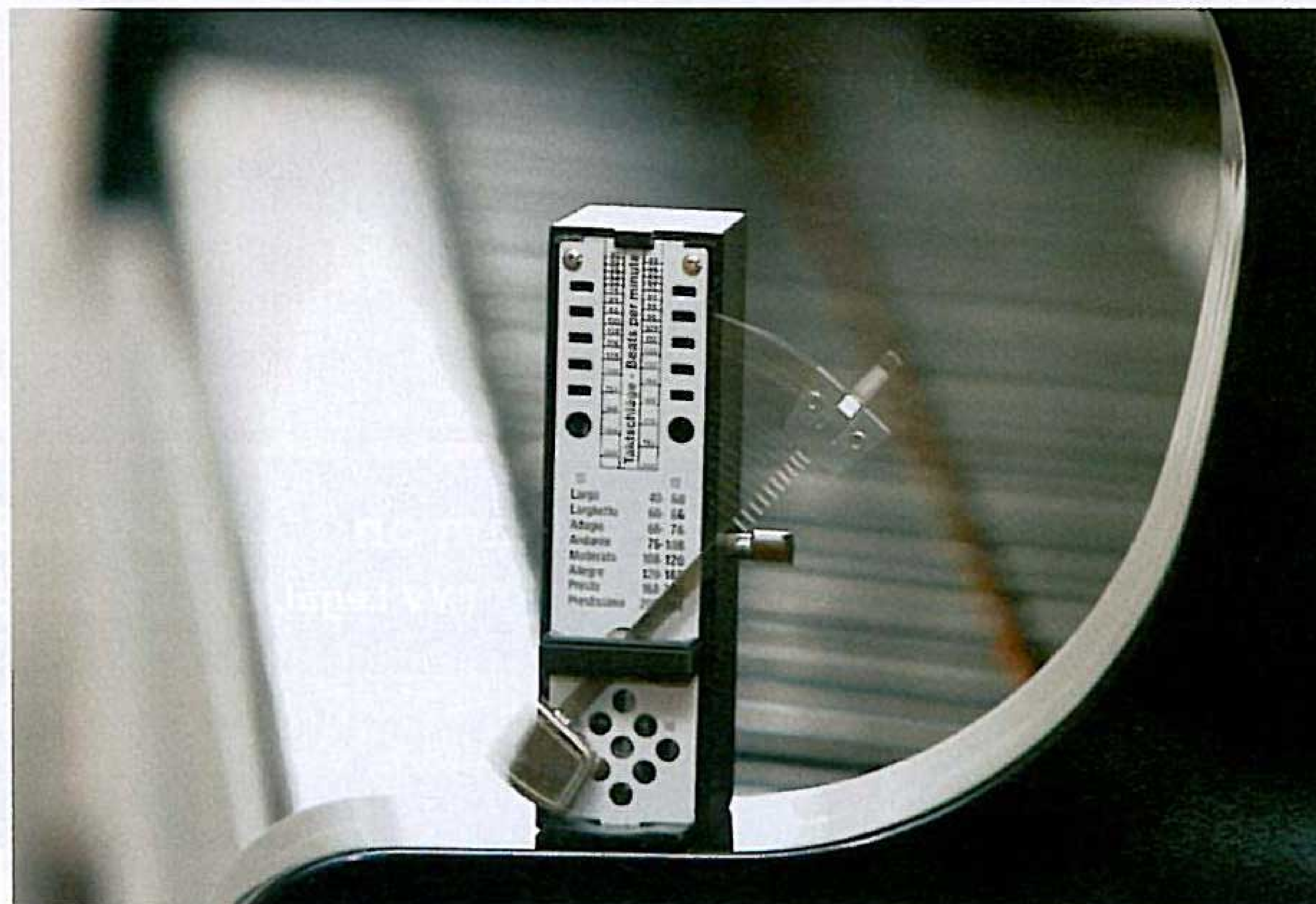
As the recession breeds more indemnity problems, law firms are on the defence and making increased efforts to control liability. Ronnie Fox looks at the main causes of negligence claims that firms are facing

TIMING IS EVERYTHING



There is a distinct correlation between professional indemnity claims and the economic cycle. When trading conditions are poor, litigation tends to increase. Claimants look for deep pockets.

