

**LEGAL COMPLAINTS REVIEW OFFICER  
ĀPIHA AROTAKE AMUAMU Ā-TURE**

[2021] NZLCRO 173

Ref: LCRO 173/2020

**CONCERNING**

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

**AND**

**CONCERNING**

a determination of the [Area] Standards Committee [X]

**BETWEEN**

**AZ**

Applicant

**AND**

**BX and CX**

Respondent

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

**Introduction**

[1] Mr AZ has applied for a review of the determination by [Area] Standards Committee [X], that Mr AZ's conduct constituted unsatisfactory conduct pursuant to s 12(a) of the Lawyers and Conveyancers Act 2006.

**Background**

[2] Mrs CX is the daughter of Mr DW who was a partner in [Law Firm 1]. On 12 May 1998, Mr DW established the [YW] Trust (the Trust). The settlor was Mr AZ. The trustees were Mr DW and Mr FT. The beneficiaries of the Trust were Mr DW, his wife (E), his children and grandchildren.

[3] Shortly thereafter, the firm's nominee company ([Law Firm 1] Nominees Ltd) made an advance to GU, secured by way of a first registered mortgage against a property at [IN], [City]. At the same time the Trust also advanced funds to Mrs GU, which were secured by way of a second registered mortgage against the same property.

[4] Mrs GU died in 1999. The property was transmitted to TU as executor of her estate. Shortly afterwards, the property was transferred to the trustees of the HU Family Trust (the HU Trust).

[5] The mortgages remained registered against the title, but it seems that they secured fresh advances to the HU Trust, which were then on-lent to [JS] Limited.

[6] Both mortgages fell into default.

[7] Mr DW retired from [Law Firm 1] in 2006.

[8] In 2012 Mr KR, a partner in the firm of [Law Firm 2], advised Mr AZ (who by that time was the sole partner of the firm) that it was proposed the nominee company mortgage be purchased by his client, in return for payment of the full amount due under the mortgage to the firm's nominee company.

[9] The transaction was completed in September 2012 by way of an assignment of the mortgage to [IN] Holdings Limited.

[10] Immediately following the assignment, [IN] Holdings Limited exercised its power of sale pursuant to the mortgage and the property was transferred to HU and GU. The exercise of the power of sale had the effect of extinguishing the second mortgage to the Trust, although the personal liability of the borrower remained.

[11] It was not until Mr BX assumed the role of accountant for the Trust in 2015 that it was realised that the mortgage had been extinguished. The amount then due to the Trust was \$184,500 plus interest and costs.

## **Complaint**

[12] Mr and Mrs BX lodged their complaints against Mr AZ in May 2019. They questioned how the mortgage securing advances to the Trust was extinguished, whilst the advances by [Law Firm 1] Nominees Limited were fully repaid.

[13] Mr and Mrs BX consider that the trustees of the Trust should have been given notice of what was about to occur and advised what steps should be taken to protect the security held by the Trust.

[14] The copies of the documents and correspondence provided with the complaint give the detail of events from inception of the loans, to the sale of the nominee company mortgage.

[15] There is no complaint form on the copy of the Standards Committee file provided to this Office, and consequently the outcome sought by Mr and Mrs BX is unknown.

### **The Standards Committee determination**

- [16] The issues identified by the Committee to be addressed were whether:<sup>1</sup>
- a. Mr AZ breached any fiduciary duties he owed to the YW Trust;
  - b. Mr AZ should have continued to act for [Law Firm 1] Nominees Limited on the sale of the first mortgage when Mr AZ was the sole director and shareholder of the nominee company; and
  - c. ... any of Mr AZ's alleged conduct meets the definition of unsatisfactory conduct as defined in the Act.

#### *Mr AZ's fiduciary duties*

[17] Considering this issue, the Committee made the following observations:<sup>2</sup>

Despite [Law Firm 3] being instructed to act for the Trust on a specific matter, [Law Firm 1] continued to hold funds in its trust account on behalf of the Trust and to carry out administrative services for the Trust.

Correspondence on the file shows that letters sent to the trustees of the YW Trust via [Law Firm 1] asked [Law Firm 1] to seek instructions from the trustees, rather than [Law Firm 3] corresponding directly with the trustees. Invoices were directed to [Law Firm 1] and payment was made to [Law Firm 3] from funds held for the Trust in [Law Firm 1]'s trust account.

