Warning notice

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Mergers, acquisitions and sales of law firms

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Published: 17 June 2024

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Status

This document is to help you understand your obligations when selling, acquiring or merging your law firm and how to comply with them. We will have regard to it when exercising our regulatory functions.

Who is this warning notice relevant to?

This warning notice is relevant to all firms and individuals we regulate who are thinking of or in the process of:

- acquiring other law firms
- seeking to sell or merge their law firm with another regulated entity.

This includes pre-pack sales/acquisitions of firms in administration.

Our concerns

We recognise that mergers, acquisitions and sales are a legitimate strategy for growth and business resilience for law firms.

The challenges of the Covid-19 pandemic and other global events have placed significant pressures on the UK economy over recent years. This has impacted upon law firms' profitability and financial stability. As a result, many firms face an uncertain future.

To meet these challenges, some firms are looking to merge with or acquire other firms. This may be to stay competitive in the legal marketplace by offering a more diverse range of services and remain financially robust to continue to trade through tough times.

In many scenarios, there can be good reasons for mergers and acquisitions and we do not seek to stand in the way of a healthy, competitive legal market.

We have seen some firms making multiple acquisitions in a relatively short period of time, which can create challenges in respect of business integration, organisational culture, and maintaining standards of service to increased client numbers. Managers of a firm should always make sure that acquisitional growth does not lead to ineffective governance structures, systems or controls which could cause detriment to clients or undermine trust in the profession.

As part of our Consumer Protection Review [https://guidance.sra.org.uk/sra/consultations/discussion-papers/consumer-protection-review/] , we are looking at a range of issues, including risks associated with mergers, acquisitions and different business models. And we are running a thematic review of growth strategies across the legal sector. We will update this warning notice to take into account any learning from these reviews.

We are concerned that some mergers and acquisitions involve behaviours - on the part of those involved on either side of the transaction - that undermine public trust and confidence in the solicitors' profession and in the provision of legal services.

We are also concerned that clients' interests are not always paramount during such transactions and that, as a result, they may suffer significant detriment either during or after the merger or acquisition.

We appreciate that it can sometimes be in clients' best interests for a firm to seek a purchaser for a swift acquisition, which 'leaves nothing behind', in order to avoid disruption or delay to their matters. On other occasions, it can be in clients' best interests for the firm, for example, to arrange to transfer specific parts of the business or particular matter types. When these kinds of decisions are being made, it will be important to ensure that clients' best interests are at the forefront of those considerations and are clearly documented. It would not be appropriate or in compliance with professional obligations to make these decisions based purely on the grounds of expediency or commercial reasons.

Here are some of the examples of the behaviours we have seen from firms on both sides of a transaction that might mean there are breaches of our regulatory arrangements.

Clients' interests

- treating client files as a commodity that can be bought or sold irrespective of what the clients want to do or who they want to represent them going forward
- failing to obtain properly informed consent from clients and failing to give them a reasonable amount of time to decide about where they want their file, documents, or money to go prior to transfer to an acquiring firm

- having acquired a firm, failing to identify urgent client matters such that important deadlines are overlooked impacting on clients' interests
- selling will banks (sometimes to unregulated entities) without the testators' knowledge or consent
- failing to have a plan and funding for the secure, long-term storage, and thereafter confidential destruction, of archive client files.
- not ensuring that client money is properly reconciled and that client account is intact before any transfer.

Due diligence

- undertaking no or inadequate due diligence on the firm being acquired and failing to consider prior to acquisition whether you have the competence, systems, staffing or capacity to do the work you will be getting
- as a seller, failing to investigate concerns about the acquiring firm's competence, systems, staffing or capacity to act in your clients' best interests going forward.

Financial difficulty – reporting obligations

- Failing to notify us promptly of any indicators of serious financial difficulty and only reporting the acquisition of your firm to us at the last minute giving us little time to engage and ensure clients' interests are being protected.

Solicitor managers

We are also seeing situations where solicitor managers have not been appointed by administrators or liquidators when a firm enters administration or liquidation: this may be to save costs or because firms or their managers are unaware of the need for one. This potentially puts at risk client confidentiality and privilege. It might also lead to breaches of the SRA Accounts Rules in respect of the handling and management of client money.

Standards and Regulations

You must comply with the Principles [https://guidance.sra.org.uk/solicitors/standards-regulations/principles/] and in particular:

- Principle 2 - act in a way that upholds public trust and confidence in the solicitors' profession and in legal services provided by authorised persons.
- Principle 5 - act with integrity.
- Principle 7 - act in the best interests of each client.

You must also comply with the relevant paragraphs in the Code of Conduct for Solicitors, RELs and RFLs [https://guidance.sra.org.uk/solicitors/standards-regulations/code-conduct-solicitors/] and the Code of Conduct for Firms [https://guidance.sra.org.uk/solicitors/standards-regulations/code-conduct-firms/] where applicable. For example:

- paragraph 1.2 of the Code of Conduct for Solicitors, RELs and RFLs states that 'you do not abuse your position by taking unfair advantage of clients or others.'
- paragraph 4.2 of the Code of Conduct for Solicitors, RELs and RFLs and paragraph 5.2 of the Code of Conduct for Firms states that 'you safeguard money … entrusted to you by clients…'
- paragraph 6.3 of both Codes of Conduct states that 'you keep the affairs of current and former clients confidential…'
- paragraph 8.6 of the Code of Conduct for Solicitors, RELs and RFLs (and the applicable standard at paragraph 7.1 (c) of the code for firms) states that 'you give clients information in a way they can understand. You make sure they are in a position to make informed decisions about the services they need, how their matter will be handled and the options available to them.'