The two main reasons for negligence problems are failure to observe time limits and poor communication.

Most legal tasks carry the risk of a negligence claim. As the recession bites, the professional indemnity insurance market is hardening. Law firms are stepping up efforts to control risk and limit liability with a view to keeping professional indemnity premiums down.

Time limits

Failure to observe time limits is a common cause of negligence claims.

Difficulty often arises because during the course of informal negotiations, a solicitor overlooks a strictly formal requirement. This can easily happen during without prejudice discussions regarding a lease if a solicitor fails to serve notice under the Landlord and Tenant Act 1954.

In employment claims, savvy clients sometimes engage in lengthy without prejudice negotiations as a diversionary tactic in the hope that the time limit for filing an application at the Employment Tribunal will be missed. The best practice is always to tell a dismissed employee client about the three months' period within which a claim for unfair dismissal may be made under Section 111, Employment Rights Act 1996. Solicitors need to check that the form ET1 has been received by the Tribunal before the time limit has expired.

A client seeking to enforce a contract should be told about the relevant limitation period. An agent loses his rights under the Commercial Agents Regulations unless within one year following termination of his agency he notifies his principal that he intends to make a claim.

Ideally a solicitor should both warn a client about a relevant time limit and explain the consequences of missing that time limit. The warning should be backed up with diary entries by two members of the firm and in a centrally-maintained critical dates diary.

There have been cases where the need to comply with a time limit is identified but the responsibility for complying with it is not carefully allocated. The safest course is for a solicitor to assume responsibility for complying with a limitation period unless someone else has expressly agreed to discharge that responsibility.

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An offer may always be withdrawn, even if the offering party has agreed to keep that offer open until a specified date. An offer may be withdrawn at any time and automatically lapses if a counter-offer is made.

Good communication

It is impossible to over-emphasise the importance of clear communication. An engagement letter should describe the scope of the responsibility that a solicitor has agreed to accept and exclude other areas. Where there is room for doubt, a solicitor should stress that he is not advising on the commercial prudence of a transaction. Only a specialist should advise on the tax or pensions implications.

A solicitor placing a document before a client for signature incurs a heavy burden. He cannot possibly explain every nuance of every word. It is best to state that he is exercising judgment in deciding which points to bring to the attention of his client. The client should satisfy himself that an agreement correctly records his intentions and meets his requirements. A formula for establishing a price should be the subject of test calculations. Clients should be warned about ambiguities in the law. For example, it is almost impossible for a lawyer to advise with complete confidence whether particular wording in a restrictive covenant or a reservation of title clause is valid and enforceable.

When money is tight, clients sometimes seek to save by asking that a solicitor not read all the documents furnished to him until litigation is inevitable.

Often solicitors are not allowed sufficient time to carry out normal enquiries and review papers. When this happens, a sensible precaution is to say that the normal measure of professional responsibility cannot be accepted.

Care should be taken to define the extent to which responsibility to third parties is incurred. Liability to a potential purchaser of a business was held to have been assumed by the auditors of that business when a partner said to the purchaser, "we stand by our audit". The result was a claim settled for £50m which led to the demise of Binder Hamlyn.

Limiting liability by contract

It was once regarded as unprofessional for a solicitor to limit or exclude liability. Now it is standard practice. As a matter of professional conduct there is no objection to solicitors' limiting their liability provided that the limitation is not below the minimum level of cover required by the Solicitors' Indemnity Rules currently £2m.

There are restrictions on the extent to which a solicitor can seek to restrict liability. The Solicitors Act 1974 and the Unfair Contract Terms Act 1977 need to be considered.

The future

Professional indemnity insurers are increasingly focusing on law firms' risk management procedures. Lexcel accreditation is a big plus. A detailed office manual accompanied by appropriate training and a culture of practising law defensively go a long way.

Ronnie Fox specialises in partnership, employment and discrimination law at City firm Fox. He was assisted by Terry Caden of Willis Group in the preparation of this article.