

Hidden Hazards of helping a law firm in trouble

When insolvency practitioners are asked to advise solicitors facing financial difficulties, they have a range of tools available to them to assist, depending on whether the solicitor is an individual, a partnership, LLP or a limited company. Solicitors are highly regulated and an insolvency practitioner assisting a solicitor's practice will inevitably encounter the Solicitors Regulation Authority "SRA". The powers of the SRA are extensive and where a solicitor faces financial difficulties, there is a real risk that the SRA will intervene in the solicitor's practice. Intervention will have serious consequences for the solicitor's practice concerned and will impact on any proposals that an insolvency practitioner may have for dealing with the solicitor's practice.

Solicitors and the Statutory Trust

Where a resolution to intervene in a solicitors' firm is passed, the effect is to impose an immediate statutory trust over certain assets of the practice. The intervention will vest client account and other monies belonging to the practice, in the SRA. This will occur notwithstanding the fact that the solicitor whose practice has been intervened may already be subject to an individual voluntary arrangement or bankruptcy order. This article will look in more detail at how and when intervention may arise, the implications of the Statutory Trust and its effect.

What is the Statutory trust?

Its source can be found in the **Solicitors' Act 1974** as amended by the **Legal Services Act 2007**.

Paragraph 6 of Part II of Schedule 1 of the amended Act provides:

"6.(1)..... if the Society passes a resolution to the effect that any sums of money to which this paragraph applies, and the right to recover or receive them, shall vest in the Society, all such sums shall vest accordingly (whether they were received by the person holding them before or after the Society's resolution) and shall be held by the Society on trust to exercise in relation to them the powers conferred by this Part of this Schedule and subject thereto upon trust for the persons beneficially entitled to them.

(2) This paragraph applies –

(a) where the powers conferred by this paragraph are exercisable by virtue of paragraph 1, to all sums of money held by or on behalf of the solicitor or his firm in connection with:

(i) his practice or former practice,

(ii) any trust of which he is or formerly was a trustee, or

(iii) any trust of which a person who is or was an employee of the solicitor is or was a trustee in the person's capacity as such an employee;

Under the Interpretation section of the 2007 Act, "Society" is defined as "The Law Society". In practice, the powers referred to in the Act are exercised by the SRA.

The statutory trust does not create a charge over the assets of the practice but does vest "sums of money" in the SRA. However the amendments in 2007 extend to other potential assets which would normally be available in the insolvency. Paragraph 6 A provides inter alia:

(1).....if the Society passes a resolution to the effect that any rights to which this paragraph applies shall vest in the Society, those rights shall vest accordingly.

(2) This paragraph applies to any right to recover or receive debts due to the solicitor or his firm in connection with his practice or former practice.

(3) Any sums recovered by the Society by virtue of the exercise of rights vested under sub-paragraph (1) shall vest in the Society and shall be held by it on trust to exercise in relation to them the powers conferred by this Part of this Schedule and, subject to those powers and to rules under paragraph 6B, upon trust for the persons beneficially entitled to them.

When does the Statutory Trust apply?

The statutory trust only comes into existence following the passing of a resolution to intervene in a solicitors' practice. The process of deciding whether or not to intervene in a practice will be instituted by the SRA and the final decision will be taken by an external panel of adjudicators.

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In what circumstances will the SRA intervene?

The Law Society through the SRA may intervene in the circumstances described in Paragraph 1 of Schedule 1 of the **Solicitors Act 1974** as amended. These include:

- (a) *the Society has reason to suspect dishonesty...*
- (c) *the Society is satisfied that a solicitor has failed to comply with the Accounts or Trust Accounts Rules....*
- (d) *a solicitor has been adjudged bankrupt or has made a composition or arrangement with his creditors*
- (m) *the Society is satisfied that it is necessary to exercise the powers in relation to a solicitor to protect:*
 - (i) *the interest of clients*
 - (ii) *the interest of the beneficiaries of any trust*

Effects of intervention

The effects of intervention are immediate, in that it will vest sums of money belonging to the solicitors' practice in the SRA with effect from the passing of the resolution. Bank accounts will be frozen and the SRA will appoint a firm of solicitors from its panel of (currently) eight firms to intervene in the practice. This will involve attending at the firm and recovering client files, accounts and computer records. In the case of larger firms such as the recent intervention of Blakemores, it can involve a logistical nightmare. The principal or partners will usually be given 24 hours' notice of intervention. The number of interventions in solicitors' practices currently runs between thirty and sixty per annum. The cost of the intervention process, which in the case of large firms can be very substantial, becomes the liability of the solicitor(s) and may include former partners.

To what sums of money does the Statutory Trust apply?

