

CONCERNING

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

AND

CONCERNING

a determination of the Canterbury-Westland Standards Committee 1

BETWEEN

TN
Applicant

AND

NK
Respondent

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

Introduction

[1] TN has applied for a review of the determination pursuant to section 152(2)(c) of the Lawyers and Conveyancers Act 2006 by the Standards Committee to take no further action in respect of his complaint. He considers that NK's conduct had allowed his fellow director and shareholder to dismiss him as a director and unilaterally sell the company.

Background

[2] TN and TP were directors and shareholders in a real estate agency called CCE Limited.

[3] NK's first involvement with the company was in 1993/1994 when an issue arose in connection with renewal of the Real Estate Agent's licence held by the company. As a result, the shareholding of the company was divided into voting and non-voting shares, with the voting shares being held by shareholder(s) who were qualified persons in terms of the Real Estate Agents Act 1976.

[4] Ultimately TP and TN became the holders of an equal number of shares in the company. At that time TN was not a qualified person, but other than voting rights, the shares held by TN had all of the same rights as those held by TP.

[5] In February 2007 the company arranged a term loan of \$50,000 from ASB Bank and in August of that year it arranged a revolving credit facility of \$20,000. This borrowing was guaranteed by TP, TN and his wife, and CCF Ltd which was a company owned by TN and TQ. The loans were secured over properties owned by TN and TQ and CCF Ltd but NK did not act for the company or the guarantors with regard to this borrowing.

[6] By this time TP was operating the company's office in [town, West Coast region, South Island], while TN was operating in the office in [small town, Waimakariri District]. By October 2007 the relationship between TN and TP had deteriorated and the company was unable to pay its accounts. An injection of funding was required from the shareholders and the parties entered into negotiation.

[7] In these negotiations both TN and TP were separately represented. Efforts to resolve matters were unsuccessful and came to a head in mid-2009 when TN paid an account due to the company's accountant out of the company funds to prevent him from proceeding to wind up the company.

[8] On 3 July 2009 TP telephoned NK and advised him that she owned all of the voting shares in the company and wished to call a meeting to remove TN as a director of the company. NK reviewed the company's constitution and advised TP verbally that the constitution allowed for resolutions to be passed in writing without the need for a meeting.

[9] TP then instructed NK to prepare the necessary resolution to remove TN as a director. NK attended to this and the resolution was signed by TP. A copy of the resolution was provided by NK to TN as required by the company's constitution.

[10] Subsequently, TP sold the assets of the company and it is understood that accounting for the sale proceeds remains an issue between the parties.

[11] TN's complaints arise out of these events.

TN's complaints

[12] In his letter of complaint sent in December 2010 to the New Zealand Law Society Complaints Service, TN complained that NK's actions had not been in the best interests of the company and breached a duty of care to TN. He considered that TP had been able to sell the company as a result of NK's conduct and that he had thereby been severely disadvantaged.

[13] He also alleged that NK had a conflict of interest when TN sought assistance to resolve the differences between himself and TP in that he had previously acted for TP and her company.

[14] After receiving the notice of the resolution terminating his appointment as director, TN contacted NK to request him to rectify the situation on the grounds that NK was aware that the shareholders were equal in responsibility, equity and ownership. In TN's view the differentiation between shares were only to meet REINZ regulations and never gave either shareholder more power within the company.

[15] He alleged that NK had "ignored his fiduciary obligation to both directors/shareholders, breached the code of ethics due to a gross conflict of interest and [had] not only abetted the fraudulent sale of the company assets and patent ... but [he had] caused [him] major health, family and financial problems which [he] felt [NK] should be held accountable for due to his conduct and actions."

[16] In his submissions to the Standard Committee TN also argued that NK should have advised him at the time that the constitution was entered into in 2004 to enter into a shareholders' agreement to protect him from the events which occurred. He says that NK did not do so and consequently he became "a materially inferior shareholder to ... [TP] who obtained effective control over the company by reason of her voting rights. This was not drawn to [his] attention. He [NK] should have recommended an ancillary document such as a shareholders' agreement to protect [his] rights or that both shareholders seek independent advice."

