LCRO 319/2012

CONCERNING	an application for review pursuant to section 193 of the Lawyers and Conveyancers Act 2006
AND	
CONCERNING	a determination of the Standards Committee
BETWEEN	**[LAW FIRM A][1]** Applicant
AND	**STANDARDS COMMITTEE** Respondent

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

Introduction

[1] The applicants have applied for a review of the determination by a Standards Committee in which the Committee made a finding of unsatisfactory conduct against each partner, expressed to be in respect of breaches of reg 17(1) of the Trust Account Regulations.[2]

[2] The breaches of reg 17(1) occurred due to the fact that the firm's account went into debit on three occasions, none of which were referred to in the monthly certificates issues by the partnership pursuant to reg 17(1).

[3] The Committee imposed a fine of $500 on each applicant and ordered each of them to pay the sum of $200 to the New Zealand Law Society on account of costs.

[4] The Committee also determined to take no further action in respect of breaches of reg 12(7) (failing to account to clients at no more than 12 monthly

[1] In the application for review the applicant was referred to as "[Law Firm A]". The applicants to this review are the partners identified in the Standards Committee determination.
[2] Throughout this decision all references to the regulations (regs) are, unless otherwise identified, references to the Lawyers and Conveyancers Act (Trust Account) Regulations 2008.

intervals) and s 337 of the Lawyers and Conveyancers Act 2006 (requirement to pay funds to the Inland Revenue Department when clients cannot be found).

Terminology

[5] In the application for review Mr GB[3] has helpfully included definitions which are repeated here, and this terminology is followed throughout this decision.

> 2.1.1. **Trust Bank** Account Is the firm's bank account at [Bank X] where funds are received and disbursed on behalf of clients.
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> 2.1.2. **Trust Account** is the firm's records of the transactions in the Trust Bank Account.
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> 2.1.3. **Firms Account** is the balancing account that records the firm's interest in the **Trust Account** and **Trust Bank Account.** Where a payment is made and insufficient funds are held in the Trust Account, the firm's account must cover that payment and can show as being in overdraft.[4]
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> 2.1.4. **IBD Account** is an Interest Bearing deposit account under the control of the Partnership whereby funds are recorded as held on behalf of each client.

Background

[6] The Standards Committee conducted an own motion investigation into matters involving compliance with the Trust Account Regulations and the Lawyers and Conveyancers Act by [Law Firm A] following receipt of a report by Mr ET (an NZLS trust account inspector) who had carried out a routine audit of the firm's trust account. The chronology of events is recorded in some detail by the Standards Committee in its determination.

[7] Mr ET's reports[5] identified breaches of reg 12(7) and s 337 of the Lawyers and Conveyancers Act. Mr ET also identified three instances where the firm's account had

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[3] Mr GB was the firm's trust account partner and all correspondence with the Inspectorate, the Lawyers Complaints Service and this Office has been from either Mr GB or the firm's general manager, Mr FP. The correspondence has been written and received on behalf of all applicants.

[4] Mr GB included a rider here that the Firm's Account "can show as being in overdraft". I do not think that is correct and I have therefore deleted that part of Mr GB's definition. Regulation 17(3) provides that the **advance account** (which I understand to be the same as the Firm's Account as defined by Mr GB) may not be overdrawn. The firm's general account with the bank, from where funds are drawn to cover overdraws in the trust account, may of course, rely on an overdraft to make advances as required to the Trust Account.

[5] Mr ET had provided two reports – the first following his routine inspection and the second after a follow up inspection.

become overdrawn. Details of the breaches will be discussed where required for the purposes of this decision.

The Standards Committee Determination

[8] The Standards Committee addressed four issues:

> a. Did the partnership breach the Regulations by not reporting trust account transactions to clients at least every 12 months as required by Regulation 12(7)?
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> b. Did the partnership breach section 337 of the Act by not actioning unclaimed monies, being dormant or stale balances?
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> c. Did the partnership breach the Regulations by certifying that the firm had complied with relevant trust accounting rules and regulations under Regulation 17(1) when that was not the case?
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> d. If the answer to any of issues (a) to (c) is yes, does the breach (or breaches) amount to unsatisfactory conduct under section 12 of the Act?

