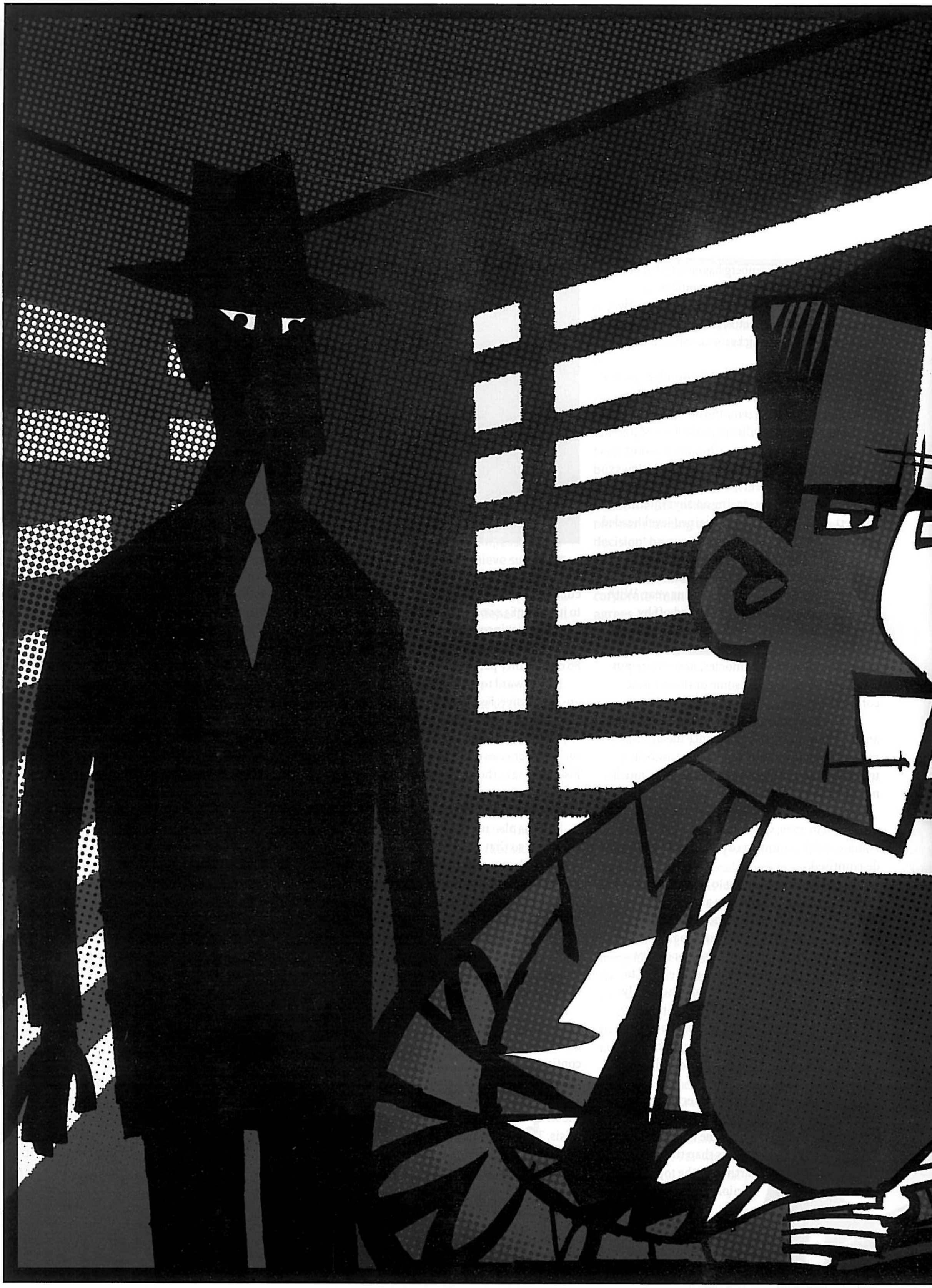


Illustration JONATHAN EDWARDS

DO THE RIGHT THING

Recent partner fraud cases at some of the largest firms have led many to question whether the profession is in moral decline. Risk and compliance procedures face stronger tests as firms come under greater scrutiny

JEREMY HODGES

A decade on, LG's current head of risk and compliance, Bill Richards, vividly recalls the moment he found out one of his partners had gone rogue.

