

LCRO 299/2013

CONCERNING

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

AND

CONCERNING

a determination of [city] Standards Committee

BETWEEN

DT

Applicant

AND

GB

Respondent

Publication note:

Lawyer's trust advanced funds through nominee company to client on two occasions - prior to and after 1 August 2008. Standards Committee determined to take no further action in respect of the advance prior to 1 August 2008, but found unsatisfactory conduct in respect of the advance after 1 August 2008 on the basis that the lawyer had not ensured the borrower took independent advice. LCRO confirmed the Standards Committee decision, specifically noting the prohibition in Rule 5.4.3 against a lawyer entering into a financial arrangement with a client if there is a possibility of the relationship of trust and confidence being compromised. LCRO also found the advance prior to 1 August 2008 constituted unsatisfactory conduct by way of conduct unbecoming. Standards Committee penalties confirmed, with additional penalty of censure.

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

Introduction

[1] Mr DT has applied for a review of a decision of [city] Standards Committee in which it determined Mr DT's conduct in relation to an advance through his firm's nominee company in April 2009 constituted unsatisfactory conduct. The Committee ordered him to repay certain fees to Mr and Mrs GB and ordered him to pay costs of

\$500 together with disbursements incurred by the Committee in considering the complaints.

Background

[2] The determination of the Standards Committee clearly sets out the events giving rise to Mrs GB's complaint. I include here only the facts which are relevant to this review:

- (a) Mr DT was a trustee of the GB Family Trust (the Trust). Mr and Mrs GB were the other two trustees.
- (b) The Trust was a shareholder of a building company, PEL (the company).
- (c) Mrs GB was the sole director of the company. Mr GB could not be a director because he was the recipient of Accident Compensation payments. Mrs GB did not work in the business – she was a school teacher.
- (d) Mr GB had been medically disengaged from his work for health reasons. He had retrained as a builder and had incorporated the company through which he could operate a building business.
- (e) The company purchased a section on which it proposed to construct a 'spec house'. The company required funds to purchase the land and carry out the work.
- (f) Mr DT was instructed to act for the company at a time when it had defaulted in settling the section purchase. He had previously acted for Mr and Mrs GB but they had instructed other lawyers during the last nine years.
- (g) The last day for settlement was 20 December 2007. Mr DT recalls this was the last working day before Christmas.
- (h) The sum of \$165,000 was required to complete the purchase. The company could not secure this finance from traditional lending sources.
- (i) Mr DT arranged to advance that sum to the company through the firm's nominee company. The sum of \$120,000 was advanced on first

mortgage secured against the section. The contributors to this loan were the firm's 'usual' nominee company investors.

- (j) The sum of \$45,000 was also advanced and secured by a second mortgage over the section, a mortgage over another property owned by the company and an agreement to mortgage two other properties owned by the Trust, one of which was occupied by Mr and Mrs GB as their family home.
- (k) The advances were guaranteed by Mr and Mrs GB personally (unlimited) and by Mr DT (limited to the assets of the Trust).
- (l) The sole contributor to the second mortgage was Mr DT's family trust.
- (m) One of the properties over which security was taken was sold in January 2008 and the mortgage of \$45,000 was repaid.
- (n) In March 2008 the company borrowed a further \$100,000 from the G Bank guaranteed by the Trust (and thereby secured over Trust assets, which included the family home.¹
- (o) In September 2008 Mr GB sought to borrow a further \$250,000 to enable the company to continue building the house. Mr DT arranged for this to be advanced through the firm's nominee company using existing securities.
- (p) In March 2009, the company needed further funds to enable it to continue building the house. Mr DT arranged a further advance of \$90,000 through the firm's nominee company. The sole contributor to this advance was Mr DT's family trust and Mr and Mrs GB were advised of this. Mr DT's trust had itself borrowed the money from its bank and the funds were on-lent at an ordinary interest rate of 15 per cent, with a penalty rate of 19 per cent.
- (q) Part of this advance was used to pay a fee charged for arranging the loan together with legal costs for preparing the securities. Outstanding legal costs were also paid.

¹ Total borrowing from the G Bank was \$400,000.

- (r) Mr DT had formed the view the company was in financial difficulty soon after he recommenced acting for Mr and Mrs GB in 2007.² As guarantor, Mrs GB's own financial position was perilous and so was that of the Trust. The family home owned by the Trust was exposed to risk by virtue of the company's financial situation.
- (s) Mr DT acted throughout for the company, the Trust and Mr and Mrs GB although other members of the firm were at times called upon to advise Mrs GB. It is clear, however, that she relied on Mr DT for advice and guidance throughout.

