Guidance note on closing down a law firm

The current financial climate, competition from new entrants to the market, changes to legal aid and the funding of civil litigation, and the ban on referral fees in personal injury cases have all contributed to a number of traditional law firms getting into financial difficulty and having to close down. In some cases the SRA has intervened to protect the interests of the firm's clients. This trend looks set to continue and all firms, whatever their size, need to be prepared for this possibility. This guidance looks at the risks associated with closing down a practice and how these risks can be mitigated by forward planning.

So what are the risks involved in closing down your practice? One of the most serious risks is that the SRA will decide to intervene in your firm, in order to protect the interests of your clients. This does not only happen where the SRA suspects dishonesty; it could be because of failure to comply with the Accounts Rules or other regulatory requirements. The SRA has recently intervened in firms where it has not been satisfied that the firm would be able to carry out an orderly closure of its practice. The SRA will seek to recover the, often considerable, costs of an intervention from you and is likely to refer you to the Solicitors Disciplinary Tribunal (SDT).

There are numerous other risks, in particular: failure to meet other regulatory requirements, leading to disciplinary action; claims against you for loss of documents, breach of confidentiality or negligence; and complaints of poor service to the Legal Ombudsman. All of these are likely to be costly and time-consuming to deal with and may affect your ability to practise in the future. Regulatory breaches can lead to fines and/or restrictions on your ability to practice and in very serious cases striking off; the Legal Ombudsman can award compensation to the complainant, or order you take remedial action at your own expense, as well as charging you a case fee; and there will be an excess to pay in respect of any claims made under your run-off professional indemnity cover. Further, the SRA will not automatically authorise a new firm if it has concerns about the individuals involved.

What can you do to mitigate these risks?

Forward planning is crucial. The SRA has identified as an emerging risk "lack of adequate succession planning or exit planning" and has made it clear that it expects all firms to have an exit plan that will allow the firm to be wound down in an orderly and transparent manner or taken over by new owners. This is regarded as part of good business management, which was promoted to the status of a principle as part of the SRA's risk-based approach to regulation.

If you do not already have an exit plan in place you will need to draw one up as soon as it seems likely that you will have to close your firm. Engage with the SRA as early as possible; if your firm is in financial difficulty you should already have done this. The SRA will be keen to help you carry out an orderly closure in the interests of clients and to avoid having to intervene in your firm. Contact the Supervision team if you do not already have an SRA supervisor for your firm.

You will need to discuss your plans with your indemnity insurer, who may have views on how you should deal with certain issues such as dealing with current matters and the storage or destruction of documents. You will need to discuss the run-off cover that will be provided by your current insurer and factor into the cost of closure the premium for this cover. Consider how you will pay for any excess on any possible future claims. Also, do not forget that you need to be careful that you do not practise into a period where you are no longer covered by insurance – this is likely to have serious disciplinary consequences.

There are others who you will need to engage with at an early stage, such as your bank or other creditors to discuss the repayment of any outstanding loans or credit.

Once you have decided on a date for closure, you will need to identify who else needs to be notified, for example any lenders on whose panel you appear; directories which include your firm's details; HMRC; the Land Registry; your staff and other business contacts such as introducers of work. Third party suppliers and outsourced service suppliers should also be notified, the latter often include IT support services.

Dealing with current matters

You will need to inform all current clients of the proposed closure of the firm and assess all current matters and decide whether you will be able to deal with them properly before the firm closes. Consider carefully whether, given the firm's circumstances, you are in a position to provide a proper standard of service. If necessary, you will need to give the client time to find another firm to deal with their matter.

You may be able to make arrangements with other local firms to deal with your clients' matters, but you must remember that it is for the client to decide who they want to instruct and therefore it is important to get the client's consent before handing their matter to another firm. This applies also to client money, that is held in trust for clients, and you need their informed consent before transferring it to anyone else. If you do not obtain proper instructions from clients about where they want their money and papers to go, you could be acting in breach of trust, breach confidentiality and be subject to a complaint and/or disciplinary sanctions.

When completing outstanding matters, take the opportunity to hand the client's documents back to them and avoid future storage costs.

You should also notify any former clients who may be affected e.g. those who have appointed you executor in a professional capacity or those for whom you hold documents such as will or title deeds. Again, use this as an opportunity to return documents to clients.