'It was 7.45 am, 4 June 2001 and I will never forget the moment that Martyn Gowar [the then senior partner] arrived at my office and told me to "stop what I was doing and read this." It was [Michael] Fielding's "valedictory" letter.'

Richards was senior partner when Fielding, an asset finance partner, was convicted in November 2005 and sentenced to eight years in prison for stealing over £5.8m from client accounts. He had pleaded guilty to 24 counts of theft. Thus ended one of the highest profile and most damaging cases of a rogue partner in recent City history. But the fact that Richards still talks of the incident with such clarity and not a little bitterness underlines the impact that one rotten apple can have on a partnership, not to mention an entire firm.

In the intervening years, LG has done much to ensure that history will not repeat itself, while Richards himself has become one of the most prominent voices on risk in the sector. Risk is an area that ten years ago was viewed by many firms as a mere distraction but has now become a core part of the modern day law firm.

With the launch of outcomes-focused regulation (OFR) by the Solicitors Regulation Authority (SRA) in early October, firms' processes will need to be even tighter, as the onus will be on firms to police themselves.

The reality is that, whatever checks and balances a firm has in place, someone intent on committing fraud will always find a way around the system. Three recent examples at Hogan Lovells, Ince & Co and Kennedys are testament to that. It is impossible to legislate for headline-grabbing incidents. Firms therefore focus on the seemingly more humdrum everyday risk and compliance procedures that, if managed properly, can significantly reduce the chances of major fallout.

'I happen to think that one or two of the firms caught out recently have actually had ▶

THE GREAT €140m SWINDLE

One of the most staggering cases of lawyer impropriety in recent years is often held aloft as an example of the excesses of the Celtic Tiger. One that is still leaving many lawyers in the Irish market asking why no criminal convictions have yet been brought.

In 2007, sole practitioners Thomas Byrne and Michael Lynn had their respective practices closed down while the Law Society of Ireland investigated allegations made against them relating to mortgage fraud.

The pair were subsequently struck off by the Irish legal body in 2008 when it emerged that they had carried out mortgage fraud against a number of Irish and foreign-owned banks, including Allied Irish Bank, Anglo Irish Bank and Bank of Scotland.

The total owed between the pair is somewhere around the €140m mark, with Lynn understood to be liable for around €80m of that. They were able to perpetrate the fraud through a change in the law made almost 25 years ago that effectively let solicitors bypass the checks required to secure the title when mortgaging residential property. This enabled the pair, acting for buyers, to register the legal title of a property for both the lender and borrower. The system therefore relies on the trust of solicitors.

In 2007, Lynn, who invested client money in property portfolios in Dubai, Bulgaria and Slovakia, fled the country and is believed to have lived in Bulgaria and Portugal. There is a warrant out for his arrest but it is for civil proceedings only so it is not enforceable in a foreign country.

Byrne, recently discovered to be working in a café in Dublin city centre, has remained in Ireland throughout this time and is yet to be formally found to have committed a criminal offence. The *Irish Independent* reported in June that during a civil action Byrne was involved in with a local property developer he made admissions as to the unlawfulness of his actions.

'Byrne was an accident waiting to happen,' says one prominent partner at an Irish firm. 'There was nothing of the rogue about him, he was just an incredibly malleable sort of guy.'

In fairness to the Law Society of Ireland it acted swiftly to close down the two offices and strike the duo off, condemning their actions forcefully in public.

The most recent reports suggest that almost four years since the Law Society first reported Lynn and Byrne to the Garda (the Irish police force), the latter's case is only now being reviewed by the Office of the Director of Public Prosecutions (DPP).

The DPP has the power to decide whether a prosecution can proceed but it is not yet clear whether the body is reviewing Lynn's case. Law Society director general Kevin Murphy told *LB*: 'What so frustrates everyone is that, with the evidence that we accumulated in six months, there has been no prosecution. It is a source of extraordinary annoyance.'

Despite the Law Society's fighting talk, it is understood that under the Irish jury system it is extremely difficult to prosecute a fraud case, absent a guilty plea. Added to that, the general consensus is that the best way to tackle white-collar crime in Ireland is to gather all the evidence of all the frauds together before making charges rather than cherry picking the most damning parts.

