

The “Succeeding Practice Rule”

The professional indemnity insurance regulations are designed to prevent situations whereby a client’s valid claims are not covered by any professional indemnity insurance cover. Provisions in the regulations relating to succeeding practices and preceding practices are among the mechanisms put in place to achieve this objective.

This article explains the effect of the regulations in circumstances where there is a succession to a firm’s practice. A succession can occur, among other circumstances, where one firm acquires the practice of another. The possibility of acquiring a practice often presents a very worthwhile opportunity for the acquiring firm. However, it is important for solicitors to be aware of the impact of the regulations in such a situation and, in particular, of a firm’s obligations in relation to the coverage of claims that may in the future be made against the acquired firm.

Background to the succeeding practice rule

Professional indemnity insurance cover is on a ‘claims made’ basis. This means that the insurance policy that will meet a claim is the insurance policy that is in place when the claim is made and notified to the insurer (or the insurance policy that was in place at the time the insurer is notified of circumstances that may give rise to a claim), and not necessarily the insurance policy that was in place when the alleged negligence occurred. For this reason, all solicitors who were proprietors of firms which were ceasing practice were previously required to continue their professional indemnity insurance cover for a period after ceasing practice.

The old regulations were found to be inadequate. The availability of cover relied on the solicitor ceasing practice arranging the necessary cover. Some solicitors did not do so. While the Law Society could, and did, take regulatory action against these solicitors, there was no means of guaranteeing that the matter would be rectified and that cover was put in place. Accordingly, there were occasions when clients who had a legitimate claim against their former solicitor could not recover because their solicitor had no means and was not insured at the time the claim was made.

The regulations provide for a scheme whereby claims made by clients of a firm that has ceased practice will be covered in situations where this might not have previously been the case. The regulations rectify this shortcoming of the previous system by:

- requiring the insurers of the firm ceasing practice to continue insuring that firm for a prescribed period, or
- for the insurance of any succeeding practice to cover the risk.

All qualified insurers must provide fixed minimum terms and conditions as part of their policies and the minimum terms and conditions include these requirements.

Requirement for insurance to cover preceding practice and succeeding practice

Under clause 2.4 of the minimum terms and conditions, a firm’s existing insurance must indemnify against civil liability to the extent that such liability arises from any provision of legal services in connection with what is defined as a preceding practice.

Under clause 2.5 of the minimum terms and conditions, where there is a succession to a firm’s practice, the firm’s existing insurance must indemnify against civil liability arising from any provision of legal services in connection with what is defined as a succeeding practice to the firm’s practice. In both cases, the requirement is subject to the proviso that:

- a) A claim in respect of such liability is first made against the insured during the coverage period, or
- b) A claim in respect of such liability is made during or after the coverage period and arises from circumstances first notified to the insurer during the coverage period.

Definitions of ‘succeeding practice’ and ‘preceding practice’

The minimum terms and conditions provide a broad but detailed definition of ‘succeeding practice’. This covers a wide variety of situations, including situations where the composition of a partnership is changing.

‘Succeeding practice’ means a practice that satisfies any one or more of the following conditions in relation to another practice (such other practice being a ‘preceding practice’ for these purposes):

- a) It is held out as being a successor to the practice or part thereof of the preceding practice, by whatever means such holding out occurs, or
- b) It is conducted by a partnership that has a majority of principals that are identical to those persons that were principals of any partnership that conducted the preceding practice, or
- c) It is conducted by a sole practitioner who was the sole practitioner conducting the preceding practice, or
- d) It is conducted by a partnership in which the sole practitioner conducting the preceding practice is a partner and where no other person has been held out as a successor to the preceding practice, or
- e) It is carried on under the same name as the preceding practice or a name that substantially incorporates the name of the preceding practice, or
- f) It is carried on from the same premises as the preceding practice, or
- g) The partnership that, or sole practitioner who, conducts the practice has acquired the goodwill and/or assets of the preceding practice, or
- h) The partnership that, or sole practitioner who, conducts the practice has assumed the liabilities of the preceding practice;

but a practice will not be treated as a succeeding practice pursuant to paragraphs (b), (c), (d), (e), (f), (g) or (h) of the definition if another practice is or was held out by the owner of that other practice as the succeeding practice.

