LCRO 240/2011

CONCERNING	an application for review pursuant to section 193 of the Lawyers and Conveyancers Act 2006
And	
CONCERNING	a determination of Wellington Standards Committee 2
BETWEEN	**SC** Applicant
AND	**MQ** Respondent

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

Introduction

[1] SC and SE both filed complaints about the conduct of MQ in acting for them and SD and their company (CBL) in connection with the purchase of a CBM car cleaning franchise. The Standards Committee issued a single determination in respect of both complaints in which it determined pursuant to section 138(2) of the Lawyers and Conveyancers Act 2006 to take no further action in respect of the complaints.

[2] This is an application by SC, supported by SE, for a review of that determination.

Background

[3] By an agreement dated 6 March 2007 SE contracted to purchase a CBM car care franchise. The proposed purchaser was to be CBL. The sole director and shareholder of that company was SE.

[4] Shortly afterwards SD was appointed a director of the Company and a Trust of which he and SC were trustees acquired 60% of the shares.

[5] The Agreement was conditional on the purchaser completing satisfactory due diligence.

[6] To provide its share of the purchase price, the Trust sought to borrow the sum of $125,000 from the CBN Bank, which advance was to be secured over a property owned by the Trust. The Trust then advanced those funds to the Company, which advance was then to be secured by way of a General Security Agreement (GSA) over the plant and equipment to be owned by the Company in the operation of the Business.

[7] As part of the due diligence, accounts for the Business for the year ending 31 March 2006 were obtained. These were provided to the accountant engaged by SD and SC and SE. They were then forwarded by the accountant to the broker who was engaged by the parties to assist with the loan application, who then provided them to the Bank.

[8] The accounts contained an error in that the gross surplus from trading figure in the statement of financial performance was overstated by $40,000.00. That error was not noted by any of the persons involved and the loan was approved by the Bank.

[9] SD instructed MQ to declare the Agreement unconditional and the purchase proceeded to settlement on 19 May 2007 as advised by MQ in his letter to the Standards Committee dated 14 March 2011. I have noted however that MQ refers to the matter being settled on 5 June 2007 in his letter dated 23 September 2008 to the vendor's solicitor. However nothing turns on this.

[10] In July 2007 the Company was in need of an overdraft facility and again applied to CBN. The facility was approved and the loan documents were executed by SD and SC at MQ's office on 26 July 2007.

[11] By August 2008 the Company was insolvent and had defaulted in its payments to CBM. As a result CBM terminated the franchise and the sublease of the premises and commenced operating the Business under management using the plant owned by CBL.

[12] The GSA executed by CBL to secure the advance from SD's and SC's Trust had not been registered by MQ and this caused some difficulty in the negotiations which ensued between CBM and the Company.

[13] No settlement was agreed and the Trust then repossessed the plant under its GSA on 9 May 2009.

[14] SD and SC and SE have all lost their investment in the Business. The Trust was forced to sell the home in which SD and SC lived to repay the Bank and SE became bankrupt. SD's health in particular has suffered considerably from the stress associated with the problems as described by SC at the review hearing.

The complaints

[15] In her complaint SC complained generally about MQ's service and fees. She also complained specifically that MQ had failed to advise them of the error in the accounts and alleges that he should have advised them to cancel the agreement.

[16] She also complained about his failure to register the GSA and the fact that he had not had the acknowledgement of debt from the Company to the Trust fully executed.

[17] She also raised the question as to whether or not there was a conflict of interest between CBP (which she described as drawing up the paper work for the purchase of the Business) and CBO by whom MQ was employed and which she says "also [does] work for the CBN Bank which [they] had the loan with."

[18] SE complained that he found that MQ had made lots of mistakes and needed to be constantly pushed to complete work for them. He also referred to the error in the accounts and considered that MQ did not act in their best interests. He also advised that he would not be completing payment of MQ's outstanding accounts.

The applicable law

[19] This review concerns conduct which occurred both prior to and after 1 August 2008. Section 351(1) of the Lawyers and Conveyancers Act 2006 provides that "if a lawyer...is alleged to have been guilty, before the commencement of this section, of conduct in respect of which proceedings of a disciplinary nature could have been commenced under the Law Practitioners Act 1982, a complaint about that conduct may be made, after the commencement of this section, to the Complaints Service established under section 121(1) by the New Zealand Law Society."

[20] The threshold for disciplinary intervention under the Law Practitioners Act 1982 was relatively high. The relevant standards were set out in sections 106 and 112 of that Act and provided that disciplinary sanctions may be imposed where a practitioner was found guilty of misconduct in his professional capacity or conduct unbecoming of a barrister or solicitor, or was guilty of negligence or incompetence in his professional

capacity of such a degree or so frequent as to reflect on his fitness to practice as a barrister and solicitor or as to tend to bring the profession into disrepute. It is this latter definition which is relevant to this complaint.

