LCRO 67/2011

CONCERNING	an application for review pursuant to section 193 of the Lawyers and Conveyancers Act 2006
AND	
CONCERNING	a determination of Waikato Bay of Plenty Standards Committee 1
BETWEEN	**KB** Applicant
AND	**WY** Respondent

DECISION

Background

[1] WY had acted for Mr and Mrs PC and their companies for a number of years. One of these companies, ADL, had carried out a subdivision of a property at North Island. Funds were owed to both the BNZ and KB which were secured as first and second mortgagees. In 2010, ADL was in default with its payments and under pressure from both lenders to clear its indebtedness.

[2] As at 31 January 2010, the balance due to KB was $723,000, which included $256,000 of accumulated interest.

[3] An offer was received for the sale and purchase of 10 lots in the subdivision for $680,000 plus GST. It seems that KB had conducted a tender process but not in the capacity of mortgagee in possession. This process had resulted in other offers being made. KB, which was at all times represented by Mr KC, indicated an intention to accept these offers unless a contract which provided a better result for all concerned was produced.

[4] At that time, Mr and Mrs PC were estranged and living apart. It would seem that Mrs PC had been responsible for negotiating the sale and also for liaising with the BNZ and Mr KC. She was also in contact with Mr WY as the negotiations relating to the sale progressed and Mr WY was in contact with both Mr and Mrs PC.

[5] The agreement for the sale of the 10 lots for $680,000 plus GST was signed by both Mr and Mrs PC as directors of ADL and dated 8 February 2010.

[6] On that date, Mr WY sent a letter of engagement to "The Directors, [ADL ... North Island]". Mrs PC was residing at that address. At the end of the section with regard to fees, the letter of engagement included the following sentence:

> "We will also deduct all other fees owed by [ADL] from the sale process."

[7] On the same day, Mr PC signed an authority addressed to Mr WY's firm (ADM) which authorised the firm "to deduct all of [sic] legal costs owed by [ADL] from the sale proceeds of this transaction".

[8] On the following day, Mr KC requested, and was provided, with a copy of the agreement as signed.

[9] The agreement became unconditional on 15 February and settlement was scheduled for 19 February. On 16 February, Mr WY sent a fax to ADN, the solicitors for KB, requesting a repayment figure for the KB loan, a discharge of the mortgage for the lots included in the sale and a release of other securities held. A copy of that request was sent to Mr KC.

[10] A deposit of $68,000 had been collected by the agent, and after deduction of the agent's commission, the balance of $42,350 was credited to ADM's trust account on 17 February. These funds were applied by way of journal entries in payment of the firm's outstanding costs on 19 February.

[11] On 17 February, Mr WY received a letter from ADN requesting amongst other things, a statement of account which would show the net balance to be paid to ADN.

[12] On 19 February, Mr WY sent a draft statement by email to ADN. That statement provided for deduction of outstanding costs due by ADL to ADM being $54,990.50, as well as estimated costs on the sale in the sum of $7,875.

[13] It is apparent from Mr WY's file that discussion took place between ADN and Mr WY about the proposed deduction of outstanding costs, although the content of these discussions has not been provided with Mr WY's file.

[14] On 25 February, ADN sent a fax to Mr WY, instructing him pursuant to clause 5(h) of the mortgage to KB, to complete settlement of the sales and to account to them for the balance of the settlement funds after deducting specified amounts. These specified amounts did not include the outstanding costs due to ADM or the GST. That letter concluded by saying:

> "If we do not receive your confirmation by 12 noon today and/or have not received the repayment to [KB] by 5pm today, our client will exercise its rights, including but not limited to completing the sale of the above properties with your client's purchaser as your client's attorney pursuant to clause 5(i) of the mortgage without delay."

[15] Later that day, ADN sent a further fax stating as follows:

> "Further to our previous correspondence and telephone conversations, we advise that our client will exercise its right to complete the sale of the above properties with your clients' purchaser as your client's attorney pursuant to clause 5(i) of the mortgage.
>
> Our client hereby demands the balance of deposit of $42,350 together with all interest earned (if any) held in your trust account to be paid to us."

