DAC BEACHCROFT

Risk Register 2023

Special edition: ESG and what it means for law firms

Welcome to the Risk Register 2023

The ESG edition

This year we have focused on ESG and the implications of this concept for professional services firms.

Continue reading

The Governance element of ESG has long been established as a core issue for solicitors' firms and is central to the way that we run our businesses. Strong governance supports a compliant culture from a regulatory perspective and ensures that firms are run in a way that not only complies with our Code of Conduct but also supports effective risk management and business critical issues such as succession planning.

The importance of the Social element of ESG was highlighted by the pandemic as it feeds into the way in which law firm leaders and their employees interact with each other in the workplace and touches on issues such as the supervision of less experienced colleagues and the well-being of all members of the firm. It is a concept which is closely connected to Governance as it encompasses issues such as discrimination and harassment and has for some time been the subject of scrutiny by the Solicitors Regulation Authority. The SRA has now formally recognised the importance of the workplace by issuing a targeted guidance note dealing specifically with toxic workplace environments. The note is supported by a statement in which the SRA makes it clear that those who fail to provide a safe place of work for their staff are likely to be referred to the Solicitors Disciplinary Tribunal.

Finally, we will consider the impact of Environmental matters on law firms. As individuals we should all be concerned about the planet. The Law Society has, however, shone a light on this issue within the last few weeks and we will examine the impact of this development.

In summary, there is no doubt that every aspect of ESG is central to law firm strategy and we would like to thank all of our colleagues and clients for their contributions to the 2023 Risk Register.

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"Building pressure is on all businesses, including law firms, to be more socially and environmentally conscientious."

"There is undoubtedly...an increased regulatory focus on law firms to ensure that past poor behaviours, toxic workplace culture and senior lawyers abusing their power is no longer tolerated."

"There is no one size fits all, a firm's culture, its client base, employee base and geographical footprint will all dictate what best practice looks like but there are fundamentals that will be applicable to all."

Introduction to ESG

"If I could pick one topic that Insurers and law firm leaders talk to me about it would be 'ESG'. "

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Environmental, Social, Governance (ESG) are not, separately, new concepts for businesses to consider. Together, though, they present a powerful phenomenon which has become increasingly important to enable businesses to succeed in an ever-competitive, risk abundant and sustainability-focused world.

Although ESG started as an investment concept, and was originally focused on environmental sustainability, recent social movements such as "Black Lives Matter" and "#MeToo" have brought a new focus.

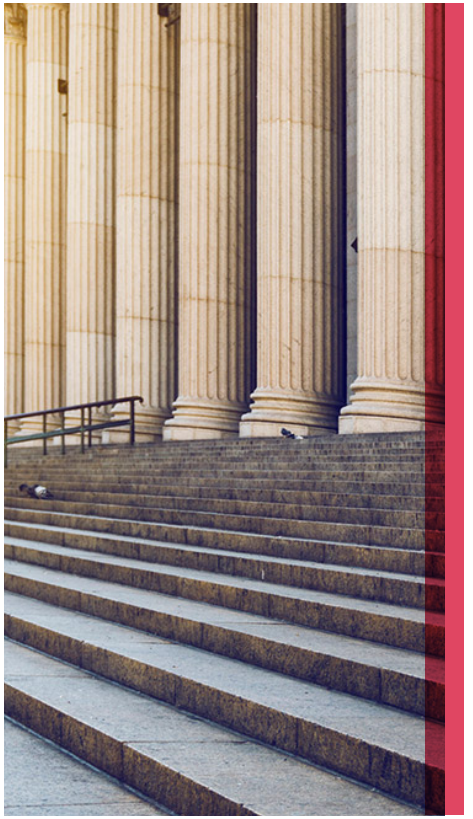
On top of that, world events, including the Ukraine war, have forced us to focus again on issues of governance. Although the social impacts of the war are obvious, in governance we have seen a new, stronger and broader sanctions regime.

For law firms the regulatory consequences of not complying with that regime are severe. ESG has become a significant issue in the UK and it is already impacting on the way that businesses operate and the decisions they make. For example, high profile climate-related litigation is an increasingly common occurrence in the US and we are starting to see the green shoots of these types of claims in the UK.

"Social" is hot on the heels of Environment in terms of the attention that it receives from regulators in particular but also law firm clients and employees. Strong D&I credentials are no longer just a 'nice to have'. They are non-negotiables. There is currently a well-documented war for talent facing professional services firms, with candidates having the pick of the market.

Culture is becoming an increasingly important consideration for candidates. Employee retention is high on the agenda for most professional services firms as a high turnover can lead to greater claims, with issues liable to slip through the "net" of supervision when files are moved between fee earners.

Strong ESG credentials and its component parts may positively impact premiums and policy terms, demonstrating further that ESG is both a threat and an opportunity.



ESG: A Professional Indemnity Insurer's perspective

Deborah O'Riordan
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As insurers of professional businesses, we have always considered an organisation's approach to management as a key factor in the overall assessment of risk, rather than merely looking at exposures, potential loss values, and claims histories. Understanding the values that make an organisation tick, and how its risk and opportunity challenges are managed, are essential indicators of future success and whether we can build a sustainable relationship as a key stakeholder in the business.

The risks associated with ESG are highly varied but so too are the opportunities, and both need to be balanced to ensure that the value created and delivered by professional practices is not eroded by failing to react to the ever-changing business environment. ESG is such a rapidly moving field at the moment that competitive advantage could quickly be lost by any business failing to react to this challenge and protect its value model.

That should be reason enough to encourage leaders to act without delay, but the increasing raft of legislation on sustainability reporting across the three ESG pillars, adherence to agreed taxonomies, and the due diligence and assurance required, is only adding to the pressure. While various Directives are initially targeting larger corporates, publicly listed entities, and financial services businesses of significance to our infrastructure and resilience, the value-chain considerations that are needed as part of their risk assessments mean that pressure to act and communicate could rapidly filter down to much smaller businesses. Information circulating on the subject also seems to be multiplying, and with no single version of the truth, it's easy to see how resource-limited small and medium enterprises might struggle to know where to start. But it's not all bad news.

