

# A time bomb ticking on partner moves

FIRST PUBLISHED IN APP, EDITION 45, DECEMBER 2016

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Change is on the way, and those involved in law firm mergers and lateral moves - and the solicitors and accountants advising them - need to factor it into their negotiations now, without waiting to see what those changes will be, or it may come back to bite them.



The issue is this: partners may be doing work now for which their current insurance would protect them, but by leaving a firm, they may have no say in the firm’s future insurance and impending changes in compulsory cover may mean that they are not protected. At present, law firms in England & Wales enjoy the widest insurance coverage of any profession in the world, but that is set to change. Because of the way professional indemnity insurance works – on a ‘claims made’ basis – future reductions in cover may impact work already done.

Those reductions may not just relate to the amount of cover, but the wide protection currently enjoyed against non-disclosure. Consider the example of a recent American case, where protection is not as wide as here. In *Illinois State Bar Ass’n Mut. Ins. Co. v. Law Office of Tuzzolino & Terpinas*, 27 N.E.3d 67 (Ill. 2015), a client alleged that his attorney, Tuzzolino, had been negligent. Less than three months later, Tuzzolino completed an insurance proposal and denied knowledge of “any circumstance, act, error or omission that could result in a claim.”

An unrelated claim was then made against another partner, Terpinas, who knew nothing of Tuzzolino’s non-disclosure, but the insurers were held to be entitled to rescind the policy and deny cover for all the partners, including Terpinas, on the basis of Tuzzolino’s non-disclosure. If these facts had arisen under the current scheme in England & Wales, insurers for the compulsory layer of cover - £3m for incorporated practices, £2m for partnerships and sole practitioners - would have to cover a partner in Terpinas’s position, and seek

reimbursement from Tuzzolino for the prejudice caused by the non-disclosure.

The Solicitors Regulation Authority (SRA) has proposed widespread change in the past, but was rebuffed by the Legal Services Board (LSB) which said they needed evidence to justify the changes. Since then, two things have happened. First, the SRA has recently published claims statistics from insurers to make its case again, but the published data is skewed by the absence of many insurers who have either withdrawn from the market or collapsed: the SRA plans publishing a consultation in the Spring of 2017.

Secondly, the LSB recently published a *Thematic Review of restrictions on choice of insurer*, from which it appears that they are driven by a desire to reduce the cost of premiums, come what may, and changes of the type proposed previously by the SRA may receive support. The move for reform has also attracted support from the recent Competition and Markets Authority Legal Services Market Study Final Report published on 15 December

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2016, though regrettably they appear to have followed the SRA's approach with a marked lack of critical analysis.

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Changes such as those previously proposed could, for example, exclude automatic cover for claims by most commercial clients – including mortgage lenders, who are a significant source of claims against law firms,

remove protection in cases of policy breach for innocent partners in the position of Terpinas in the example above, and reduce the level of cover, perhaps as low as £500,000, including costs, which may be inadequate for a large proportion of claims relating to ordinary everyday property transactions and much other work.

Partners who leave a firm would lose control over the insurance arrangements and level of cover. Uninsured lateral hires are also a threat to the firms they join – nobody wants partners in financial distress. And firms which are merging or demerging need to understand the risks too.

So, in conclusion, anyone involved in law firm change, whether mergers, demergers, lateral hires or retirements, needs to think through how the likely changes may impact on the future financial wellbeing of all those involved. The writer has already had cases where this has been a significant factor in clients' decision-making.

*Frank Maher is a partner in Legal Risk LLP, solicitors specialising in professional regulation and professional indemnity.*  
[www.legalrisk.co.uk](http://www.legalrisk.co.uk)

*This is an updated version of an article first published in the Association of Partnership Practitioners Newsletter, Issue 45, December 2016*