Review

[21] A review hearing took place in Wellington on 26 September 2012. SC and SE attended supported by SC's daughter. MQ attended as required.

[22] The conduct and service complained of provided by MQ related to the purchase of the Business in April/May/June 2007 while the remaining conduct took place in late 2008/2009.

The purchase of the Business

[23] It is pertinent to observe that the Business purchase took place prior to the commencement of the Lawyers and Conveyancers Act and therefore the threshold referred to in [20] in respect of conduct must be reached before a complaint can be considered by the Standards Committee.

[24] Although SE complains that MQ had to be continually pushed to complete work, there are no specific complaints with regards to the general attendance relating to the purchase of the Business. I have noted that settlement took place sometime after the contractual settlement date, however, no details in relation to this general complaint have been provided.

[25] The two specific issues arising out of the purchase relate to the error in the accounts, and the failure to register the GSA. I have dealt with the GSA in a later section of this decision.

[26] With regard to the error in the accounts, there is no clear evidence that a copy of the accounts with the error noted was in MQ's possession prior to the Agreement being declared unconditional. The copy of those accounts was sent by fax from the accountant to the broker on 23 April 2007 who then sent them on to the Bank.

[27] SC said that she found the accounts on the files that she uplifted from MQ, but that file related to the issues arising after the Company had defaulted in its obligations to CBM.

[28] MQ had retained the file relating to the purchase of the Business and no copies of those accounts were on his file. Consequently, there is no evidence which would

support the suggestion by SC that MQ had failed in his duty to disclose information to his clients.

[29] Even if those accounts had passed through his hands, it would be difficult to suggest that MQ had failed in a duty to disclose information as he would have been justified in thinking that anything in relation to the accounts would have been dealt with by the accountant whose role it was to review them.

[30] In addition, MQ received instructions to declare the Agreement unconditional on the basis that his clients were satisfied with investigations undertaken by them or on their behalf. It would therefore have been a reasonable assumption on his part that anything to do with the accounts had been addressed by his clients with the accountant.

[31] SC argues that the Bank would not have approved the loan if the error had been drawn to its attention, and that MQ should have done this. In its letter of 8 October 2008 the Bank stated that "the application for funding would have been declined" if it had been aware of the error. However the letter from the Bank dated 1 October 2009 records that the Bank relied on cash flow forecasts provided to it by the broker. These forecasts had been prepared in consultation between the complainants and CBM and were based on sales for the year ending March 2007. The Bank noted that the cash flow forecast showed cash flow similar to the financial accounts to March 2006.

[32] It also has to be borne in mind that all parties accepted that the accounts did not necessarily reflect the true trading position of the Business, due to the fact that part of the income generated by the Business was undeclared. In addition SE advised that the purchasers considered that there was potential for the Business to grow and consequently it is not necessarily accepted that the Bank would have declined to approve the loan if it had been aware of the error, notwithstanding the statement in its letter of 8 October 2008.

The events in July 2007

[33] In July 2007 MQ received instructions from the Bank to document the overdraft facility that had been approved. SC asserts that two matters were discussed when they attended MQ's office to execute these. The first related to the potential breach of the restraint of trade provision in the Agreement, and the second was the advice from the Bank in respect of the error in the accounts.

[34] There are a number of uncertainties about the time when MQ became aware of the error in the accounts. He says that he was not aware of the error until September/October 2008 which is when the Bank wrote to SD and SC to formally record the situation. By that stage the Business had already failed.

[35] SE has advised by email that he was present in MQ's office on 26 July 2007 when SD and SC attended to sign the overdraft documents. He confirms that MQ was advised at that time of the error in the accounts. However, MQ's file note of the same date indicated that only SD and SC attended at his office to sign the documents, and then records that they took the documents away to get SE's signature. In addition, his file notes do not refer to any discussion about the matter. Conversely, the letter dated 27 July to SD and SC specifically refers to the restraint of trade provisions discussed with them on the 26th and his account also refers to that. No mention is made in that letter or the account of any discussion relating to errors in the accounts.

[36] The letter of 8 October 2008 from the Bank to SD and SC states that the error was discovered "after lending was approved and advanced by the bank". This would appear to refer to lending approved by the Bank to complete the purchase of the Business. However, after MQ wrote to the Bank on 11 September 2009 suggesting that the Bank had a duty to the Trust and SD and SC, the Bank responded by letter dated 1 October 2009 in which it advised that the error was discovered after the overdraft facility was approved in July 2007. This means that for SD and SC to have mentioned the matter to MQ when they called to sign the overdraft documents it would have been necessary for the Bank to have contacted them after the facility was approved but before the documents were signed. Although I do not have any evidence as to when the facility was approved, it is likely that this period of time would have been relatively short.