Dealing with clients' money

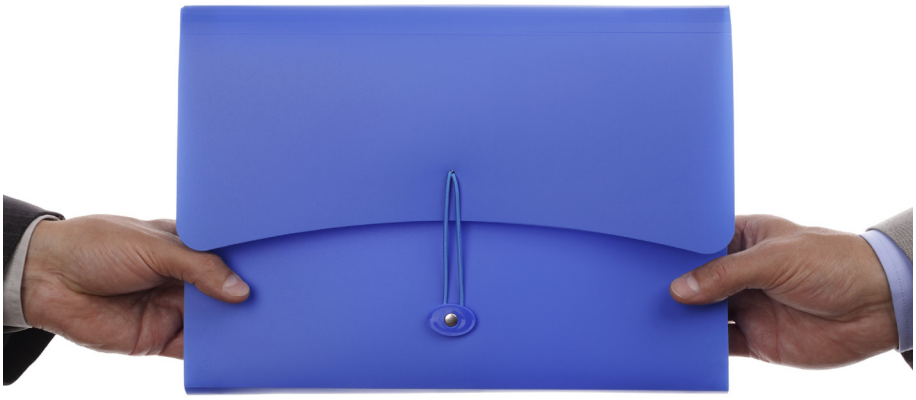
You must ensure that your accounts are in order and in particular that there is no shortage on client accounts. It is vital that you deal properly, that is in accordance with the Accounts Rules, with any client money you hold up to and after the closure of the firm. If you do not do so you risk serious disciplinary action and even intervention. Ideally, you should deal with all client money before closing the practice, for example sending money to clients or others, paying disbursements and billing for your outstanding costs. You also need to consider how you will deal with any client money being sent to the firm after it has closed. If you continue to hold client money after the practice has closed you will need to continue to submit annual accountant's reports until you cease holding clients' money and you must deliver a final accountant's report within six months of ceasing to hold clients' money. If you only hold a small amount of client money you may be able to apply for a waiver of the requirement to submit accountant's reports. You will also need to inform the SRA of the date on which you cease to hold client money.

If you hold money for clients who cannot be traced you will be able to pay to charity amounts of £50 or less (for each client), provided you comply with the conditions set out in the Accounts Rules i.e. you establish the identity of the owner of the money, or make reasonable attempts to do so; make adequate attempts to ascertain the proper destination of the money, and to return it to the rightful owner, unless the reasonable costs of doing so are likely to be excessive in relation to the amount held; pay the funds to a charity; record the steps taken and retain those records, together with all relevant documentation (including receipts from the charity); and keep a central register of these withdrawals.

If you hold sums of more than £50 or you have out of pocket expenses you will need to make an application to the SRA for authorisation to deal with the money See SRA website for an application form and advice for applicants http://sra.org.uk/guidance-sar.

Undertakings

You should already have a system recording any undertakings given by the firm and when these have been discharged. You will need to review these records and consider which undertakings you can discharge before the firm closes and what to do about any that will remain outstanding. Your firm's managers will be responsible for ensuring compliance with any undertakings given by anyone within the firm, even after the firm has closed. You cannot unilaterally withdraw from an undertaking and cannot vary its terms unless the recipient agrees. It may be possible in some cases to arrange for another firm to take over responsibility for complying with an undertaking but unless the recipient specifically agrees to release you from it you will continue to be responsible.



Records, files and documents

Deciding what to do with files, records and documents can be one of the biggest headaches, both in terms of time and cost, facing a firm about to close, particularly if you do not already have a robust system for dealing with them. Many firms have a tendency to store files indefinitely rather than address the issue – particularly as the length of time you are required to retain some documents is not always clear – thus accumulating vast numbers of files. Storing these files after your firm has closed is likely to be a significant and ongoing cost and there is a danger that, if at some point you are no longer able to pay those costs, the security and confidentiality of clients' documents will be put at risk. The SRA has stated that this is one of the greatest costs involved in interventions – a cost that they will seek to recoup from you if they intervene in your firm. It is therefore worth taking time now to dispose of any many documents as possible, either by returning them to clients or destroying them if you can safely do so. Although this can be time consuming, involving going through files and deciding what belongs to the firm and what belongs to the client and which documents need to be retained and for how long, it will represent a significant cost saving in the long term.