Taking the Governance pillar of ESG, professional practices should already be more than familiar with the strict legal and regulatory framework under which they must operate. Anti-money laundering, sanctions monitoring, anti-corruption practices, and codes of conduct, plus the growing list of 'failure to prevent' duties (bribery, tax evasion, and fraud), will all be areas where the necessary systems of governance and control should already be established, meaning that some elements under the G banner of ESG could already be classed as established, even mature.

For professions, where the 'stock-in-trade' is its people, the ability to attract, nurture, and retain talent is critical to a sustainable value model. The working environment plays a much greater role in today's employment relationship where people expect to work in a way that suits them and fits with family demands, where they are included, engaged and valued, and there is zero tolerance for any behaviour or practices that could see them disadvantaged or might negatively impact on their health and wellbeing. The balance of power has shifted and a culture that supports these expectations is now a basic requirement, or an organisation may risk losing its talent. For those that have already met this challenge head on, these ESG milestones will hopefully be easier to address.

Apart from employee stakeholders, the firm's customers, its local community, supply chain and the wider communities impacted, also need to be considered within the ESG framework. For these aspects, existing legal and regulatory demands for treating customers fairly, protecting their data, taking care of vulnerable customers, and the prevention of modern slavery are ESG elements that already feature on the compliance agenda. Many businesses have also accepted the corporate social responsibility mantle where initiatives such as educational partnerships, charitable sponsorships, services and donations, and the provision of pro-bono services, feature widely.

Maybe less familiar to many professions will be the environmental element of ESG and the risk and opportunities this presents. Environment-friendly practices shouldn't be new to the construction professions where the tenets of sustainable design, whole-of-life performance, biodiversity surveys, and more lately 'building back better' are established policy in many arenas. For lawyers, accountants, and other advisory services though, the need to consider green house gas emissions across the whole value chain,

including those of its customers and their activities, is comparatively new and still in the early stages of awareness and action.

Recent guidance by professional bodies including the SRA and ICAEW highlights the potential for professional indemnity claims to arise from failing to advise on the ESG aspects and impacts of corporate and commercial work, investments, M&A deals and the like, as the duty of care owed to clients grows to include responsibility around sustainability principles. Add that to the already extensive list of possible claims related to the sustainability agenda: further PI claims for advice on ESG, supply chain due diligence, and reporting assurance as new areas of specialism; management liability claims for failing to preserve the value of a business during transition; for reporting failures and errors, whether mandatory or voluntary, intentional or not ('green washing' (or social, pink, and blue washing)); and for individual or class actions and whistleblowing cases which highlight working practices that no longer fit societal demands. It's a testing landscape, and one where reputations which have taken generations to build can be damaged overnight.

Balancing the risk of professional claims, litigation, non-compliance, and supply chain pressure, are the many opportunities for innovation: new services, products, behaviours and cultures that could all benefit the business and its stakeholders. Forward-thinking professional firms will already have strong foundations for building a comprehensive ESG risk management strategy with several of the social and governance pillars already established, forming a framework against which gaps can be identified and priorities set. Actions arising can be absorbed into existing risk management/ERM frameworks where risk appetite can be defined, risk owners appointed, controls agreed and monitored, goals and targets set. This aligns with the four key components adopted by many of the mandatory and voluntary reporting standards – governance; planning; risk management; and metrics, and so should assist with the consistency of communications and reporting.

There is no need to treat ESG risks differently to any other challenges on the risk register - although their addition, if not included already, could mean that priorities need to be revisited. It's also possible that conflict situations could occur if discrepancies arise between the organisation's ESG objectives and those of its customers and other stakeholders. Knowing your customer ('KYC') and the overall scope of this assessment might need to extend to include, not just commercial and financial goals, but to ESG related objectives so that these can be considered in conflict checks and the advice given. This could pose a new dynamic that would need careful management to mitigate the risk of losing previously valued relationships.

But what better indicator is there of robust risk management than a sustainable business model that is agile enough to keep flexing to changing customer demands, societal norms, and ever increasing legal and regulatory requirements? That capacity must surely signal the ability to maintain sustainable relationships in a way that continues to add value for long-term success. The climate emergency may need to take centre-stage for a while to achieve the global warming objectives set by the Paris Accords, but the wider ESG agenda also needs to continue its progress around that.

Businesses should ask themselves: what can we do to manage our ESG risk? What can we ask our employees, suppliers, partners, and customers to do? Which opportunities could we exploit to stay relevant to the changing demands and needs of our stakeholders? As with any change project, some quick wins should be possible so that progress can be made, and perhaps celebrated - even if there is a reticence around openly reporting on those actions for fear of getting it wrong, leading to 'green hushing'. Of course, for those subject to a legal requirement to report, accuracy is essential, but for the vast majority not (yet) subject to these regimes, action is what counts. But something is better than nothing- we strive for progress rather than perfection. So let's make a start.

Index

Environmental

Social

Governance

Environmental

- Law Society Guidance on the Impact of Climate Change on Solicitors
- ESG, the Law Firm and B Corp Certification

Back

Law Society Guidance on the Impact of Climate Change on Solicitors

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On 19 April 2023, the Law Society issued guidance for its members to consider the way that they practise in the context of climate change. The Solicitors Regulation Authority supports the guidance but it should not be interpreted as its regulatory position on these matters. Still, it remains an important development.

The guidance is ambitious in scope, considering both how law firms and in-house employers manage their business in a manner consistent with the transition to net zero and how climate change risks may be relevant to client advice, solicitors' professional duties and the solicitor/client relationship.

CLIMATE AND PROFESSIONALS GENERALLY

The Law Society is one of many professional bodies considering how climate risk and the transition impacts the way in which its members conduct themselves and provide advice. The Institute of Chartered Accountants in England and Wales, the Financial Reporting Council and the Royal Institution of Chartered Surveyors are three further bodies developing guidance in this area.

GUIDANCE ON MANAGING BUSINESS

The guidance demonstrates the subtlety and complexity of the challenges associated with climate change for the legal profession, introducing the concept of advised (or Scope 4) emissions.

