# Guidance

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# Recovering costs and payments from third parties

## *Recovering costs and payments from third parties*

Updated 25 November 2019 (Date first published: 8 August 2016)

### *Status*

This guidance is to help you understand when and how we recover costs and payments from third parties following an intervention. We will have regard to it when exercising our regulatory functions.

### *Who is this guidance for?*

This guidance applies to all individuals and SRA-regulated firms.

### *Purpose of this guidance*

We have published separate guidance on recovering the costs [https://www.sra.org.uk/solicitors/guidance/disciplinary-recovering-costs/] of regulatory action against those we regulate. This guidance sets out the approach we take when deciding whether to recover these costs from other parties. In doing so, it is important to maximise recoveries to help minimise our costs and therefore the cost of regulation for individuals and firms, which is ultimately passed on to the public.

This guidance should be read in the context of decision making at the SRA [https://www.sra.org.uk/sra/decision-making/decision-making-sra/] and other guidance listed at the end. We may update it from time to time.

### *Intervention costs*

#### *Who is liable?*

Where an intervention is into a partnership, all partners in the firm at the time of intervention are jointly and severally liable for the costs, which we can enforce directly against them.

We have statutory powers that allow us to apply to the High Court to require a former partner, or a manager or former manager of an authorised or licensed body to pay intervention costs (Paragraph 13A of Schedule 1 of the Solicitors Act 1974, paragraph 35(g) of Schedule 2 of the Administration of Justice Act 1985, and paragraph 18 of Schedule 14 of the Legal Services Act 2007).

This power can only be exercised where the person's conduct contributed to the need to intervene. This means we can recover costs from those directly responsible. In some circumstances this allows us to take action where a perpetrator within a firm anticipates the intervention and resigns before we intervene.

Where we intervene into a firm, the entity itself is liable for the costs. However, individual solicitors do have individual practices within the corporate entity and those practices can themselves be subject to intervention (see The Law Society v Blavo [2018] EWCA Civ 2250). In that case, the individual will be liable for the costs of intervention into their practice. The way we deal with those individuals is covered in the separate cost recovery guidance.

This guidance deals only with the scenario where individuals are not specifically subject to the intervention, and how as managers of the entity they can be made liable for the costs of our intervention into the firm.

*The statutory test*

In order to succeed, we will need to satisfy the court that the conduct within the firm which made it necessary for us to intervene was "carried on with the consent or connivance of, or was attributable to any neglect" by the person we intend to bring the claim against. This wording is broad. We will examine all evidence in our possession to assess the conduct of the individual concerned.

*Example 1*

n a two-partner firm, Mr A deals mainly with conveyancing and Mrs B deals with wills and probate. We receive complaints from clients that they have not received sale proceeds due to them after completion. We find there have been a number of misappropriations by Mr A of client money on conveyancing transactions. These have been hidden by false entries in the accounts (which Mr A maintained). Mr A resigns from the practice.

Mrs B tries to replace the missing money, but she does not have the personal resources to do so. Mrs B is now the sole principal and she therefore faces full liability for the intervention costs whereas Mr A, whose actions prompted the intervention, is not automatically liable. We decide to make an application to the High Court for Mr A to be made liable for the costs of the intervention. We provide evidence to the court that it was Mr A's activities which led directly to the intervention. The court is satisfied and makes the order. We can now pursue Mr A for the costs of the intervention.

*Example 2*

We intervene into an incorporated practice and into the practice of its sole director, Mr C, on the ground that they failed to comply with the SRA Accounts Rules. Mrs D had also been a director of the company, and majority shareholder, but resigned and sold his shares three months prior to the intervention. The breaches of the Accounts Rules which led to the intervention occurred when both Mr C and Mrs D were directors. We commence proceedings against Mrs D on the basis that the intervention was as a result of both Mr C and Mrs D's conduct at the firm. Mrs D settles our proceedings by paying a significant proportion of the outstanding intervention costs.

### *Deciding whether to use these powers*

Our guidance on recovering costs [https://www.sra.org.uk/solicitors/guidance/disciplinary-recovering-costs/] explains that, where an individual is liable to pay the costs of intervention, we will examine their ability to pay by considering their assets, income and liabilities and personal circumstances. If they cannot pay in full, we may accept a reduced lump sum in full settlement or payment by instalments. We may also accept a charge over property to secure our debt. The guidance also explains that we will take enforcement action against anyone who does not cooperate with us, for instance by refusing to complete a financial statement or by providing misleading, false or inadequate information.

We will take the same approach when considering whether to seek an order against a former manager or a current manager of an incorporated practice where we have not intervened into their personal practice. We do not wish to bring unnecessary proceedings before the court and succeed in a claim only to find out the individual has neither the assets nor the income to pay the debt. Therefore, usually, we will try to engage with the individual and ask if they will provide financial information. We will also, where appropriate, carry out our own investigations into their financial position.

If an individual cooperates and provides us with satisfactory evidence that they would not be able to pay the debt if the court ordered it, then we are not likely to proceed with that action.

Where an individual can pay the debt, we will try to reach an agreement with them at an early stage to avoid the need and costs of taking court action. Assuming they accept that they are likely to be found liable for the costs, we will treat the potential debt due from them as we would from those automatically liable and consider instalments, charges and other mechanisms.

If the individual refuses to provide information or tries to mislead us, then we are likely to proceed to court to obtain an order which will open up the full range of enforcement action to us. This could include issuing a statutory demand in bankruptcy.

