

LCRO 006/2013

CONCERNING

an application for review pursuant to section 193 of the Lawyers and Conveyancers Act 2006

AND

CONCERNING

a determination of Standards Committee

BETWEEN

CM

Applicant

AND

JD, RE, MI, PF, OL, VQ, NA and SH

Respondents

The names and identifying details of the parties in this decision have been changed.

Introduction

[1] Mr CM has applied for a review of a determination by the Standards Committee to take no further action in respect of his complaints concerning the administration of the nominee company operated by [Law Firm X] (Nominee Company X). Mr JD was the firm's practice manager, and the other respondents were directors of the nominee company at various times during which the events giving rise to Mr CM's complaints took place.

[2] This review involves a consideration of the degree to which the complaints and disciplinary process provided for in the Lawyers and Conveyancers Act 2006 should investigate and critique decisions of nominee company directors and administrators.

The parties

[3] The Standards Committee processed Mr CM's complaints as being against Mr JD and the respondents, all of whom were directors, or became directors of the

nominee company during the events giving rise to Mr CM's complaints. Messrs OL and SH are no longer directors. As the Lawyers and Conveyancers Act applies to former practitioners and employees, the parties named in the Standards Committee determination and in this decision as respondents, are correctly identified.

Background

[4] Mr CM invested in two advances through [Nominee Company X] one of which was secured over a property over in [City A], and the other over a property in [City B]. In his letter of complaint Mr CM describes the [City A] property as a "residential building with rental income" and the [City B] property as "a hotel with income".¹ Both mortgagors went into liquidation and the mortgages fell into default.

[5] [Nominee Company X] took possession as mortgagee of both properties and engaged the services of a property manager to manage the [City A] property. At the time of Mr CM's complaints, investors were receiving reduced interest payments, and it was highly likely that when properties were sold the contributors would incur a loss on capital.

Mr CM's complaints

[6] In his complaint, Mr CM alleged that "greed" and a desire to continue with a "gravy train" directed the actions of the directors of the nominee company. Specifically, the matters raised by Mr CM in his letter of complaint were:

- (1) A general inquiry as to how the money being collected by the manager of the [City A] property was being applied, but more specifically, a complaint that [Law Firm X] was deducting commission (at the agreed rate of 9.1 per cent) from payments being made to contributors. His view was that the remuneration being paid to the property manager should cover collection costs and that [Law Firm X] should not be deducting commission from the payments.
- (2) Mr CM considered that payments being made to contributors should be paid in reduction of capital rather than as interest, on the basis that "it is painfully obvious that [investors] are in for a large capital loss ..."²

¹ Letter CM to Lawyers Complaints Service (12 June 2012).

² Above n 1.

- (3) Mr CM's second complaint³ concerned a reference by Mr JD to rule 10.1 of the Nominee Company Rules which provides "No security may be released (... wholly or partially) ... without the prior written consent of all of the investors ...".⁴ This was in response to Mr CM's requests for payments to be made as capital rather than interest.
- (4) Mr CM also complained that the advance on the [City A] property exceeded the firm's lending criteria of not advancing more than two thirds of a registered valuation. In addition, Mr CM pointed out that the valuation of the [City A] property was a GST inclusive figure, and that when making the advance no account had been taken of the fact that "the property is subject to GST".⁵ He took the view that the value of the property that should have been applied was the value net of GST.

The Standards Committee determination

[7] The Standards Committee determined to take no further action on any of the complaints but addressed each of the issues in some detail.

Deduction of commission

[8] The Committee summarised this issue in the following way:⁶

Mr CM's complaint is that, in circumstances where there is a property manager then, that manager would normally collect rents as part of his duties and therefore [Law Firm X] should not have deducted commission from interest collected (and distributed to contributors).

[9] It noted the explanation from Mr JD that "... the rents are not collected by the property manager but are paid by the tenants to the [Law Firm X] Trust Account".⁷

[10] Mr JD described the functions of the property manager as being "... to oversee maintenance, respond to tenant issues and to ensure that the property is compliant and safe, to liaise with trades people where necessary and to negotiate lease renewals".⁸

³ Complaints 1 and 2 above were included in Mr CM's first complaint.

⁴ Lawyers and Conveyancers Act (Lawyers: Nominee Company) Rules 2008.

⁵ Above n 1.

⁶ Standards Committee determination, at [9].

⁷ Above n 6 at [10].

⁸ Above n 6, at [11].

