



Professional Partnerships

INSURANCE BROKERS

# ***A PII GUIDE TO THE BUYING & SELLING OF PROFESSIONAL PRACTICES***



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# A PII GUIDE TO THE BUYING & SELLING OF PROFESSIONAL PRACTICES



The purchase or sale of a professional practice is a major financial and commercial transaction for all concerned.

Considerable time and effort will be spent on “due diligence”, particularly by the potential purchaser and its advisers, in order to ensure that both parties understand as much as possible about the financial, commercial and personal consequences of the proposed deal.

Unfortunately, the issue of Professional Indemnity Insurance – or, indeed, the management of professional risk - is often not addressed until very late in the day, when most of the terms of the proposed deal have already been agreed, and when someone has remembered that “we ought to tell our insurers”.

This is a mistake: the consequences of not considering the PI implications of a sale or acquisition can often be disastrous, as this is one of the problematic areas of PI cover.

As specialist insurance brokers, we can assist you through this process and provide you with practical advice before, during and after the completion of the legal contract, in order to ensure your interests are best protected.

The notes that follow are intended to be a general guide only.

Each transaction has its own unique features, and you would need to discuss with us specifically the details of any specific proposed deal.

## The basic starting point: a change in insurance risk

When a PI underwriter agrees to insure your practice, he is basing his terms and assessment of risk on the details you have provided – through your broker – of the history of your firm, its present and past activities and risk profile, its fee income and its claims record.

In simple terms, the acquisition of another business means that the underwriter has to re-assess the risk.

He may conclude that there is very little change in risk following that assessment and he requires no extra premium or terms; on the other hand, he may decide the risk has changed so fundamentally, he no longer wishes to be involved.

In practice, most acquisitions will fall somewhere between the two extremes.

## Before the deal: PII and professional risk due diligence

When a professional practice is considering the making of an offer for another firm, it should explore what effect the acquisition might have on its own PI terms, its future PI claims record and last but not least, its professional reputation.

The practice needs to undertake some detailed due diligence regarding the PI history and arrangements of the potential vendor, together with an exploration of its professional risk management and profile and then discuss further with its PI brokers.

Key information should include the following:

- Ask for a full copy of the current PI policy or policies;
- Ask for a full copy of the last completed PI proposal form on which policy terms were based.
- Ask for a full history of the firm’s ownership, including details of any previous acquisitions and who was responsible for the past liabilities of the acquired firms.
- Ask for a full and detailed claims record of the firm and its predecessors in business.
- Ensure you understand both the full range of the professional activities currently provided by the firm, as well as details of other activities that may have been carried out in the past and are not ascertainable from the information on the PI proposal form (if you are likely to be responsible for past liabilities as part of the deal).

- Ask for details of the firm’s current professional risk management procedures, including such key points as how work is allocated and supervised, agreement and recording of the client brief, ongoing file documentation and client reporting, peer reviews and complaints procedures.
- Have all potential claims matters been notified to the current insurers?

## Negotiating the terms of the deal: PII Implications

One of the key terms which impacts on the future PI insurance arrangements is determining who is responsible for the past liabilities of the acquired firm. This is a decision that should not be taken lightly: the assumption of past liabilities increases the purchaser’s PI exposure going forward and its impact directly on the future of the premiums you pay! There are also regulatory requirements to take into account, especially for the legal profession where the concept of “successor practices” comes into play\*.

In all cases you should send a draft copy of the sale and purchase agreement to your PI broker as soon as possible, and ask for advice regarding the PI implications. If the purchaser is only acquiring the assets and goodwill of the other firm, then responsibility for past work is usually with the vendor, who will need to arrange run-off PI cover for a reasonable period of time.

A minimum of six years run-off is usually recommended, since this the standard limitation period for a client to bring a claim against a professional firm under contract; however, longer periods of run-off cover may be more appropriate in some instances: please consult us. Run-off cover is usually only available from the insurer who is insuring the vendor firm at the time of the sale and then only on an annually renewable basis. On the other hand, if the purchaser is acquiring the liabilities of the vendor business, as well as its assets, it will need to insure the PI run-off. This can be done in two principal ways: cover can be incorporated into the purchaser’s own existing PI arrangements for an additional premium, or alternatively the purchaser can take over the vendor’s existing PI policy and keep the run-off insured separately.

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The latter option is generally more expensive over the period of the run-off, but it does have the advantage of ring-fencing the acquired firm's past liability exposure.

This may be useful if the terms of the deal include a requirement for the vendor to pay for the cost of the run-off cover.

Sometimes the terms of the sale and purchase agreement are rather vague about responsibilities for past liabilities and their insurance; sometimes, the terms make the purchaser responsible for arranging the run-off cover even though the past liabilities are not being assumed legally. The broker can advise on the practicality or otherwise of the relevant clauses.

Armed with the key information highlighted in the 'Before The Deal' section, together with a copy of the sale and purchase agreement and the parties' intentions regarding the insurance of the past liabilities, the PI broker will be able to obtain premium indications from the current insurers and to make recommendations about the handling of your PI affairs going forward, prior to the final sealing of the deal between the two parties.

### Completing the deal: tell the insurers and monitor the position

As soon as the sale or purchase has been completed, both parties will need to tell their PI brokers/insurers in order to give immediate effect to the legal agreement and to protect the appropriate interests.

Obligations to keep ongoing or run-off PI cover in force should be properly monitored to ensure compliance with the terms of the agreement. In some instances, it may be advisable for one party to arrange "contingent" cover, which would operate in the event of the failure of another party to satisfy its obligations to maintain appropriate cover.

**\*(For solicitors' practices, it is the "successor practice" (as defined by the minimum terms of the Solicitors' Regulation Authority) that has the responsibility for insuring the run-off, whether or not it is technically liable to do so under the sale and purchase agreement. (Solicitors should consult their PI broker for advice in this area).**

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