'Judges should be sitting alone to decide fraud cases, they're too long and too complicated to keep juries interested,' reckons one leading Irish litigation partner. 'It is a given that these cases will come to court but the real issue is that we really do need white-collar legislation in Ireland to prosecute effectively. We just don't have that.'

▶ effective systems in place,' says Frank Maher, partnership specialist at Legal Risk. 'With the best will in the world, if someone is hell-bent on breaking the rules then they will get around them. Part of the problem is that it is in the nature of lawyers to find ways around rules, it is what they were invented for.'

ALL THE SMALL THINGS

As risk and compliance have moved up the agenda in the past decade, firms have moved from diverting fee-earners to sign off a few documents to having fully fledged risk experts.

'If you go back ten years, most law firms in the City would have had no legally qualified compliance officers and no general counsel; "compliance" would have comprised little more than a conflict checking team,' says Aster Crawshaw, a partner in Addleshaw Goddard's professional practices group.

'Magic Circle firms now have risk and compliance teams of over 50 people, and even mid-sized City firms often have a dozen full-time compliance lawyers in addition to their conflict checking and client acceptance teams,' he continues.

Most of the risk management procedures that firms have in place are not directly aimed at managing fraud but more the so-called pedestrian failings that can still cause considerable personal cost to the individual and the firm. These include money-laundering checks, knowing your client requirements and keeping up to date with internal procedures.

The Bribery Act, which came into effect in July, is not only focused on the client entertainment area but also the checking of counterparties. Ensuring that lawyers know whom they are dealing with and when money comes into the firm; making sure there is an understanding of where the money is coming from.

The risks are countless: whether it's neglecting to report claims so a lawyer ends up not being insured, or advising beyond expertise and ensuring the engagement letter is correct.

The sorts of measures that firms have had in place for some time include a register of appointments where partners list their private business interests. Most firms will require partners to reveal when they are investing in any stocks or shares to avoid any potential market abuse. The slightly newer areas include putting together a risk register that charts all the possible risks a firm could face and mid-transaction file reviews. The latter will ask questions around the engagement letter, fee estimates, deadlines and whether there are any red flags.

The SRA handbook, which launched on 6 October 2011, is expected to increase the compliance workload for firms (see 'Focus on the SRA', page 36). The new regime feels fairly light touch but the sector is split as to its potential effectiveness.

Loosely based on the model used by the Financial Services Authority (FSA), the SRA is pledging to move away from taking a reactive approach to governing the legal sector (see 'In the soup', *LB*210, page 42). This means the watchdog will do less box-ticking and put the onus of risk regulation onto the law firm.

Despite these measures, there is still the suggestion that the sector is some way from ▶

FOCUS ON THE SRA

The new SRA Handbook went live at the beginning of October 2011. Part of the wide-ranging changes to regulatory requirements is outcomes-focused regulation (OFR) which signals something of a regime change for the SRA. A number of the current rules in the Solicitors Code of Conduct will be replaced by professional standards expected of an individual and an explanation of how they should be experienced by clients. Allied to this will be a supporting structure of non-mandatory 'indicative behaviours', which are meant to show when an outcome has been achieved.

The SRA is calling it a more risk-based approach to monitoring and enforcement, moving away from pure investigations when a breach is reported, to having discussions with a firm to ensure it is behaving in a responsible way. The body vehemently denies that the new regime is a light touch, box-ticking exercise in regulation but it certainly feels like it is to lawyers.

The largest firms should be more than capable of regulating themselves if it works. The SRA will be able to take a far more heavy-handed approach to any instances of wrongdoing. Samantha Barrass, executive director of supervision, risk and standards at the SRA comments: 'Part of our OFR is to make it clear that it's the firm's responsibility. The first expectation is that they are professional and that the risk identified goes back onto them. Our relationship manager will work alongside the firms to ask the right questions.'

The truth is that much of the discussion around the impact of the handbook is just that, the effects won't be known until they have been in place for some time or the SRA is faced with a large-scale breach of the rules, whichever happens first. Lawyers are saying though that the increased compliance burden may be a step too far. Some are questioning the worth of having to change their letterhead, e-mail signature and websites from 'Regulated by the Solicitors Regulation Authority' to 'Authorised and Regulated by the Solicitors Regulation Authority'. Not an earth-shattering change by any stretch but an annoying alteration with little benefit to the public.

