule 2.05 (complaints handling), which was amended on 1 March 2010.

For advice on compliance with rule 2.05 and other aspects of client engagement, contact francis.dingwall@legalrisk.co.uk

Enron

Nearly nine years after Enron descended into Chapter 11 bankruptcy, the case of **Raiffeisen Zentralbank Osterreich AG v Royal Bank Of Scotland Plc** [2010] EWHC 1392 (Comm) has reached the English courts. www.bailii.org/ew/cases/EWHC/Comm/2010/1392.html

The following extracts are perhaps worth pondering –

1. The transaction at the heart of the present claim struck the Group Credit Committee of the Royal Bank of Scotland Plc ("RBS") at its meeting on 22nd September 2000 as "21st Century Alchemy". The alchemist's stone was reputed to turn base metal into gold. Its 21st Century equivalent, if it worked, realised a profit in the accounts of Enron Corp ("Enron") by the use of £138,500,000 borrowed from RBS, against what was in economic substance a guarantee by Enron, without the borrowing featuring in Enron's accounts...
139. I have come to the clear conclusion that both Enron and RBS intended and understood that Enron's assurances were not to be legally binding obligations and that they did so because, if they were, the accountancy treatment which Enron intended to adopt could not apply. Enron made clear to RBS that the accounting position was such that there could not be a legally binding agreement. For Enron then to have given RBS a legally binding assurance ... would have undermined the purpose of the transaction and denied Enron the very benefit which it was designed to secure.
360. In this market, "documented" was synonymous with "contractual" and "not documented" with "non-contractual". The assurance/"promise" could not be documented because it could not be contractual and it could not be contractual for accounting reasons.

Health warning: When, to the knowledge of the participants, documents do not accurately record a transaction, adverse consequences may ensue. Perhaps the accounting reasons were there for a purpose.

Continued ...

Duty to report serious misconduct

We have had an increasing number of requests - including City firms and in-house solicitors - for advice about reporting solicitors and their staff for misconduct under SCC Rule 20.06. There have been cases in the Solicitors Disciplinary Tribunal for failure to comply – see 10090-2008 and 10322-2009.

Ireland

Law Society of Ireland

Legal Risk LLP are delighted to have been appointed by the Law Society of Ireland to its panel of specialist risk management consultants. Our aim is to assist law firms in all aspects of risk management and regulatory compliance. See www.legalrisk.co.uk/Pages/Article.aspx?id=265. Contact francis.dingwall@legalrisk.co.uk

Money Laundering

The Criminal Justice (Money Laundering and Terrorist Financing) Act 2010 was signed into law on 10 May 2010. This covers the requirements of the Third EU Money Laundering Directive.

The commencement date is 15 July 2010 after which, law firms will have to comply with the obligations required under the legislation.

Guidance is available from the Law Society of Ireland at www.lawsociety.ie/Pages/General-Information/AML-Guidance-Notes/

Legal Risk LLP can assist firm in all areas of compliance and have numerous years experience in this area, contact sue.mawdsley@legalrisk.co.uk

Events

Frank Maher will be delivering the keynote speech for the LAWASIA Conference: Updates in Legal Professional Indemnity Insurance in Singapore on 27 - 28 August 2010, followed by private speaking events in Australia.

He will also speak at the C5 8th Professional Indemnity Insurance conference in London on 20 – 21 October 2010.

For further details of these and other events, please see the Events page on our website www.legalrisk.co.uk.



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