[16] Mr WY replied on 1 March in the following manner:

> "We refer to your facsimile of 25 February 2010.
>
> We no longer hold the balance of the deposit in our trust account as this was previously paid out in accordance with our client's instructions."

[17] ADN responded on the same day in the following terms:

> "You were on notice that the balance of deposit was required for part payment of the mortgages to the mortgagees and that our client was exercising its right to complete the sale of the above properties with your clients' purchaser as your client's attorney. Thus you were deemed to be holding the balance of deposit in trust for the mortgagees. You have breached your fiduciary duty as the trustee of such funds by dispersing them without our client's authority.
>
> Our client's demand for the balance of deposit to be paid to us was an instruction from our client on behalf and as attorney of your client company. Thus you have breached your duty as solicitors to act in accordance with the client's instruction by disbursing the fund in a way contrary to our client's instructions."

[18] The letter went on to outline proposed actions to be taken by KB if Mr WY did not comply with the requirement to remit the balance of the deposit to ADN. That included reporting him to the Law Society for professional misconduct.

[19] In subsequent correspondence, ADN asserted security over the funds pursuant to a General Security Agreement, but as at the date of the review hearing, no proceedings had been issued by KB against the company, Mr and Mrs PC as guarantors, or ADM.

[20] A final demand was made by ADN on ADM for repayment of the funds by 5:00 p.m. Friday 30 April 2010. Mr WY did not make payment as demanded.

[21] Mr KC lodged a complaint with the Complaints Service of the New Zealand Law Society on 13 May 2010.

The complaint and the Standards Committee etermination

[22] Mr KC's complaints were as follows:

1. ADM have utilised the balance of deposit monies to pay their own fees without any apparent authority from ADL and/or KB as the attorney of ADL.

2. ADM have also prejudiced the interest of and caused significant cost to KB as mortgagee and attorney of ADL by withholding the settlement of the sale of the properties. Thus ADM have breached their fundamental obligation to act in accordance with all duties of care owed by them as the lawyer to KB as mortgagee and attorney or ADL.

3. ADM also appear to have engaged in misleading and deceptive conduct concerning their handling and distribution of client's funds.

[23] Having considered the complaint, the Standards Committee determined, pursuant to section 138(2) of the Lawyers and Conveyancers Act 2006 to take no further action in respect of the complaint. That section provides a Standards Committee with discretion to decide not to take any further action on a complaint if it appears to the Standards Committee that, having regard to all of the circumstances of the case, any further action is unnecessary or inappropriate.

[24] In its determination, the Standards Committee noted that

> "The Committee did not believe [Mr WY] misled the complainant or its solicitors regarding disbursement of the monies to meet fees. The practitioner had the authority of his client to apply the sole proceeds to order outstanding costs and was therefore entitled to do this [sic]. The practitioner replied upon this authority and agreement in writing to act.
>
> No evidence was provided to support the allegation that the practitioner misled the Complainant or its solicitors in any way."

[25] Mr KC has applied for a review of that determination.

Application for review

[26] With his review application, Mr KC included a draft statement by Mrs PC which Mr KC stated was "prepared by [ADN] based on information supplied by us following various conversations with [Mrs PC]". A sworn copy of that statement was received at this Office on 3 May 2011. The detail of that affidavit is referred to in subsequent sections of this decision. I have taken cognisance of the somewhat unusual procedure adopted in the preparation of the affidavit, in that it would seem that it was prepared on the basis of information provided by persons other than the deponent. However, as Mrs PC did swear the affidavit, it has to be assumed that the information in the affidavit is confirmed by her and in addition, the outcome of this review does not stand or fall on the content of the affidavit.

[27] Mr KC also submits that ADN's file notes and the correspondence between ADN and ADM is evidence that ADM were still holding the balance of the deposit in their trust account as at 19 February. Mr KC submits that this is contrary to the statement in the Standards Committee determination that costs were deducted upon receipt of the deposit prior to the involvement of KB and its solicitors.

[28] Mr KC also submits that he considers the authority provided to ADM which was signed by Mr PC as a director of the company, was invalid. He submits that even if it were valid, it must be read in conjunction with the engagement letter dated 8 February referred to in the authority. As that letter only refers to the sale of the North Island properties, Mr KC argues that only fees in respect of that transaction can be deducted.

