Happy New Year!

What plans do you have for your firm in 2007? Thinking of merging or demerging, taking over another firm or taking on partners from another firm, or being taken over yourself? If so, high on your agenda should be consideration of the successor practice rules for professional indemnity insurance purposes – will one or more firms be a successor practice or will run-off insurance be required?

Successor practices and run-off

When a law firm ceases to exist, two alternative consequences follow in insurance terms. If the firm is succeeded to by one or more firms, the insurer(s) of the successor firm(s) must provide cover for claims arising out of work done by the ceased firm. If the firm ceases without a successor then run-off insurance will become operative. We discuss run-off at end of this article.

Successor practice liability can be confusing, not least because it is often completely divorced from the question of where legal liability for a claim lies. Whilst the partners in a successor practice might not be liable in legal terms to a claimant, the practice that has been succeeded to (the prior practice) will become an ‘insured’ under the successor practice’s insurance. The successor’s insurer will therefore cover claims against the prior practice.

Successor practice liability has been a major issue for law firms, brokers and insurers alike since the start of open market solicitors’ professional indemnity insurance in September 2000. With recent increased merger activity (and more expected in light of the Carter reforms), the end of concepts such as a job for life, and with legal professionals becoming ever more mobile, successor practice issues and potential attendant disputes look set to become even more widespread in the future.

The Minimum Terms

All insurance companies that provide solicitors’ professional indemnity insurance must do so in accordance with the Law Society’s ‘Minimum Terms and Conditions of Professional indemnity insurance for solicitors registered in England and Wales’. These can be accessed at:

www.lawsociety.org.uk/professional/professionalinsurance/minimumterms.law

What is a successor practice?

The successor practice rules are set out in paragraph 8.2 of the Minimum Terms, which states:

“Successor Practice means a Practice identified in this definition as ‘B’, where:

(a) ‘A’ is the Practice to which B succeeds; and

(b) ‘A’s owner’ is the owner of A immediately prior to transition; and

(c) ‘B’s owner’ is the owner of B immediately following transition; and

(d) ‘transition’ means merger, acquisition, absorption or other transition which results in A no longer being carried on as a discrete legal Practice.

B is a successor 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, form 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; and/or

(ii) (where A’s owner was a sole practitioner and the transition occurred on or before 31 August 2000) – the sole practitioner is a Principal of B’s owner; and/or

(iii) (where A’s owner was a sole practitioner and the transition occurred on or after 1 September 2000) – the sole practitioner is a Principal or Employee of B’s owner; and/or

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Cessation of a discrete legal practice

A fundamental point arises from the definition of ‘transition’. It is that in order for a firm to be succeeded to, it must no longer be carried on as a discrete legal practice. It must completely cease providing legal services from all of its offices. For example, if a two office firm (Z) sells to another firm one of its offices and the legal business carried on from that office but continues to practice from the office it has retained, Z continues as a discrete legal practice and no successor practice issue arises. The potential claims liabilities arising from the work Z carried out at the office it disposed of will remain with Z.

Holding out

As can be seen from the provisions of paragraph 8.2 above, holding out is key. Even if the conditions in paragraphs (ii) through to (vi) are fulfilled, B will not be a successor to A if another practice is held out as being the successor to A.

So what can constitute holding out? There are obvious indicators such as changing the name of your firm to incorporate the name of the firm being succeeded to: e.g. ‘B & Co incorporating A & Co’ or ‘B formerly known as A’, or B being carried on under the same name as A or a substantially similar name to A.

However, less obvious factors, often in combination, can also indicate that a holding out exists. This has led to many firms taking on successor practice liabilities unintentionally.