## *Liability for compensation fund payments*

### *Managers – Indemnity Insurance*

The liability of current managers is highlighted in the guidance on recovering costs. If the compensation fund makes payments to those clients whose money has gone, it will inherit the rights those clients had to take action against the firm, or its managers (see rule 17.1 of the SRA Compensation Fund Rules [https://www.sra.org.uk/solicitors/standards-regulations/compensation-fund-rules/] ). This is called subrogation.

However, if these individuals were not involved in the wrongdoing which led to the payment, they may have the protection of indemnity insurance. All firms are required to have insurance that meets certain minimum terms and conditions (rules 2.1, 3.1, and Annex 1 of the Indemnity Insurance Rules).

In the case of an incorporated practice, the minimum terms state that an insurer can only decline an indemnity if all members/directors committed or condoned the dishonest activity. The burden is on the insurer to justify their refusal (called a declinature) and not on the insured to justify why they should have cover.

Therefore, where the evidence shows that there is a manager who was not involved, we may bring a subrogated claim against them for any payments made out of the compensation fund, knowing that they should be indemnified. If we find that the person is entitled to an indemnity, we will write to the insurer directly to explain our position including details of payments made from the fund and why we think this.

### *Example 3*

An incorporated practice has four directors. Three report to us that they have discovered that the fourth director has been committing probate fraud and that a significant amount of client money has been misappropriated. The three directors have not been able to replace the missing money and while they hope that the insurer will provide an indemnity to them, this has not yet been confirmed and the matter won't be resolved for some months.

They accept that the only option is for us to intervene. We do so and the compensation fund makes payments to replace the stolen money. The culpable director is made bankrupt but a recovery from the bankruptcy is unlikely. Our investigation shows that the other directors were not involved in the wrongdoing at all. We therefore bring claims against them, which they refer to their indemnity insurer. The insurer accepts that they are not implicated in the fraud and confirm they will indemnify them. The insurer replaces the payments made.

Just as an innocent manager at the time of intervention is liable for losses which arise during their time in that role (albeit with the protection of indemnity insurance), similarly liable is someone who was in that role in the past. However, in the same way, if they were not involved in the wrongdoing, they will have the benefit of indemnity insurance. We are able to bring a claim against them for payments by the fund if they were a manager at the time of the loss. The individual concerned will refer the matter to the indemnity insurer.

*Example 4*

We intervene into a sole practice because the principal has been stealing client money for a number of years. Although a sole practice at the time of intervention, the firm was a partnership until the resignation of a partner two years ago. The compensation fund makes a number of payments covering money which was stolen at various times over the last few years. A number of these losses were incurred when the partnership was in place. We bring a subrogated claim against the innocent partner who refers it to the indemnity insurer. The insurer confirms they will provide an indemnity against the claim.

*Reporting accountants*

Under rules 12.1 of the Accounts Rules, most firms have to have an independent accountant's annual report and submit this to us if it identifies any breaches of  the Accounts Rules or risks to client money (otherwise known as a "qualified" report).

Section 34 (9) of the Solicitors Act 1974 imposes an obligation on a firm's accountant to notify us immediately if they discover evidence of fraud or theft in relation to the firm's accounts. Or if they believe  a solicitor is not a fit and proper person to hold money for clients or other persons (including money held on trust) or to operate an account of a client of the solicitor or an account of another person.

The Court of Appeal has also confirmed that reporting accountants owe us a duty of care (Law Society v KPMG Peat Marwick & Others [2000] 4 All ER 540). If an accountant fails to immediately report to us something which is urgent and high risk, or fails to identify concerns which they were or should have been aware of, they are in breach of this duty of care.

In either case, the risk is that any prohibited activities will remain undetected and the loss to the clients, and ultimately the compensation fund, will be greater.

Solicitors Regulation Authority

Where we make payments on the basis of a client account shortfall or other risks to client money, we will review the firm's accountant's reports to see if these issues were identified, and if not, whether they should have been and when. We will also consider whether the issues identified were sufficiently serious that the accountant should have reported them to us immediately.

If the compensation fund payments all relate to losses caused in the period since the last accounting report, then clearly there is nothing the accountants could have done to notify us of that. However, if there's evidence of long standing problems, such as ongoing shortages on the account or suspicious transactions taking place over a period of years, then we will assess whether the accountants should have noted this and if it should have been reported to us. If so, we can make a claim against them for breach of their duty to us.

*Example 5*

We intervene into a two-partner firm on the grounds that we have reason to suspect dishonesty. It becomes clear to us that the partners have been committing fraud for a number of years and using the client account to assist in the fraud. Despite this, the firm's reporting accountants had prepared unqualified reports for each of the periods when the frauds were committed. Significant payments are made to clients from the compensation fund.

We commence proceedings against the accountants, claiming damages on the ground that they had been negligent in preparing the accountant's reports and, as a result, we had not intervened as quickly as we could have done had we known earlier of the serious problems in the firm and risks to client money. That would have reduced the losses and the amount paid out of the compensation fund. The accountant's insurer settles the claim and transfers the payment to the fund.

## *Further guidance*

Guidance on how we make decisions (high-level) [https://www.sra.org.uk/solicitors/guidance/make-decisions-criteria-apply/]

Guidance on how we recover our costs [https://www.sra.org.uk/solicitors/guidance/disciplinary-recovering-costs/]

## *Further help*

If you require further assistance, please contact the Professional Ethics helpline [https://www.sra.org.uk/contactus] .