

Picking up the pieces

By **Frank Maher**

With many law firms downsizing, some splitting into separate firms and some even folding, there are many good quality lawyers on the market, some with client followings or reputations for specialist practice. Those with an eye for investment may be looking to recruit either teams or individuals.

Like picking up pieces of broken glass, however, care is needed. There may be insurance implications that need to be addressed in advance, as they can rarely be put right after the event. Nor are these solely issues for the high-street firm: I have advised on several situations involving international firms, including four transatlantic practices. US firms present particular issues where they have dissolved, leaving former partners in a closed London office.

The issues in this article, however, are relevant not only where firms fold, but also to the common issue of firms that split in two, perhaps when a key team is poached.

In order to protect the public, solicitors and their staff, the Minimum Terms and Conditions of Insurance (MT&C) for solicitors in England and Wales ensure that there is insurance cover in place when a firm ceases to exist as a discrete legal practice. Although this protection comes at a price, it is the envy of valuers, whose practices are folding in increasing numbers, leaving individual valuers exposed to personal liability on claims following the decision in *Merrett v Babb* [2001] EWCA Civ 214.

The MT&C achieve this in one of two ways:

- a. In most cases there will be a 'successor practice', whose policy must provide cover for the firm that has ceased; or,
- b. Less often, the insurer of the firm that is closing down has to provide six years run-off cover from the end of the current policy year, which is then followed by £1m cover from the Solicitors Indemnity Fund until 2017.

The latter scenario causes particular problems in the case of international firms insured under a global programme, where the policy may be subject to a multimillion pound excess, for which the former partners (and even LLP members) may be personally liable.

Becoming a successor practice is not necessarily something to be avoided. It is a business decision to consider on the facts of each case when planning a merger or acquisition and to take into account in the due diligence.

Sometimes it is possible to structure a transaction to achieve the desired result. Simply declaring that a practice is or is not

successor in a merger document, however, will not work; although I have seen a number of examples of provisions purporting to achieve that result, but which were doomed from the start.

So, why does all this matter? There are several reasons:

1. The provisions can have unintended consequences and can make a merger or acquisition a total economic disaster;
2. You may have to pay for someone else's claim;
3. It may make you uninsurable;
4. Your premium may go up;
5. Your excess may go up;
6. Even principals in LLPs and Limited Companies may have personal liability; or,
7. I am acting in one case where, independently of insurance issues, potential disciplinary consequences have arisen for Accounts Rule breaches.

The most difficult issues in practice tend to arise when a firm splits. If one takes a simple example of a two-solicitor practice – A, B & Co – splitting and the partners joining different firms: A goes to X & Co and B goes to Y & Co. The possible outcomes, depending on the precise facts, can be that there is no successor, one successor or two successors (the last of these is generally to be avoided).

A brief summary of the rules can be found in the revised Law Society's Practice Note on Professional Indemnity dated 28 April 2009 (replacing the version issued on 23 April 2009, which contained a mistake in relation to successor practices) and a more detailed explanation at www.legalrisk.co.uk.

The rules are complex, but, like tax, it may be possible to plan the merger or acquisition – mistakes cannot be undone afterwards.

The 80 or so successor practice issues on which I have advised are by no means solely the province of the high street: they are becoming a major issue on lateral hiring of teams.

These are just a few of the many insurance points to consider on practice mergers and acquisitions: there are many more traps for the unwary! The cost, if it goes wrong, can run into the millions and leave a firm unable to insure and, in turn, unable to practise. *FDLegal*



Frank Maher is a partner at Legal Risk LLP, solicitors, and a member of the editorial board. He can be contacted at frank.maher@legalrisk.co.uk