In addition to monies held in the firm's client account it will also include other sums of money held by the practice. For this purpose the term "sums of money" also included work in progress accrued on client matters as was held in **Dooley v The Law Society 23 November 2001**. Pending realisation and/or receipt of work in progress payments or outstanding debts, the solicitor is prevented from dealing with the debts, i.e. by sale or assignment. All book debts and their proceeds are also vested in the SRA.

In **Williams v The Law Society [2015] EWHC 2302 (Ch)** it was noted that the statutory trust applies to all sums of money held by or on behalf of the solicitor in connection with both "his practice or former practice". In that case consideration of a "former practice" became relevant when determining entitlement to a payment received from the Legal Aid Agency. It was held that the Legal Aid monies that were subject to the statutory trust were only those attributable to the activities of the solicitor in his "practice" and in relation to his involvement in any "former practice". It would not affect other monies held by a former firm in which the solicitor had previously been involved.

The effect of a solicitor entering into an IVA and the statutory trust imposed by intervention was considered in the case of **The Law Society v Beller [2014] EWHC 3923 (Ch)**. Shortly after the SRA intervened in Mr. Beller's practice he entered into an IVA. The costs of the intervention amounted to £99,457. In addition the Solicitors Compensation Fund paid out the sum of £100,000 to a former client. Following the conclusion of the IVA, the solicitor took steps to recover work in progress (which had been excluded from the IVA), and this resulted in the debtors paying the sum of £23,500 into court. The Law Society sought to claim that sum by virtue of the statutory trust. On appeal, it was held that The Law Society could have no further claim against Beller for either the intervention costs or the compensation paid to the former client. This was because the IVA was operated as a composition of those claims.

In that case it was noted that there was a distinction between the vesting of monies held in client account which would then be held on trust for the benefit of the individual clients whose monies they represented, and the recovery of work in progress/book debts. In relation to the latter once held under the statutory trust, The Law Society would then hold those monies on trust for the "persons beneficially entitled to them". Because of the IVA The Law Society were not beneficially entitled, and the only other person who would be entitled to the funds was Mr. Beller himself. As such The Law Society's appeal failed in respect of those monies.

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Questions to be asked at the outset

Insolvency Practitioners seeking to advise solicitors facing possible insolvency should make enquiries and satisfy themselves as far as possible that there are no obvious circumstances that may give rise to an intervention being made. Enquiries should be made of the SRA to determine whether or not any resolution has already been passed and a notice served indicating intervention. Whilst contacting the SRA may trigger the process leading to an intervention, it is a requirement that they are notified of any solicitor who is proposing to enter into an insolvency procedure. Where there is likely to be an intervention, the SRA may provide an estimate of the likely costs of the intervention, which can then be factored into any proposals for dealing with the insolvent solicitor's practice.

An insolvency procedure in relation to a solicitor's practice, whether it be administration, a partnership voluntary arrangement or an individual voluntary arrangement, will need to take into account the potential effect of the solicitor's statutory trust. The effect of the trust will be that all sums of money to which the trust applies will be payable to the SRA. Whilst the SRA may deduct the costs of intervention from sums of money recovered under the statutory trust, it does not follow that the costs of any insolvency practitioner who is appointed in relation to the practice may deduct his costs from such monies. The remaining sums of money after intervention costs have been paid will then be paid to those beneficially entitled i.e. clients. Where the funds are insufficient then the intervening solicitors will put forward a distribution proposal report to the SRA adjudicator who will make a final approval of the proposed distribution.

The overall effect can mean that insolvency practitioners will have assisted the practice in placing it into an insolvency procedure and have invested a significant amount of time and effort. Notwithstanding the fact that they have realised assets by the way of a pre-pack administration or other form of sale, they are not automatically entitled to claim their costs and remuneration from the sale proceeds that fall within the definition of "sums of money" where intervention takes place. Discussion with the SRA should provide some guidance as to what assets/sums of money will be available to meet the costs of an officeholder in given circumstances.

Where a solicitors' practice is disposed of prior to intervention, whether or not it is within an insolvency process, it is important that consent is obtained from the client to transfer matters where there is outstanding unbilled work in progress. Where such matters are disposed of and consent has not been obtained from the client, then in the event of intervention, those matters will be recovered by the SRA's agent and any costs recovered in relation to such matters will be subject to the statutory trust.

When advising solicitors, insolvency practitioners must be aware of the constant risk of intervention and its effect. Intervention will cause the statutory trust to vest "all sums of money" in the SRA. This may leave few, if any, free assets available to the insolvency practitioner to realise for the benefit of creditors and to pay the costs and remuneration

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