Bill Richards, LG's head of risk and compliance, says: 'The change from the current, more prescriptive code of conduct to OFR allowing firms to exercise their judgement more has the potential to expose firms to the wrath of the SRA should it decide that judgement was not properly exercised. We have to wait and see how the SRA enforces the new code after October. Ultimately, we feel that the new regime is likely to increase rather than diminish the compliance burden for firms.'

The SRA is all too easy a target for lawyers and commentators to blame for the profession's failures. While OFR may not be to everyone's taste, the fact that the SRA is being seen to change things deserves some respect at least. In a global financial crisis world, the days of pastoral care are over. The body needs to be seen as an aggressive gatekeeper of the standards of the profession and perhaps this is the answer. Legal Risk partner, Frank Maher suggests: 'If the SRA gets them [fraudulent partners] it does take a hard enough line, but I think the big firms have a sufficient vested interest to police themselves on these sort of things. I think the SRA's efforts are better focused on mortgage fraud on the high streets, which is a huge problem.'

▶ others when it comes to regulatory and compliance burden.

'Even now, other professional services sectors are much more compliance driven – for example, law firms generally do not run credit checks on their partners or ask for annual statements of assets and liabilities; few check on the information provided for their registers of other business interests,' says Crawshaw. 'As a rule, due diligence on lateral hires is focused on client relationships, portable revenue and personal fit, not risk.'

If a firm rigidly sticks to the above and countless other measures, then the chances of rogue partner activity will be significantly reduced, but the bottom line is it does not matter what a firm does. A fraudster will always find a way through the mesh.

Good risk measures are about being alive to factors that don't necessarily fall into the risk and compliance category. For example, a partner who is engaged in complex work that no-one else understands is more isolated and therefore a likely risk. Partners who rarely take holiday if at all, so they do not lose control of a deal, are a risk. As are partners who tend not to delegate and even when they do it is to a range of junior lawyers who do not have a good view of the bigger picture.

FACT OF LIFE

Recent history tells us that every 12-18 months, a large-scale case emerges where fraud or money laundering is evident. The case of former Berwin Leighton Paisner real estate partner Vinay Veneik is rarely far from people's lips when tackling the subject.

He was struck off by the Solicitors' Disciplinary Tribunal (SDT) in March 2010 having been accused of misusing client money on transactions, including neglecting to pay stamp duty and Land Registry fees. The SDT said at the time: 'It was the profession as a whole that had had its reputation sullied.'

Veneik resigned from BLP in January 2008 and was investigated by the SRA. He now works at former BLP client and real estate investment house Aprirose.

'I categorise [rogue partners] not only as being partners who have been dishonest but also those who are perhaps pushing the acceptable risk appetite,' says Maher.

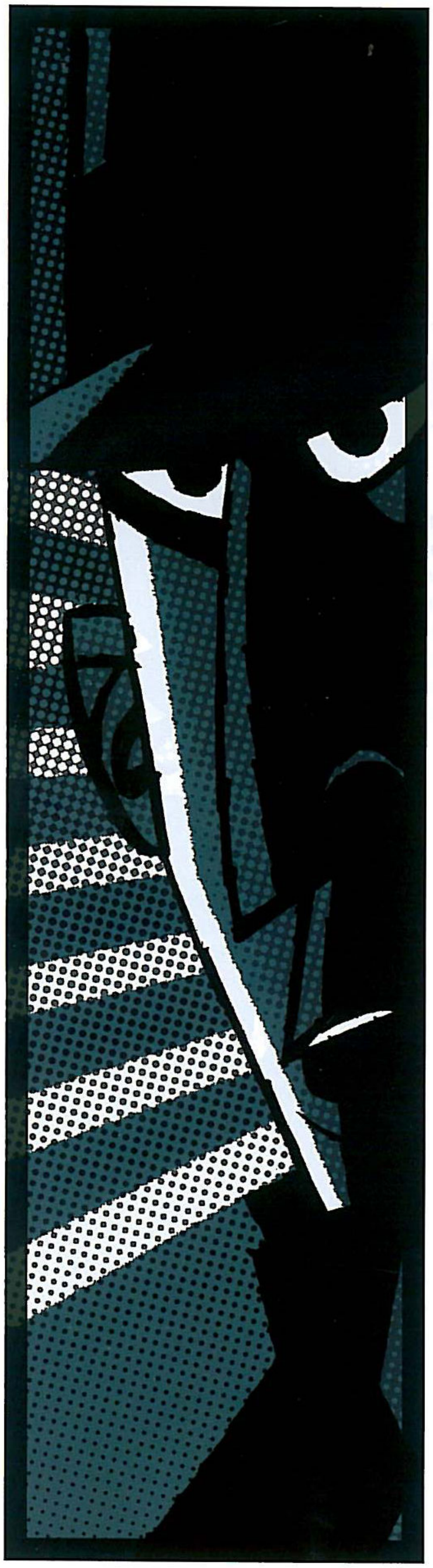
Four high-profile cases have made it into the public domain over the last six months. It's understood that there are a handful of similar cases currently going through the motions that are yet to hit the front pages. Not to mention the countless number of cases already being investigated at smaller practices up and down the country.