In this context, it states that the most significant greenhouse gas emissions associated with a law firm's organisation are likely to be emissions associated with the matters upon which they advise, rather than the law firm's own activities. Guidance suggests that firms committed to pursuing the Paris Agreement goal should also consider how they might be able to influence the reduction of advised emissions in line with their broader target setting. This includes:

- understanding the climate change-related strategy, goals and transition plans of your organisation or clients to the same extent that you understand their commercial and financial position.
- understanding the climate-related risks and opportunities that typically present themselves in your practice area and the matters you advise on.
- advising clients of relevant climate legal risks and opportunities associated with the global transition to a net zero economy.
- assisting clients who wish to reduce their emissions and engage in transition planning.
- considering whether it is consistent to accept instruction and to advise on certain matters that the firm decides are incompatible with its climate change commitments.

Even a cursory review of these observations raises important and potentially sensitive issues for lawyers. Other management issues raised include greenwashing and the attraction and retention of talent.

THE IMPACT OF CLIMATE RISKS ON PROFESSIONAL DUTIES

The guidance highlights the fact that the solicitor's duty of care may require us to look beyond the narrow scope of an instruction to consider whether and to what extent climate risks are relevant. Further, climate change may have an impact on the solicitor's duty to warn clients of legal risks. This may have a knock-on effect in terms of retainers, training and professional indemnity insurance.

CONCLUSION

With the promise of further sector-specific guidance on how solicitors should advise clients on climate risks, this will continue to be an evolving and important issue for the legal profession which represents both a significant opportunity and, in some respects, an enhanced risk.

Back

ESG, the Law Firm and B Corp Certification

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Read More

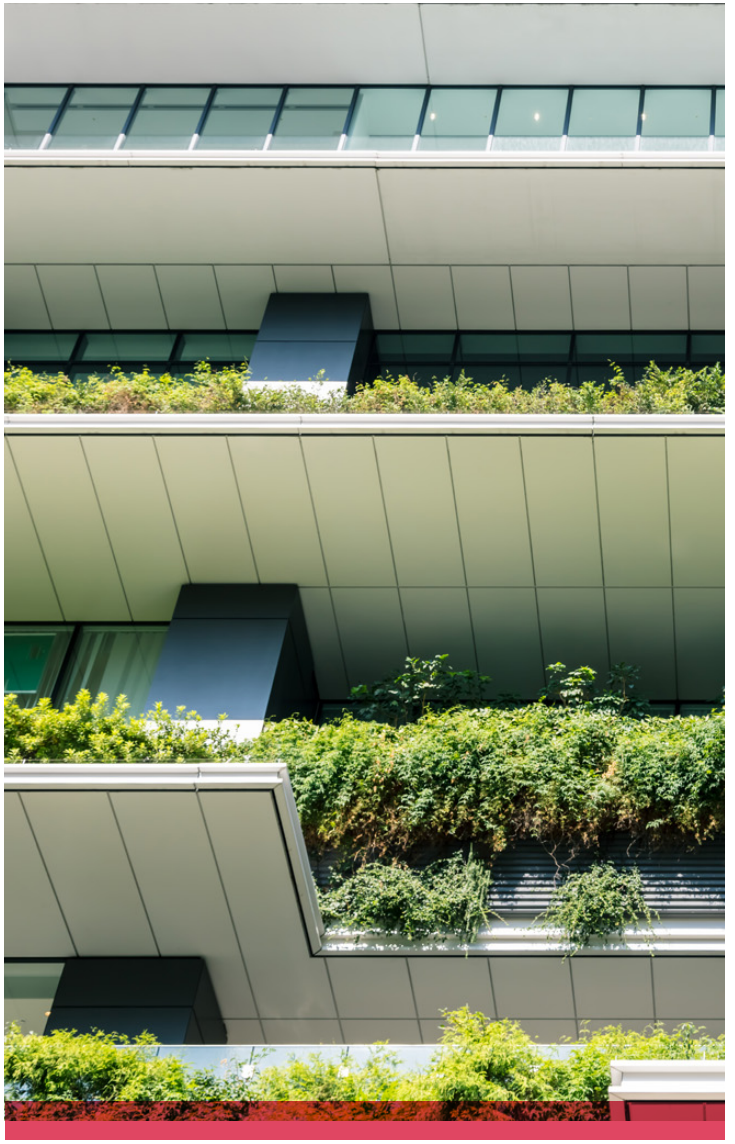
B Corp certification is one response several law firms, and over 5,000 businesses in 84 countries, have taken to the sharpened interest in ESG. As of March 2023, there are eight B Corp certified UK law firms, which include full-service firms like Brabners and Shakespeare Martineau. The number of B Corps is growing exponentially, and many more B Corp law firms are in the pipeline. The benefits and risks of B Corp certification for law firms are discussed below.

WHAT ARE B CORPS?

B Corps are profit-making businesses that voluntarily meet high standards of social and environmental performance and accountability. To qualify for B Corp certification the firm must:

- Complete the B Impact Assessment (BIA), an online survey that asks over 200 questions tailored to the firm's size, sector, and location. It measures the firm's impact on four main stakeholders: workers, suppliers, community, and environment.
- Achieve at least 80 points out of the 200 points available on the BIA. The responses are validated by B Lab (an independent not-for-profit organisation).
- Formally commit to "creating a material positive impact on society and the environment, and consider the impact of their firm's decisions on all stakeholders, including shareholders, employees, suppliers, society and the environment", known as the Statement of Interdependence.
- Pay the annual fee calculated on the firm's total revenue in the last 12 months.

B Corp certification is different from an ESG rating, which is available to any firm, whether or not they are socially or environmentally focused, and is calculated by an ESG rating agency that utilises differing scoring criteria and methodologies. This has led to criticism that they can be manipulated and observations that these different approaches make it difficult to compare one firm's rating to another. Conversely, B Corps are measured using the same methodology, and only those that have met the stringent criteria are certified B Corps.



WHAT ARE THE BENEFITS OF B CORP CERTIFICATION FOR LAW FIRMS?

Firms with B Corp certification identified the BIA itself as being a driver for B Corp certification, describing it as a "helpful tool" to validate their firm's current ESG activities. ESG is of heightened importance for many firms, but it is a complicated landscape and the BIA provides reassurance that a firm is "doing the right thing" in relation to actions already taken. It was also identified as a useful framework to focus high-level management decision-making around ESG as it enables future decisions to be considered in a structured way. The framework exposes areas a firm may be weaker in and provides direction on where further attention can be directed in the future for maximum impact.

