



# Lawcover's Risk Management

Due Diligence Guide for Principals

Law Practice Mergers and Acquisitions

## Due Diligence Guide for Principals

The following guide can assist in considering whether to merge with or acquire another law practice. Due diligence should be conducted subject to a confidentiality agreement being in place.

Some of the areas mentioned may not be applicable to your merger or acquisition, and it is not an exhaustive list of all areas which you may need to consider.

We recommend that you take independent legal advice prior to merging with or acquiring another law practice.

Category	Recommendation
<b>Structure of Entity</b>	Conduct searches on the law practice and all related entities with ASIC, including business name and ABN searches.
	Review any shareholder, partnership and employment agreements involving the law practice to determine the practice's current corporate structure, ownership or equity relationships. Consider whether these agreements contain any departure or non-compete provisions.
<b>Analysis of Each Practice Area/ Service</b>	Analyse the structure of each service and practice area, including staff. This should include the number of active matters, and the number of new matters per month, per principal and practice area for the last twelve months. Review at least ten active matters (or twenty for high volume law practices) in each practice area, selected at random.
<b>Strategic Plan</b>	Obtain details of any current Strategic Plan and assess whether the firm's vision, mission and values align with your firm.
<b>Business Plan</b>	Obtain a copy of any current Business Plan and assess how the firm is tracking against it.
<b>Financial Health</b>	Profitability – work out the overall profitability of the law practice, as well as for each individual practice area.
	Working capital – for each principal, fee-earner and practice area, calculate the current value of WIP and debtors, as well as how effectively credit control is being managed. Is the law practice billing clients promptly and are clients promptly paying the invoices of the practice? Identify the proportion of clients with a poor payment history.
	Debt – how much is the law practice relying on external financing to fund the business (eg. bank loans). Is this dependency increasing or decreasing, and how has it affected how the law practice selects clients?
	Cash Flow – evaluate the cash flow of the law practice as a whole, as well as for each practice area.
	Tax – what taxation liabilities exist and what taxation liabilities will be created by the merger or acquisition?
	Liabilities – identify current and future liabilities (for example, leases, leave liabilities) and to whom they will belong. Include any off-balance sheet liabilities and commitments.

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<b>Financial Health</b>	<p>Fee Levels – What are the fee levels (hourly rates and basis of calculation) charged by the law practice? Are the fee levels similar to your firm’s fee levels, or are they significantly different? If they are different, problems may arise where clients are used to paying less than the new practice charges for the same or similar services.</p>
	<p>Obtain details of insurance policies, such as Directors and Officers insurance, General Liability insurance, Cyber Risk Insurance, and any other insurances.</p>
<b>Professional Indemnity Risk</b>	<p>Check with Lawcover whether your law practice will be determined to be the Successor Practice to the law practice you are merging with or acquiring, for the purposes of the Lawcover Professional Indemnity Insurance (PII) Policy. Being the Successor Practice may have implications for your PII premiums.</p>
	<p>With the law practice’s consent, obtain the Lawcover claims history (including all prior practices, if any). This will include all the law practice’s claims and defence costs payments, any reserves held, and any excess payments made. If the law practice has at any time arranged its Professional Indemnity Insurance with a provider other than Lawcover, you should obtain that provider’s claims history also.</p>
	<p>Obtain independent legal advice in relation to the new merged practice, entering a Deed of Release with the prior practice for any claims or notifications arising from legal practice before the date of the merger or acquisition.</p>
	<p>Assess the adequacy of the risk management practices of the law practice (e.g. consider client selection and identification, client engagement procedures, practice management processes and systems).</p>
<b>Professional Indemnity Risk</b>	<p>Enquire as to whether the law practice has Top Up insurance and assess whether Top Up insurance will be required for the new merged practice. Discuss with the new principals to determine the right level of cover for you.</p>
<b>Regulation &amp; Compliance</b>	<p>Ask each principal in the law practice whether any complaints have been made by clients about their practice to the Office of the Legal Services Commissioner. Such complaints could potentially result in future claims against the law practice. Also ask about any current disputes with clients or suppliers.</p>
	<p>Ask whether the firm and/or any related company or principal has been the subject of any other regulatory investigation, finding or penalty [in the last five years].</p>
	<p>Review the law practice’s letters of engagement and costs disclosure letters to ensure that they contain all necessary information and disclosures.</p>
	<p>Obtain a copy of the complaints history of the law practice and/or any adverse media publicity.</p>

