Difficult Times for the Legal Sector

The legal services profession operating in the mid-tier market is currently in the midst of a perfect storm. Whilst the majority of UK business appeared to have weathered the post-recession storm with insolvencies down year-on-year (3,617 companies entered insolvency in Q2 2016 which was 4.2% lower than Q1 in 2016, and 2.7% lower than Q2 in 2015), the legal sector is facing increasing challenges, which will increase consolidation in the legal sector.

What are the issues?

- **Increased costs of Professional Indemnity Insurance (PII)**
- **Jackson Reforms**
- **Criminal Legal Aid**
- **Increased Competition**
- **Financial Management**

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Increased costs of Professional Indemnity Insurance (PII)

Although legal firms have improved risk management significantly in the past 15 years, the underwriter's view of acceptable risk management has also changed. As a result, PII premiums, especially in the legal sector, have increased significantly if not doubled in recent years.

Jackson Reforms

The Legal Aid Sentencing and Punishment of Offenders Act (LASPO) became law in April 2013, as a result of Lord Jackson's review of civil litigation. LASPO has fundamentally changed the costs of litigation, including what a losing party has to pay, which determines what legal costs the claimant can recover. It introduced the test of proportionality of costs, and abolished referral fees paid by solicitors to secure personal injury clients. Also, a reduction in the categories for which civil legal aid applies and narrower means-test criteria means fewer people qualify for legal aid, which has reduced the number of claims. These changes have hit the profitability of legal firms operating in the personal injury market significantly, and led to some firms being heavily exposed.

Criminal Legal Aid

In June 2015 the Ministry of Justice (MoJ) announced its decision to proceed with a second criminal legal fee cut of 8.75 per cent. It also announced that the number of contracts for solicitors providing 24-hour cover at police stations in local communities would be reduced to 527 from 1,600, thereby reducing the number of firms operating in this market.

Increased Competition

The Legal Services Act 2007 introduced Alternative Business Structures (ABS) to legal firms, which allows a non-lawyer or non-legal entity to own or invest in a legal practice. This has enabled equity to be raised from a wider pool of participants and allowed non-legal staff to hold board or partner status, thereby enhancing commercial knowledge, skills and operations.

This has also led to increased competition, particularly in the large volume consumer end of the legal services market. Scale has never been a guarantee for profit, and there have been some high profile ABS financial failures, including volume claimant personal injury ABS's Parabis and Quindell.

Financial Management

The legal sector is highly regulated, which requires a firm to spend time ensuring they are compliant. Add on top day-to-day work commitments, it is not surprising detailed and careful financial management can be put on the back burner. A recent report, published by the SRA, cited poor financial management as one of the key reasons law firms face financial difficulties. Lack of financial control typically results in poor forecasting, overpayment of monthly drawings to partners, and an over exposure to contingent matters where there is WIP lock-up - which result in cash shortages (or a requirement for expensive short-term loans) to meet VAT, PII and other commitments, which drive profitability down.

Our Experience

Quantuma and Ashfords have significant experience in advising legal firms how to manage financial difficulties, including insolvency.

Whilst we cannot disclose any advisory instructions, formal law firm appointments in the public arena include the largest global law firm collapse to date, King & Wood Mallesons LLP, in addition to: Jeffrey Green Russell Limited, Challinors Solicitors (Partnership at Will), Davenport Lyons Solicitors (Partnership at Will), Linder Myers LLP, St John Law Limited, Isaac Abraham (Partnership at Will), Maitland Hudson Limited, Prolegal Limited and Carter Law Solicitors Limited.

How can we help ?

We can provide the following specialist planning services for law firms facing financial and regulatory challenges:

1) Options evaluation

We provide a review of the current threats facing the firm and the options available to it, including both regulatory matters and cash-flow pressures.

2) SRA Communications

We provide regulatory reassurance and client protection planning, reducing the risk of regulatory action, including intervention and the impact of the statutory charge.

3) Merger talks

We introduce potential merger partners and oversee merger talks with interested parties.

4) Introduction of potential acquirers

We have a network of firms who are nterested in acquiring legal practices and can facilitate introductions.

5) Financial forecasting and cash management

6) Regulatory guidance

When required we can support law firms with regulatory investigations and provide guidance in terms of regulatory outcomes.

7) Business Structure planning

This includes obtaining regulatory authorisations for Newcos to enable firms to seize opportunities, as well as provide protection and contingency planning for rainy days.

8) Negotiating with key stakeholders

This includes secured and unsecured creditors, key stakeholders and other partners and staff within a firm.

9) Acquisition of the Firm by way of a merger, solvent or insolvent transaction, either in whole or in parts

10) Contingency planning support and guidance for contingency planning to include scenario planning

This is applicable in the event a distressed sale fails to complete.

CASE STUDIES

KING & WOOD MALLESONS LLP
Solicitor Administration of Global law firm

Overview:
- Multi-branch law firm, with London head offices, together with SRA regulated branch offices in Brussels, Munich, Frankfurt and Cambridge
- The firm was placed into Administration in January 2017, following the transfer of all live files to 24 separate acquiring firms via separate sale agreements
- The Administrators utilised a regulated Newco so as to maximise realisations for creditors Indebtedness: £30M secured.

CHALLINORS SOLICITORS
Solicitor Liquidation of Midlands-based practice

Overview:
- The firm was a 9 office solicitor practice based in the Midlands
- The company's records, including archived files, were in very poor order;
- The Firm was placed into Administration in August 2013 following the transfer of all live files to 23 separate acquiring firms via separate sale agreements
- At the date of the administration there were Legal aid files with circa £2m value, where the final billing had not been submitted to the Legal Aid Agency ("LAA").
- Indebtedness: £4.5M secured.

Outcome:
- The Liquidators re-archived the Firm's 20,00 deeds and as a result have been successful in securing a sale of the Firm's Deeds to a legal practice regulated by the SRA, thus removing significant on-going management costs
- A specialist cost draftsman has been appointed to assist with the unbilled files and in conjunction with liquidators' specialist knowledge of distress legal practices and the support of the LAA has now commenced the billing process and is expecting a surplus from legally aided funded cases in excess of £1M.

DAVENPORT LYONS
Partnership Administration of law firm

Overview:
- Law firm was a Partnership governed by the Partnership Act 1890 and had traded for nearly 80 years
- Indebtedness – Numerous financial institutions (bank, secondary lenders & trade creditors) circa £15M.

Outcome:
- Partnership Administration (likely to exit via a Partnership Voluntary Arrangement)
- Ongoing-sale of business & earn out of WIP
- With the professional practices team a distressed M&A programme was actioned for a four month period
- Constant liaison with the Solicitors Regulation Authority ("SRA") regulator needed
- A tailored sale was achieved providing the SRA with comfort, enhanced realisations for creditors and assistance given in providing partners with personal debt solutions
- After a series of failed merger talks, creditor pressure resulted in the firm commencing and accelerated M&A process. Out of 3 interested parties, a deal was actioned via a pre-packaged administration. The successor firm took on the majority of staff, all client files and the regulatory responsibilities required for the SRA to bless the transaction
- Unlike other insolvency assignments, Insolvency Practitioners are not legally capable of providing reserved legal activities (both in terms of risks and also because of regulatory issues). Accordingly it is not possible to trade a law firm and the overriding concern from the regulators perspective is to protect the insolvent estate's former clients rather than it's creditors. This makes these assignments extremely complex and difficult to resolve.

We are happy to discuss your situation, whatever stage you may be at. Please remember, the earlier you address issues, the more we can do to help.

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