[17] Linked to this was TN's suggestion that NK should have made arrangements to have TN's shares converted to voting shares when he became aware that TN had become a fully qualified real estate agent.

The Standards Committee determination and the application for review

[18] The Standards Committee resolved that the matter should proceed to a hearing on the papers and called for submissions from the parties. Having received and considered these the Committee came to the view that it was “not credible for [NK] to say that he was only acting for the company when there is no conceivable way that both of the directors would have instructed him to prepare a resolution removing one of them from office. That being the case, the Committee concludes that NK did not have valid instructions to prepare the resolution.”

[19] The Committee considered that it would be “unhelpful to speculate what may have happened if NK had refused to act and had instead alerted TN to the possibility of him being removed without notice as a director.”

[20] After weighing all of the material before it, the Committee determined that “the complaint is justified and that NK ought to have refused to act on the instructions of only one director when he knew that the relationship between them was dysfunctional.” However, the Committee did not consider that by so acting NK’s conduct had reached the threshold of unsatisfactory conduct.

[21] Nevertheless, the Committee felt that the complaint was justified and resolved pursuant to section 157(2) of the Lawyers and Conveyancers Act 2006 to order that NK pay to the New Zealand Law Society the sum of \$500 in respect of the expenses of and incidental to the investigation.

[22] Although NK has not himself applied for a review of this determination, a review concerns all aspects of the Standards Committee investigation and determination and as a result, the costs order is also open to review.

[23] In his application for review, TN noted that he did not think the Standards Committee took into account the “gross conflict of interest by NK...as he was actively solicitor for TP...and he also acted for a company TP owned named [CCG].” TN considers that NK had acted on behalf of TP and oppressed him as a co-director and shareholder.

Review

[24] A review hearing was held in Christchurch on 15 November 2012 with both parties being accompanied by a support person.

[25] The two issues which required to be addressed in this review are:

- Did NK have a conflict of interest?
- Has NK breached a duty of care to TN?

Did NK have a conflict of interest?

[26] TN alleged that NK had acted for TP in her personal capacity and on behalf of her company. NK does not deny this but states that he acted for TP and her company on matters unrelated to TN and CCE Limited. He advises that he or his firm have acted similarly for TN on unrelated matters.

[27] TN however asserts that because NK had acted for TP or her company, he therefore had a conflict of interest when acting on her instructions to prepare the resolution to remove him as a director. Conflicts of interests are dealt with by rule 6.1 of the Conduct and Client Care Rules¹. That rule provides as follows: -

A lawyer must not act for more than one client on a matter in any circumstances where there is a more than negligible risk that the lawyer may be unable to discharge the obligations owed to one or more of the clients

[28] A conflict of interest will arise however only if a lawyer acts for one party against the interests of another. The general obligation to protect and promote the interests of a client does not mean that merely because a lawyer has acted for a client in an unrelated matter, he or she thereby becomes automatically aligned with that client's position on all matters thereafter. In the present instance, the fact that NK had acted for TP and her company in respect of unrelated matters did not necessarily mean that NK was promoting her position against TN with regard to the issues relating to CCE Limited.

[29] Rule 6.1 applies to prevent a lawyer acting for more than one party in respect of the same matter. The allegation made by TN is based on an assumption that NK was acting for TP. NK contends that he was acting neutrally as the company solicitor and there is much to support this contention.

[30] Both TP and TN had been separately advised and represented throughout their disagreements and negotiations. NK's services were utilised in an independent capacity in an attempt to facilitate agreement between them.

¹ Lawyers and Conveyancers Act (Conduct and Client Care) Rules 2006.

[31] When TP sent her email to NK she wrote to ask him to call a meeting of shareholders. That was sent to him in his capacity as the company solicitor. The constitution of the company required the Board to call a meeting if more than 5% of the shareholders entitled to vote on a matter requested to do so.