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<b>Client base</b>	<p>For each practice area and principal, obtain details of fee income for any key clients for the past two financial years. Analyse any client feedback gathered by the law practice over the last two years. The size of the client base and number of key clients surveyed will depend on the nature of the practice and the volume of work performed. For a general commercial practice, you may decide to survey the top ten clients. More may be required for a conveyancing practice and less for law practices engaged in corporate work.</p>
	<p>Gain an appreciation of the number of wills and other documents held by the law practice in safe custody.</p>
	<p>Obtain a description of any significant client relationships that have been terminated within the last two years including an explanation of why the relationships ended.</p> <p>Consider client reviews, comments and feedback – within the firm and online (e.g. Google, social media platforms).</p>
<b>Human Resources</b>	<p>Obtain a current organisational chart.</p>
	<p>Obtain a full resume or CV for each principal, fee earner and support staff member you are planning to employ, including their position description, professional qualifications, areas of expertise, experience, and membership of associations.</p>
	<p>Speak to each staff member you are planning to employ.</p>
	<p>Review the professional integrity of each principal and fee earner by considering the following:</p> <ul style="list-style-type: none"> <li>i Speak to at least three legal practitioners nominated by each principal concerning their perceptions of that principal</li> <li>ii Review each principal’s CLE attendance over the past three years</li> <li>iii Check the credit worthiness of each principal</li> </ul>
	<p>Obtain the staff turnover rate for the practice for the last five financial years.</p>
	<p>Obtain copies of any employment contracts the practice has entered.</p>
	<p>Obtain full details of the staff entitlements owing, such as long service leave, annual leave, sick leave, and superannuation.</p> <p>Obtain details of any outstanding employee related liabilities, worker’s compensation, or other issues associated with staff.</p> <p>Obtain details of any significant future leave plans.</p>
	<p>Obtain information about the firm’s performance in the areas of equal employment opportunity, gender pay equity, and participation in mentoring and volunteering programs.</p>

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<b>Human Resources</b>	<p>Obtain details of all policies pertaining to employment.</p> <p>Obtain details of all corporate policies that the law practice may have in place, such as a Privacy Code of Conduct, bullying, harassment and discrimination, complaints; conflicts of interest, training and development, climate impact, modern slavery (if relevant).</p>
<b>Third Party Providers</b>	<p>Obtain details of any (international and local) subcontractors used by the firm to provide its services.</p> <p>Obtain details of the third-party providers used by the firm.</p>
<b>Information Technology and Cyber Security</b>	<p>Information Technology – Obtain full details of IT systems used including, but not limited to: databases, software, hardware, subscriptions, applications, licence agreements, support and maintenance arrangements and other IT.</p> <p>Cyber Security - Obtain full details of current cyber security measures including, but not limited to:</p> <p>Incident logs, support and maintenance arrangements, data storage and use, incident response plans, staff awareness training history.</p> <p>Obtain details of any due diligence assessment of the practice’s IT service providers including, but not limited to: police checks of the provider/s employees and consultants, cyber breach/ incident history.</p> <p>Obtain details about where and how client information is stored e.g. whether offshore.</p>
<b>Formal Agreement</b>	<p>Formalise the arrangement with your new principals and staff by way of legal documentation which should address issues including, but not limited to, the following:</p> <ul style="list-style-type: none"> <li>i The approach to decision making.</li> <li>ii Staff delegations and entitlements.</li> <li>iii How to dissolve or end the business relationship.</li> <li>iv The division of assets and liabilities.</li> <li>v Identify each party who will be responsible for future expenses, such as premium loadings and excess payment obligations for past or future claims, and any premium for an increased indemnity limit. Determine their proportion of these expenses.</li> </ul> <p>If appropriate, agree restraints of trade and exit arrangements for principals or staff who will be leaving the practice within a known timeframe.</p>

### Prior Practices – why they are relevant to your Professional Indemnity Insurance

If your law practice merges with or acquires another law practice (including in the circumstances set out in clause 40 below), the Lawcover Professional Indemnity Insurance (PII) policy allows us to make a prior practice determination that means you become the successor practice to the law practice you have merged with or acquired.

#### The relevant clauses in the PII policy are:

39. The insured agree that
  - (a) we may determine whether the law practice is the successor to a prior practice; and
  - (b) our determination is final and binding.
40. In so determining, we may have regard to one or more of the following:
  - (c) the law practice holding itself out as the successor of the prior practice or as incorporating it where:
    - i the holding out can be express or implied;
    - ii the holding out can be contained in notepaper, business cards, form of electronic communications, publications, promotional material or otherwise, or is contained in any statement or declaration the law practice makes to any regulatory or taxation authority;
  - (d) the law practice employing, or taking on as principals, all or a majority of the principals of the prior practice;
  - (e) the law practice employing a majority of the employees previously employed by the prior practice;
  - (f) the law practice acquiring the goodwill, the assets, or the majority of client files of the prior practice; or assuming its liabilities;
  - (g) the law practice adopting the name formerly used by the prior practice, or a name which substantially incorporates that name;
  - (h) the law practice carrying on business from the premises of the prior practice.

The effect of a prior practice determination is that continuity of cover will be maintained for all the former principals and employees of the prior practice under your law practice's PII policy.

It also means that the premium and claims history of the prior practice and the successor practice will be combined for premium rating purposes. As we use a law practice's premium and claims history to calculate its PII premium, combining the history of both law practices may affect whether the successor practice is entitled to a claims discount or will be subject to a claims loading.

The impact that a merger with or acquisition of a prior practice may have on a law practice's future PII premiums is just one factor to consider when making your decision. Before you merge with or acquire an existing law practice, we recommend that you enquire into the professional standing and performance of that law practice.

We have prepared this due diligence guide to assist you in considering whether to merge with or acquire another law practice. We recommend that you take independent legal advice prior to such a merger or acquisition.