Attracting, engaging, and retaining talent is also mentioned by B Corp law firms as a benefit of B Corp certification. This is a key challenge for law firms. There is a large body of research connecting meaningful and satisfying work with increased levels of organisational commitment, work engagement, and higher performance. The recent challenging recruitment environment highlighted that those traditional motivations of predictable salary, pension, and insurance are no longer enough to attract the best talent. B Corps intrinsically have a clear purpose and give employees the opportunity to address societal issues through their work.

B Corp firms also report that certification provided them with a shorthand to communicate to customers the firm's identity and values. A firm's social and environmental values are now a central part of a firm's public image, and B Corp firms said that B Corp certification instantly communicates these values to customers and stakeholders. Law firms operate in a highly competitive market and B Corp certification helps firms differentiate in the way they create value.

GREENWASHING WITH B CORPS

With much of the industry engaging in mainstream ESG efforts, there is a risk for many firms making claims about their social and environmental behaviours that these will be seen as misleading, leading to allegations of greenwashing. B Corp certification requires a firm to amend its governing documents to include a Statement of Interdependence which places sustainability at the heart of all decision-making and therefore this should sift out the good from just good marketing, and stand B Corp firms apart from less authentic competitors. It does not however provide a guarantee. B Corp firms tend to speak more publicly about their sustainability practices and with more confidence.

Credibility in the B Corp brand is achieved through the rigorous validation process which can take over 12 months to complete. The integrity of the brand and the efficacy of the BIA has been brought into question with some controversial accreditations which include Nespresso, Brewdog and Danone. B Corp responded by reviewing the BIA and this year is likely to introduce minimum standards in relation to each of the five impact areas assessed.

B Corps hold all stakeholders equal and therefore, by design, will necessitate firms to review their willingness to work for environmentally and socially contentious clients. This will and should preclude some law firms from the B Corp community who are unwilling to make these priorities. Many firms, however, already consider these types of instructions from a risk perspective. Other certification schemes e.g. ISO 14000 are available or ESG ratings may be more suitable in this situation.

Building pressure is on all businesses, including law firms, to be more socially and environmentally conscientious. There is more scrutiny and accountability than ever before which is only to become more rigorous. Many lawyers are recognising that reforming their business model to align profit with societal and environmental impact is a key requirement for 21st century business. B Corp provides a credible and tested business model which drives a more inclusive and sustainable economy through a certification process that identifies firms that make a profit and that also use their activities as a "force for good".

Lindsay is an alumnus of DAC Beachcroft. She is a solicitor, B Corp enthusiast and NED. In January 2023 she completed a research dissertation 'To B or not to B: an analysis of the motivations, drivers and benefits of B Corp certification in the UK legal service sector' at Oxford Brookes University as part of her Executive MBA studies. If you are interested in pursuing a B Corp journey, please contact Lindsay.

Social

- Social Movements and their Impact on Law Firms
- Social Inflation: Just a Load of Hot Air?
- Claims, Trends and Predictions
- Supervision

Back

Social Movements and their Impact on Law Firms

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Social movements such as Black Lives Matter and #MeToo have shaped attitudes to racial discrimination and sexual harassment and have made us all more aware of the importance of how people are treated.

For solicitors none of this is new as the Code of Conduct has contained anti-discrimination provisions for some time. There is undoubtedly, however, an increased regulatory focus on law firms to ensure that past poor behaviours such as toxic workplace culture and senior lawyers abusing their power are eradicated.

Back

CULTURE

This increased focus on work place culture clearly emerged with the introduction of the SRA's Standards and Regulations in 2019 and has been underlined by the work that the Regulator has been doing more recently in preparation for the introduction of the new regulations dealing with toxic work place environments. The SRA's proposals have now been adopted and will introduce an increased level of scrutiny which will affect law firms and potentially individuals.

The SRA's objective is undoubtedly at least in part to promote a culture within law firms in which ethical values and behaviours are embedded. The new provisions reinforce the SRA's powers to deal with poor workplace culture in law firms as the SRA is concerned that such cultures can have a negative impact on the service that individuals employed by law firms deliver to their clients.

The SRA's focus in this area remains therefore the risks to clients and third parties and the SRA is not assuming a pastoral role in relation to the profession.

REGULATORY FRAMEWORK

The Code of Conduct provides that firms must maintain the trust that the public has in the profession. This is one of the cornerstones of our Code and underpins many of the other principles. A firm that tolerates a poor culture is likely to undermine this trust.

A key element of a positive culture is a comprehensive supervision framework that amounts to more than simply checking that staff are progressing client matters. Firms should have in place arrangements to regularly monitor and assess employees' workloads and capacity as well as their competence to do the work. Supervisors and managers should have at the forefront of their minds the fact that they have a responsibility for the culture and systems in their firms and that they will be held responsible for failures of those systems under Paragraph 8.1 of the Code of Conduct for Firms.

The SRA knows what we already know namely that firms which have systems and policies in place which ensure that their colleagues feel supported in the context of their work are more likely to enjoy a positive culture which empowers our employees and enables them to raise concerns if they are experiencing problems in the knowledge that law firm leaders will listen to them and act appropriately. The SRA's focus is to try to prevent problems arising in the first place or the situation becoming worse through inaction.

Poor work place cultures have arguably contributed in some cases to solicitors concealing mistakes. This has led to serious regulatory consequences for the lawyers involved that could have been avoided had they simply found the courage and confidence to speak up.

We are required to treat our colleagues fairly and with dignity. One element of this concept is building a safe environment which enables staff to raise issues with senior managers in the knowledge that they will be dealt with promptly, fairly, openly and with sensitivity.

The SRA will hold individuals and firms to account for serious failures to meet the required standards in accordance with their Enforcement Strategy.

Under the new rules the obligation to treat staff fairly and with respect is explicit and the SRA will be expected to provide definitions for bullying and harassment.

At the same time, the SRA will introduce provisions on health and fitness to practice. We welcome the move by the Regulator to take into account such issues which may result in a reduction in the number of prosecutions of lawyers who are genuinely suffering from mental health or other medical problems.

This is a challenging area for all law firms and their managers but it is an area on which we must shine a spotlight if we are to make our firms happier places to work and avoid the reputational damage that a prosecution under the new provisions will create.