[9] The applicants accepted that "apart from providing bank certificates, it had not always reported Trust Account transactions to clients at least every 12 months as required by [reg 12(7)]".[6] The Committee took note of the steps which the applicants advised had been taken to ensure ongoing compliance with the regulation, which included the "preparation of a standard reporting letter".[7]

[10] The Committee came to the view that the breaches of reg 12(7) "could amount to unsatisfactory conduct under s 12 of the Act".[8] In particular, the Committee was referring to s 12(c). However, the Committee considered that the breaches were "at the lighter end of the spectrum"[9] and that "the partnership had taken significant remedial steps in response to Mr ET's initial report".[10] The Committee decided "in all these circumstances … to exercise its discretion under s 152(3) of the Act in relation to the breaches of reg 12(7) and s 337 of the Act"[11] and take no further action in respect of these breaches.

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[6] Standards Committee Determination (20 November 2012) at [18].
[7] At [18].
[8] At [29].
[9] At [30].
[10] At [30].
[11] At [31].

[11] In correspondence with the Committee, the applicants acknowledged the existence of 235 dormant balances[12] and accepted that the failure to address them was a "serious issue".[13]

[12] The Committee took note of what it described as the "significant steps"[14] to clear the balances taken by the firm since Mr ET's report. It also took note of the fact that the firm's authors had been reminded of their obligations under s 337 of the Act and accepted that "repeat dormant balances [were to be] pursued and reasons provided if there [was] any reason for not dealing with them immediately".[15]

[13] The Committee again considered that the breach of s 337 fell within the "lighter end of the spectrum" and, taking into account the remedial steps being taken by the firm, exercised its discretion pursuant to s 152(3) of the Act to take no further action in respect of this matter.

[14] The final issue considered by the Committee was the potential breach of the regulations "by certifying the firm had complied with relevant trust accounting rules and regulations under reg 17(1) when that was not the case".[16] The breaches the Committee addressed under this issue was the three overdraws of the firm's account. Having considered the firm's explanations as to how the overdraws had occurred, the Committee nevertheless expressed "significant concerns about the partnership having signed off [the] trust account reconciliation on three consecutive occasions when a trust account was overdrawn".[17] In this way, the focus was on the fact that the monthly certificates were incorrect rather than on the fact of the overdraws themselves.

[15] The Committee considered the breaches of reg 17(1) "to be at the more serious end of the spectrum" and made the following comment:[18]

> For such a breach to have occurred on three consecutive occasions suggests that the firm has failed to have sufficient checks and balances in place and has, in turn, failed to adhere to important requirements – the purposes of which are to maintain public confidence in the provision of legal services and to protect consumers of those services (section 3 of the Act). Without these checks and balances, an overdrawn trust account for one client means that the funds of other clients could have been drawn on. This breach went to the fundamental basis of trust accounting requirements.

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[12] Attached to Mr ET's report of 7 April 2011 was a Lawbase Stale Projects Report from 1 February 2010 which identified stale credit balances.
[13] Letter GB to a Standards Committee (14 March 2012).
[14] Above n 6, at [20].
[15] At [21].
[16] At [16](c).
[17] At [27].
[18] At [32].

[16] The Committee recorded it had taken into account the steps taken by the firm to "put in place the required checks and balances".[19]

[17] The Committee determined that the overdraws constituted unsatisfactory conduct by all of the partners in the firm (the applicants) and imposed a fine of $500 each. Each partner was also ordered to pay the sum of $200 to the New Zealand Law Society by way of costs.

Application for review

[18] In the application for review the applicants addressed in detail the finding of unsatisfactory conduct for filing the incorrect certificates. This necessarily addressed the overdrawn firm's account.

[19] On 2 August 2013, a letter was sent to the applicants by this Office, noting that on review, this Office is required to consider all issues. The applicants were invited to address the issues relating to s 337 of the Lawyers and Conveyancers Act and reg 12(7). Submissions on these matters were received on 23 August 2013.