[32] That was an action demanded by TP of the Board. The Board comprised two persons and consequently TP on her own could not give instructions. That was recognised by the Standards Committee.

[33] However, TP then noted that as she held all of the voting shares she was able to validly pass a resolution and all that was required was for notice of the resolution to be provided to TN as the other shareholder. This observation by TP was presumably made as a result of the verbal advice provided to her by NK as to the provisions of the company constitution. The question is whether in offering this advice, NK was thereby acting for TP personally.

[34] In its determination² the Standards Committee has noted the difficulty in determining what constitutes personal advice and what constitutes advice given to the company. In this instance, NK was not providing advice to the Board or acting on the instruction of the Board. However if TP had called for a meeting, then the Board was bound to act. Similarly, whoever TP instructed to prepare the resolution and give notice thereof was immaterial as the constitution provided that a valid resolution could be passed on that basis.

[35] It is a reasonable conclusion that on balance, NK was not actively promoting TP's interests over those of TN. Both parties had consulted NK at separate times with regard to the difficulties between them but he had always endeavoured to maintain neutrality in advising them as individuals and providing impartial advice as to their rights and duties as members of the company.

[36] In this regard, I agree with the determination of the Standards Committee that NK was in a difficult position, but ultimately maintained the necessary degree of impartiality such that he cannot be said to have acted to promote TP's interests to the detriment of TN.

Has NK breached a duty of care to TN?

² Paragraph 4.

[37] NK acted for the company. His primary duty of care was to the company. If a lawyer acts for a company he or she must be careful to ensure not to assume instructions from one member of the company against the interests of other members of the company and ensure that instructions carried out on behalf of the company do not unfairly advantage one member over another.

[38] In this regard, TN does have some justification for complaining that NK did not advise him to seek independent advice in 2004 when the current company constitution was adopted. That document perpetuated the arrangement existing since 1994 to satisfy the REINZ requirement that effective control of the company was exercised by those who were qualified persons. TN had been a member of the company since its inception, and was fully aware of the reasons why this arrangement was in force. Historically, those shareholders who held voting rights had not exercised that control to the detriment of the non voting shareholders and as far as TN was concerned all shareholders were considered to have an equal say in the running of the company.

[39] To have documented this tacit agreement would have defeated the purpose of the division of shares into voting and non-voting shares and placed the company in breach of the requirements of the REINZ. What could have been documented is an agreement which required all shareholders to cooperate in converting a shareholder's shares to voting shares when that shareholder qualified. It would seem that this had occurred in the past without any formal agreement, and in particular when TP qualified. Notice of her qualification was sent to the company and was then sent on to NK who effected the change. That had not occurred in the case of TN who had qualified some years previously. At that time he had instructed another solicitor to have him appointed as a director of the company but no steps were taken to convert his shares into voting shares.

[40] In his submissions to the Standards Committee, TN alleges that NK had a duty to advise him (or the company) that there should be a shareholders' agreement to document this understanding. When NK prepared the constitution in 2004 he continued the arrangement that had been in place since 1994. No agreement had been in place since that time and had not been required. Although it could be suggested that the lack of this documentation presented something of a gap in shareholder rights, it cannot be said that this constituted negligence or incompetence of such a degree as to reflect on NK's fitness to practice. That was the degree of

negligence required by sections 106 and 112 of the Law Practitioners Act 1982 in force at the time before a lawyer could be subject to disciplinary action.

[41] If TN had instructed NK to effect this change when he did qualify, it would have been necessary for TP to cooperate to achieve this. If she had not, then it presumably would have been possible for TN to apply to the Court to enforce the unwritten understanding. TN did not advise NK that he had qualified. He says however, that there were many occasions on which NK should have realised that he had qualified and should have acted independently to protect TN's position. That is asking too much of NK.