SEXUAL MISCONDUCT

Turning to another area of workplace culture, the SRA expects firms to foster a culture of zero tolerance of sexual misconduct and amendments have been made to the SRA's Enforcement Strategy which came into force on 15 February 2023 which reflect this approach. The SRA has made it clear that it considers that

> *"Some behaviours demonstrated by individuals such as those relating to sexual misconduct, discrimination, and non-sexual harassment - are unsuitable for a financial penalty, except in exceptional circumstances."*

In theory therefore all matters involving allegations of sexual misconduct will be referred to the SDT for a full hearing and it is often difficult to predict the outcome in terms of sanction.

This year alone we have seen a number of cases involving allegations of sexual misconduct. The cases range in severity facts from the associate who made a sexual gesture to a trainee solicitor at a Christmas party – he accepted a rebuke by way of penalty and the case was resolved without a referral to the Tribunal – to the solicitor who touched a woman twice in a nightclub, who was referred and was fined £30,000 by the SDT.

There has also been the long running case involving the prosecution of Oliver Bretherton who was found to have committed misconduct which involved an 18 year old paralegal. He has been struck off by the Tribunal.

The SRA has already indicated that, in their view, a financial penalty will be an insufficient sanction where sexual misconduct allegations are found proven.

We are expecting to see further sexual misconduct cases in the SDT which will undoubtedly provide clearer guidance on the Tribunal's approach to sanction in what is such a sensitive area to regulate.

We predict that the profession will become far less tolerant of bad behaviour and poor culture in the workplace. Lawyers who ignore the SRA's increased interest and fining powers as well as the reputational damage that these cases cause do so at their peril.

> *"Culture is all about people and behaviours and is fundamental to any successful law firm. A healthy workplace culture encourages people to make suggestions, speak up when they are struggling or admit mistakes, which is vital for effective risk management. Fostering an environment where people feel they belong and are respected for who they are, where they can flourish and meet the high expectations of them from clients, colleagues and the regulatory framework, should be a priority for every law firm leader."*

Elizabeth Rimmer
Chief Executive of Law Care

Back

Social Inflation: Just a Load of Hot Air?

Social Inflation is the trend of rising claim costs due to social, political, legal and economic factors.

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The notion of social inflation is not a new concept, being first identified in 1977 by Warren Buffett who warned that 'social inflation' would cause costs in the insurance sector to rise – he described it as *"a broadening definition by society and juries of what is covered by insurance policies."*

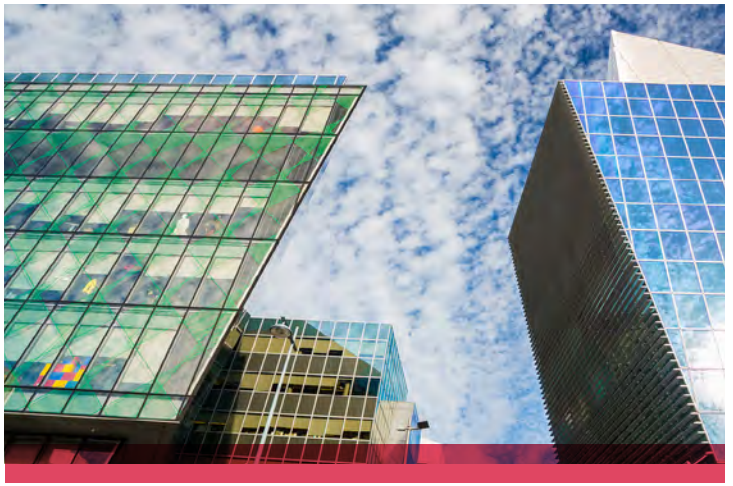
Social inflation is largely contained to the US and there is no obvious case for stating that social inflation has arrived in Europe. However, there are signs of change in terms of claimant approach, which could see a rise in the frequency and severity of claims.

Although England and Wales do not have an established plaintiff bar like that seen in the US, there are signs of a shift towards a more aggressive style of litigation. In the UK there are established claimant law firms that specialise in litigating on behalf of claimants in different areas, including claims against professional services providers. These firms are becoming more overt in their marketing strategies, with some advertising for potential claimants through radio, television and newspaper adverts.

We have already seen the effects of such approaches in claims against the solicitors' profession, in waves of multi-party actions, akin to a form of class action. Professional indemnity insurers and firms affected will recall, with suitable distaste, the waves of claims in relation to right to buy transactions, under-settlement of miners' claims and failed buyer-funded developments. Whilst each of these has a naturally finite cycle, they leave in their wake specialist Claimant lawyers who at the end of each cycle will no doubt look to line up replacement workstreams.

In terms of tactics, often the quantum of claims is inflated and designed to extract a quick settlement as an alternative to protracted litigation. Where there is a choice of defendant, those with insurance are most likely to be targeted given the perception that Insurers have "deep pockets". When claims are made against professional service providers, claimants might make specific, personal allegations against the professionals themselves in order to secure their engagement and encourage them to put pressure on their insurers.

In summary, although the impacts of social inflation remain largely contained in the US for the moment, we can already see subtle changes to the litigation landscape in England and Wales.



Back

Supervision

Supervision, or its absence, straddles both the ‘Social’ and ‘Governance’ strands of an effective ESG policy.

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Good supervision, especially of our junior colleagues, is essential to ensure that employees feel supported and confident in their roles, it will help to alleviate stress and worry, safeguard against them becoming overwhelmed and operating beyond sensible capacity and will also help to avoid a sense of isolation. More fundamentally, it also means that our colleagues will be able to develop their skills, capabilities and competence.

It is of course also vital from a risk management and governance perspective, particularly given the widespread switch to more flexible modes of working where staff can spend part if not all of the week operating remotely. Many of the professional negligence claims that we deal with arise as a direct result of inadequate supervision, a lack of expertise in a particular field, or simply having too heavy a workload. This can lead to mistakes or important issues being missed. Examples of cases that we have dealt with recently include:

- Important procedural steps being taken too late and/or incorrectly leaving no time to attempt to remedy the mistake.
- Overlooking or incorrectly identifying deadlines for primary or secondary limitation thereby allowing potential civil claims to become statute barred.
- Not appreciating or understanding key dates, notice periods and the need for strict compliance with statutory requirements, such as break clauses in commercial leases or applications for statutory lease extensions.

