Solicitors and Insolvency 2

This is the second of two articles looking at the effects of the recession on solicitors firms. A particular feature of the current recession is that it has had a significant impact on firms of solicitors. In the case of the largest firm of solicitors to fail to date, insolvency practitioners are continuing to calculate the total loss to creditors. It is not however the headline failures that have been felt by the profession most, but the increasing number of medium size and small firms that are being seriously affected by the current economic climate. The causes of this have been well canvassed to date.

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Vehicles and options

Solicitors trade through a variety of different vehicles. The differences between the types of structures adopted by solicitors become more apparent when a firm faces insolvency. The insolvency practitioner instructed to advise a struggling firm will have various options which may be applied depending on the type of structure used. Early reported cases during the current recession have seen solicitors practices placed into administration, sometimes combined with a pre-pack, which provides for the practice to be sold simultaneously with the appointment of an administrator. Other options, such as voluntary arrangements and liquidation are also available. The final choice will depend on the particular circumstances of the firm in question.

Continued trading

Whilst it is not unusual for an insolvency practitioner to continue trading a business pending sale or disposal, trading a solicitors practice comes with its own difficulties. Apart from the ever present risk of intervention by the Solicitors Regulation Authority, any continued trading within an insolvency process will normally have to be conducted by an insolvency practitioner who is also qualified as a solicitor. With difficulties over continued professional indemnity insurance this means that trading by insolvency practitioners of solicitors firms is rare.

Successor Practice

A key concern is whether or not the disposal of the business to another firm of solicitors will constitute the purchaser as a successor practice. Where a firm ceases without a successor practice, then the principals of the firm will usually be liable to pay an additional premium for compulsory run off cover for professional indemnity insurance. If the practice is disposed of to another firm who is a successor practice, then the new firm picks up the professional indemnity position of the old firm and the need to obtain run off cover is avoided. The risk to a purchaser is that if they are deemed to be a successor practice they will assume certain liabilities of the old firm. A poor claims history of the old firm will become part of the successor practice's claims history with a potentially adverse effect on premiums. This has caused problems for firms and insolvency practitioners advising them as increasingly purchasers are unwilling to take on the risks and liabilities associated with a successor practice.

Definition of "successor practice"

The definition of a successor practice is contained in the **Minimum Terms and Conditions (MTC) 2009**. The definition is detailed, and too lengthy to reproduce here. However key elements of the definition include the word "transition" which is defined as "merger, acquisition, absorption or other transition which results in A no longer being carried on as a discrete legal Practice".

It continues that "B is a successor practice to A where:-

> (i) B is or was held out, expressly or by implication, by B's owner as being the successor of A or as incorporating A, whether such holding out is contained in notepaper, business cards, forms of electronic communications, publications, promotional material or otherwise, or is contained in any statement or declaration by B's owner to any regulatory or taxation authority …."

The effect of the successor practice rule is that a firm taking on any part of a former practice in any way either becomes a successor practice or runs the risk of doing so. From the above definition, it can be seen that even attempts to dispose of the assets on a piecemeal basis can result in the purchaser becoming a successor practice. It is for this reason that the SRA issued a consultation paper proposing changes to the definition. Since then some changes were introduced on 1 October 2010 which include the right to elect to trigger run-off cover where a firm ceases with a successor practice subject to certain conditions being met.

The disposal of any part of a solicitors practice requires careful consideration of the successor practice

rules, and regard should be had to the guidance of the SRA, the Minimum Terms and Conditions and the requirements of professional indemnity insurers.

The firm's employees

As mentioned above, early reported cases involving firms of solicitors centred on pre-pack administrations. Part of the transfer of a firm's practice may include the potential transfer of employees.

Earlier case law indicated that in the case of an administration the rights and obligations attaching to employees did not pass to the purchaser where the undertaking was disposed of by a company in administration. In the recent decision of **OTG Limited v Barke [2011] UK EAT0320/09**, the Employment Appeal Tribunal took a more purposeful view and held that where an undertaking is disposed of by an administrator, the rights and obligations attaching to employees will pass to the purchaser under TUPE. The acquiring firm will take on the additional liabilities for all employees transferred in such circumstances.

Personal liability under professional indemnity policies

The different vehicles used by solicitors practices to trade has meant that the terms of professional indemnity insurance policies have evolved over the last few years. The increasing use by solicitors of LLP's and Limited Companies, has meant that in the event of a firm ceasing, careful regard must now be had to the terms of the professional indemnity insurance policy in order to determine the extent to which individual directors/ shareholders/solicitors/members may be personally liable for both run off cover and any excess. Policies vary and should be considered individually. Examples include terms which provided for joint and several liability by each Principal in respect of monies owed to the insurer under the policy. "Principal" is defined as any person who is a director and any solicitor held out as a director, or who beneficially owns the whole or any part of the shares in the company. In the case of limited liability partnerships, careful examination of the definition of a "member" should be undertaken in order to determine the extent of any personal liability.

The difficulties facing firms of solicitors are likely to continue and the task of insolvency practitioners engaged to advise firms will be challenging. It is to be hoped that further guidance will be issued by the SRA concerning the position of successor practices in order that the interests of creditors, clients and stakeholders can be made clearer and protected.