Indicators can include:

- B including in its title the name of a former partner of A who did not become a partner of B.
- B adopting A’s DX address or telephone number.
- B writing to clients suggesting that it is the successor e.g. ‘we have acquired A’, ‘we have taken over A’.
- The layout and font of B’s stationery reflecting the style of A’s former stationery.
- B informing the Law Society or other regulatory authority or public body that it is a successor to A.
- B adopting A’s Law Society registration number.
- B adopting A’s VAT registration or otherwise indicating to HM Revenue and Customs that it is a continuation of A’s business.
- B submitting tax returns to HM Revenue on the basis that it is continuing A’s business.

What clients are told is also important. Many firms have ended up being successors because although the partners have been careful to avoid assuming successor practice liabilities, their employees have held the firm out as a successor, such as by writing to clients of the ceased firm stating that it has ‘merged’, ‘been acquired by’ or ‘joined’ with their own firm. If you are intending not to be a successor take care not to let your employees, including your marketing staff, undo all your good work.
**Sole practitioners**

Since 1 September 2000, if by way of transition, a sole practitioner’s discrete legal practice ceases and the sole practitioner joins another firm whether as a principal or employee, that firm will succeed to the sole practitioner’s practice. There’s no way around it. ‘Employee’ is widely defined in the Minimum Terms. It includes “anyone employed or otherwise engaged in the Firm’s Practice (including under a contract for services) including, without limitation, as a solicitor, lawyer, trainee solicitor or lawyer, consultant, associate, locum tenens, agent, appointed person (as defined in the Solicitors’ Indemnity Insurance Rules 2006), office or clerical staff member or otherwise”.

Once taken on, a sole practitioner’s successor practice liabilities are not something you can get rid of. For example, if a sole practitioner becomes a partner or employee in another firm (B) and then six months later leaves that firm to set up on his own again, his original liabilities will stay with B because that firm remains a discrete legal practice. There having been no ‘transition’ at that point, no possibility of a successor to B arises.

**Incorporated practices**

When a Limited Liability Partnership or limited company ceases to practice there will only be a successor practice if either the LLP or limited company itself becomes a principal of another practice or if another firm holds itself out as the successor to the LLP or company.

**Can more than one firm be a successor?**

Yes. Imagine that a ten partner firm ceases and splits up into two five partner firms. If both new firms hold themselves out as successors to the ceased firm then both will be successors. Alternatively, if both new firms fulfil the criteria in paragraph 8.2 (vi) of the Minimum Terms then both would become successors by that route.

**No succession to part of a practice**

One of the issues that has caused confusion over the years is whether a firm can succeed to part of a practice. In short, the answer is no. Why? Because ‘succession’ requires that all of the ceased firm is subject to the transition. Take the example of a firm with three offices which, upon cessation, becomes three separate firms (i.e. discrete legal practices) each of which operates from the premises of the former firm and each of which uses the same name as the former firm. Each of the new firms would be a successor to the whole of the ceased firm.

To take another example, C&D is a two partner firm undertaking conveyancing and personal injury work. It ceases and its work is split between two other firms. C joins X&Co as a partner, taking the conveyancing work with him. D joins Y&Co as a partner, taking with him the personal injury work. If both X&Co and Y&Co hold themselves out as successors to the former firm of C&D, both will be successors to the whole of that firm and not just the specific area of work they took over. If a claim were made in respect of the personal injury work carried out by C&D, both X&Co and Y&Co’s insurers would have to respond to the claim. Likewise, if a conveyancing claim were made the two successor firms’ insurers would also have to respond.

**Taking over files**

Simply having the files of a ceased firm transferred to your firm, without fulfilling the conditions in paragraph 8.2 of the Minimum Terms, will not lead to a successor practice liability arising.

However, there are other matters to consider when taking over another firm’s files. One of these is whether to issue new engagement letters to the clients who are transferring. After all, the terms of the previous firm’s engagement may be very different from your own. And even if they’re not and you wish to continue acting under those pre-existing terms, you should at the very least write to the transferred clients confirming this. Whenever taking on transferred files you should always be mindful of the need to comply with your professional obligations under the Solicitors’ Costs Information and Client Care Code 1999.