The reality of having to deal with a rogue partner hit home at Hogan Lovells in January this year when it became apparent that one of the firm's most prominent lawyers, Christopher Grierson, had, over a period of four years, defrauded the firm out of £1m.

Similarly, in May, the news broke that Andrew Iyer, a former partner at Ince & Co, had been referred to the SDT following his resignation from the firm in July 2010 for 'irregular financial behaviour'. It is alleged that the 'behaviour' involved £3m of client money. The matter is currently with the Metropolitan Police.

And again it emerged at the end of the same month that Mark Gilbert, a former senior equity partner at Addleshaw Goddard, had been reported to the SRA by the firm following an investigation that uncovered several discrepancies relating to expenses and disbursements. He is currently a consultant at Devonshires Solicitors.

The last of the headline makers came in August with the news that Peter Lloyd-Cooper,



'YOU CAN NEVER DO ENOUGH TO PROTECT CLIENT MONEY. MOST SOLICITORS HOLD A LOT OF MONEY FOR CLIENTS.' RONNIE FOX, FOX LAWYERS

a City-based commercial partner at Kennedys, had been expelled from the partnership in May 2010 after financial irregularities were uncovered surrounding client money. The SRA investigated and absolved the firm of any responsibility and the firm reimbursed the client to the tune of around £1m.

Every one of the above firms and the individuals accused of wrongdoing were approached for official comment for this piece and all declined.

Of the above, the Hogan Lovells incident was the most shocking. Three months passed before the news of the Grierson fraud became public, partly because the firm was going through its own internal investigations but also because it handled the situation exceptionally well.

It first became apparent that there was something not right in early January 2011 when a junior member of the accounts team flagged up an irregularity with the finance director.

Grierson, a senior member of the litigation practice who specialised in acting for clients being investigated by the authorities for fraud, was approached by the firm and said that he would provide an explanation. However, he then went into hospital for triple bypass heart surgery – this is understood to have given the firm time to realise the full scale of what had been going on.

What emerged was a pattern of four years of regular false expenses claims totalling £1m, and working out to about £5,000 a week. It is thought that Grierson booked first-class travel on his own credit card and subsequently cancelled the bookings, claiming the refund for himself.

A core team of co-chief executive David Harris, litigation, arbitration and employment head Patrick Sherrington; firm co-chair John Young; firm general counsel Michael Seymour and global head of corporate communications Chris Hinze was assembled. The team held the information and details of the investigation very close until partners were informed on Sunday 15 May. Some 12 hours later staff were told and within 24 hours the story had hit the legal and then the national press.

Grierson paid the money back within a matter of weeks and the firm reported the case to the City of London Police. The investigation is ongoing.

In communications terms, Hogan Lovells could not have managed the process better. There was some criticism that the firm did not go to the police soon enough but it could be argued that because the money was the firm's and not a client's they acted appropriately by conducting internal investigations and subsequently referring the matter to the SRA.

'The sacrosanct nature of client money means that if firms so much as sniff any sort of issue, they are going to take it to the police and/or the SRA very quickly,' says Kingsley Napley's employment head Richard Fox. 'But with office account money it is less clear, and not all firms are going to want to report to the police straight away.'

Samantha Barrass, executive director of supervision, risk and standards at the SRA, comments: 'Whether there is a duty to report to the police depends on the facts. There will sometimes be a duty to report financial fraud because it could be the result of money having been laundered and therefore be the proceeds of crime. Firms will need to consider both their obligations in law and in conduct. The SRA also has to make reports of suspected laundering.'