[20] By her letter of 2 August, the Review Officer had put the applicants on notice, that this review is not limited to the grounds for review put forward by them.[20] It must also have been apparent to the applicants, having engaged in a review process established by the Act, that on review, it is open to the Review Officer to "confirm, modify or reverse"[21] the determination of the Standards Committee and that the Legal Complaints Review Officer (LCRO) may "exercise any of the powers that could have been exercised by the Standards Committee in the proceedings in which the decision was made or the powers were exercised or could have been exercised".[22] That necessarily includes the power to make orders pursuant to s 156(1) of the Act consequent upon a finding (or confirmation) of unsatisfactory conduct.

[21] This review has been completed with consent of the parties on the material to hand.

Review

The ranking of the breaches

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[19] At [33].
[20] Lawyers and Conveyancers Act 2006, s 203; *Deliu v Hong* [2012] NZHC 158, [2012] NZAR 209.
[21] Section 211(1)(a).
[22] Section 211(1)(b).

[22] At paragraph 30 of its determination the Standards Committee categorised the breaches of reg 12(7) and s 337[23] of the Act as being "at the lighter end of the spectrum." The Committee also took note of the remedial steps being taken by the partnership.

[23] In exercising its discretion to take no further action in respect of these matters, the Committee has endorsed an approach to the management of a law firm's trust account that accepts that a failure to comply with the Act and/or Trust Account Regulations will not necessarily result in an adverse finding. Such an approach seems to be out of step with the often stated principle that one of the main purposes of the Lawyers and Conveyancers Act is the protection of the public. That purpose is stated in s 3(1)(b) of the Act as being "to protect the consumers of legal services and conveyancing services".

[24] Protection of client funds is fundamental to the principle of consumer protection. The Trust Account Regulations and the requirements of the Lawyers and Conveyancers Act dealing with client funds have been developed over many years and the breaches in this instance are of regulations and a statutory requirement that are not new. They are requirements that no partner or director of a law firm can be unaware of.

[25] It must be acknowledged, and emphasised, that there is no question of client funds being misappropriated, and that is clearly recognised by the fact that the issue to be considered is whether or not a finding of unsatisfactory conduct should be made, and the penalties imposed as a result thereof.

[26] The requirement "to protect the consumers of legal services" must include a requirement to manage client funds in a way that complies with all regulations and statutory requirements relating to the handling of client funds. There is limited room to exercise a discretion when breaches occur.

[27] I have no facts available to me, but on the basis of matters coming before this Office, it would seem that the majority of law firms comply with what is required of them in the management of client funds. It is unfair to those firms which scrupulously comply with those requirements if no further action is taken where breaches by others occur.

[28] There is clearly a discretion to be exercised in the first instance, as to whether or not breaches are put before the Lawyers and Conveyancers Disciplinary Tribunal.

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[23] S337 does not impose a mandatory obligation so it is incorrect to refer to a 'breach' of s337/

There is also the opportunity to exercise discretion when considering what penalties should be imposed following a finding of unsatisfactory conduct.

[29] Every lawyer who wishes to become a partner or director of a law firm must evidence a knowledge and understanding of trust account management. If that expectation is lowered by not adopting a reasonably stringent response to breaches when they occur, the effectiveness of the protections which the Regulations and the Act were designed to achieve, is lessened.

[30] I have applied these principles referred to in [22] – [29] to this review.

The parties

[31] The Standards Committee made a finding, and imposed penalties, against all of the partners of the firm, regardless of which office they were based at. It was Mr GB who drew the attention of the Committee to the fact that the Notice of Hearing had only been sent to the partners at the firm's [Area 1] office when the firm had two other partners in the [Area 2] office. Notices of Hearing were then sent to the [Area 2] partners.

[32] This observation by Mr GB amounts to an implicit, if not explicit, acceptance, that all the partners had a responsibility to ensure that the firm's trust account was properly managed and the findings were properly made against all partners.

[33] It is important to record that none of the applicants have attempted to minimise their responsibilities and I mention the matter only to reinforce the collective responsibility imposed on all partners or directors of a law firm to ensure compliance with the obligations imposed by the regulations and the Act.