...

The Committee considers that the YW Trust was a client of [Law Firm 1] when Mr AZ acted in relation to the sale of the [Law Firm 1] Nominees Limited first mortgage. As such, Mr AZ owed a fiduciary duty to the trustees of the Trust.

[18] The Committee continued:<sup>3</sup>

The distinguishing duty of a fiduciary is the obligation of loyalty. A duty of loyalty includes a duty to avoid conflicting interests, a duty of commitment to the client's cause and a duty of candour.

[19] The Committee considered that:<sup>4</sup>

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<sup>1</sup> Standards Committee determination 23 July 2020 at [6].

<sup>2</sup> At [9]–[10] & [12].

<sup>3</sup> At [13].

<sup>4</sup> At [16].

... in order to exercise his duty of candour to the YW Trust, Mr AZ would have had to have breached his duty of confidentiality to the [Law Firm 1] Nominee Company.

[20] The Committee was somewhat critical of Mr AZ for not being alert to the potential consequences of a sale of the mortgage (as distinct from redemption by the mortgagor) to a company associated with the borrower, and that he should have been aware of the possibility that the purchaser had an 'ulterior motive'.<sup>5</sup>

*Should Mr AZ have acted for [Law Firm 1] Nominees Limited?*

[21] Having determined that Mr AZ owed a fiduciary duty to the Trust the Committee determined that he "...should have recognised his conflicting duties to both clients and should have instructed another firm to act in relation to the sale of the first mortgage".<sup>6</sup>

[22] The Committee also observed that, as sole director and shareholder of the firm's nominee company, Mr AZ was putting his own interests ahead of those of his client. It considered that Mr AZ should have disclosed his personal interest to the Trust.

*Conclusion*

[23] The Committee concluded Mr AZ should have recognised:<sup>7</sup>

- a. That he owed a duty of loyalty to the YW Trust;
- b. The conflicting interests of [Law Firm 1] Nominees Limited and the YW Trust created by the sale transaction and taken steps to avoid or satisfactorily address those conflicting interests;
- c. That while completing the transaction in accordance with the structure directed by the mortgagor had no disadvantage to [Law Firm 1] Nominees Limited, it had the potential to disadvantage the YW Trust and, by so acting, he was putting the interests of one client ahead of the other.

[24] The Committee determined that Mr AZ's conduct constituted unsatisfactory conduct pursuant to s 12(a) of the Lawyers and Conveyancers Act 2006. It said:<sup>8</sup>

...Mr AZ's failure to understand the nature of the transaction, to see the implications for the YW Trust of the mortgagor taking control of the first mortgage by purchasing rather than repaying it and to recognise or adequately address the conflicting duties is conduct that falls short of the standard of competence and diligence that a member of the public is entitled to expect of a reasonably competent lawyer.

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<sup>5</sup> At [18].

<sup>6</sup> At [20].

<sup>7</sup> At [26].

<sup>8</sup> At [27].

[25] Following the finding of unsatisfactory conduct, the Committee made orders as set out in [29] of the determination.

### **Mr AZ's application for review**

[26] Mr AZ's application for review is accompanied by comprehensive comments on the Committee's determination. He seeks that the finding of unsatisfactory conduct, and consequent orders, be reversed.

[27] Mr AZ's submissions are addressed to the extent that is necessary, in the Review section of this decision.

### **Mr and Mrs BX's response**

[28] Mr and Mrs BX hold to the view that Mr AZ was acting for the Trust or, at least, that, being aware of the circumstances surrounding the lending and the default, he had a duty to protect the interests of the Trust.

[29] I have disregarded the comment made by them with regard to "the other (related) complaint" which presumably relates to a complaint against KR of [Law Firm 2].

### **Process**

[30] This review has been completed on the material to hand which includes the Standards Committee file.

### **Review**

[31] The issues to address in this review are:

1. What services did [Law Firm 1] provide to the Trust, and who provided these?
2. Did Mr AZ owe a duty of loyalty to the Trust?
3. Did Mr AZ put his own interests ahead of those of his clients?