[11] The Committee accepted that the appointment of a property manager to carry out the duties referred to was an appropriate step for [Law Firm X] to have taken. It also noted that “[Law Firm X] have continued to account to contributors for the net income received”.⁹

Capital v interest

[12] The Committee stated that [Law Firm X] was acting on behalf of all the contributors and noted that the designation of payments as a return of capital could have a significant effect on contributors’ tax positions. The Committee noted (and accepted) [Law Firm X]’s advice that the firm had sought a view from the IRD and had also taken independent accounting advice, albeit informally.

[13] Having received a response from the IRD, in which the department sought the names and details of all contributors to the advances, [Law Firm X] continued with payments to contributors as interest payments.

[14] Having considered the issue, “the Committee ... found that the distribution of the payments as payment of interest was not inappropriate”.¹⁰

GST

[15] The Committee noted that the valuation obtained to support the advance on the [City A] property valued the property on a GST inclusive basis and recommended an advance up to 70 per cent of the valuation.

[16] The Committee further noted that lending to 66 per cent of a valuation “... may be a common practice but there is no formal requirement for lending to be restricted to this percentage”.¹¹

[17] The Committee further noted that:¹²

The valuation clearly states that the property in the valuer’s opinion provided security for a sum of up to 70% of the valuation amount (which included GST and chattels) [and that] the valuer is the professional who is qualified to give this recommendation.

[18] The Committee concluded “... that the lending in accordance with the valuer’s recommendation was not inappropriate”.¹³

⁹ Above n 6, at [13].

¹⁰ Above n 6, at [20].

¹¹ Above n 6, at [24].

¹² Above n 6, at [25].

The application for review

[19] Mr CM applied for a review of the Standards Committee determination. He considered that:¹⁴

The decision is based solely on the response of [Law Firm X]. It gives them full benefit that everything they say is true. Nowhere in any correspondence does the standards officer ask [Law Firm X] to support their statements, they are just accepted as true and correct. My questions to the Standards Committee remain unanswered

[20] Mr CM holds to his view that the role of the property manager was to collect the rent and that by charging commission on the payment made to contributors, [Law Firm X] was “double dipping”.¹⁵

[21] Mr CM recorded that he “asked the standards committee to determine what this fellow is paid”.¹⁶

[22] He also notes that the Standards Committee did not refer to any accounts despite him asking for information as to how the money received was accounted for. He says:¹⁷

WHERE DOES ALL THE MONEY GO [?] ... the standards committee did not look at the accounts, they did not ask how much rent is received or how much the manager is paid. They simply accepted the statement from [Law Firm X], that the manager is not remunerated on [the] basis of rent collected.

[23] He considers that:

7 The money is rent being collected for the investors who now own the property. The property manager is paid by the investors. The only involvement from [Law Firm X] in this process is to take money they are not entitled to. This money is not interest payments coming from the mortgagor. The mortgagor defaulted in 2008 and has not paid since. If [Law Firm X] wish to take an interest collection fee, go chase the mortgagor and collect some. They have not done this in over 4 years.

8 My question to the standards committee, what does the property manager get paid?, is still unanswered. I had mentioned in my complaint that I felt these accounts needed auditing. No questions regarding the accounts were ever put to [Law Firm X] by the standard committee. I do not see anything in the correspondence that suggests these question[s] were ever asked.

¹³ Above n 6, at [25].

¹⁴ Application for review, 4 January 2013.

¹⁵ Mr CM used this expression at the review hearing.

¹⁶ Above n 14.

¹⁷ Above n 14.

- 9 Regarding the amount advanced. I had asked two questions. Is the GST component of a property valuation considered equity held as security by investors, or is it tax owed to IRD that investors have no claim on. No answer to this question is provided. The second was, can [Law Firm X] lend out a sum greater than 2/3rds of the valuation? A quote from [Law Firm X] letter dated 5 September 2008.

Page 2 Line 3 "They are secured to a limit of maximum two-thirds of the valuation."

[24] Although the summary of the review application recorded above relates only to the issue of the property manager and deductions of commission, Mr CM's reasons for applying for a review are predominantly that the questions he has asked have not been answered.

[25] The outcomes he seeks from the review are that:¹⁸

All money taken by [Law Firm X] as interest collection commission needs to be returned to investors. As [Law Firm X] have demonstrated they act only in their own best interests, a statutory manager needs to be appointed. The accounts relating to the [Company] investment need auditing.