The overdrawn firm's account

[34] The Standards Committee determined that the certificates required by reg 17(1) provided by the applicants were incorrect in that the firm's account went into debit on three occasions: 30 September 2011, 19 October 2011 and 25 November 2011. Although not mentioned by the Standards Committee, the breaches identified by Mr ET was that the firm's account in the trust account ledger had become overdrawn, which is a breach of reg 6. It was the three overdraws which formed the basis of the Standards Committee finding of unsatisfactory conduct. The breaches should have been identified as breaches of reg 6, which require a practice to cover any overdraws

in a particular client's trust account. That had not occurred, resulting in the firm's account becoming overdrawn.

[35] The explanations provided by Mr GB explain how individual client trust account ledgers had become overdrawn, but Mr ET identified that it was the firm's account being overdrawn.[24] I mention this for no reason other than to correctly reflect the issue but do not intend the ambit of this decision to be widened beyond the approach taken by the Standards Committee. The overdraw of the firm's account was caused by the overdrawn client trust accounts and the explanations as to how that occurred are relevant. However, a daily check of the firm's account in the trust account would have revealed the problems that existed with the individual client accounts. The daily check was clearly not occurring.

[36] The completion and filing of incorrect monthly certificates serves to reinforce an impression that the oversight and control of the trust account was inadequate.

[37] The Standards Committee referred to drawing of cheques against the trust account without ensuring funds had been received or receipted. Expressing the resulting overdraw in this manner, omits to take note of the fact that the partners signing the cheques, or authorising payments, must therefore have failed to require to sight evidence of funds before doing so. This also amounts to a lack of care by those concerned.

[38] Overdrawing a trust account represents a fundamental breach of the obligation to protect client funds. The consequence of an overdraw in the firm's account is that other client funds rather than the firm's funds are used to meet the payment being made. That is the protection that reg 6 is designed to provide. An overdraw of the trust account is a serious matter. These concerns were expressed by the Committee and I agree with those expressions of concern.

[39] The matters referred to in the preceding paragraphs highlight the shortcomings by the partnership in the operation of the firm's trust account.

[40] The Committee placed some weight on the assurances by the applicants that steps had been taken to ensure no further breaches occurred. It is important that the assurances made by the applicants are adhered to and if further breaches come before a Standards Committee again, it is to be expected that the occurrences which have been the subject of the own motion investigation and this review, will be taken into account.

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[24] Letter ET to [Law Firm A] (24 November 2011).

[41] The Committee made a determination of unsatisfactory conduct against each of the partners in respect of this issue and although the breach may have been more accurately expressed, I do not intend to do anything other than to confirm the finding of unsatisfactory conduct.

Dormant balances

[42] Regulation 12(7) requires no less than annual reporting to a client where funds are held, and where a client cannot be found, s337 of the Lawyers and Conveyancers Act, provides that funds may be paid to the Inland Revenue Department.

[43] In each case, the facts spoke for themselves. The applicants accepted they had not complied with reg 12(7) and there were 235 balances (referred to as "dormant") either unaccounted for or not paid to the Inland Revenue Department. Any submissions could only therefore go to whether or not the discretion to take no further action should be exercised (as it was by the Committee) or to the issue of penalty.

[44] The applicants advised[25] that remedial work being taken in respect of the dormant balances was that they were being reviewed monthly. The letter also noted that balances other than those referred to by Mr ET and the Committee were being considered.

[45] The steps taken by the partnership since Mr ET's report focussed on reminding authors of their obligations and for dormant balances to be referred to partners. The primary responsibility for ensuring that the operation of the trust account complies with the regulations and the Act, rested with the partners, and the defaults referred to in Mr ET's report indicate that the required oversight of the trust account was not taking place, a failing which the partners must take responsibility for.

