PARTNERSHIPS OF (IN)CONVENIENCE – YOU'RE LIABLE TOO

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Partnership/pahrt-ner-ship/ (noun):
The relation which subsists between persons carrying on business in common with a view of profit.[1]

In West Malaysia, there are 5,786[2] law firms in operation, 48.75% are partnerships.

Of late, some cases reported under the mandatory PII scheme have brought to light certain alarming practices by law firms and partnerships. To illustrate our point, we include here two case studies.[3]

CASE STUDY 1

Firm W notified three claims to the Insurer in 2008. All three claims arose from three files that were handled by W's Johor Bahru branch (JB branch).

Partner A of Firm W set up the JB branch in July 2006 pursuant to a profit sharing arrangement with his lawyer friend, X. Up till then Lawyer X had been a partner of Firm Q, he told A that he no longer got along with his partners and wanted a new set up. X explained to A that the branch (in Firm W's name) was his best solution, as it would ensure he maintained his bank panelship opportunities.

The Insurers received and managed the three claims but appointed an adjuster to investigate the set up of the JB branch. It was discovered that

- ☒ Lawyer X's Practising Certificate had actually expired in January 2006 and could not be renewed as he was by then already struck off the rolls;
- ☒ Lawyer X closed Firm Q in August 2006, he was a sole proprietor, there was no partnership;
- ☒ Once the JB branch was operating, Lawyer X allowed two property brokers/agents to conduct their business from the branch and also to manage conveyancing work at the branch;
- ☒ The JB branch was set up in the same premises where Firm Q was located;
- ☒ In Firm W's application to Bar Council to set up the JB branch, Lawyer N was named as the solicitor in charge. Investigations showed that Lawyer N seldom attended office;
- ☒ Lawyer N only went in to the branch office when his services were needed e.g. sign or attest documents. He signed a declaration admitting to this when located by the adjuster;
- ☒ Lawyer N also did not meet clients; two clerks would verify clients' identities. These two clerks were actually "employed" (paid) by the property brokers/agents; and
- ☒ The three claims arose because Lawyer X and the two agents siphoned out monies paid to the branch by clients.

1 Section 3(1), Partnership Act 1961 (the Act).
2 As at 31 Dec 2009.
3 Whilst there are various breaches of Bar Council Rulings in both case studies, we touch only on the relevant PII Policy Clauses in this article.

Upon completion of their investigation, Insurers repudiated all three claims. All partners in Firm W, including partners who were not aware of the arrangement in the JB branch were not covered under the PII Policy.

TOOLS FOR THOUGHT:

In participating and allowing the above arrangement, Partner A's conduct was found to amount to **misconduct** under Clause 36(i), Certificate of Insurance (COI).[4]

The facts showed clear breaches of Bar Council Rulings and that the branch was **not** a genuine legal practice – not only was it managed by non lawyers but neither Firm W nor any of its partners had any management or supervisory control over the branch.

Firm W's Partners had collectively failed to review and determine the propriety of the arrangement and ensure that proper risk management procedures were exercised in the branch. They put their firm, reputation and clients at risk.

CASE STUDY 2

S and E were both partners at Firm J. Both were sued after leaving Firm J and setting up new (separate) practices.

Suit stemmed from work done by Firm J in respect of a sale and purchase of a property, and the subsequent loan agreement to finance the purchase. Investigations revealed that the whole transaction and both agreements were handled by Partner S for the claimant and the borrower. Partner S readily admitted to this and stated that Partner E was not involved at all in this work.

Upon notification, Partner E informed the Panel Solicitor that his defence should be different than that of Partner S as he had neither knowledge nor involvement in the above transactions!

Investigations revealed that:

- ☒ The partnership between S and E at Firm J was not a normal partnership – it operated based on an understanding that each partner, S and E worked independently of each other.
- ☒ They had separate client registers and separate office and client accounts whilst sharing the same premises.
- ☒ They did not share or exchange records with each other.
- ☒ Client account statements from the bank were sent to separate addresses for both partners.
- ☒ The whole transaction was a sham; it was planned by a syndicate with the intention to induce the bank into lending over the value of the property. Partner S advised the bank to release the monies knowing that the sale and purchase agreement was a sham and before the charge was presented for registration.

Insurers repudiated the claim for breach of Clause 12(e), COI.

4 Clause 36(i), COI defines '*misconduct*' as dishonest or fraudulent conduct in the discharge of an advocate and solicitor's duties.

TOOLS FOR THOUGHT:

Even though Partner E did not have any knowledge of this transaction he was denied PII cover as he was in a partnership that was not genuine and he could not satisfy the provisions of Clause 12.

Under Clause 12, COI, whilst cover is provided for innocent partners in the event of **misconduct**,[5] the proviso in Clause 12(d) qualifies this by stating that the lawyer must be practising as a genuine principal of and carrying on practice in common with other principals of the firm.

In addition, Clause 12(e) requires compliance with risk management procedures at the time of such misconduct. These include *inter alia* a two-to-sign policy and compliance with Bar Council Rulings on client and office accounts.

In essence Partner E lost his PII protection by virtue of his (in)convenient partnership with S.

DO NOT BE TEMPTED!

It is basic law; if your partner is liable, you are too. Regardless of your personal and internal arrangements, in law every partner is liable jointly with his co-partners and also severally for everything while he is a partner.[6]

Our aim in reporting the above case studies is to highlight the pitfalls that arise if you "franchise" your firm name or join a 'partnership' of convenience. If you choose to do so and a claim arises, one or all of these three things will occur:

1. All partners will be implicated, regardless of whether or not you were aware of what the errant partner or branch partners were doing. This applies even if you have left the firm.

2. You may not have recourse to your PII as an innocent partner if you are not able to satisfy Clause 12, COI. Pleading ignorance or the fact that you have no knowledge of what your partner was doing, or that you were not involved will **not** help your case.

3. You will be held responsible for any attendant costs related to the suit including base excess and claims loading.

REMEMBER!! Any arrangement or agreement you have with your partners in relation to your liability as a partner cannot be imposed on any party outside that partnership.

So, **never** agree to enter or join a partnership **unless** you have every intention of starting a genuine partnership. It's just not worth the trouble or the loss of reputation.

5 Subject to other terms and conditions of the COI.
6 Section 14, the Act.