Mrs GB's complaints

[3] Mrs GB lodged a complaint with the Lawyers Complaints Service on 1 February 2013. She summarised her complaints in the following way:³

- (a) Mr DT failed to perform his duties as professional trustee of the GB Family Trust.
- (b) Mr DT failed to keep her informed of or involved in events and meetings affecting the future security of the Trust's assets.
- (c) Mr DT had a 'conflict of interest' by lending his personal funds to the Trust and then charged extreme interest rates for the service.
- (d) [Mr DT] admitted to her at their last meeting that Mr DT got it wrong and should have advised her not to sign the documents ...
- (e) Mr DT acknowledged her husband's 'confused' mental state and that Mr DT had been shouting at her husband because he was not listening.

[4] During the course of the Standards Committee investigation Mrs GB provided further material. In the final paragraph of a letter dated 18 June 2013 addressed to Mr DT she said:

To conclude, I want to share with you the devastating effect this situation has had on me. I have always felt insignificant or treated "*like the little wife*" when around you in a professional capacity. At present I am on stress leave from my job because of the continual ongoing stress I have been subjected to over the past six years, and still continue to deal with. The threat of losing my home and everything I have worked for, dealing with a sick husband as well as laying complaints with both the Law Society and the Banking Ombudsman has taken its toll on me both mentally and physically and I have been advised by my G.P. to take a month's rest.

² The fact the company was unable to secure finance to complete the section purchase would have been an initial indicator of this.

³ Mrs GB's complaint to Lawyers Complaints Service (1 February 2013).

This paragraph provides an insight into the general thrust of Mrs GB's complaints.

[5] The Standards Committee summarised the issues for consideration in the following way:⁴

1. Were Mr and Mrs GB coerced into signing loan and guarantee documentation without being properly informed of the implications of doing so, and were they advised to seek independent legal advice.
2. Did Mr DT have a conflict in acting for the GB[s] given his position as professional trustee to the GB Family Trust.
3. Did Mr DT have a conflict of interest by lending personal funds to the GB Family Trust, and were his charges for doing so excessive.

The Standards Committee decision

[6] The Standards Committee did not set out focused and detailed reasoning in respect of each issue posed but addressed the issues generally. As best can be discerned from the Committee's decision, the determinations in respect of each issue were:

1. Mr and Mrs GB were not coerced into signing the various documents. The GBs wanted to settle the section purchase and complete building a house on the property. Mr DT enabled that to happen by arranging finance through his firm's nominee company although he made clear 'the difficult situation that was arising'. However, the GBs wished to continue with the property venture.⁵
2. The question as to whether or not Mr DT had a conflict of interest in acting for the GBs, given his position as professional trustee of the Trust, was not directly addressed by the Committee. It noted:⁶

From the files it is apparent that Mr DT was making it quite clear the position the company was in when the borrowings took place. He made clear what he believed the properties would sell for, however the Committee's view is that the GBs were by that time determined to carry on.

Mr DT followed instructions.

⁴ Standards Committee decision (26 August 2013) at 2.

⁵ At 4.

⁶ At 4.

3. The Committee also did not seem to directly address the third issue as to whether or not Mr DT had a conflict of interest by lending personal funds to the GB Family Trust.

[7] Nevertheless, the Committee expressed concern 'about the failure by Mr DT to ensure Mr and Mrs GB received independent advice in respect of the further lending in April 2009, particularly as it was the practitioner's family trust lending the funds to the company'.⁷ The Committee took note of the fact that Mr and Mrs GB were required to personally guarantee repayment of the advance⁸ and fees were received by 'the practitioner including outstanding costs from the GBs and the company.'

[8] The Committee determined that Mr DT's conduct constituted unsatisfactory conduct in respect of the 2009 advance, but determined to take no further action in respect of the initial advance in 2007.

The application for review

[9] Mr DT applied for a review of the Standards Committee determination. In summarising his application he submitted that:⁹

... the only clear allegation made by Mrs GB as to failure to advise to obtain independent legal advice, related to Mr TM in relation to the G Bank guarantee signed in March 2008 – and the Standards Committee specifically found against Mrs GB in that respect.

[10] He further submitted that Mrs GB had, in fact, received independent advice from Mr TM.¹⁰

[11] The outcome of the review sought by Mr DT was for the finding of unsatisfactory conduct to be reversed. If that is not the outcome of the review, Mr DT submits that the penalties should be reviewed. He notes he had 'no enthusiasm to make the advances' to his client, implying that he did so under pressure and to assist his clients in a difficult situation.

Nature and scope of review

⁷ At 4.