Of course we all recognise that these sorts of problems can occur no matter how careful we are in relation to supervision arrangements but the likelihood is significantly reduced if there are adequate and appropriate procedures in place. Such procedures should be aimed at ensuring that key dates are diarised, important steps are not left until the eleventh hour (unless unavoidable), and that work is either carried out at the correct level of expertise, or else approved by someone with the necessary experience before it is finalised.

Supervision is not just an issue for junior staff. It should feature at all levels of a business as part of our quality and control measures. Firms should have measures in place to ensure the quality of the work being produced by senior as well as junior colleagues. We recommend regular peer reviews and senior colleagues should also have visibility in relation to the nature of the work the firm is undertaking to effectively ensure that the business is being protected from unnecessary exposures. It is thankfully rare to encounter rogue employees but it does happen and careful oversight and broader scrutiny can uncover issues such as the misuse or theft of client money and money laundering.

As we have said peer review is an important tool but other strategies include file and financial audits, as well as the implementation of systems which require the authorisation of payments and transfers by more than one senior individual.

The SRA is also showing an increased interest in this area and in November 2022 it published its guidance note on 'Effective Supervision', to help firms to meet their regulatory requirements for the provision of legal services. As with risk management generally, much of the note is common sense, but a few key points are worth noting:

- The note reminds firms that they are responsible for the legal services that are provided, and in turn the actions of those they supervise.
- The note reminds us of the need for appropriate and effective supervisory arrangements, that are carefully and deliberately aligned to the nature, extent and importance of the specific risks that are posed by the type of work being undertaken. It is not a case of 'one size fits all' and supervision should be tailored to the type of work that is being undertaken.
- Those acting as supervisors must be sufficiently experienced and competent, have capacity to actually perform that role, and be available (whether remotely or in person).
- The SRA also wants to see evidence that supervision is being undertaken through time recording, sign-off of specific classes of document or the production of review or file notes.

Inadequate supervision can therefore result not only in claims against a firm but also in serious cases can give rise to a potential exposure to an SRA investigation and sanction.

Good supervision should therefore be a key objective for firms and can protect and support staff, help to manage the risk of claims, positively influence the ongoing availability of PII cover and minimise the risk of regulatory scrutiny.

Sharon Glynn, Director, Underwriting, Professional Indemnity at Travelers Insurance with a focus on large law firm clients.

"Supervision has always been of interest to insurers, but became the subject of greater focus as a result of homeworking during the pandemic. While we may no longer be in lockdown, the scrutiny on supervision remains as firms adjust to changed and changing working patterns.

If it is any consolation to readers, I am not sure that many firms, if any, feel that they have the perfect supervision model. There are many factors at play here: different working patterns within teams as well as across practice areas, office locations and jurisdictions, firms battling to balance (sometimes) competing interests of employees and clients not to mention business needs.

What is key for us as insurers is to see that firms a) recognise that they need to face the challenge of getting supervision right and b) demonstrate that they are doing something about it and seeking to apply and embed a best practice for the firm.

There is no one size fits all. A firm's culture, its client base, employee base and geographical footprint will all dictate what best practice looks like but there are fundamentals that will be applicable to all as outlined earlier in this article.

Whatever policy a firm decides is right for it, it is critical that the policy is applied consistently and proportionately throughout the firm. Consistently applying a supervision policy, or any policy, will result in a better risk profile in respect of that particular policy, and it also goes to evidencing good culture, another focus of the SRA, which is critical to staff wellbeing and the ultimate wellbeing of the firm. "

Claims, Trends and Predictions

Life after Covid – what people and claims risks are firms facing now?

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As lawyers who look after lawyers, we are often the first to see the claims risks which are impacting the profession.

With the last couple of years having been dominated by the fear and expectation of a claims spike following the pandemic, we look at the issues we are seeing now, and what might be around the corner.

PEOPLE RISKS

In 2023, and with the Covid pandemic behind us, safeguarding the mental health of those working in law firms remains as relevant as ever. LawCare's Life in the Law research collected information from 1713 legal professionals, and reported that the average score for burnout for participants exceeded the level at which an individual is at a "high risk of burnout". In addition, 69% of respondents said they had experienced mental ill health in the previous 12 months. Law firms are therefore quite right to be concerned about these issues.

Well-being and mental health issues may also be a factor in the professional negligence claims made against a firm.

Fee earners working under excessive pressure, or experiencing mental ill health, may be more prone to make a mistake, miss a Court deadline or fail to communicate effectively with clients. They may also be less able to reflect on their work, so as to identify and rectify mistakes or miscommunication at an early stage, before matters escalate.

CONVEYANCING REMAINS THE BIGGEST CAUSE OF CLAIMS

Conveyancing is often a high pressure work environment, where small mistakes can have very significant consequences, and lead to high value claims. For example, when acting for the purchaser of a leasehold property, onerous provisions in the lease which may impact the purchaser's intended use, or whether the property is acceptable to lenders, may be missed. We had anticipated that conveyancing claims would rise, particularly taking into account the boom in the housing market during the pandemic, which meant conveyancers were stretched to capacity, often when working remotely and without their usual support network. In fact, as yet, we haven't seen that. However, as it is often only some years later that an issue emerges, perhaps when a property owner comes to sell or re-mortgage, it may be some time before the full extent of the problem is known.

The SRA Warning Notice on investment schemes references dubious or risky schemes being presented as routine conveyancing, when the reality is very different. With the benefit of hindsight, it may be that lawyers acting in relation to such schemes, working under pressure, and without access to peer support or appropriate supervision, did not reflect on the nature of the transaction involved, and consider the risks for their client. Claims related to buyer funded property development schemes appear to have reached their peak. That said, firms should remain alert to the principles referenced in the Warning Notice when considering taking on new and unusual work, to reduce the risk of regulatory breaches and claims.