[46] Mr ET's report attached a list of stale credit balances and although he did not specifically refer to all balances, it is assumed that the balances mentioned were referred to by way of example (or the more serious matters), but the requirement was that all stale balances needed to be addressed. A brief review of the Lawbase report attached to Mr ET's letter of 7 April 2011 shows that the last date on which any activity had occurred in some instances was as far back as 2002. Other instances identified the last activity as being in subsequent years. There is no specific period of time during which these balances were overlooked and the report shows that no attention had been paid to the outstanding balances over the period of years from 2002 to the

[25] Letter GB and FP to LCRO (23 August 2013).

date of the report in February 2011. This indicates a complete lack of recognition of the obligations imposed by reg 12(7).

[47] The Committee refers to this as being "a serious issue"[26] and then goes on to refer to the issue as being at the "lighter end of the spectrum."[27] The two statements are not reconcilable. In any event, following my earlier comments, I consider there is limited room when considering whether or not there has been a breach of trust account regulations, to apply degrees of seriousness to the breach, referred to by the Committee as being at various positions on a spectrum.

[48] I take note of a letter written by Mr ET to the Standards Committee in which he wrote:[28]

> Inspectors find instances of dormant balances and lack of annual reporting on a regular basis and in most cases will just deal with this issue by a routine follow up inspection. In these two instances the level of dormant balances is, in my opinion, greater than an acceptable level, having also been reported on in previous inspection reports. We are talking about client funds which are just sitting there and should have been auctioned, in some cases many years before, no matter how small the balance might be.

[49] Mr ET's comments reflect what I consider to be a serious disregard of the trust reposed in lawyers to act as caretakers of client funds. No matter how small the balance is, it belongs to the client, and every effort must be made to return it to the client. If clients cannot be located then the Act requires the unclaimed money to be sent to the Inland Revenue Department. Mr GB expressed a reluctance to send clients' money to the Department.[29] This gives the impression that the firm had been aware of the dormant balances, but out of some sense of obligation to their clients was reluctant to take the step provided for in s337 of remitting unclaimed funds to the IRD. However, once this issue was drawn to the firm's attention, it would seem that many clients were in fact able to be located, and Mr GB advised[30] that only a small number of balances remained to be forwarded to the Inland Revenue Department. The impression that the firm was aware of the issue but had made a positive decision to take no action, is not correct. There does not seem to have been any checking of dormant balances, or an understanding of what was required.

[50] I refer to my earlier observation that the last activity on the various balances dated back to 2002 with varying numbers spread over the ensuing years. This is a

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[26] Above n 6, at [19].
[27] Above n 6, at [30].
[28] Letter ET to a Standards Committee (13 September 2011).
[29] Letter GB to a Standards Committee (14 March 2012).
[30] Above n 28.

clear indication there was no oversight of the trust account, which oversight should have included a regular review of client balances. In this regard, the failure to carry out regular reviews meant that the monthly certificates that "trust account transactions … have been properly accounted for to clients"[31] was also not correct.

[51] The largely self regulated audit process put in place some years ago relies heavily on partners and directors of law firms being aware of their obligations, implementing proper processes, and paying close attention to the correctness of the monthly certificate. If that is undermined by lawyers not paying careful attention to their obligations, the audit process will need to be reconsidered, at a cost to all lawyers.

[52] I do not consider this a case where a discretion to take no further action should be exercised. In the circumstances, the Standards Committee determination to take no further action is reversed. The conduct of each partner in this regard constitutes unsatisfactory conduct.

Annual reports

[53] With regard to this issue, the applicants noted there had been a voluntary reporting of shortcomings. This is a somewhat odd submission to make, as the monthly certificate required by reg 17(1) to be provided by each law firm, includes a certificate that the practice has complied with the regulations (and other requirements). I note again, that if the requirement for reporting at intervals of no less than 12 months has not been complied with, then (again) the monthly certificates would be incorrect. A "voluntary" reporting of shortcomings does not somehow ameliorate the fact that the certificates filed by the partnership were not correct.

[54] Again, I do not consider this a case where a discretion to take no further action should be exercised. The partnership had provided incorrect certificates on a number of occasions. This constituted a breach of reg 17(1). The lack of any systems or checking process to ensure compliance with these requirements, evidenced either a disregard for the regulation, or, at least, a lack of knowledge of what was required. Either disregard or lack of knowledge of the obligations imposed on a lawyer dealing with client funds, is inexcusable. In the circumstances, the Standards Committee determination to take no further action is reversed. The conduct of each partner in this regard constitutes unsatisfactory conduct.