⁸ The Committee did not note that Mr DT was also required to provide a guarantee as a trustee so that the Trust assets could form part of the security. Mr DT's guarantee was limited to the trust assets and was not a personal guarantee.

⁹ DT application for review (10 October 2013) at 5.

¹⁰ Mr TM was a solicitor in Mr DT's firm.

[12] The nature and scope of a review have been discussed by the High Court, which said of the process of review under the Act:¹¹

... the power of review conferred upon Review Officers is not appropriately equated with a general appeal. The obligations and powers of the Review Officer as described in the Act create a very particular statutory process.

The Review Officer has broad powers to conduct his or her own investigations including the power to exercise for that purpose all the powers of a Standards Committee or an investigator and seek and receive evidence. These powers extend to “any review” ...

... the power of review is much broader than an appeal. It gives the Review Officer discretion as to the approach to be taken on any particular review as to the extent of the investigations necessary to conduct that review, and therefore clearly contemplates the Review Officer reaching his or her own view on the evidence before her. Nevertheless, as the Guidelines properly recognise, where the review is of the exercise of a discretion, it is appropriate for the Review Officer to exercise some particular caution before substituting his or her own judgment without good reason.

[13] More recently, the High Court has described a review by this Office in the following way:¹²

A review by the LCRO is neither a judicial review nor an appeal. Those seeking a review of a Committee determination are entitled to a review based on the LCRO’s own opinion rather than on deference to the view of the Committee. A review by the LCRO is informal, inquisitorial and robust. It involves the LCRO coming to his or her own view of the fairness of the substance and process of a Committee’s determination.

[14] This review is not therefore restricted to the matters raised by Mr DT in his review application. Mrs GB had herself applied for a review but subsequently withdrew it. Nevertheless, all of the issues raised by her are necessarily considered in completing this review.

Review

[15] A review hearing took place in [city] on 21 July 2015 attended by Mr and Mrs GB and Mr DT.

Mr DT’s role as a trustee

[16] In her complaint Mrs GB alleged that Mr DT had failed in his duty as a trustee in that he did not decline Mr GB’s request for finance. Mrs GB says that Mr DT:¹³

¹¹ *Deliu v Hong* [2012] NZHC 158, [2012] NZAR 209 at [39]-[41].

¹² *Deliu v Connell* [2016] NZHC 361, [2016] NZAR 475 at [2].

... could have just said no to more borrowing (which is what I had hoped you would do) and that would have brought the end around sooner. But instead, your advice was to continue doing what he had been doing, borrow more money, thereby adding to an already advanced situation.

[17] Mr DT denies this allegation.¹⁴ He says it was the company undertaking the borrowing, not the Trust. Nevertheless, the Trust facilitated the borrowing by providing guarantees and securities, without which the borrowing could not have proceeded. Mrs GB is correct.

[18] The actions (or inactions) of a trustee are subject to the scrutiny and supervision of the High Court. In a number of decisions by this Office the LCRO has been careful to ensure that the complaints procedure provided for in the Lawyers and Conveyancers Act 2006 (the Act) is not used as a substitute for Court proceedings.¹⁵ For that reason, this decision does not address allegations made by Mrs GB that Mr DT had failed in his duties as a trustee.

[19] There is of course some cross-over, in that Mr DT had a fiduciary duty to his clients, as indeed a trustee has to the beneficiaries of a trust. However, the issues have a different perspective. For example, the trustees were required to consider whether or not it was in the interests of the Trust to guarantee advances to the company, whereas the duty of a lawyer was to ensure that the trustees made that decision with full knowledge of the legal consequences of doing so.

[20] There is no inherent conflict of interest in a lawyer acting for a trust of which he or she is a trustee and it is difficult to ascertain the issue which the Committee identified in this regard.

[21] Mrs GB says that she was looking for Mr DT to provide some guidance to her (and her husband) as to the wisdom of pursuing the building project. That was not an unreasonable expectation of a lawyer. In the circumstances, Mr DT was attuned to the dynamics of the situation. He should have taken particular care to ensure that the instructions being given to him, on behalf of the company, were being given with the wholehearted support of Mrs GB, fully apprised of all matters relating to the company. She was after all, the sole director of the company, and some probing may have been required to ensure she was fully acquainted with the financial situation of the company and her duties as director, as well as her duties as a trustee providing the guarantee and securities. Mr DT himself noted that Mrs GB was in tears at one stage when

¹³ Letter from Mrs GB to Legal Complaints Service (11 June 2013).

¹⁴ Letter from Mr DT to Legal Complaints Service (25 June 2013).