PRIVATE CLIENT

In the private client arena, we had expected claims to arise from will preparation during Covid. Where wills were witnessed by video, the testator may have been influenced by someone in the room but out of sight of the solicitors, meaning the validity of the will could be challenged. Equally, execution of wills by video during Covid increased the risk of a will being challenged on the basis that the testator lacked capacity. Solicitors are often blamed for failing to spot capacity issues, notwithstanding the difficulty of doing that when a will is executed remotely. Again, we are yet to see a significant increase in claims arising from this practice area, but it could just be a matter of time.

CLAIMS ARISING FROM THE CHALLENGING ECONOMIC CLIMATE

If the cost of living crisis persists, and property prices continue to fall, an increase in claims against insured professionals will probably follow. For example, claims may be brought by banks where losses are suffered when mortgaged properties are repossessed, and negligence in the earlier conveyancing process is identified. We are already increasingly dealing with claims brought by liquidators of failed businesses. In our experience such claims are often pursued robustly, with liquidators under pressure to recover funds for creditors, and to justify the legal costs being incurred in pursuing recovery.

In addition, we are seeing an increase in claims brought by litigants in person alleging professional negligence. Whilst on the one hand such claims may be cheaper to resolve, as Claimant costs are lower, in our experience disproportionate costs are often incurred in defending the claim due to a litigant in person's unfamiliarity with Court process and their general approach to claims.

WHAT CAN FIRMS DO

We recognise that dealing with a professional negligence claim is a distraction that firms would rather avoid. There will always be unmeritorious claims which could neither be predicted or prevented. However, there are proactive steps which firms can take to try and avoid negligence actions.

Law firms who want to reduce the impact of professional negligence claims on their business should consider the pressures that staff are working under, and the steps that can be taken to address issues and concerns. This includes not only initiatives directly aimed at mental health and well-being, but also consideration of the wider working environment, including the IT systems provided to assist in running files, the training and supervision of the teams engaged on client matters, and the firm's cultural principles, all by reference to the SRA guidance and requirements.

Governance

- Cyber and Data Security
- Law Firms' Risk & Compliance Obligations in Light of SRA's Increased Supervision
- SLAPPing Down on SLAPPs

Cyber and Data Security

The Impact of Lloyd v Google

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No look at governance issues for law firms would be complete without considering cyber and data security. When things go wrong, claims inevitably arise.

On 10 November 2021, the Supreme Court handed down the long-anticipated judgment in Lloyd v Google LLC [2021] UKSC 50. The Court unanimously agreed that Mr Lloyd's claim against Google for breach of his data protection rights under section 13 of the Data Protection Act 1998 (the "DPA") should not proceed.

In 2017, Mr Lloyd had issued a claim in the High Court alleging that Google had breached its duties as a data controller to a class of over 4m Apple iPhone users during the period 2011-12, when Google collected and processed browser generated information.

Mr Lloyd alleged that Google had acted in breach of the DPA by wrongly tracking the internet use of Apple iPhone users for commercial purposes. He claimed £750 in damages per claimant which amounted to a total of £3bn for the full class of 4m affected users.

The Court held that a Claimant must show evidence of financial loss or distress in order to succeed in a claim for damages for non-trivial breaches of section 13 of the DPA. A "loss of control" of personal data is not sufficient. The Court therefore distinguished this case from cases involving the misuse of private data where such evidence is unnecessary.

Finally, the Court found that the "same interest" test for representative actions does not mean that each claimant must have identical claims and/or interests.

Representative actions may be used as vehicles to bring claims for damages but except in exceptional circumstances where the claimants have suffered the same loss it may be preferable for the cases to proceed in two stages: a claim for a declaration on the issue of liability brought by a representative followed by claims for damages by individuals or groups of individuals.

The judgment is important for solicitors who traditionally hold huge amounts of data as it means that any Claimant who makes a claim under s.13 of the DPA will have to demonstrate by reference to evidence that they have suffered distress or financial loss.

THE EFFECT OF THE GOOGLE DECISION

We predicted that the outcome of the case would impact on a number of existing claims, however, claimant law firms have continued to pursue claims and have instead focused on showing non-trivial levels of distress and psychiatric injury in an attempt to characterise the claim as a personal injury claim which should be allocated to the fast and multi-tracks. This also side steps the issue of limited costs recovery of the small claims track.

In our experience many data breach claims only give rise to distress, however, there will be occasions where the infringement may also cause a psychiatric injury or aggravate a pre-existing condition. In such circumstances, damages for distress will still, in principle, be recoverable.

WHAT'S OVER THE HORIZON?

UK Data Protection and Digital Information (No 2) Bill

In March 2023 the UK Government introduced a new Data Protection and Digital Information Bill, with the aim of easing the burden on businesses having to comply with data protection legislation. This includes redefining whether a data subject is "identifiable", reducing record keeping requirements, removing the requirement to conduct Data Protection Impact Assessments for high-risk processing activities, limiting who needs to appoint a DPO and giving businesses grounds to decline Data Subject Access Requests that are "vexatious" or "excessive".

The Government's press release in relation to the Bill provides an ambitious target that the proposed data reforms will "unlock £4.7billion in savings for the UK economy over the next 10 years". However, the Bill aims to stay aligned with UK GDPR on most data protection standards and therefore is unlikely to reduce the number of data protection claims.

Back

Law Firms' Risk & Compliance Obligations in Light of SRA's Increased Supervision

The SRA continues to closely monitor firms to ensure they meet their compliance obligations.

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There will be no let-up on the regulatory burden on law firms as the SRA continues to closely monitor those they regulate to ensure they meet their compliance obligations. Following the Law Society's risk and compliance annual conference in March, it is clear that compliance remains top of the SRA's agenda with a particular focus on anti-money laundering ('AML'), transparency and competency.

ANTI-MONEY LAUNDERING

The events of the last year, including the economic upheaval as a result of the Covid-19 pandemic and the war in Europe, have resulted in an unprecedented focus on the role of the legal sector and its response to economic crime. In June 2022, the SRA imposed a new duty on 6,000 firms to provide data on the extent and scale of their potential exposure to AML risks and it is evident that its monitoring of firms is only going to increase. The SRA published its annual AML report for 2021/22 in October which confirmed its increased capacity and resource to supervise law firms and ensure they are keeping up to date with their regulatory responsibility having already carried out 273 AML inspections and desktop reviews.