There are particular issues where you hold documents relating to wills, probate and trusts, not just in relation to original wills and trust deeds but also supporting documents and records which may be relevant should a dispute subsequently arise, possibly several years later, about the will or trust. Your own or your firm's conduct in the matter may be called into question and you may need to refer to documents in order to defend your position. See QBE's current guidance on file storage, retention and destruction which can be found on our risk management resources web page: http://www.qbeeurope.com/risk-solutions/professional-indemnity/best-practice.asp.

However you decide to store files, it is important that you, the client and your insurer are able to obtain the file if necessary, for example if there is a subsequent claim against your firm. In order to avoid problems in the future, you should consider:

- appointing another firm to receive your firm's files, both open and closed;
- informing clients in writing of this arrangement, giving them details of how they or their new solicitor can obtain the file;
- giving the client the opportunity to appoint another firm to which the file should be sent or to take possession of the file themselves (including time limits for doing so, after which the file will be sent to the appointed firm). Note: the appointed firm cannot act on the client's matter unless the client has specifically consented to this;
- keeping a record of where files have been sent and agreeing with the appointed firm (or other third party storing the files) that they will also keep a record if they forward the file to the client or their new solicitor;
- sending a copy of this record to your insurer;
- being satisfied that the firm holding files on your behalf will retain the files in accordance with an effective document storage and destruction policy;
- copying or scanning the file where the client has requested that it is sent to them or to another firm.

In relation to storage of the firm's own financial and administrative records, such as those relating to the firm's accounts, VAT, financial services and verification of clients' identity there are specific legal and regulatory requirements which you should treat as minimum periods and make a decision as to how and where these documents will be stored and how any ongoing storage costs will be met.

Confidentiality

The risk of breaching confidentiality is an issue in relation to many aspects of closing down your firm, as set out above. You will need to consider whether there are any further risks to client confidentiality. For example, you will need to dispose carefully of any computer equipment, ensuring it no longer contains any confidential information. Also, you will need to have post redirected to one of the former owners of the firm if there is any risk that post relating to former clients of the firm might be delivered to your former offices.

Practising after closure

Following the closure of the firm, there are likely to be various 'loose ends' to be tied up and you must take care not to practise or be held out as practicing through the firm when dealing with these. It is generally accepted that you will not be practicing if you submit bills for your costs, account to clients for money held of their behalf, or deal with outstanding client money. If you continue to practise this may lead to disciplinary action as well as having possible indemnity insurance implications, particularly if you practise into a new indemnity period for which you should have obtained a new policy of insurance. If you continue to use your firm's notepaper when dealing with outstanding administrative tasks you will need to adapt it to make it clear that the firm has closed.

Indemnity insurance

Some firms are having to close because they are unable to obtain indemnity insurance for their practice. If you are unable to obtain insurance by the end of an indemnity period, your last insurer will have to provide up to a further 90 days coverage. This is known as the extended policy period (EPP). The EPP comprises a 30 day 'extended indemnity period' and a 60 day 'cessation period'. During the cessation period you can only deal with existing instructions and the firm will have to close if it cannot obtain a new policy by the end of the EPP. You must notify the SRA, as well as your insurer, no later than five business days from the date on which your firm enters the EIP and the CP under its policy. The insurer will not be required to provide any cover beyond the EPP except for run-off cover for a period of six years from the expiry of the firm's final policy of qualifying insurance.

Other possible costs

Finally, don't forget to take into account the costs involved in making staff redundant, any penalties on contracts with third party suppliers, surrendering a lease, and repaying any loans or credit.

Check-list

- Draw up a plan
- Engage early with the SRA, your insurer, your bank and any other creditors
- Agree a date for closure
- Notify all clients and any former clients who may be affected
- Notify staff, third party suppliers, relevant contacts and organisations
- Assess all current matters
- Decide what to do with client files and documents, arrange storage where necessary
- Arrange storage of the firm's records
- Ensure your accounts are in order
- Assess any future or ongoing costs and how these will be met
- Ensure any money owing to the firm is paid where possible
- Ensure that any outstanding undertakings are dealt with
- Ensure that when you vacate your offices no confidential information remains or will continue to arrive

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