[42] A lawyer predominately acts on instructions from a client. TN was aware that he had qualified and the primary obligation to instigate the share variation lay with him. He had in fact instructed another lawyer to have him appointed as director of the company and NK was not consulted at that time. NK would not have had any cause to investigate the status of the shareholding of the company until TP raised the matter by which time the differences between TN and TP were such that she would not have agreed to the variation of shareholding rights.

[43] In summary therefore, if there was a gap in the company documentation, that gap did not constitute negligence or incompetence of such a degree as to warrant disciplinary action. In addition, NK cannot have been expected to deduce from events that TN had qualified, and then to also recognise without prompting, that a change in shareholder rights was necessary to provide him with full protection. A lawyer cannot be expected to bring this information readily to mind in respect of every client for whom the lawyer acts. In addition, NK was aware that TN had instructed another lawyer to take action on his behalf to appoint him as a director, and it would be reasonable for NK to assume that lawyer would have dealt with everything required to protect TN's interests at that time.

[44] TN also alleges that NK had a duty not to implement TP's instructions to remove him as a director. The facts were clear. TP held all of the voting shares. She was able to pass a resolution to remove TN as a director. Whether NK did this or any other solicitor did this was immaterial. The most that NK could have done was to advise TN of the intended action before the resolution was passed. Whether he did this before or after the event was also immaterial. In either case, TN would have been obliged to apply to the Court to enforce the unwritten agreement that his shares

converted to voting shares when he qualified. In terms of the constitution TN was provided with notice of the resolution within five working days of it being passed and TN had the opportunity to act at that stage.

[45] In the circumstances, NK acted in as neutral a way as he could have. He documented what TP was able to do in terms of the constitution and provided the appropriate notice of the resolution that had been passed. It was then up to TN to take whatever steps he chose to protect his position. I do not consider that NK acted in a way which breached any duty NK had to TN as an individual.

[46] TN alleges that the subsequent sale of the business was only made possible by the illegal cancellation of his position as director and that NK was complicit in this. That is not correct. As noted, TP could have arranged for the resolution to be prepared by anyone. What was required was for TN to take steps to protect his position. NK could not have assisted him in any way in that regard. It is therefore incorrect for TN to suggest that NK facilitated the sale of the business against his best interests.

Costs

[47] In its determination, the Standards Committee ordered NK to pay costs of \$500. This order was made pursuant to section 157(2) of the Lawyers and Conveyancers Act which provides that even though a Standards Committee determines to take no further action in respect of the complaint, it may, "if it considers that the proceedings were justified and that it is just to do so," order the lawyer to pay costs to the New Zealand Law Society.

[48] The Committee considered that TN's complaint was justified and that NK ought to have refused to act on the instructions of only one director when he knew that the relationship between them was dysfunctional. Section 157(2) requires not only that the Committee determine that the complaint was justified, but also requires the Committee to determine that it is "just" to order the lawyer to pay costs. This implies a measure of conduct that, whilst not constituting unsatisfactory conduct, has some degree of disapproval attached to it. That is what the Committee determined in holding that NK should not have accepted instructions to act from TP alone.

[49] The Committee acknowledged the difficulty in discerning the correct cause of action in these circumstances but awarded costs to mark out its muted disapproval of NK's conduct.

[50] I have some sympathy with NK's position much as the Committee did. On balance, I may not have made this award of costs as it signifies some measure of disapproval which is perhaps unfair to NK. However, the amount awarded also reflects the Committee's limited disapproval of NK's actions and to alter this decision would constitute a somewhat unwarranted interference with the Committee's decision. In the circumstances therefore I do not intend to modify the Committee's decision in this regard.

Decision

[51] Pursuant to section 211(1)(a) of the Lawyers and Conveyancers Act 2006, the determination of the Standards Committee is confirmed.

DATED this 22nd day of January 2013

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:

TN as the Applicant
NK as the Respondent
NJ as Partner of CCH
Canterbury - Westland Standards Committee 1
The New Zealand Law Society