TRANSPARENCY

In August 2022, the SRA announced it would also be increasing its supervision of firms' compliance with the SRA's Transparency Rules. The SRA will be checking that all regulated firms' websites display specified information on costs for certain services, the experience and qualification of fee earners and details of the firm's complaints procedure. Firms must also display the SRA badge to prove they are a regulated entity so it is important firms make sure their websites are up to date and compliant with the Rules.

ENFORCEMENT

With increased resourcing and the promise of increased inspections and desk-based reviews, the SRA warns firms that now is the time for them to "put your house in order" and take compliance seriously in order to avoid regulatory action.

The SRA's Enforcement Strategy, published in February 2023, sets out how the SRA will use its enforcement powers in relation to a failure to meet SRA standards and requirements and which factors it considers when determining whether conduct is serious enough for investigation and/or a penalty. COLPs and COFAs should familiarise themselves with this resource and ensure that their firm's current protocols and practices are compliant.

The SRA's fining powers rose from £2,000 to £25,000 in July 2022 and the Economic Crime and Corporate Transparency Bill, currently making its way through Parliament, will provide the SRA with unlimited fining powers for firms and individuals that have inhibited the prevention or detection of economic crime. With the Bill set to place extra reliance on the SRA to prevent money laundering, the SRA's chief executive has warned that the SRA will not be afraid to make use of its new fining powers.

In addition, the SRA has introduced a new financial penalties regime which came into force on 1 June 2023. The new regime introduces a schedule of fixed penalties of up to £1,500 for low-level breaches which can be found at Rule 11 of the Regulatory and Disciplinary Procedure Rules. The regime also now takes into account the turnover of firms and income of individuals when calculating fines in all cases with the maximum fine imposed on a firm being increased to 5% of its turnover. The SRA has provided guidance as to how fines are calculated and we suggest firms familiarise themselves with this guidance.

In January 2023, the SRA fined a small firm £20,000 for its "reckless" failure to comply with AML requirements. This is the largest fine issued since its fining powers were increased. In another case, the SRA levied another record breaking fine of £3,500 after a firm failed to publish mandatory details about its costs for motoring offences and its complaints procedure.

In light of the SRA's increased firm supervision and fining powers, it is crucial for a firm to ensure its risk profile is as good as it can be to keep both the SRA and its insurers happy. If a firm is found to be in breach of its regulatory obligations this could drive up renewal premiums to an unsustainable level or risk losing cover entirely so firms should make this a priority for 2023 and beyond.

SLAPPing Down on SLAPPs

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The issue of SLAPPs has become an important area of focus for the SRA. When instructed to act in litigation, firms must consider carefully the nature of the client's instructions, whether the client has a genuine claim and how they conduct themselves with their opponent. If there is any aspect of the claim which appears to be abusive or an attempt by the client to silence its opponent in an oppressive or unreasonable way, the solicitor should consider whether to accept instructions given the potential regulatory consequences of proceeding.

WHY ARE SLAPPS RELEVANT TO ESG?

SLAPPs engage two of the three elements of ESG.

Strong law firm governance will support litigators so that they are alive to the risk of SLAPPs. Compliance teams should regularly remind staff of the SRA's Warning Notice in this area and ensure that their own internal policies and procedures are updated and disseminated regularly to raise awareness of this issue.

SLAPPs are by definition an attempt to stifle freedom of speech and to thwart "public participation". This is where the "S" pillar of ESG is relevant. SLAPPs can, if successful, prevent important issues affecting society from being aired in public.

For this reason the targets of such claims are often investigative journalists or civil rights groups. The claims themselves may take the form of libel or defamation claims and pre-action threats may include claims for significant damages and costs.

Given the potential regulatory consequences, the disruption to the law firm and the stress to the individual solicitor that SRA investigations cause, we recommend a cautious approach in this area.

There is an access to justice consideration, however, and the SRA recognises that law firms must be free to protect the legitimate interests of their clients whilst always remaining within the regulatory framework.

What are SLAPPs?

"SLAPPs" stands for "Strategic Litigation against Public Participation" but has no statutory definition.

The SRA and others use this acronym to describe the bringing or threatening of proceedings with the objective of harassing or intimidating another who could be criticising or holding the client to account for their actions.

SLAPPs are regarded as an abuse of the legal system as they are claims without merit threatened or launched for the sole purpose of preventing scrutiny and publication of matters which are in the public interest.

The UK government has proposed the following three part test to identify a SLAPP:

1. The case relates to a public interest issue.
2. That it has some features of an abuse of process.
3. There is insufficient evidence of merit to warrant further judicial consideration.

WHAT IS THE SRA DOING?

The SRA currently has a significant number of ongoing investigations, and they are actively reviewing this issue and conducting thematic reviews. The SRA is also encouraging solicitors to report any concerns they have about the behaviour of their own firms or colleagues.

As we are all aware, the SRA requires law firms and individuals to self-report if they become aware of a potential breach of the Code within their own organisation. The SRA is now seeking to support solicitors to comply with this duty by seeking statutory designation as a 'prescribed person' under the Public Interest Disclosure Act 1998. If the SRA is successful, a solicitor who makes a report to the SRA would enjoy the more advantageous employment rights available to "whistle blowers".

The SRA has also approached certain groups, for example the Foreign Policy Centre, for evidence of allegedly abusive conduct by solicitors.

The good news so far is that in its thematic review of around 25 firms, the SRA did not identify any cases which met the definition of SLAPPs and contravened the Code.

Our own experience when representing clients in investigations in this area is that firms are complying with their regulatory obligations and none of the investigations that we have been involved in have proceeded further.

WHAT IF FIRMS GET THIS WRONG?

Firms and the SRA have to get the balance right. The SRA has made it clear that it recognises the need for inaccurate reporting to be legitimately challenged and for clients' interests to be protected.

If firms find themselves on the wrong side of this delicate line, however, the SRA has made it clear that they will make serious allegations against firms and individuals including for example lack of integrity. If proven, these breaches of the SRA's Principles can lead to career damaging sanctions.

THE FUTURE

The UK Government has plans to legislate in relation to SLAPPs and the Courts are trying to find ways to make it easier for parties to strike out this sort of vexatious litigation. Law firms also have an important role to play in ensuring that they assess cases properly to avoid becoming involved in abusive pre-action correspondence or litigation.

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