[37] The standard of proof required when considering a matter where there is conflicting evidence is that of a balance of probabilities - i.e. whether it is more likely than not that an event occurred. When considering the documentary evidence provided by MQ's file notes and his account, I am unable to accept that the matter was raised with MQ at the time asserted by SC and SE.

[38] The relevance of their assertions is that they have been told by other lawyers with whom they have discussed this matter, that they would have been able to cancel the purchase if they had been properly advised by MQ at the time. Instead, they allege

that he dismissed the matter by stating that it was the vendor's problem and otherwise of no relevance.

[39] SC says that she would have pursued the cancellation at that time because she had just received an inheritance and would have been financially able to do so.

[40] Given my finding as to when he became aware of the error, the consequences of whether or not MQ discussed the possibility of cancelling the contract if indeed that had been raised, is somewhat academic. However, without giving the matter full consideration, I have some doubts as to whether proceedings could have been commenced against MQ under the Law Practitioners Act with regard to this matter and consequently even if SC's and SE's assertions are correct, this aspect of the complaint would not reach the threshold required by section 351(1) of the Lawyers and Conveyancers Act.

[41] It is however quite clear that there were discussions with MQ about the fact that the vendor had commenced operating a competing business in close proximity to the Business being operated by CBL.

[42] SD and SC and SE considered that this constituted a breach of the restraint of trade in the Agreement for sale and purchase. However, the trade restriction applied only in respect of the vendor operating a CBM franchise, and so consequently there was no possibility of pursing the vendors for breach of this clause. There were apparently some discussions with CBM about that company pursuing the vendors, but it is not clear on what grounds this could have been considered, and it seems also that CBM was reluctant to become involved.

[43] For the reasons noted, the advice provided by MQ during this period is not such as was either deficient at all, or reached the threshold required by section 351(1).

A conflict of interest?

[44] In her letter of complaint SC asked the Complaints Service to investigate the "possibility of a conflict of interest between CBP (the firm that drew up the paper work for the purchase of the Business and coincidentally a division of CBO) and the law firm that MQ represents – CBO also they do work for CBN Bank which we had the loan with." [sic] The potential conflict referred to was in respect of the firm (whether through CBP or directly) acting for them and the Bank in the same transaction, rather than any conflict between the two arms of CBO.

[45] MQ advised SD and SC that he could not act for them if they wished to pursue an action against the Bank because the firm acted for the Bank in other matters. In his response to the complaint, MQ advised that when instructed to pursue the Bank for compensation he had told the complainants that "we could not act against the Bank, which is also our client."

[46] As the Standards Committee noted at point 3 of its determination, "[i]t is normal practice for a law firm to act for a Bank and the Bank's clients on the provision of finance." In this instance, it may be that CBO acted for the Bank generally on other matters. Regardless of whether MQ was referring to the fact that he had acted for the Bank in documenting the loans to SD and SC and the Company, or whether he was referring to the fact that the firm acted generally for the Bank, he was correct to advise SD and SC that he could not act for them in respect of a dispute, and particularly in respect of any litigation against the Bank.

[47] Without exploring in detail the nature of the firms instructions from the Bank (i.e. whether in respect of the advances to SD and SC, or generally), MQ was not conflicted at the time he documented the loans. As noted by the Standards Committee it is common practice in New Zealand for the same firm to act for the bank and the clients in these circumstances.

[48] However, if the client then wants to sue the bank for compensation, quite clearly a conflict arises, because what information was provided by CBP or CBO to the Bank may be brought into question. If the firm acted generally for the Bank, there would be an even greater conflict. Consequently, MQ was quite correct in advising his clients that he could not act for them (or the Bank) in the circumstances.

[49] I therefore concur with the determination of the Standards Committee in this regard as there was no conflict at the time MQ was acting for the complainants, and he declined to act for either party as required by the Conduct and Client Care Rules when it became clear that there could be a conflict between the Bank and his clients.

The advice in 2008/2009

[50] SD and SC and SE again sought assistance from MQ following the failure of the Business. He corresponded with the accountants, CBM, the Bank and the vendor's solicitors alleging negligence and misrepresentation. He negotiated with CBM to endeavour to reach a settlement taking into account the amount due to CBM and payment to SD and SC for the Company's plant and equipment. He did not consider

that there was any option to cancel the Agreement pursuant to the Contractual Remedies Act 1979 due to the time period that had elapsed and the events that had occurred.

[51] An offer of settlement by CBM was received, and although MQ recommended that this be accepted, his clients determined not to do so. SC said that MQ agreed with that decision, but he was of course obliged to follow their instructions.

[52] SD and SC then repossessed the plant and equipment and shortly thereafter ceased to instruct MQ.