Summary

[31] Lawyers and Conveyancers Act (Trust Account) Regulations, reg 17(1)(b).

[55] The discussions above lead to the possibility of two further findings of unsatisfactory conduct. However, the significant issue relates to the lack of reporting to clients where funds are held. That in itself, leads to the situation of a dormant balance, and so consequently, the two issues are related. In addition, I recognise that s337 (2) of the LCA is not a mandatory requirement – it is only if the person holding the funds "thinks fit" that money may be paid to the Inland Revenue Department. In conclusion therefore, only one further finding of unsatisfactory conduct for breaches of rule 12(7) can be sustained.

Penalty

[56] I have confirmed the finding of unsatisfactory conduct by the Committee in respect of the trust account overdraws and made a further finding of unsatisfactory conduct in respect of the failure to address the stale balances and to report no less than annually to clients.

[57] In *Workington v Sheffield* the LCRO observed:[32]

> The function of a penalty in a professional context was recognised in *Wislang v Medical Council of New Zealand* [2002] NZAR 573, as to punish the practitioner, as a deterrent to other practitioners, and to reflect the public's and the profession's condemnation or opprobrium of the practitioner's conduct. It is important to mark out the conduct as unacceptable and deter other practitioners from failing to pay due regard to their professional obligations in this manner.

[58] The LCRO went on to say:[33]

> In cases where unsatisfactory conduct is found as a result of a breach of applicable rules (whether the Rules of Conduct and Client Care, regulations or the Act) and a **fine** is appropriate, a **fine** of $1000 would be a proper starting place in the absence of other factors. I consider it appropriate to impose a penalty that reflects the egregious nature of the wrongdoing in this case. I am also mindful of the significant difference between the present and former legislation concerning the range of possible **fines**, and the fact that the original omission occurred under the former Act.

[59] Those observations would support a decision to increase the amount of the fine imposed on the applicants or to impose a censure.[34] However, I do not consider it is appropriate to make any change to the penalties imposed by the Standards Committee for the following reasons:

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[32] *Workington v Sheffield* [2009] LCRO 55/2009 at [65].
[33] At [68].
[34] See article by Duncan Webb as to the nature of a finding of unsatisfactory conduct – reproduced on the website of this Office

(1) To do so would be to discount altogether the explanations put forward by the applicants as to how and why the various breaches occurred.

(2) It would also discount the remedial steps being taken by the applicants, which it is hoped have removed the opportunity for further breaches to occur.

(3) The period of time that has elapsed between the events giving rise to the findings of unsatisfactory conduct and the issuing of this decision, removes any reinforcement value that a penalty (or increase in penalty) would provide to those findings.

(4) It is to be assumed that the Inspectorate will have monitored the firm's trust account compliance closely since these matters came to light to ensure that the assurances provided by the partners have been complied with.

[60] For the above reasons, I do not consider any further penalties are appropriate in the circumstances in respect of the additional findings of unsatisfactory conduct, or to increase the penalty imposed by the Standards Committee.

Decision

(1) Pursuant to s 211(1)(a) of the Lawyers and Conveyancers Act 2006 the determination of the Standards Committee to take no further action in respect of the breaches of reg 12(7) is reversed.

(2) The conduct of the applicants in respect of the breaches of reg 12(7) constitutes unsatisfactory conduct.

(3) In all other regards the determination of the Standards Committee is confirmed.

Costs

[61] Pursuant to the Costs Orders Guidelines issued by this Office, and to s 210(1) of the Act, a single costs order in respect of this review in the sum of $1,800 is made, such sum to be paid to the New Zealand Law Society by no later than 30 June 2016. The applicants are jointly and severally responsible for payment of these costs.

DATED this 31st day of May 2016

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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:

[Law Firm A] as the Applicant:
Mr GB
Ms CC
Mr DD
Ms HH
Ms II
Mr JJ
Mr KK
Mr LL
Mr MM
A Standards Committee as the Respondent
The New Zealand Law Society