Scenarios in which files are transferred

There are different scenarios in which files are transferred from one practice to another practice.

The following are examples:

- The firm ceasing to practice transfers all files, current and closed, and the acquiring firm assumes all liabilities.
- The firm ceasing to practice transfers current files, wills and deeds, but the acquiring firm does not assume any of the liabilities.

- The firm ceasing to practice agrees with two or more different firms that they will divide the current files.
- No firm acquires all or part of the practice. The clients choose their own new solicitors.
- A firm acquires the current files of the practice, but some or all individual clients choose a different solicitor.

Possibility of more than one firm being a succeeding practice

Depending on the precise circumstances, more than one firm can be a succeeding practice, and the destination of the files handled by a prior practice is only one of a number of factors that may need to be taken into account to identify these succeeding practices under the definition above. Paragraph (a) of the definition refers to “the practice or part thereof”. In this context, ‘part’ may mean a recognisable part of a practice, such as all the conveyancing or litigation or probate files, or all the residential conveyancing or personal injury or debt collection or family law files, or all the files of a branch office, depending on the context and structure of the practice. However, this is not an exhaustive list.

Determination of whether a firm will be a succeeding practice

It is clear from the above that the determination of whether a firm will be a succeeding practice depends on the particular circumstances in question. While the Law Society will seek to assist firms in determining, on the particular facts provided, whether a particular firm might be considered a succeeding practice for the purposes of the regulations, it will not and cannot provide a declaration or ruling to this effect. The Law Society would also consider that it is best practice for the relevant firm to liaise with its broker and/or insurer with a view to ascertaining its views on whether the firm would be considered to be a succeeding practice and to discuss generally the impact on its professional indemnity insurance.

Insurance policy of succeeding practice must respond to claims made against preceding practice

A significant practical implication of the system introduced by the regulations is that the insurance policy of a succeeding practice will be required to respond to claims made against a practice that falls within the definition of a preceding practice, and any excess due in respect of such claims may (depending on the terms of the policy) be payable by the succeeding practice. Claims made under the succeeding practice’s insurance policy may also affect the succeeding practice’s claims record, with possible consequences for future premiums, as well as the succeeding practice’s reputation.

Need for due diligence

The system introduced by the regulations highlights the need for firms considering the acquisition of another firm to carry out comprehensive due diligence. This is common practice in the business world and should be undertaken in any event, regardless of the effect of the regulations. An important aspect of due diligence ought to relate to the previous claims history of the practice. A properly conducted due diligence process will identify risks that can be notified to the target practice’s existing insurer. The acquiring solicitor may also have the opportunity to negotiate a term of the acquisition agreement to require the acquired practice to obtain specific run-off cover for specific identified potential risks.

Possible additional premium

The insurance policy may permit the insurer to charge an additional premium in respect of coverage for a preceding practice provided pursuant to clause 2.4 and in respect of coverage for a succeeding practice provided pursuant to clause 2.5, but the insurance may not provide that the insurer can decline to indemnify the insured or cancel, terminate or avoid the insurance due to non-payment of any such additional premium when due.

Possible cancellation

The insurance of the preceding practice may be cancelled if a firm's practice is merged into a succeeding practice, provided that the succeeding practice has insurance in compliance with the minimum terms and conditions. Such cancellation may not prejudice the accrued rights and obligations of the parties as at cancellation. If such a cancellation does not take place, there may be more than one insurer liable to cover a particular claim.

Insurer liability where more than one insurance applies

In a situation where more than one qualifying insurance covers a claim or circumstance, the insurance may provide that the contribution between insurers shall be determined in accordance with the relative numbers of principals or owners of the respective constituent practices immediately prior to the relevant succession.