However well a firm handles a rogue partner, there is no telling how a partnership, an unwieldy beast at the best of times, will react. Sure enough emotions at Hogan Lovells are still raw, with one partner drawing comparisons to the grieving process, particularly for those who worked closely with Grierson. ▶

'It was greeted with astonishment individually and collectively,' suggests another partner. 'Part of it was that he was of such high regard and a trusted senior member of the firm. If you had made a list of the 100 least likely partners to commit fraud he would have been at the top somewhere.'

Another partner suggests that perhaps the firm was more focused on client money controls, which they say is 'understandable because everything we do here is to protect clients' money. We trust people with the firm's less onerous money controls'.

Admirably there has been no knee-jerk overhaul of the firm's internal controls but a slight tweaking to signing-off procedures. All travel expenditure now has to go through the firm's travel agent, all expenditure has to go on firm credit cards and has to be effectively countersigned.

'Although you are not in a covenant of marriage, as a partner you are cheek by jowl with someone through thick and thin. At the heart of it is a personal connection so I can understand why people feel aggrieved,' says Fox.

LG's Richards says that the biggest challenge for his firm's management team at the time news of Fielding's activities broke was ensuring that the firm was focused on its day-to-day business, rather than the aftermath of an investigation.

The seniority of those involved in many of the cases suggests that it is easier for those at the top to find ways around the systems in place. The word 'trust' comes up time and time again. The rationale being that an owner of the business would be reckless to not only put their career on the line but potentially damage other partners and the business.

'In many cases, partnerships don't work professionally. There are difficult rivalries and people often won't say the things that need to be said because they don't want to hear the answer; they're scared,' says David Salamons, consultant at Cubism Law. 'You also have this imbalance of power. If it is a senior partner who has gone rogue it takes a lot for junior partners to actually ask those questions and put them to the sword because the imbalance of power militates against a genuine, searching investigation of individuals in more senior positions.'

Fox continues: 'What these cases have shown is that we must now do things differently. Regrettably, no longer can we have systems in place that do not involve cross-checking of equity partners' expenses on the basis that "as they own the business" they are never going to submit false claims.'

WHY US, WHY NOW?

The very fact that firms have become bigger means that the concept of trust within a partnership has become eroded. In the largest firms, the partners will not necessarily all know each other but compliance requirements dictate that trust is not such an important part of a partnership any more.

'Arguably, now that we have such huge monolithic firms these days, not every partner feels like a real partner any more, and this can include even those in the equity,' suggests Fox.

The one question that firms ask themselves the most on the discovery of fraud is: 'Why?' Why put the business at risk? Why put individuals at risk? Why risk reputational damage?

The gossipmongers have a field day coming up with plausible explanations for the recent examples.

Certainly in Grierson's case, the whole gamut of rumours has done the rounds, from outlandish lifestyle choices to covering mortgage repayments. The truth, however, is likely to be