You must also comply with your obligations under the SRA Accounts Rules 2019. For example:

- Rule 5.1 You only withdraw client money from a client account:
  - for the purpose for which it is being held
  - following receipt of instructions from the client, or the third party for whom the money is held, or
  - on the SRA's prior written authorisation or in prescribed circumstances.

Our expectations

We expect you to ensure that the protection of all clients' interests is at the forefront of any decision-making when selling, merging, or acquiring another law firm. This is the case whatever the reasons are for the proposed transaction. We do not expect to see any of the behaviours detailed above which might impact on clients or undermine confidence in the delivery of legal services.

Keeping clients informed of what is happening and allowing them to make unfettered and informed decisions as to who they want to act for them in the future is vital. Giving clients a reasonable amount of notice about what is happening is also essential. What is reasonable will depend on the type of client and the type of issue that you are handling. This might mean that what is considered reasonable will be different for each department in your firm.

Unreasonably short timescales for a response from clients is likely to mean that you have not managed the situation effectively and have not

complied with our regulatory arrangements.

We consider that the obligation to act in the best interests of each client applies to any seller when negotiating with a potential purchaser of their firm. If you have any concerns about the acquiring firm's competence or capacity to act in your clients' best interests going forward, you should make whatever enquiries are necessary to satisfy yourself that clients' interests will continue to be paramount.

All reasonable efforts should be made to contact testators to seek instructions as to the continued storage of their will. They should not be left in a position where they do not know where their will is stored, or discover it was sold to another entity without their knowledge or consent.

Where there is no response from testators, you should keep evidence of the steps taken to show that all reasonable efforts were made to contact them, otherwise you may be unable to evidence that you have complied with our regulatory arrangements. Ultimately, in the absence of any response from testators, you should make appropriate arrangements for the safe-keeping of any unclaimed wills.

If you have acquired archive files you should have in place a file storage and destruction policy that makes sure that files are kept for an appropriate period and then destroyed in a confidential way.

You should also undertake a systematic review of any acquired residual client account balances and make sure that they are dealt with in accordance with the SRA Accounts Rules and associated guidance [https://guidance.sra.org.uk/solicitors/guidance/general-granting-authority-withdraw-residual-client-balances/] .

Solicitor managers

If your firm is going through financial difficulties, leading to either administration or other insolvency situation, we expect that in most circumstances a solicitor manager will be appointed. Where this does not happen, we would expect clear justification as to why that was not considered appropriate. This is to make sure that client money, assets, confidential and privileged information is safeguarded and there is overall compliance with our regulatory arrangements.

Our guidance on closing down your practice [https://guidance.sra.org.uk/solicitors/guidance/closing-down-your-practice/] states:

'To ensure that your duties to your clients continue to be met, (for example, in respect of confidentiality and independence), it is important to ensure that any appointment of an insolvency practitioner, whether as administrative receiver, administrator, or liquidator, is a solicitor. This might not be necessary in the case of a pre-pack administration sale to

another law firm, which is unlikely to involve the disclosure of confidential information. You will need to continue to hold a practising certificate.'

Why are solicitor managers needed?

If a law firm is placed into administration, then the management of the firm transfers to the administrator. Liaising with clients about the firm closure, the transfer of client files and their money with informed consent will always be the urgent priority. Therefore, the insolvency practitioner may have access to confidential and privileged material and client money, so they should either be a solicitor, or a separate solicitor manager should be appointed.

Enforcement action

If an issue arises, failure to have proper regard to this warning notice is likely to lead to disciplinary action. For further information on our approach to taking regulatory action, see our Enforcement Strategy [https://guidance.sra.org.uk/sra/corporate-strategy/sra-enforcement-strategy/?epiprojects=3] .

If we find evidence that solicitors or firms we regulate have acted in ways that contravene our rules we can and will take action.

As well as considering enforcement action, we will swiftly take preventative action where we consider that a solicitor or law firm presents an imminent risk to clients, future clients, the public or the public interest. Commonly, this will be where there is a need to protect the public, for example from dishonest solicitors.

The need for urgent regulatory protective steps may be amplified when a merger, acquisition or sale places at risk live client files, client money or archive files, wills and deeds. We will take such action if live files are abandoned, if client money is misused or misappropriated by either party to the transaction, or if no one is taking responsibility for an archive.

There is a cost in taking preventative action in the interests of clients and the public interest and we will seek to recover those costs from those who are responsible. Further detail is in our guidance on how we can recover our costs [https://guidance.sra.org.uk/solicitors/guidance/disciplinary-recovering-costs/] .

Further guidance

For guidance on any of the above conduct matters contact the Professional Ethics helpline [https://guidance.sra.org.uk/contact-us/] .