Liabilities for files taken over

The regulations govern the extent to which professional indemnity insurance is provided by existing insurance. The regulations do not necessarily definitively determine the underlying liability for a particular file, which may be influenced by factors other than the existence of insurance cover, such as the contractual terms that apply between the firms involved in an acquisition or merger and any representations that have been made to clients. The holding of insurance cover for a claim does not necessarily make a firm liable for the claim. The holding of insurance cover for a claim for which a firm is not liable is of benefit to the firm, since the insurance may meet the defence costs of a claim that is ultimately not upheld.

Run-off cover

The regulations provide that run-off cover is required for a firm that has ceased to carry on practice only where there is no succeeding practice. Run-off cover is provided automatically by the last insurer (with the run-off cover premium terms being set out in quotations and renewal notices for normal cover) for a firm that has ceased to carry on practice where there is no succeeding practice. The insurance policy must provide that, where there is a succeeding practice in relation to a firm's practice, run-off cover will not be activated, provided that the succeeding practice has insurance in place in compliance with the minimum terms and conditions.

In a situation where the files of a closed practice, to the extent that they are distributed, are distributed to many different firms without any of the factors in paragraphs (a) to (h) above being present, it is likely that there will be no succeeding practice and therefore that run-off cover will come into force.

A solicitor ceasing practice can always decide, or agree with an acquiring solicitor, to take out run-off cover, notwithstanding that this may not have been triggered automatically under the terms of his insurance policy.

In setting up a new firm, it should be borne in mind that, if the firm later ceases practice without there being a succeeding practice, the principal or principals of the firm will be liable to the last insurer for premium payments in respect of the whole run-off period. The run-off cover for firms ceasing practice now must be for the first two calendar years from the date on which the firm's last coverage period expires.

Rationale for the succeeding practice rule

The intention of the succeeding practice rule is to minimise the application of the run-off cover provisions and to maximise the application of the succeeding practice provisions. While run-off cover

is necessary to ensure that claimants have recourse to cover, it has a number of consequences for insurers and for solicitors that are ameliorated by the succeeding practice rule. The insurance industry is inherently uneasy about being obliged to provide run-off cover for a prolonged period, due to the associated difficulties in assessing risk. Minimising reliance on run-off cover should tend to reduce the premiums and increase the stability of the market. In addition, run-off cover is a significant financial burden for retired solicitors, and it is to the advantage of retired solicitors to reduce reliance on run-off cover to a minimum. A system for covering ceasing practices based solely on run-off cover would place a significant financial burden on all retiring solicitors without offering them any alternative option to reduce that burden.

Summary of existing system

In summary, mandatory insurance must cover claims arising from a preceding practice or a succeeding practice. Whether or not a firm is a preceding practice or a succeeding practice in relation to any other firm will depend on a detailed analysis taking account of the facts of the particular case. No generalized practical guidance can be given: each case must be individually examined with reference to paragraphs (a) to (h) of the definition of 'succeeding practice' as set out above.

Pending change

The succeeding practices provisions of the regulations have proved to be problematic for the profession as no firm wants to acquire a practice in difficulty if the result would be a negative impact on a previously good claims record. Under the succeeding practice rule, the insurer of the succeeding practice takes responsibility for claims arising from the acquired firm. In practice, the profession takes the view that their claims record is likely to be damaged if they become a succeeding practice. The Society's position is that due diligence should take place before a sale to prevent this from happening but this has not been widely acknowledged by the profession. It should be noted that the Society does not decide if a firm is a succeeding practice; it is simply a matter of fact in each case.

The succeeding practice rule was introduced to reduce pressure on run-off cover. Run-off cover is now not as unattractive as it once was to insurers partly due to the reduction in the mandatory period of run-off cover to two years.

The Society has decided that the succeeding practice rule should be amended for the indemnity period commencing 1st December 2010 in order to assist solicitors wishing to cease in practice by allowing the preceding firm and succeeding firm to elect whether run-off cover or the succeeding practice rule will apply in their case. If they decide to make an election, such an election must be made prior to the merger or acquisition taking place. If they do not make an election, then the default position will be that the succeeding practice rule applies. Insurers have indicated that they are in favour of this change.