An unknown quantity

The SRA may want firms to come to them at the first sign of trouble, but confidentiality means its successes are harder to quantify than its failures, says **Susanna Heley**

The message which has been coming from the SRA this month is that they want firms to engage with them at the first sign of trouble. We are told that the SRA has recently had a number of 'success' stories, where its engagement with firms in financial difficulty – in the form of intervention, insolvency or both – has meant disaster has been averted. Naturally the SRA can't give details of the averted crises due to considerations of confidentiality and the possibility that publicising the financial difficulties of any firm will create a self-fulfilling prophesy.

On the other hand, those working on behalf of individual solicitors are universally able to relate similarly vague horror stories, where the involvement of the SRA in a firm has merely added to existing problems and caused more problems than it solved. There is a worrying inconsistency in firms' reports of engaging with the SRA. Some firms and individuals see it is as a helpful and relatively painless process, others report a very different and quite alarming experience.

The focus of attention at present is on firms with financial difficulties. Given the well-documented problems which are facing all businesses at present, it is safe to say that financial difficulties are not necessarily caused by misconduct. Sometimes, a firm is just unlucky.

Immediate risk

The problem the SRA faces when a firm is in financial difficulties is determining whether or not the nature and extent of the difficulties present an immediate risk to client funds or files. It is inevitable that there are some within any profession who will react badly to financial pressure. The temptation of using client account as a source of loans to assist a temporary cash flow problem has caught a persistent minority of solicitors. From the profession's perspective, those who give in to such temptation must be weeded out swiftly and ruthlessly. As a profession, we have established that client account should be held inviolable and we have the processes in place to support that aim.

Intervention is just one of the processes intended to support client account. The problem with intervention is that it is a sledgehammer; a ramraid on a firm allowing the SRA to secure client files and funds. It does not provide for an orderly business closure.

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The process was designed at a time before the concept of entity regulation was ever envisaged. Indeed, before the current insolvency regime was brought in.

The SRA's focus on financial instability has again raised a number of questions about the necessity of intervention where there is no suspected dishonesty and, importantly, the interaction between an intervention and a formal insolvency process. This has not been such a problem in the past where firm structure was overwhelmingly based on the traditional partnership. Since the introduction of LLPs and with the change in focus from purely personal regulation towards entity based regulation under the Legal Services Act 2007, the profession has become increasingly corporate – a trend which is only likely to continue.

Not enough

Intervention does nothing to dissolve or wind up a corporate structure and the SRA has no responsibility towards creditors. Since the SRA is able to claim the costs of the intervention in priority even to secured debts, the intervention regime does not sit comfortably, in practical terms, with an insolvency process.

If the SRA gets first call on all available assets, how is a liquidator to be paid? What happens to secured creditors?

Another concern is that the existence of a formal insolvency process is not necessarily sufficient to prevent an intervention. Although control of the business assets is vested in a liquidator, control of the client account is not. As a trust account, it is expressly outside of the control of a liquidator and the liquidator clearly would not be able to justify incurring costs managing client account, as there could be no benefit to creditors as a result. Given that one of the objects of intervention is to protect client funds, the risk of intervention will clearly continue to exist.

At the launch of the SRA's Risk Outlook in Birmingham on 2 July, financial difficulties were clearly at the front of the SRA's current thinking on risk. It is expected that more firms will fail in the relatively near future and the numbers predicted are significant. Hopefully, most of the potentially affected firms will become the SRA's success stories that no one ever hears about. Until we can resolve some of the issues over the process; the uncertainties facing insolvency professionals and the inconsistency in some of the SRA's own approaches to firms in financial difficulty, that may be a pipe dream.

Susanna Heley is a solicitor at RadcliffesLeBrasseur (www.rlb-law.com)