¹⁵ See *VL v SB LCRO* 142/2014 and 160/2014.

signing documents. This must surely put a lawyer, whether trustee or not, on alert that all was not well. Although Mr DT asserts that Mrs GB was well aware of the company's financial situation,¹⁶ that is not relevant to his obligation to advise.

[22] Allegations that Mr DT had failed in his duties as a trustee must be addressed by the Court and the remedies available to the Court are different and greater than what can be awarded by a Standards Committee or this Office. There is also insufficient evidence as to the required standard of proof from which it could be said that Mr DT had failed in his duties as a lawyer to Mrs GB generally. The fact that she acquiesced in the borrowing by the company, and executed all the required documentation, outweighs Mrs GB's complaints some years following the events.

Mr DT's conflict of interest as lender

[23] The Standards Committee:¹⁷

... was concerned about the failure by the practitioner to ensure Mr and Mrs GB received independent advice in respect of the further lending in April 2009, particularly as it was the practitioner's family trust lending the funds to the company.

[24] Rule 5 of the Conduct and Client Care Rules¹⁸ reinforces the need for a lawyer to be 'independent and free from compromising influences or loyalties when providing services to his or her clients'.

[25] Rule 5.4.3 specifically provides:

A lawyer must not enter into any financial, business, or property transaction or relationship with a client if there is a possibility of the relationship of confidence and trust between lawyer and client being compromised.

[26] The underlying principle in the rule is the requirement that a lawyer should not continue to act for a client if there is a 'conflict or a risk of a conflict between the interests of the lawyer and the interests of a client for whom the lawyer is acting or proposing to act'.¹⁹

[27] Addressing the issue in the context of a failure to ensure the GBs received independent advice somewhat minimises the absolute prohibition against continuing to

¹⁶ Correspondence and diary notes provided by Mr DT.

¹⁷ Above n 4 at 4.

¹⁸ Lawyers and Conveyancers Act (Lawyers: Conduct and Client Care) Rules 2008

¹⁹ Rule 5.4.

act for a client where there is a conflict between the lawyer's interests and those of the client.

[28] Whilst in New Zealand it is accepted that a lawyer may act for a lender and a borrower in the same transaction, that acceptance cannot have any application where the lawyer is the lender of the money to the client. Rule 5.4.3 is expressed as an absolute prohibition against continuing to act for a client in these circumstances.

[29] That prohibition extends to 'any transaction in which the lawyer has an interest'.²⁰ That would include acting in respect of any transaction which would have resulted in repayment of any advances made by Mr DT or his trust and advising the company in respect of any matter which would have affected the company's financial position.

[30] In his text, *Ethics, Professional Responsibility and the Lawyer*, Professor Webb makes the general observation that "entering into a relationship of debtor or creditor with a client is problematic, as it is often inconsistent with the fiduciary obligations a lawyer owes".²¹

[31] Mr DT's role as an independent adviser became compromised when he advanced funds through his firm's nominee company to PEL, and obtained guarantees from Mr and Mrs GB and the Trust, secured over Trust assets.

[32] Mr DT was at pains to emphasise the difficult financial circumstances the company and the GBs were in. Objective advice was required, but that became impossible when Mr DT became personally exposed to the company's financial situation.

[33] Mr DT also became a lender to himself as a trustee of the GB Family Trust. He tendered advice to the GBs on marketing the house being built by Mr GB. Mr DT had a direct interest in whether or not the property was sold.

[34] In both instances where Mr DT or associated interests advanced funds to the company there was a profit to be made. In the second instance, part of the funds were used to pay an application fee for the advance as well as paying outstanding legal fees. That diminishes, if not extinguishes, any philanthropic element that could otherwise have been promoted by Mr DT as his motivation.

²⁰ Rule 5.4.2.

²¹ Duncan Webb *Ethics, Professional Responsibility and the Lawyer* (3rd ed, Lexis Nexis NZ Limited, Wellington, 2016) at 204.

[35] It is difficult to discern from the Committee determination why it differentiated between the lending in 2007/2008 and the lending in 2009. The Committee seemed to place some weight on Mr DT's submission that all transactions were approved by Mrs GB as the director of the company and as trustee of the Trust.

[36] That does not take cognisance of the difficult position Mrs GB was in. Her husband was endeavouring to establish a new career for himself after a forced resignation from [employment] due to medical reasons. There would have been implicit, if not explicit, pressure on her to support her husband in his endeavours.

[37] Mrs GB was a client in her own right. She was entitled to expect and receive objective advice from Mr DT. That was impossible when he became a lender to the company.

[38] There is no difference between the lending in 2007/2008 and the lending in 2008/2009. Mr DT breached fiduciary obligations to his clients, particularly to Mrs GB, in both instances.