Review

[26] An applicant only hearing took place in [City C] on 1 March 2016. Mr CM attended in person. Mr JD and Mr RE exercised their right to attend and did so by telephone. Prior to the hearing I advised the parties that the hearing would be more in the nature of a discussion of the issues between myself and Mr CM and the stated intention of Mr JD to attend would assist in clarifying any issues that arose during the course of that discussion. I also referred the parties to two previous decisions of this Office involving nominee company lending.¹⁹

[27] I record here that in accordance with usual practice, I had received and thoroughly reviewed the whole of the Standards Committee file prior to the hearing. Mr CM came to the hearing with a large file of documents and (it would seem) submissions which he wished to read to me. I ascertained this material was no more than a repeat of the material already provided to the Committee. As no new complaints will be entertained on review and all evidence should be provided prior to a hearing I declined Mr CM permission to read to me what I perceived would merely be a repeat of what was already available to me and with which I was thoroughly familiar.²⁰

Overview

¹⁸ Above n 14.

¹⁹ *AP v ZG* LCRO 278/2012; *GA and BD v X* SC LCRO 186/2013.

²⁰ LCRO Guidelines for Parties to Review at [2], [6] and [28].

[28] As noted above, this review involves a consideration of the degree to which the complaints procedure provided for in the Lawyers and Conveyancers Act 2006 should extend to an investigation and critique of decisions made by nominee company directors and administrators. It also involves a consideration of the relationship between, and application of, the Nominee Company Rules and the Conduct and Client Care Rules.²¹

[29] In *AP v ZG*²² I referred to the proscriptive nature of the Nominee Company Rules and the circumstances out of which they developed. The present rules are largely repetitive of the Solicitors Nominee Company Rules 1996 which were in force prior to the 2008 rules. It is important to record that none of the complaints include allegations that [Nominee Company X] failed to comply with the specific requirements of the rules and I have not seen any indication or evidence that this was not the case.

[30] A summary of Mr CM's complaints, and now his reasons for this review, is that Mr CM holds to certain views as to the steps that the [Nominee Company X] directors should have taken in the administration of the mortgages when they went into default and seeks to have both the Lawyers Complaints Service and this Office act on his directions to require production of certain documentary evidence.

[31] Early on in the review hearing, I advised Mr CM that this Office does not have jurisdiction to order either of the outcomes sought by him (the appointment of a statutory manager and an audit of the accounts relating to the [City A] property). I also referred Mr CM to the terms of the investment authority signed by him, in particular, the following:

[Nominee Company X] shall be entitled as its directors deem appropriate to exercise on behalf of the investors all the rights, powers and remedies conferred by law ...

... I am ... not entitled ... to direct the officers or the company as to the exercise of their duties ...

[32] The wording of the authority signed by Mr CM follow the wordings specified in appendix E of the 1996 rules and schedule 3 to the 2008 rules. The acknowledgements by Mr CM in these authorities are pivotal to the outcome of this review.

²¹ Lawyers and Conveyancers Act (Lawyers: Conduct and Client Care) Rules 2008.

²² Above n 19.

[33] In *AP v ZG* I noted the statement made in paragraph 1 of the “Office Procedures and Controls” section of the Notes for Guidance of Practitioners to the Nominee Company Rules 1996:²³

All partners in a firm are, in the end result, individually responsible to ensure that the firm’s nominee company is operated in a manner which complies with all statutory provisions, the Solicitors Nominee Company Rules and the Trust Account Rules **as well as in accordance with the duties owed by the partners to investor clients.**

(Emphasis added).

[34] I noted further that:²⁴

This comment confirms that while the Rules are directed to the operation of the nominee company and include what information is to be given to an investor, they recognise that there are duties owed by the partners to investors, independent of the requirements of the Rules.

[35] These duties include the general conduct requirements of the Conduct and Client Care Rules insofar as they extend to the interaction between a lawyer and his or her investor client. For example rule 3.1 (respect and courtesy) and rule 10 (proper standards of professionalism). However, by way of example, rule 13.3 (the requirement to follow instructions) and chapter 7 (disclosure and communication of information to clients) do not override the specific requirements of the Nominee Company Rules.

[36] It is necessary to treat each issue on its facts and determine which of the sets of rules applies. Clearly a lawyer cannot stand accused of unsatisfactory conduct for a breach of the Conduct and Client Care Rules when his or her conduct otherwise complies with the Nominee Company Rules.

[37] This review is undertaken within the parameters established above.

The director’s discretion

[38] If there is to be any criticism made of the Standards Committee determination, it is that it examined the complaints made by Mr CM in some detail, and then confirmed the validity of the decisions taken by the directors of [Nominee Company X]. The powers and duties of directors of a nominee company are similar to the powers and duties of the directors of any company. They have full authority to make decisions as to the operation of the company, subject of course to the requirements of the rules.