*What services did [Law Firm 1] provide to the YW Trust?*

*Who provided these?*

[32] Until 2006, Mr DW carried out all legal work for the Trust. Following his retirement, a staff solicitor in the firm (LQ), assumed responsibility for Mr DW's files.

[33] In May 2009, Mr LQ sent a memorandum to Ms MP who was leaving the firm in the near future. Ms MP described her role in the firm as 'estate administration'.<sup>9</sup> Mr LQ noted that Ms MP had "over a long period of time been liaising with X ,D and perhaps P<sup>10</sup> concerning the recovery of funds from certain individuals or entities that would constitute debtors of the Trust".<sup>11</sup>

[34] Mr LQ considered that the firm had a conflict of interests in that the debts were owed to the Trust rather than to the firm. It is not clear what Mr LQ meant when referring to the 'firm', but it is likely that he was referring to the firm's nominee company.

[35] Mr LQ had earlier written<sup>12</sup> to Mr HU, advising that [Law Firm 1] could not act "for any or all of the parties involved". He advised that the Trust would "be using alternative solicitors".

[36] Ms MP received instructions from the surviving trustee of the Trust to instruct another firm to act for the Trust to recover the debts, and wrote to [Law Firm 3] on 23 June 2009 with details of the debts outstanding. The firm's retainer with regard to collection of these debts was terminated at that stage.

[37] On 8 October 2010, Ms NO (a solicitor with [Law Firm 3]) sent a letter addressed to "[Law Firm 1] Nominees Limited" to ascertain the views of the nominee company, as first mortgagee, to the proposal of [Law Firm 3] to issue a Property Law Act notice to the HU Trust. Ms NO also asked for the amount secured by the first mortgage to the nominee company.

[38] Mr PN, the firm's accountant, was responsible for the day to day management of the nominee company, and responded to Ms NO. A file note made by her of a telephone conversation with Mr PN on 24 November 2010, records the amount due to the nominee company and Mr PN's advice that the nominee company had served a notice pursuant to s 119 of the Property Law Act earlier in the year.

[39] Mr PN also continued after Mr DW had retired from the firm, to prepare the financial accounts for the Trust. Mr AZ had no involvement with this.

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<sup>9</sup> Letter MP to [Law Firm 3] (Mr RL).

<sup>10</sup> D is Mr DW who had died on 23 April 2009. P is Mr PN.

<sup>11</sup> These included debts other than the debt due to the Trust.

<sup>12</sup> On 28 December 2007.

[40] [Law Firm 1] held funds for the YW Trust which appear to have been generated by receipt of dividends paid on shares. Payment of Trust debts were made from these funds, including, Mr AZ says, payment of invoices rendered by [Law Firm 3]. It is unclear why Mr FT (the surviving trustee) did not redirect these funds into a bank account held by the Trust but it would seem that the firm was acting more in the nature of a banker, holding funds for the Trust and paying debts when instructed by the trustees.

[41] Consequently, [Law Firm 1], and Mr AZ specifically, had not undertaken any legal work for the Trust after Mr DW's retirement. The fact that members of the firm were providing, what can be termed 'administrative services' to the Trust, does not convert to a professional duty of loyalty by Mr AZ.

*Did Mr AZ owe a duty of loyalty and candour to the Trust?*

[42] The duty of loyalty that Mr DW had to the Trust did not pass to Mr AZ when Mr DW retired. Mr AZ did not act for the Trust until 2014 to document a change of trustees.

[43] In 2012, when the mortgage was assigned to [IN} Holdings Limited, Mr AZ acted for the firm's nominee company. The Committee is critical of Mr AZ for not being alert to signposts indicating that the assignment of the mortgage to [IN] Holdings Ltd, rather than repayment by the mortgagor, may have resulted in detrimental consequences for the Trust as second mortgagee.

[44] The Committee's finding against Mr AZ results in a finding (by implication) that Mr AZ was required to put duties to the Trust ahead of his duty to the nominee company. To do so would be putting a perceived duty to the Trust ahead of a clear duty to the nominee company, and the contributors to the advance.

[45] From the information provided by Mr AZ, there were 27 contributors to the loan. The suggestion by the Committee that the perceived duty to the Trust, for which Mr AZ had not acted, took priority over the duties to the contributors, is difficult to comprehend.