[53] A review of MQ's file shows that there were a number of issues dealt with by him during this time, and from correspondence between the complainants in November 2009 and MQ's supervising partner, it would seem that they were somewhat frustrated by what they considered to be general tardiness on MQ's behalf in dealing with their affairs. Understandably, SD and SC needed their problems to be dealt with urgently. In some cases, I have noted requests from them to reply urgently on the same day. If any criticism of MQ is to be offered, it would seem that he may have failed to empathise with his clients and appreciate the pressure that they were under. Any delay to clients in their position is accentuated.

[54] However, looking objectively at the correspondence on the file it does not appear to me that MQ can be accused of conduct such as would attract a finding of unsatisfactory conduct under the Lawyers and Conveyancers Act 2006.

[55] There is no doubt, that there are matters where MQ clearly did not pay sufficient attention to detail such as his failure to have the acknowledgement of debt properly executed and errors in company documentation. However, none of these are sufficient to support a finding of unsatisfactory conduct, although MQ will need to be careful to ensure that more serious oversights do not occur in the future.

[56] The Standards Committee came to the conclusion that MQ had handled the file "adequately", and I agree with that. The use of the word "adequately" is an appropriate description and it is clear that MQ could have done better. However, his performance was not so inadequate as to justify a finding of unsatisfactory conduct in terms of section 12(a) of the Lawyers and Conveyancers Act.

The GSA

[57] The failure to register the GSA was however a serious oversight on MQ's part. The failure to do so was a continuing failure. There is no evidence on the file as to when he became aware of the fact that the security interest was not registered, but I have no doubt that CBM would have raised the issue early on.

[58] Registration was not however effected until 3 March 2009, some considerable time after the dispute with CBM had commenced. There is no doubt that non-registration of the GSA would have provided difficulties to the Trust in enforcing its security over the plant although I acknowledge that registration of a GSA only becomes relevant where there are competing interests over the same assets. In this case there were none.

[59] Section 12(a) of the Lawyers and Conveyancers Act defines unsatisfactory conduct as being "conduct of the lawyer...that occurs at a time when he...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". Registration of a GSA is expected, so that it obtains priority over other registered interests. Whilst I acknowledge that non-registration of the security interest did not affect its enforceability and there were no adverse consequences in the end to the Trust, the uncertainties and stress associated with the non-registration was such that SD and SC would not have been reassured by advice in this regard. In addition, the consequences could have been completely different if the Company had granted other security interests over the same property as the clients would not, and could not have been expected to, understand the consequences of granting further security interests over the same assets. In the circumstances, I consider that MQ's failure to register the GSA constituted unsatisfactory conduct, as it could fairly be expected by a reasonable member of the public that this is something that would be done as part of general instructions to take security over the Company's assets.

[60] Weighing everything up however, I do not consider that any penalty in respect of this finding is appropriate. I expect that MQ will take note of the various matters that have been raised in this complaint and commend that he learn from these events to ensure that similar situations do not arise in the future.

Apology

[61] In coming to my conclusions in respect of this matter, I have had regard to the apology tendered by MQ to SC directly at the review hearing. He acknowledged that

he could have done better and expressed his concerns at the effects that these events have had on all parties and on SD in particular.

[62] Since the hearing, SC has advised that her husband has yet to receive a written apology from MQ and in doing so MQ may go some way towards restoring relations with his former client. I do not however intend to make any orders in this regard as the apology provided at the hearing was genuine and freely offered by MQ.

[63] I would also observe that responsibility for the situation in which SD and SC and SE found themselves cannot in the main be laid at MQ's door. The complainants had an expectation that the Business purchased by them had potential which was not realised and the reasons for this cannot be attributed in any way to MQ.

Fees

[64] The Standards Committee considered that the fees rendered by MQ were reasonable and I do not disagree with that. MQ has advised this Office that the balance of fees has been written off and I take this opportunity to record that.

Decision

[65] Pursuant to section 211(1)(a) of the Lawyers and Conveyancers Act 2006 the determination of the Standards Committee is modified to the extent that MQ's conduct in failing to register the General Security Agreement until 3 March 2009 constitutes unsatisfactory conduct. In all other respects the determination of the Standards Committee is confirmed.

Costs

[66] Pursuant to the Costs Orders Guidelines provided by this Office, a costs order will usually be made against a practitioner in favour of the New Zealand Law Society where an adverse finding is made. As the finding of unsatisfactory conduct is in respect of one aspect of the complaint only, a full costs order is not appropriate.

[67] In the circumstances, pursuant to section 210 of the Lawyers and Conveyancers Act 2006, MQ is ordered to pay the sum of $300 by way of costs, such payment is to be made to the New Zealand Law Society by no later than 23 November 2012.

DATED this 23rd day of October 2012

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:

SC as the Applicant
MQ as the Respondent
Wellington Standards Committee 2
The New Zealand Law Society