²³ Above n 19 at [45].

²⁴ At [46].

This authority is reinforced by the terms of the investment authority signed by contributors.

[39] Provided directors operate within any restrictions imposed by the rules, their decisions are not subject to direction by the contributors. Nor should such decisions be subject to review through the complaints procedure.

[40] In this regard, the decision as to how payments were treated by the nominee company cannot be directed by Mr CM. Once that position is accepted, the deduction of commission cannot be challenged. That was the basis on which Mr CM invested through the nominee company. Similarly, the engagement of the property manager and the terms on which he was engaged are beyond the direction of Mr CM.

[41] Mr JD advised Mr CM that he had sought confirmation from the IRD that distributing funds as capital would not compromise investors.²⁵ Mr CM does not accept that the firm had written to the IRD and calls for evidence to verify that statement. One of his reasons for seeking a review is that the Standards Committee did not do so, and Mr CM now calls for this Office to satisfy his demands for evidence.

[42] I accept Mr JD's advice – not to do so would constitute an affront to Mr JD's integrity. Mr CM's allegations are easily made, but with no grounds, other than his view that [Law Firm X] had no wish to comply with his suggestion other than to continue the "gravy train".

[43] The directors made a decision to continue to treat payments as interest payments. That did not constitute a breach of any of the rules and was not contrary to any authorities provided by the contributors. It is not the role of the complaints procedure to place itself in a position of passing judgment on the wisdom of director's decisions, or to take on board and pursue allegations from disgruntled investors.

[44] Mr JD's reference to the requirement of rule 10.1 (that the consent of all investors is required to the release of any security without payment in full) was somewhat unrelated to what Mr CM was suggesting, but does not affect my decision.

GST

[45] The directors of [Nominee Company X] met all of their obligations with regard to the information to be provided to contributors in respect of the [City A] advance. In particular, the authority recorded the advance was to be \$1,039,900. A copy of the

²⁵ Letter JD to CM (28 May 2012).

valuation recommending an advance up to 70 per cent of the valuation was provided. The directors of [Nominee Company X] considered that an advance of the amount specified (being 67.09 per cent of the GST inclusive figure) was in order. Mr CM approved his contribution on this basis.

[46] Nothing further needs to be said except to observe that Mr CM's assertion that GST would be payable on sale of the properties is not necessarily correct and would not have been anticipated at the outset, as it is likely that any sale would have been zero rated. On this basis, the loan only marginally exceeded the general statement in the letter to Mr CM of 5 September 2008 that the firm's investment lending criteria prohibited lending in excess of two thirds of the valuation.

[47] In any event, Mr CM had the opportunity to decline to be included in these advances if he considered the loan to value ratios were too high.

Rule 13

[48] Rule 13 of the Nominee Company Rules sets out the procedures to be followed if a mortgage falls into default. From the information available to me, the directors of the company complied with the requirements of this rule and Mr CM's complaints do not include complaints that this rule has been breached.

[49] The situation that developed with regard to the [City A] property, including the need to appoint a manager, is somewhat unique. The reporting obligations of a solicitor to his or her clients required by rule 13.7 have been complied with but not in the detail that Mr CM demands.

[50] Following the review hearing, Mr JD sent me (as requested) the reports that were provided to contributors following settlement of the sales. That included a reconciliation from February 2009 through to settlement in respect of the [City A] property which included all of the expenses incurred. I consider this meets the reporting requirements of the rules.

Summary

[51] Overall, it seems to me that Mr CM's complaints reduce to a view that the directors of the company did not act in accordance with Mr CM's views as to how matters should be dealt with and provide all that he demanded. They acted as they were authorised to and in accordance with their own decisions.

[52] There have been no breaches of professional standards, and I reach the same conclusion as the Standards Committee, that no further action is appropriate or necessary.

Decision

Pursuant to s 211(1)(a) of the Lawyers and Conveyancers Act 2006 the decision of the Standards Committee is confirmed.

DATED this 10th day of March 2016

O W J Vaughan
Legal Complaints Review Officer

In accordance with s 213 of the Lawyers and Conveyancers Act 2006 copies of this decision are to be provided to:

Mr CM as the Applicant
Mr JD, Mr RE, Mr MI, Mr PF, Mr OL, Ms VQ, Mr NA and Mr SH as the Respondents
The Standards Committee
The New Zealand Law Society