Transitional matters

[39] Under the heading 'Transitional Matters', the Standards Committee set out the relevant sections of the Law Practitioners Act 1982 and the Lawyers and Conveyancers Act. However, the Committee did not expand on the meaning and manner in which the transitional provisions of the Lawyers and Conveyancers Act apply.

[40] The threshold for disciplinary intervention under the Law Practitioners Act 1982 was high. Misconduct was generally considered to be conduct of sufficient gravity to be termed 'reprehensible' or 'inexcusable', 'disgraceful' or 'deplorable' or 'dishonourable'.²² Conduct unbecoming a barrister or solicitor is perhaps a slightly lower threshold. The test will be whether the conduct is acceptable according to the standards of 'competent, ethical, and responsible practitioners'.²³ As observed by the LCRO²⁴ 'one of the fundamental duties of a lawyer is to protect and promote the interests of his or her client to the exclusion of the interests of third parties'. Mr DT failed in his fundamental duty to his clients, and regardless of the terminology used, his

²² *Atkinson v Auckland District Law Society* NZLPDT, 15 August 1990; *Complaints Committee No 1 of the Auckland District Law Society v C* [2008] 3 NZLR 105.

²³ *B v Medical Council* [2005] 3 NZLR 810 at 811.

²⁴ *AB v CD* LCRO 38/2009 at [10].

conduct was not acceptable to an ethical or responsible practitioner, concerned to ensure his clients received objective advice.

[41] Mr DT should not have acted for Mr and Mrs GB at the time of the first advance. It was not acceptable for Mr DT to place himself in the position of a creditor of his clients, and continue to advise them in relation to the company's activities. I acknowledge that the first advance was repaid within a short period of time, but even acting on the sale of the property which enabled that borrowing to be repaid placed Mr DT in conflict with the interests of his client. This constitutes unsatisfactory conduct by way of conduct unbecoming a lawyer.

[42] Consequently, both advances to PEL constituted unsatisfactory conduct, the first by way of being conduct unbecoming, and the second by way of breach of rule 5.4.3.²⁵

Penalty

[43] Having made a finding of unsatisfactory conduct, the Standards Committee ordered Mr DT pursuant to s 156(1)(f) and (g) of the Act, to refund the sum of \$2,626.37 to Mr and Mrs GB. It also ordered Mr DT to pay the sum of \$605 by way of costs pursuant to s 156(1)(n) of the Act. I have made an additional finding of unsatisfactory conduct in respect of Mr DT's lending to the company.

[44] This is not a situation where Mrs GB's request for compensation can be entertained. The conduct in respect of which the findings of unsatisfactory conduct have been made were not the cause of the losses incurred by Mrs GB. However, the penalty imposed by the Committee does not recognise the egregious nature of Mr DT's conduct.

[45] The Court of Appeal has described a censure of lawyers as a 'rebuke' to be taken seriously.²⁶ That is what is called for in this situation. In the circumstances, Mr DT is censured pursuant to s 156(1)(b) of the Act. It is a censure on behalf of the legal profession that Mr DT, as a senior member of the profession, has failed to recognise he was compromising his fiduciary obligations to his clients, jointly and severally, by not remaining a disinterested and objective advisor.

Decision

²⁵ See Lawyers and Conveyancers Act 2006, s 12(c).

²⁶ *New Zealand Law Society v B* [2013] NCA 156 at [39].

1. Pursuant to s 211(1)(a) of the Lawyers and Conveyancers Act 2006 the determination of the Committee is confirmed.
2. Pursuant to s 211(1)(a), the determination of the Committee is modified in the following way:
 - (a) Mr DT's conduct relating to the lending in 2007 constitutes unsatisfactory conduct by way of conduct unbecoming.
 - (b) Mr DT is censured pursuant to s 156(1)(b) of the Act.

Costs

[46] Pursuant to s 210(1) of the Act and in accordance with the Costs Orders Guidelines issued by this Office, Mr DT is ordered to pay the sum of \$1,200 by way of costs to the New Zealand Law Society, such sum to be paid no later than 23 June 2017.

Publication

[47] This review involves serious matters relating to conflicts of interest between a lawyer and his clients. The facts of the case and the outcome of this review should be brought to the attention of the profession for educational reasons. In the circumstances, I direct pursuant to s 142(2) of the Lawyers and Conveyancers Act 2006, that this decision should be published but with all identifying details of the parties being removed.

DATED this 23RD day of May 2017

D Thresher
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 DT as the Applicant
Mrs GB as the Respondent
[city] Standards Committee