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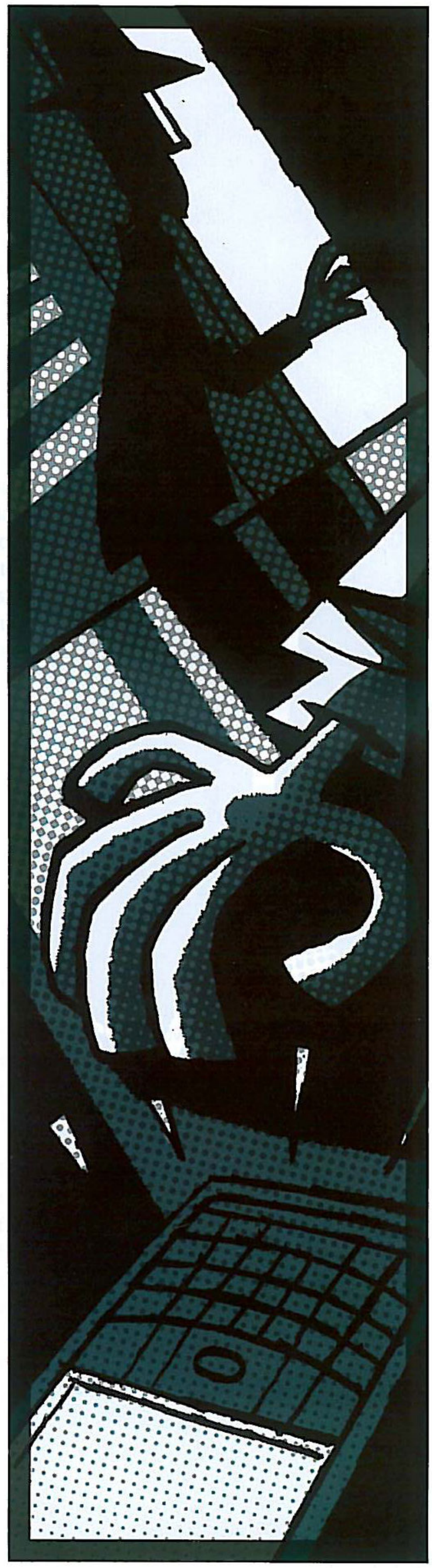
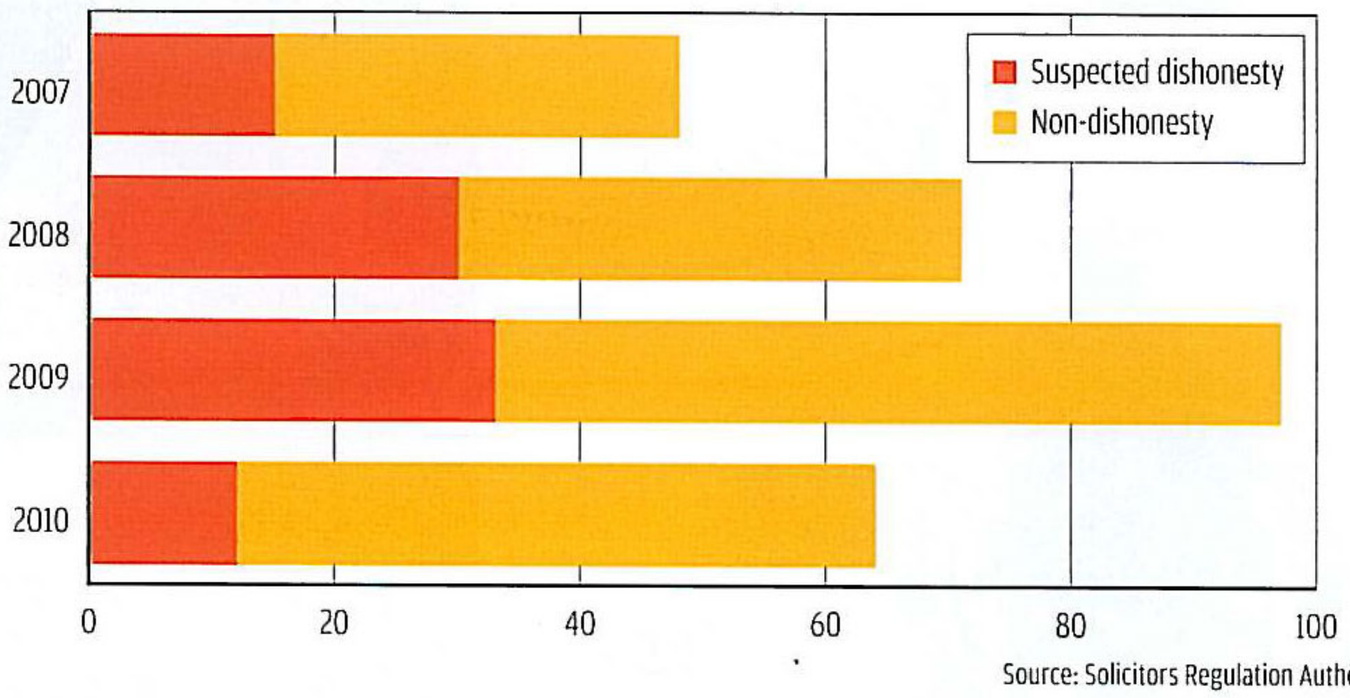
RICHARD FOX, KINGSLEY NAPLEY



SRA INTERVENTIONS



Source: Solicitors Regulation Authority

The above graph charts the number of interventions made by the SRA since its creation in 2007, data for the current year is not yet available. The striking thing about the data is that while interventions for non-dishonesty, which include bankruptcy or the death of a solicitor who was a sole practitioner, increased year on year during the recession (from 33 in 2007 to 64 in 2009). The suspected dishonesty cases don't form any sort of concrete pattern, suggesting that wider economic factors are not necessarily the key drivers behind any wrongdoing. It is worth noting that this data does not include interventions that have gone on to become criminal investigations.

far more pedestrian. Although nothing has been confirmed by the firm it is likely that it was a simple case of Grierson over-stretching himself.

