



Risk Management – Helping Law Firms face the challenge

By Jim Stanley

One of the stark new realities facing Partners within law firms across the country is a dramatic increase in the risk of significant liabilities that can affect their firms.

The recent actions filed against Partners in connection with Money Laundering and other forms of fraud are a clear reminder of the potential vulnerability of law firms to the actions or mistakes of individual partners and their support staff.

But the new risks facing law firms go well beyond the problem of criminal activity. In an effort to address the issues raised by criminal activity situations, The Law Society has introduced requirements covering Money Laundering (Know Your Client) together with a range of additional rules covering activities in a Law Firm.

Although most law firms of any size have for many years had ethics and practice committees or risk management partners charged with broad oversight of risk issues, most such committees or partners have spent their time dealing with more traditional risk questions, such as conflicts of interest and review of fee arrangements etc.

They have not generally focused on the more subtle - and arguably more important - risks now confronting their firms.

The problems posed by these new risks have, of course, been greatly exacerbated by the rapid growth of law firms and the dispersion of the firm's lawyers in numerous offices across the country or around the world.

Simply put, how can Partners know if one or more of their lawyers or a member of their support team, somewhere, is "pushing the envelope too far" or taking risks that are unacceptable from the firm's standpoint? The question is even more difficult where the Lawyer concerned is practicing in a highly esoteric field that takes an expert to understand the risks being taken.

Traditionally, law firms relied on a common culture and shared sense of quality standards among their partners to address these issues. And, in a time when firms were relatively small and when partners were "home grown," learning their craft from senior Lawyer who mentored them, the system worked well enough.

Today, the situation is far different. In an era of rapid expansion, frequent mergers, and constant lateral acquisitions, most firms can no longer claim to have anything like the common culture of bygone days.

To become 'risk averse' a Law firm should focus on the following areas. These areas form the basis of a 'Best Practice Risk Management' manual.

The Partnership Agreement

A Partnership or Shareholder Agreement should help to translate overall firm philosophy into day to day policy and then provide the wherewithal to see that the policy is carried out.

The Agreement should have provisions setting out duties and responsibilities of the Partners. It should set out a basic compensation scheme which provides for compensation to those Partners who are responsible for not just the billable hours but also for doing other things important to the overall health of the firm; things like training associates and supervising staff. These may not make money in and of themselves but they help provide a setting in which money can be made. In the long run, particularly in a Risk Avoidance context, they are just as important as billing.

It is just this simple: law firms which have a clearly defined structure with duties and responsibilities set out, do not have the claims problems of firms which do not have such a structure.

Overall Management Structure

The general structure of the firm, whether or not it has a Managing Partner, an Executive Committee, etc., should be delineated in the Partnership Agreement or Shareholder Agreement. An analysis of this structure as it functions on a day to day basis determines the firm's capability to develop policy, translate that policy into a plan of action and then carry it out.

Firms that have an effective Management Structure are less likely to have claims, not because they have better lawyer s, but because they have created policies which are well considered and then carried through.

Mechanics of the Practice

The translatable goals of the Partners, affected by the then- created structure of management nets the Mechanics of the Practice. This encompasses the system design for the day to day firm activity. It also includes the hiring of staff to carry out those Partner-created objectives. A firm which sets goals for itself including the rewarding of Partners for doing not strictly billable work will avoid many claims situations.

Financial Management

Adequate Financial Management in a law firm means that the firm has accurately anticipated its financial requirements by profit planning and budgeting. The quality of its Financial Management affects the way that the firm makes decisions. Cases in which there appears to be a conflict may not be handled properly if a firm is suffering from cash shortages. Risks are taken to which claims are very often the inevitable result.

A law firm which is well managed financially may be able to withstand the difficulties which ensue if there is a major claim. Firms that are not well managed financially do not survive for very long in their present form.

Case Acceptance Principles

The ability of a law firm to make accurate determinations of what they are good at, what their attorney population is capable of doing effectively and what they should avoid is the crux of claim avoidance today.

The notion that a firm can be all things to all people does not work well for most law firms. It is the reason that so many small and medium sized firms have experienced so many claims.

Law firms must set standards for their case work just as they do for their finances and for their compensation. They must also determine the way in which the firm accepts new matters: how they're approved and who must sign off on them. Case Standards and Procedures need to be in place before the case arrives in order to be effectual. Those standards must be determined by the Partnership. Individuals who will not accede to those standards must be controlled.

Conflicts and Ethics

Is the same matter a Conflict for your firm when you need billable client work in the office as it is when there is more than enough work to go around? That's the question that partners should ask themselves. Conflicts are close calls. They don't rise up and announce themselves (most of the time). They are difficult because they are complicated.

Law firms must address the ethical issues of their practice in their Partnership or Shareholders agreement. Beyond that, systems must be developed (Mechanics of the Practice), which will isolate potential conflicts and make them known to the Partnership, not to just the individual attorney. More than one opinion should always be brought to bear in a potential conflict situation.

Looking ahead.

