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Advisory

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Law firm partnerships and directorships

The Legal Practice Council draws the attention of all practitioners to an article about partnerships at a law firm, written by Advocate Ivor Heyman of the Johannesburg Bar. Certain extracts are quoted below.

This article is particularly pertinent to legal practitioners who are considering accepting partnerships. Although it only refers to partnerships, it applies equally to directorships, and discusses the personal liability imposed by section 34(7)(c) of the Legal Practice Act for debts and liabilities and for theft.

Re: Misappropriation of Trust Fund and Personal Indemnity Insurance: a key issue for prospective partners

If you are considering whether to accept an offer of partnership at a law firm, it is crucial to keep in mind that partnership comes with a series of legal responsibilities that can be quite onerous. Making sure that your firm has certain safeguards in place to protect you from personal liability and disciplinary sanction from the Legal Practice Council (LPC) is essential before you accept the offer. Some issues to take into consideration are described below.

*In **Law Society, Northern Provinces v Stuart and others** 2019 (3) SA 523 (GP) an attorney was found to have misappropriated trust funds belonging to an unsuspecting client. His partner, who was equally unsuspecting and had no knowledge of the theft, was found guilty of unprofessional conduct meriting a suspension from practice (albeit suspended). The guilty finding was particularly troubling in light of the fact that the unsuspecting partner only had a 1% shareholding in the firm.*

*A minority partner's problems do not end with disciplinary sanctions. He or she can also be held jointly and severally liable with the remaining partners in the firm for the theft of trust money in terms of Section 19(3) of the Companies Act, Act 71 of 2008. This was the issue that arose in **Laniyan v Negota SSH and Others** [2013] 2 All SA 309 (GSJ). In that case, the court held the partners jointly and severally liable for trust monies that were stolen by a partner.*

[The client will in appropriate circumstances have recourse to the Legal Practitioners Fidelity Fund in respect of claims arising under s. 55 of the Legal Practice Act, but this claim may not cover the full loss arising from theft.]

The terms of the professional indemnity coverage available to legal practitioners are set forth in the LPIF Insurance Policy (available at www.lpiif.co.za) (the LPIF Policy).

The problem is that the LPIF Policy offers extremely limited cover. According to clause 16(b), the LPIF Policy does not cover misappropriation or unauthorized borrowing of any money or other property belonging to a client or third party. Furthermore, the LPIF Policy provides for an extremely modest amount of professional indemnity insurance for errors and omissions by legal practitioners. A review of Schedule A of the LPIF Policy shows that,

depending on the number of partners in a particular firm, a law firm's cover ranges from R1 562 500 to R3 125 000 per year.

To combat these risks, as you consider a partnership offer, you should inquire whether the law firm has misappropriation of trust fund (MOTF) cover and professional indemnity (PI) cover in place. Ideally, you would request to review these policies to determine how much protection they actually offer, and at what cost.

WHAT IS MOTF?

MOTF insurance protects the law firm and its partners from trust fund account theft by a director or employee of the firm who holds a valid contract of employment. There are three options for MOTF coverage:

Blanket Basis - covers the firm for all staff members who hold contracts of employment.

Named Positions Basis - covers only specific employees in the firm (e.g.: accountants, computer technicians, personal assistants, etc.)

Named Persons Basis: covers specific people only within the firm.

WHAT IS PI?

PI is intended to cover attorneys whose negligent acts or omissions during the course of carrying out work for a client lead to the client suffering damages. As mentioned above, the LPIIF Policy provides a base level of cover of between R1 562 500 to R3 125 000. However, most law firms require much more insurance cover than that, and they need to take out additional or "top up" cover. This top-up cover bridges the gap between what is provided by the LPIIF and what the law firm actually needs.

WHAT ARE MINIMUM OPERATING STANDARDS (MOS)?

Before you join a firm as a partner, you should familiarize yourself with the firm's Minimum Operating Standards (MOS). Things to look out for include:

Clearly defined policies on supervision of staff – as we saw from the **Stuart** case, the failure to supervise attorneys and staff with access to the law firm's trust account can lead to disciplinary sanctions from the LPC.

File audits – conducting of regular audits of client files can alert you to potential problems or internal deficiencies in the handling of matters before a situation spirals out of control.

Diary systems – ensuring that your firm has an effective diary system in place will prevent claims from prescribing.

Letters of Engagement – clear protocols that set out the terms and conditions of the contract between the attorney and the firm's client will cover the scope of work, and ensure that there are no misunderstandings after the work has commenced.

Payments – a robust protocol with embedded separation of duties when making any payment or receiving funds will minimise negligence and trust account theft.

Closing Thoughts

As you consider whether to accept a partnership offer, whatever benefits it might present must be weighed against the onerous responsibilities and potential liability that come with the position. In the **Stuart** case, the partner in question accepted a partnership offer where he was a salaried director and did not receive any dividends. Nor was he party to any profit-sharing arrangement. In light of the severe repercussions that befell him, he must have wondered whether the partnership position was worth all the accounting and administration responsibilities that he unwittingly assumed when he became a partner. With that said, if your firm has an effective matrix of PI, MOTF and MOS in place, then you can rest more comfortably in the belief that the risks of becoming a partner are being effectively managed."

Issued by the Legal Practice Council