[46] Mr AZ did not owe any duty of loyalty to the Trust and consequently there was no duty to advise the trustees of the proposed sale or to instruct another firm to act for the nominee company.

*Did Mr AZ put his own interests ahead of his clients?*

[47] Having concluded above that Mr AZ did not act for the Trust, the question as to whether or not Mr AZ put his own interests ahead of the Trust's does not arise. However,

some comment is necessary about the position of a lawyer as director of a nominee company.

[48] A lawyer's nominee company is a non-profit entity and a director owes little, if any, duty to its shareholders (who must be a majority of the principals or directors of the law firm<sup>13</sup>). A nominee company acts as the vehicle for contributors' funds to be amalgamated and advanced to a borrower, with a view to enabling contributors to receive a return on their investments. To that extent, the nominee company is acting as a trustee for its contributors' funds.

[49] The Nominee Company Rules impose considerable duties on directors of the company to protect the interests of contributors to an advance, and Mr AZ's duties in this instance, were to ensure that the contributors received repayment (in this case, in full, principal and interest) of an advance that had been in default for some time.

[50] Although not evident from the materials provided, the proposal put forward by KR's client may not have been available on any terms other than by way of a sale. If Mr AZ had declined this option, and the offer was then withdrawn, Mr AZ could rightly then have been held to account by contributors to the advance.

[51] Mr AZ was not acting in his own interests when acting for the nominee company on the sale. He was protecting the interests of the contributors.

#### *The finding of unsatisfactory conduct*

[52] The Committee determined that Mr AZ's conduct constituted unsatisfactory conduct pursuant to s 12(a) of the Lawyers and Conveyancers Act 2006. Section 12(a) defines unsatisfactory conduct as being:

- (a) conduct of the lawyer or incorporated law firm that occurs at a time when he or she or it is providing regulated services and is conduct that falls short of the standard of competence and diligence that a member of the public is entitled to expect of a reasonably competent lawyer; or

...

[53] The Committee's finding pursuant to s 12(a), is based on its view that a sale of the mortgage to a company associated with the mortgagor (as distinct from repayment by the mortgagor) should have put Mr AZ on notice that the assignee could then exercise the power of sale, to the detriment of the second mortgagee.

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<sup>13</sup> Lawyers and Conveyancers Act (Lawyers: Nominee Company) Rules 2008 (Nominee Company Rules), r 4.6.



[54] The Committee describes this in the following way:<sup>14</sup>

...Mr AZ's failure to understand the nature of the transaction, to see the implications for the YW Trust of the mortgagor taking control of the first mortgage by purchasing rather than repaying it and to recognise or adequately address the conflicting duties is conduct that falls short of the standard of competence and diligence that a member of the public is entitled to expect of a reasonably competent lawyer.

[55] This raises the potential for a general principle to be established, that a lawyer must consider what conduct another party to a transaction could engage in as a result of the transaction, and assume a responsibility to advise other clients of the firm, if such (potential) conduct could detrimentally affect their interests. Such a principle would impose an unwarranted burden on solicitors.

### **Conclusion/decision**

[56] The Trust was not Mr AZ's client. There is nothing to support the view that Mr AZ owed a duty of loyalty to the Trust, which was breached when the nominee company assigned the mortgage to [IN] Holdings Limited. Mr AZ owed no duty to the Trust to either advise it of the proposed sale and/or advise the trustees to take independent advice.

[57] For the reasons discussed above, and pursuant to s 211(1)(a) of the Lawyers and Conveyancers Act 2006, the determination of the Standards Committee is reversed. Orders made against Mr AZ are consequently cancelled.

### **Publication**

[58] The facts of this review give rise to a consideration of a number of issues which impact on the duties of a solicitor.

[59] Pursuant to s 206(4) of the Lawyers and Conveyancers Act 2006, I direct that this decision be published in anonymised format.

**DATED** this 1st day of NOVEMBER 2021

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**O Vaughan**  
**Legal Complaints Review Officer**

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<sup>14</sup> At [27].

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

Mr AZ as the Applicant  
Mr and Mrs BX as the Respondents  
[Area] Standards Committee [X]  
New Zealand Law Society