Experts agree that the most effective way to manage the growing risks facing law firms is not simply through the issuance of elaborate rules or policies [as useful as those may be], but rather through the creation of a genuinely risk-sensitive culture in which acceptable risk levels are understood and lawyers seek consultation and guidance when confronting questionable situations. More importantly the role of technology to enable a Law firm to police the activities of its Partners, Fee Earners and support staff is crucial one.

Many Law firms will not have a naturally risk sensitive culture. And as if it does not exist it must be consciously created. Defining 'best risk practice' within their firm should be a major priority for the Partnership. Law firms today must adopt a systematic approach to risk management similar to that adopted in other regulated industries such as banking, accounting etc. Governance and compliance is the key objective.

In determining 'Best Practice Risk Management' several important factors should be considered.

- A clear definition of roles and responsibilities so that every individual within the practice understands the extent of his or her authority and the circumstances under which consultation with others is required.*
- A system of supervision and monitoring that provides general oversight and periodic reviews of the work of every Partner, Fee earner and employee.*
- Written policies and procedures [and codes of conduct, in some cases] that defines expectations, rules and procedures.*
- Comprehensive training programs to insure that all professionals understand the policies and procedures under which they are expected to work.*
- Reporting mechanisms that recognise that mistakes will be made and that encourage rapid "no fault" reporting of circumstances that may give rise to claims and*
- Enforcement mechanisms to "put teeth" into the written policies and procedures.*

Unfortunately, most law firms have implemented very few of these steps in any significant way. Those firms that have face the challenge of 'policing' the firm to ensure that each person regardless of position is complying with the rules determined by the 'Best Risk Management' practice document.

For example, the notion that making mistakes is a normal part of any professional's learning and experience [an essential element of a "no fault" reporting concept] flies in the face of the strong culture of perfection that exists in most law firms.

Likewise, an effort to clearly define roles and responsibilities and to impose supervision and monitoring over their activities might cause many lawyers to bristle at a perceived loss of professional independence, even though the supervision is provided by other lawyer s. The use of technology to supervise or 'police' in a subtle, supportive and welcoming manner is the way forward.

In short, the adoption of a comprehensive and effective risk management program in most law firms will not be easy, but Partners can simply not afford to ignore the problem. As a starter, firms might focus on the following manageable steps:

- *Adopt and implement a strong practice management program which incorporates 'Best Risk Management Practice'. Comprehensive practice management is a firm's first line of defence against any risk. If implemented correctly, a practice management program will provide both supervision and intake control over all matters handled by a particular practice group and provide firm management with a powerful tool for monitoring the risk exposure of the firm.*
- *Institute an intake screening program that identifies clients and matters requiring special scrutiny. Such special review might be triggered by the type or financial condition of the client or by the nature of the transaction or other matter that the firm is requested to handle. Practice groups should be asked to identify matters in their areas that would justify such scrutiny. The adopting of Money Laundering and other checks is a crucial feature at this stage.*
- *Institute a process for special review of the firm's advice in particularly risky matters. Many firms have an "opinions committee" that is required to approve all formal opinions issued by the firm [particularly in financial or securities transactions], but there are many risks a firm can incur short of the issuance of a formal opinion. Other firms have a "two-partner rule" that is applicable to any significant advice rendered by the firm. That approach may be somewhat better but only if there is an assurance that the "second partner" will be disinterested and objective.*
- *Adopt and implement a formal risk management solution with a designated partner in charge who spends a significant portion of his or her time focusing on these issues [and who is adequately compensated for these efforts]. Such a solution should include a comprehensive training plan - ideally implemented through the practice groups - to insure that all lawyers, fee earners and support staff are aware of the standards and procedures applicable to their work.*

Given the significant and growing risks of liability confronting virtually every mid- and large-size law firm today, it is incumbent upon the Partnership to take the lead in implementing a strong and effective risk management solution.

How can technology help?

Adopting the R2R Risk Management suite will allow you to:

1. **Compliance** - *Checks that all documentation (contracts, letters, emails, fax) generated comply with the firms 'Best Practice Risk Management' manual. A key feature being that ALL documents are 'checked' to ensure that no risks are being undertaken on behalf of the firm by the author of the document. The system also checks all inbound documentation (contracts, letters, emails and faxes) for key words or phrases.*
2. **Education** – *Ensure that all Partners, fee earners and staff have access to training materials, have been trained and have reached an acceptable level of knowledge relating to the policies and procedures determined by the 'Best Practice Risk Management' manual. In addition the system alerts individuals within the firm to any changes in the practices policy of Law affecting their role and area of responsibility within the firm.*

3. **Conflict of interest** – Checks any new instructions against existing clients and matters regardless of the system they are held within and alerts nominated individuals in the event of a potential or actual conflict

4. **Criminal and unethical activity** – in accordance with Law Society Rules and guidance the system ensures the identity of a client is correct through the use of procedures and checks at the point of case acceptance. The system also checks documentation to ensure that practice ethics are being adhered to.

Mechanics of the Practice – the system ensures that the activities of individuals within the firm comply with those determined by the Partnership. The use of information, access to information, regularity of review and update are key features within the system

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