**No contracting out, no cover for indemnities**

It isn’t possible to contract out of the successor practice provisions of the Minimum Terms. To mitigate against potential claims liabilities, some successor practices seek to obtain from the partners of the prior practice an indemnity relating to any uninsured losses that the successor may incur, typically the excess payable in respect of any claim arising from work performed by the prior practice. If entering into such an arrangement, don’t forget that excesses can change. We are aware of one sole practitioner who found himself liable for a £50,000 excess pursuant to an indemnity he had given to a large firm which had acquired his practice. Indemnities are of course a private arrangement between the individuals involved, which insurers have no interest in and will not seek to pursue on behalf of the beneficiary. Furthermore, there is no cover under the policy for liabilities arising under such indemnities.

**File retention**

If you do intend to assume successor practice liabilities make proper arrangements so that you will have ammunition to defend a claim resulting from work carried out in the name of the prior practice. You don’t want to be left defending claims where you have little knowledge of the underlying facts, with no assistance from the person who actually carried out the work who may not have joined your firm, and perhaps even without access to the original file.

Prior to the date of succession, arrange for the transfer into your custody or control all files in respect of which there may be a potential liability to your firm i.e. those where the limitation period for a negligence claim is still running (keep in mind the 15 year long-stop provided by section 14B of the Limitation Act 1980). Ideally, obtain a list of all archived files and their whereabouts so that there can be no doubt over who’s got the file should it be needed.
Record keeping
Make sure that you keep accurate records, not only of all mergers, take-overs or the taking on of sole practitioners or principals but also of the dates relating to partner appointments and retirements. All too often, when a dispute arises, firms find themselves without accurate records, and likewise the Law Society which is dependent on information provided by the firms themselves.

A business decision
We are not saying that assuming successor practice liability is to be avoided at all costs. In some circumstances, the potential financial benefits of merging, taking over another firm, taking on a sole practitioner or principals from another firm will far outweigh any potential successor practice liabilities. What we are saying is that whether to assume such liabilities should be a business decision taken in full knowledge of all the facts and the insurance implications. Successor practice liability should never be taken on in ignorance: once assumed it will stay with a firm forever.

- The successor practice rules are complicated and may not operate as you would imagine.
- They are governed by the Law Society’s Minimum Terms.
- You cannot contract out of the successor practice rules.
- The fact scenarios of each succession are different.
- If taking on a sole practitioner you can’t avoid becoming a successor.
- It is possible for more than one firm to be a successor.
- It is not possible to succeed to part of a practice.
- Simply taking over files won’t make you a successor.
- Prior to becoming a successor, investigate the target firm’s claims and complaints experience. Have they ever been refused insurance? Make appropriate enquiries, including of the Solicitors’ Disciplinary Tribunal, about all prospective partners and employees.
- The insurance profile of your practice will be altered by any succession and may impact detrimentally on the level of premium charged.
- Get in contact with us before the event if you are thinking of: merging or demerging; taking over another firm, taking on the majority of principals from another firm; taking on one of more principals from another firm who are not the majority when the majority of principals from that firm will not become principals in another; taking on a sole practitioner whether as a principal or employee.

Run-off cover
If during the period of insurance your firm ceases to practise without a successor, we will require you to pay a run-off premium calculated at 225% of the annual premium for the minimum level of cover (with a nil excess) your firm would require under the Minimum Terms. You must make payment in full immediately upon cessation. Payment of the run-off premium is in addition to and not in substitution for payment of the premium for the current policy period.

Run-off cover lasts for six years commencing on the 1st October following the expiry of the insurance for the year in which the firm ceased.

Where a claim is notified after a firm has gone into run-off we will need access to the file in order to investigate the claim. If your firm is going into run-off you should make appropriate arrangements for the storage of your files. Furthermore, it is essential that you provide us with the contact details of a partner who will be able to provide us with the relevant file, and that you let us know of any changes to these details.

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