In Fielding's case at LG, court documents showed that he owed The Royal Bank of Scotland close to £13m in personal loans – an extraordinary amount of money even for a top-earning City lawyer to have borrowed. When casting around for opinion as to why we have seen a series of high-profile fraud cases at the larger law firms there is some disagreement, but the general consensus is pressure.

Pressure can push even the most unlikely of candidates into dangerous decisions, with the changes at the SRA, the onset of the Bribery Act and the fact that firms have been managing their costs much more tightly during the recession.

Increased pressure to perform at work, to maintain a certain lifestyle, not to mention economic pressures could be determining factors in fraudulent behaviour. The recession didn't help. Between 2005 and 2007 some of the City partners who were earning, without a great deal of effort, between £500,000 and £700,000 could well have seen their drawings drop dramatically. Even though firms would have broadly maintained profitability, individuals will have been aggressively managed within the lockstep.

Undoubtedly, the pressure is on partners to perform; to still bring in the clients and the money in a market that is far from firing. A significant drop in earnings could quite feasibly lead to temptation or even a sense of entitlement following years of service to a firm. Being a partner these days is not necessarily a job for life and being managed out of a partnership is a stark reality of the modern law firm.

More often than not, it is a case of covering up a mistake or temporarily plugging a hole to save face behind a large number of cases.

Ronnie Fox of Fox Lawyers recounts a case that he worked on some years ago at a smaller firm where: 'The senior partner could not pay partner drawings. He knew that some of his partners relied on the prompt payment of their drawings each month. At the time he was advising on the sale of a number of flats for a substantial, slightly disorganised client; some of the proceeds of sale did not make it through to the client. The senior partner was so ashamed that he could not pay his partners out of office money that he used the client's money for partner distributions instead and then covered up the whole thing. The other partners assure me not one of them had a clue what was going on and I believe them.'

The senior partner in question was struck off and there was a substantial hit for the Solicitors Indemnity Fund. Professional pride and the risk of reputational damage are yet another set of factors at play here.

Here is the crux of the problem for firms trying to protect themselves from the damage that a rogue partner can inflict. The menu of potential motivations is endless, compliance and risk, although fairly rigorous, are always going to allow a determined fraud through.

EXCUSES, EXCUSES

Let's not make excuses for the perpetrators – fraud of any sort, on any level, at any scale is wrong. It is a sad fact of life in any sector where large sums of money are at play. There have been many more high-profile cases and involving much more money in the banking sector, like the recent case of UBS trader Kweku Adoboli, who is alleged to have lost UBS £1.3bn in unauthorised trading and was charged with fraud in September.

In the main, lawyers at the senior end of the profession are well educated, they manage large sums of money and know exactly what they are doing when they do it. What the recent spate of cases does not prove is that the legal profession is in the midst of some sort of moral decline.

As Richard Fox says: 'We need to get this into proportion, there is no evidence of a horrific malaise, but there are other factors at play.'

'You can never do enough to protect client money,' adds Ronnie Fox. 'Most solicitors hold a lot of money for clients. A solicitor in financial difficulty might be tempted to "borrow" from the client account. Yielding to that temptation will almost certainly lead to a personal disaster for the lawyer and damage to the profession as a whole.'

Increased levels of risk management and compliance allied to tighter financial controls have all played a part in uncovering fraud at firms and will continue to do so.

Short of becoming amateur psychiatrists, the trick for firms is how they manage a situation as and when it arises. Ensuring that it has done everything in its power to regulate itself and that it is satisfied that its internal workings are as good as they can be are the only practical steps that, sadly, a firm can take.

To a large extent the reaction from the SRA, the SDT and the police will act as a deterrent for would-be fraudsters, if punishments are severe enough. The SRA in particular with its regime change is keen to show it has teeth.

Barrass at the SRA concludes: 'We are not going to accept a nice letter from a firm telling us that everything is OK. We expect a robust analysis. The critical thing is that we expect all of the firms that we regulate to regulate themselves in a sensible way.' **LB**

jeremy.hodges@legalease.co.uk