

## No Magic Bullets

### Managing Risk Today

*Piers Wigan, Director, TLO Insurance Services*

Welcome to the second edition of The Look Out.

In our first edition, "Caught in Conversation", we looked at electronic communication and how business was managing the risks arising from the ever-increasing popularity of e-mail.

In this edition, we consider risk management more broadly and, in particular, two issues which continue to provoke much discussion: limited liability partnerships (LLPs) and liability caps. But how effective are they in helping manage risk in today's increasingly litigious environment?

We consulted our contributors for their views on each of these very different topics. We were not surprised to hear that there were no magic bullets, that there is no substitute for a comprehensive risk management strategy, and that good client relationships and effective internal and external communication remain vitally important in reducing the risk of a claim.

We find the same in the insurance broking world. Whilst some classes of business may now be available on-line and have become commoditised, it is difficult to see how this would work in the professional indemnity world where underwriters are now making it a priority to go out with the broker to visit clients. The proposal form gives an

underwriter an initial overview of a client's business but it is difficult from this to get a feel for the culture within that firm. These visits also create a three way dialogue between broker, client and underwriter. This alone lays the foundation for a strong working relationship, which we at TLO pride ourselves in creating. If the culture within the firm is one that embraces risk management then this will

benefit the firm when it comes to the underwriting of the risk.

Now – over to our contributors, who represent a broad range of professions – a solicitor, an accountant, a barrister and a chartered surveyor and for whose thoughts we are most grateful: **Gary Christianson**, Partner, Shakespeare Putsman LLP; **Mark Evans**, Partner, Bentley Jennison; **Justin Fenwick QC** (Four

New Square), Deputy High Court Judge Chancery and Queen's Bench Divisions, Recorder, and Chairman of the Bar Mutual Indemnity Fund Limited; and **Mark Swallow**, Proprietary Partner, Head of Birmingham, Knight Frank LLP.

### LLPs - A One Stop Solution?

LLPs seek to limit the liability of partners in a partnership while retaining most of the characteristics of a traditional unlimited partnership. In short, after conversion to LLP status, the partners will still run the business and can deposit or withdraw capital as before. However, as an LLP, the partners will have to make some information about the business publicly available: the LLP must



be registered at Companies House, and must publish certain financial information (although this will be limited where disclosure exemptions are available).

So are LLPs a one stop solution?

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*“...It doesn't matter what size you are – soon it will begin to look very outdated not to be an LLP.”*

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*Mark Evans, Partner, Bentley Jennison*

LLPs are now almost the norm. The choice for new professional firms seems to be which form of incorporation to adopt, either that of a limited company or of an LLP. For unlimited partnerships, the question is more when, than if, they convert.

The necessary evil of public availability of their financial information appears to be an issue that partners are gradually becoming willing to accept in order to achieve limited liability status.

LLPs are attractive to those firms that participate in riskier areas of practice, but the limited liability afforded by both LLPs and companies only becomes an issue in the disaster scenario, where the liability of a claim exceeds the professional indemnity insurance limits and the assets of the firm itself.

*Gary Christianson, Partner, Shakespeare Putsman LLP*

Conversion to LLP status has been going on for a while among firms of solicitors. LLPs are a good idea, whatever your size of practice and a 'no-brainer' if you are starting up a new practice. The liability protection is appealing, although there are downsides on the tax front and the costs of conversion from partnership to LLP can be prohibitive in the first year, due to the less flexible tax treatment available to LLPs as compared to partnerships.

The legal profession has seen a constant drift towards LLP status and everybody will get there eventually. But conversion to LLP status is only part of an overall risk strategy.

*Justin Fenwick QC, Four New Square*

Whilst LLP status protects the partners who have not been involved in the negligent act or omission, it leaves the firm's assets exposed and it provides no protection to the negligent partner who can be sued in his own name.

For these reasons, LLP status is not the Holy Grail, and although it provides a degree of protection against collective disaster, the need for adequate insurance and proper limits on liability remain.



*Mark Swallow, Proprietary Partner, Head of Birmingham, Knight Frank LLP*

We see the majority of partnerships in the professions converting to LLPs. It's happening en masse for accountants and lawyers and increasingly for surveyors - size and location don't really matter. The only thing that really puts partnerships off is the complete disclosure of their results. But we think that

partnerships will increasingly need to demonstrate their own credibility to the market in terms of financial performance and that this is actually a small price to pay for something that can be turned to a PR advantage. It's not a case of large practices leading and small following – it's a case of practices with commercial foresight taking the only sensible route.

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*“...conversion to LLP status is only part of an overall risk strategy.”*

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Converting to LLP status is about more than just limiting liability. Of course it's key to providing a minimum level of security for partners but, as

importantly, it is often a useful platform from which to modernise partnership business practices bringing the benefits of a more corporate approach to a partnership culture. It doesn't matter what size you are - soon it will begin to look very outdated not to be an LLP.

