

# The Pelican Brief



Risk insights and intelligence

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## Successful Mergers



### Background

We highlight in this Risk Management update steps that firms should consider taking as part of their due diligence to make a success of succession.

Mergers between law firms are not new but they are a growing trend, with some very high profile activity last year. If you have been a spectator thus far, and are worried that you will be left on the sidelines, perhaps 2017 is the year in which you don't just weigh up the opportunities but take the plunge. So long as you are aware that there may be rocks below the surface.

**Even if you think you think you know the target firm well, leave your rose-tinted spectacles at home. Some firms have skeletons in the cupboard and you don't want any nasty surprises after the deal has been signed. Don't rely on the other firm making full disclosure. Ensure that your due diligence is meticulous and thorough.**

Consider the sole practitioner in his late 60s with perhaps thousands of wills stored in a dusty basement. Don't let the prospect of anticipated probate instructions distract you from essential analysis of how the firm has been run over recent years. His turning a blind eye to succession planning may be indicative of failings in other areas.

Property work carries risk too. In June 2011, Firm C acquired Firm B which had itself taken over Firm A, a conveyancing firm, the previous year<sup>1</sup>. At the time of the second merger, Firm C had an unblemished claims record but not for long. A lender claim in November was quickly followed by 16 others but that was as nothing compared to the notification of 5000 circumstances in September 2012 all of which related to Firm A's poorly run property files. Firm C's grossly inadequate due diligence made it uninsurable.

If your target firm has acquired other firms in the recent past, your due diligence should include the earlier merger. All the target firm's work, whether ongoing, archived or inherited, will lie at the door of your insurer if claims later emerge. This can prove a very significant issue for the successor practice, not only in terms of increased insurance premiums, but also the potential costs of unbilled time and possible investigations by the SRA.

This can only be avoided if the firm being acquired elects in advance to be insured under the run-off provisions with its existing insurer. Care is also needed to ensure that you are not held out to be the successor to a ceased firm. That is obviously more attractive to the acquiring firm, but carries significant cost for the ceasing firm. If you are going to be the successor practice, you must be absolutely clear about what you are acquiring. Do not make assumptions.

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you should.**

**Apart from all usual investigations, and not least a detailed analysis of the firm's financial viability, pay particular attention to the following:**

## Claims

The target firm's claims experience will have a direct impact on the newly merged firm's premium. Look beyond paid and reserved claims to consider how conscientious the firm has been in identifying and reporting potential claims which should far outweigh actual claims. Look carefully for any patterns or trends. Probe the firm to see what procedures have been tightened as a result as this can give a valuable insight into the firm's culture.

## Future claims

Acquiring a significant archive of property, probate and trust files can appear massively attractive but it may produce future claims that makes your firm uninsurable, particularly as potential claims can lie dormant for some years. Many of the wills in the above example may have been revoked by newer wills made elsewhere or the testator may be untraceable. There is also the risk that some of the wills will have been badly drafted or that the will file containing crucial evidence has been destroyed. Specifically on wills, check for the existence of a *Larke v Nugus* statement.

## Branch offices

**They are often allowed to operate as a firm within a firm, with little supervision and centralised checks and balances ignored.**

Assess how branch offices, particularly those some distance away from the main office, have been managed. They are often allowed to operate as a firm within a firm, with little supervision and centralised checks and balances ignored. Keeping outlying branch offices may make it more difficult to achieve a unified culture, particularly if no-one from the management team visits regularly.

## Regulatory footprint

Check the firm's regulatory history, as investigations can run for years. In the merger example above, three members of Firm A faced SDT proceedings before the second acquisition was completed. Ask the firm to obtain a printout of its regulatory history and consider speaking to the SRA. Review the firm's compliance documentation including its risk register, compliance plan and compliance breaches, paying particular attention to any material breaches reported to the SRA. Don't forget to review the firm's AR1s (in relation to its client account) and complaints referred to the Legal Ombudsman as both receive SRA scrutiny.

## Complaints

Review the firm's complaints process and record. This is often a good indicator of the quality of services being provided.

## Client due diligence (CDD)

**Assess the rigour of its client care and file management processes to see how conscientiously they are undertaken.**

In Firm A above, poor practices were endemic. In 2016 two property fraud cases<sup>2</sup> identified failings by the firms in their CDD, echoing results found by the SRA during its recent AML thematic review<sup>3</sup>. Consider whether the firm pays lip service to its CDD obligations or has effective procedures.

Whilst a well-managed merger can be an excellent springboard for both firms, an unwise merger may lead to an unhappy separation or worse. Don't just dive in because you think you should. When it comes to mergers or acquisitions, with so many potential pitfalls, a spectator role may be your best option.

1. *European Risk Insurance Co HF v McManus Seddon Runhams* (2013) EWCA Civ 1545

2. *Purrunsing v (1) A'Court & Co*, (2) *House Owners Conveyancers Limited* (2016) EWHC 789 (Ch) and *P&P Property Limited v (1) Owen White & Catlin LLP* (2) *Crownvent Limited t/a Winkworth* (2016) EWHC 2276 (Ch)

3. AML thematic review: SRA 12 May 2016, a copy of which can be found at [www.sra.org.uk/sra/news/press/aml-report-2016.page](http://www.sra.org.uk/sra/news/press/aml-report-2016.page)

## Final checklist – have you checked?

- Financial Performance and Profitability of the firm
- Financial controls and Cyber fraud prevention
- Prior Practices/Succession
- Complaints Handling procedures and Performance
- Client care and file opening procedures
- SRA monitoring visit history
- Disciplinary matters of all Solicitors in the target firm
- Claims record of both circumstances and claims
- Details of ALL outstanding claims with or without a reserve
- Staff turnover
- Internal Disciplinary matters
- File retention
- File review or audit



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