

## Insurers should be vigilant in cases of sham partnerships



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In the UK, lenders' requirements usually dictate law firms should consist of two or more partners to qualify for a place on conveyancing panels.

This (usually express) requirement acts as a fraud-prevention tactic and ensures there is professional indemnity (PI) insurance cover in place, even if one partner of the firm acts dishonestly.

However, the not-uncommon occurrence of "sham partnerships" raises some interesting coverage questions in relation to such PI cover.

Sham partnerships can take a variety of forms.

For example, a law firm may represent itself as a partnership but might in fact not be so constituted; solicitors may be held out as partners on letterheads to satisfy lenders as to the size of the firm and thus qualify for a lender's panel. Sometimes those held out as partners are not even involved in the law firm at all.

pal, each former principal and each person who becomes a principal during the period of insurance".

So, where a person has held himself out as a partner or has been held out as a partner, he could still attract liability as a partner pursuant to s14 of the Partnership Act 1890.

Although this often arises where that individual has acted dishonestly, circumstances could arise whereby the "sham partner" has innocently been held out as a partner (for example, without his knowledge).

In those circumstances, the "sham partner" would be entitled to indemnity even if that arrangement was not genuine, unless a policy exclusion applies. The exclusion for fraud/dishonesty is often relevant.

For an insurer to avoid liability for fraud/dishonesty, an insurer must be able to apply the policy exclusion against each and every partner, on the basis each partner

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Spotting a sham partnership can be difficult, but things to look out for include: whether there is a partnership deed outlining the arrangement; documentary evidence of a lawyer's involvement in the firm, for example acting as an authorised signatory; and possible motives for holding out as a partner, for example to fulfil regulatory requirements.

What are the implications for PI cover where a sham partnership is exposed? The Law Society's minimum terms and conditions (MTC) regulate the terms on which insurance must be provided to UK law firms. Insurers can provide more (but not less) generous terms than those stipulated and, in the event of any discrepancy, the MTC wording prevails.

The existing MTC wording defines an "insured" as including employees, as well as "each princi-

pal has either committed or condoned dishonesty or a fraudulent act/omission that has resulted in the claim being brought.

Sometimes, (as in the case of *Zurich v Karim*), this can be simply turning a blind eye to the regime in which a fraud was committed.

Demonstrating a "sham partner" committed or condoned the sham partnership (where that partner may have no visible involvement in the firm and may protest his innocence) can be difficult.

Declining cover for fraud/dishonesty where it is argued a sham partnership was in operation is a complex and uncertain area. Case law highlights the need for insurers to be especially vigilant when considering new risks. ■

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