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*“...The big issue today is successfully integrating risk management into the culture of an organisation – professionals are resistant to change!”*

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### **Liability caps – How effective are they?**

The consensus among our contributors is that liability caps, which are becoming increasingly common, could be a very effective way of reducing potential liability. However, they raise some difficult issues. For example, it is crucial that any liability cap is tailored to the engagement in question and that the client's informed consent is obtained.

*Gary Christianson, Partner,  
Shakespeare Putsman LLP*

Caps are regularly used in engagement letters, most commonly in relation to non-contentious work.

We believe that the bigger clients will come to expect them and see them as an indicator of a well-run firm. Insurers also like to see them – they expect clients to take a mature approach to risk management and liability caps give them comfort. Whether or not a liability cap is effective will, of course, depend on the facts of the case.

However, liability caps are not a solution in themselves; they need to be used as part of an overall risk management strategy. Good risk management is about using as many tools as possible to reduce a business's exposure to potential liability. The big issue today is successfully integrating risk management into the culture of an organisation – professionals are resistant to change!

*Mark Evans, Partner, Bentley Jennison*

Limiting liability within engagement letters for work is a more useful and practical tool than conversion to LLP status. Carefully drafted engagement letters which consider the risks of an engagement are a commercial necessity and the use of liability caps is a good standard practice to adopt whenever possible. The use of liability caps to limit liability at an assignment level is likely to evolve as global firms set the accepted business practices which other firms will follow. For example, audit firms continue to lobby (with some potential success) for the right to limit their liability for audit work which is currently prohibited.

Liability caps have been tested, and the general principle is that they must reflect the circumstances of the assignment, be reasonable and that the client must clearly understand that they are agreeing to limit the liability of their advisor. If these conditions are not met, then the liability cap is void.

*Justin Fenwick QC,  
Four New Square*

There are very real issues concerning the type of liability cap which is to be

imposed, whether it is across the board or case specific, and how much has to be done to ensure that the client has given informed consent so that the provision cannot be overturned under The Unfair Contract Terms Act 1977.

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*“...Liability caps become more important as an organisation gets bigger, faces increased commercial pressure, and is potentially seen as having deep pockets.”*

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Barristers are still uncertain as to what they are allowed to do and discussions are currently ongoing with the Bar Council about this. For solicitors there are also problems caused by doubt as to whether it is



permissible to limit as opposed to exclude liability in a contentious business agreement. Such agreements used to be rare, but recent amendments to the Solicitors Act 1974 may have inadvertently extended them to most forms of litigation retainer.

There is also a real issue as to whether the professional bodies should give guidance on the terms of any limit of liability. Having worked with the profession and the Department of Trade & Industry in formulating the ambit and text of the provisions for auditors limiting their liability in the Companies Act 2006, I have been reminded forcibly of how variable the understanding of the issue is and how much education is still needed.

The Act gives significant guidance but still leaves difficulties over identifying and agreeing an effective limitation of liability which the courts will be prepared to enforce when the time comes.

*Mark Swallow, Proprietary Partner,  
Head of Birmingham, Knight Frank LLP*

Liability caps become more important as an organisation gets bigger, faces increased commercial pressure, and is potentially seen as having deep pockets. The use of liability caps is all about ensuring that an organisation is not unfairly exposed to liabilities totally disproportionate to its involvement in advising on a transaction.

Everyone has concerns about the effectiveness of liability caps, although they should work provided you have the client's informed buy-in. The very act of talking about them introduces a very healthy discussion between advisors and their clients that helps to clarify respective roles and responsibilities. Generally, they are a force for commercial good as they ensure that everyone has properly considered

their obligations in relation to an engagement as well as the accompanying risks/rewards.

### **No magic bullets but one can manage the risk**

In short, as we have seen, there are no magic bullets. However, there are steps a business can take to limit its potential exposure. It's a question of devising a comprehensive risk management strategy, effectively communicating that strategy both internally and to clients, and then implementing it.

#### *Finally, some practical tips from Justin Fenwick QC:*

- consider LLP status, and whether it should be adopted;
- choose an appropriate level of professional indemnity cover;
- decide whether the level of professional indemnity cover is sufficient to cover foreseeable hazards without any limitation of liability;
- if not, decide on the form(s) of limitation, how such limitation(s) is/are to relate to the insurance cover available and anticipated, and how any limitation is to be justified if challenged; and
- devise and implement guidelines for the imposition of standard or bespoke limitations, including the steps that need to be taken by individuals to ensure that a sensible limit is put in place in a manner which is likely to be effective, including proper communication to and informed agreement by clients.



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