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Legal tribe

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Overseas claims

Your law firm's international offices may be putting you at risk of high professional indemnity insurance claims, warns Frank Maher

The international expansion of UK and US-based firms and, to a lesser extent, European-based firms, has continued apace in recent years. There was a time when overseas offices were considered low risk by insurers, perhaps because the Anglo-Saxon culture of litigation had not then spread. But, times are changing.

Insurers have seen a deterioration in the claims experience of overseas offices, perhaps not surprisingly when firms have increased their overseas income as a proportion of the whole. Claims by overseas clients against domestic offices seem to have increased too. This article looks at both aspects and examines some of the causes.

The claims

There have been several high-value claims in recent years, many in the tens of millions of pounds and some in the hundreds of millions. UK firms have been affected by claims, particularly in the Netherlands and Germany. The position regarding the US offices of UK firms is less clear as, in some cases, they are covered under separate insurance arrangements. Cultural attitudes to compliance may vary along national lines.

The claims experience of overseas offices covers the spectrum of practice areas, including litigation. Some of these involve client fraud, where the alleged victims have sought to access the deep pockets of the insurer. Others involve time limits, drafting errors and wrong advice, much as in UK offices.

Defending claims in foreign jurisdictions can sometimes be problematic: there may be less relevant expertise, or the limited available expertise may be snapped-up by the claimant before the firm and its insurers get a look in. In one case, there was a perception that the local profession was closing ranks, making it hard to achieve any feeling of justice really being done.

Conflicts allegations

Conflicts are not only issues of compliance and conduct: allegations of conflict have featured frequently in some of the most contentious liability claims in my experience of defending claims. While there is no suggestion of a claim, the case of *Georgian American Alloys v White & Case* [2014] EWHC 94 (Comm) shows how conflicts can arise where multiple offices of the same firm are instructed on separate matters.

Cross-border conflicts cause problems. Desire to take on work may result in international offices taking on a smaller matter, which precludes the firm acting on a larger instruction.

In one example in which I was involved, the London office of a large US firm acted in credit-crunch litigation for the liquidators of a company in relation to a multibillion-dollar revolving credit facility provided by a syndicate of banks. The firm also acted for some of the US banks in unrelated matters. The liquidators accepted that the firm would cease acting for them if they became adverse to a bank client of the firm, in the sense that the firm could not sue a bank client for recovery after seeking and obtaining declaratory relief. This was an important qualification on the ability to act and, as events turned out, revealed that there had in fact been a significant risk of conflict, which backfired when a conflict emerged.

Perceptions of what constitutes an information barrier may be rather low

among lawyers in smaller jurisdictions overseas. Lawyers may think they can create an information barrier in their heads. Some leading firms will act for three or even four competing bidders. They argue there is no one else who could do the work, but they do so without critical analysis of whether that is true on a case-by-case basis; it is a point which has failed in the past. The profession in Sweden, where bar rules forbid acting for competing bidders, has managed to continue to serve clients, albeit in part due to a falloff in M&A activity.

Many lawyers see conflicts as substantially a matter inception issue and rather lose sight of it after that. If you are instructing other firms, are they also acting for another party? If so, who gets the tax or the environmental advice? Are both clients getting the same advice? Even big firms struggle in some areas, such as tax or environmental law – you may have more than one environmental partner, but only one who does, for example, water pollution. So, which client will have to put up with an environmental partner without the right specialty?

How effective are your controls on outside counsel guidelines? What about terms being sent to accounts after engagement, rather than the client partner? This topic was covered in my previous *Managing Partner* article 'Reputations at risk'.[1]

Emerging markets

Many firms are expanding into emerging markets as they are seen as largely untapped compared to the overcrowded markets in which they already practise. International expansion continues to be a strategic priority for the UK's top-50 firms, with Asia, Middle East and Africa the preferred locations, according to PwC's 2014 law firms survey. However, unfamiliar territories may carry both unfamiliar risks and familiar risks on an unfamiliar scale.

By way of example, the *International New York Times* has reported that lawyers in Myanmar are well accustomed to paying out a stream of bribes to clerks and judges as part of a widely-acknowledged culture of graft. Myanmar is bound to attract interest as trade barriers fall. But, foreign investment is prohibited in mining, administering electricity supply and certain national security interests, and can only be done as a joint venture in restricted activities, which covers most manufacturing activities. The need for a joint venture inevitably increases counterparty risk, with associated party implications under sections 7 and 8 of the UK's Bribery Act. Ethnic tensions, political uncertainty and the time it takes to get things done add to the problems.

Another example involved a solicitor who was found by a judge to have arranged the payment of a bribe in India in an attempt to secure an agency agreement from an airline, in *Nayyar & Ors v Denton Wilde Sapte & Anor* [2009] EWHC 3218 (QB).

Law firms often act for blue-chip clients, but the list of blue-chip companies with issues around anti-money laundering compliance, bribery and wider financial crime (such as LIBOR rate-rigging investigations) is endless. There are seemingly endless reports of action being taken in the USA, the UK and China.

There has also been a high-profile case in Argentina involving lawyers linked to the vice-president and the drafting of a sale and purchase agreement. This included a provision for one party to get the benefit of a tax payment plan, with cash deposits going through a special purpose vehicle which had not been traced.

Inevitably, law firms doing international work may have to instruct local lawyers if they do not have lawyers in a particular jurisdiction. They should consider what controls they have over selection. Simply having met someone at a conference or looked them up in a directory may not stand scrutiny: the larger firms are doing due diligence on their 'best friends' and others whom they engage or recommend to clients. There may be liability for failing to identify errors by the local firm – see, for example, *Gregory v Shepherds* [2000] P.N.L.R. 769.

"Unfamiliar territories may carry both unfamiliar risks and familiar risks on an unfamiliar scale"

This is particularly significant when instructing firms may have provided indemnities to their clients for the work done by firms they retain in other jurisdictions (client indemnities are another topic in themselves).

The topic of risk in emerging markets leads on to wider issues of financial crime.

Financial crime

Anti-money laundering, counter-terrorist finance, financial sanctions and wider issues of financial crime are occupying the minds of law firms the world over, but to varying degrees.

One of the dangers is that firms may only be instructed on part of a transaction and not see the full picture. They may be alert to the risk profile of their own client, and even the client's counterparty, but what of the counterparty to the counterparty? What is the big picture?

"If you sort out your client and matter inception, you have addressed 80 per cent of your risk management"

This is increasingly a concern with the wide reach of financial sanctions following the Arab Spring and events in the Ukraine in particular. In the UK, the Solicitors Regulation Authority has warned that if a law firm is working as part of a referral network, it will need to ensure due diligence covers the transaction as a whole, not just the section the firm carries out.[2]

It cannot be assumed that fee earners in other firms, even the most eminent, have the same level of understanding of financial crime risk as yours do – a point which we have established through online testing of staff in some leading non-UK firms. When one takes account of the fact that lawyers in the UK probably do far more reports than those in the rest of the world put together, it is not too surprising if the understanding on reporting obligations may differ there.

Putting sanctions to one side, another big issue on anti-money laundering is failures in ongoing monitoring of business relationships. This is generally required under anti-money laundering legislation in most jurisdictions. It is just as relevant to protecting the firm from claims as it is to ensure regulatory compliance.

The SRA has also noted that there is inadequate due diligence around the true

source of funds. In some circumstances, this is around whether the individuals or businesses approaching the firm are politically exposed persons (PEPs) or have connections to organised crime who may engage with the firm through an intermediary. Again, these are equally relevant to liability concerns.

People issues

There have been many cases in which firms have faced substantial liabilities from the work of lateral hire partners, particularly where the lateral is in a branch office and is the only person, or is in a small group of people, doing that type of work.

There is often a wide variation in standards of supervision. Cultural differences may play some part in this, but it occurs even across the same office. Culture may also be relevant to the question of whether someone will tell you if they have made a mistake. Online testing of staff has exposed significant differences in the willingness to be open about such things.

Protecting the firm

Are terms of business used in every case? How often do your lawyers say 'the client wouldn't like them'? There is a greater culture of compliance on using terms of business and engagement letters in the UK than there has ever been, but it has not yet prevailed so widely in many other countries. If you sort out your client and matter inception, you have addressed 80 per cent of your risk management. By this we mean:

- acting for the right clients;
- with appropriate client due diligence;
- on work you are competent to do;
- with the right resources for the work;
- with a clear written agreement at the outset as to what is included and excluded in the engagement; as well as
- agreeing on the price to be paid for the advice.

The culture of keeping attendance notes may vary widely – apparently it is not done in Greece, but then perhaps one might say that about even London at times too.

A key message is to ensure people are trained to raise awareness in their practice areas and that they understand the big picture of the transactions in which they are involved, even if they are only involved in a small part of it.

The following questions may help you to test whether your firm is fully protected: Do you know what is happening in your other offices today? Are you truly one firm? How will you find out? mp

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References

1. See 'Reputations at risk', Frank Maher, *Managing Partner*, Vol. 17 Issue 4, Dec 2014/Jan 2015
2. See 'Cleaning up: Law firms and the risk of money laundering', Solicitors Regulation Authority, November 2014

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