[29] The outcome sought by Mr KC is to receive payment of the balance namely $42,350, and a contribution to the legal costs of $4,000 incurred by KB in connection with the matter. The amount sought is beyond the jurisdiction of the standards Committee or the LCRO.

Review

[30] A review hearing was held in Auckland on 22 March 2012, attended by Mr KC and Mr WY, together with Mr WX as counsel for Mr WY.

Misleading conduct

[31] Mr KC complained that:

> "[ADM] also appear to have engaged in misleading and deceptive conduct concerning their handling and distribution of client funds."

[32] In its determination, the Standards Committee made three references to misleading conduct by Mr WY:

> "1. The Complainant alleges the Practitioner did not have authority from his client to deduct costs from a deposit held in the trust account. Any authority was revoked by the Complainant in accordance with its power of attorney and the practitioner misled the Complainant as to whether costs had been deducted.
>
> 2. The Committee did not believe he misled the Complainant or its solicitors regarding disbursement of the money to meet fees.
>
> 3. No evidence was provided to support the allegation that the practitioner misled the Complainant or its solicitors in any way."

[33] The allegations of misleading conduct in the complaint, and as addressed in submissions by Mr KC to the Complaints Service, relate to conduct occurring after ADN became involved on instructions from KB, to act for it in relation to the discharge of mortgage.

[34] At the review hearing, Mr KC alleged that Mr WY misled him in discussions between them prior to ADN being instructed. His allegation is that Mr WY misled him by omission, the omission being that Mr WY did not tell him that he intended to deduct all outstanding costs from the proceeds of sale. Mr KC's understanding and expectation was that Mr WY intended to deduct only his costs in relation to the sale.

[35] In the first instance, this was not something that Mr KC had referred to in his complaint or was considered or referred to by the Standards Committee. Arguably therefore, it is a matter which is not properly a matter to be considered in this review.

[36] However, as part of a review, the LCRO can determine that a matter should have been investigated by the Standards Committee, and if it had not, the LCRO can investigate the matter him or herself.

[37] Even if I were inclined to take this step, I do not consider that aspect of Mr WY' conduct can be considered to be unsatisfactory conduct, or warrant referral to the Lawyers and Conveyancers Disciplinary Tribunal to consider a misconduct charge for the following reasons.

[38] For this allegation to succeed, it would need to be shown that Mr WY had an obligation to acquaint Mr KC of his intentions. KB was not Mr WY's client. It had not instructed Mr WY to act on its behalf in connection with the discharge of the second mortgage and Mr WY had no duty to advise Mr KC of his intentions. The only reason that he would have needed to advise Mr KC of his intentions was to ensure that the discharge of mortgage was available to his client to enable the company to fulfil its obligations under the agreement for sale and purchase. By not discussing his intentions with Mr KC prior to the agreement being signed, he exposed his client to the

risk that the sale could not proceed because KB refused to provide a discharge of mortgage.

[39] As it turned out, KB instructed ADN as ADL's attorney to proceed with the sale, as the contract represented the best offer available for the properties.

[40] Consequently, the parties that could be considered to be aggrieved are ADL and Mr and Mrs PC. ADL was Mr WY's client. Mr WY had disclosed to his client in the letter of engagement that he intended to deduct his outstanding costs and he then obtained an authority to take this step by way of a signature from Mr PC.

[41] In all of the circumstances, I do not therefore consider that Mr WY's conduct up to this point in time can be considered to be misleading or deceptive.

[42] Mr KC refers to Mr WY's actions thereafter generally as misleading and deceptive conduct with regard to the handling and distribution of client funds. This aspect of the complaint relates to the circumstances in which Mr WY acted on the authority and deducted his costs from the funds received and also in his correspondence with ADN.

[43] The balance of the deposit was credited directly into ADM's trust account on 17 February. On 19 February, these funds were transferred by way of journal out of the ledger relating to the sale of the properties and applied in payment of outstanding costs. On the same day, Mr WY included those amounts in the draft statement provided to ADN. There was no misleading or deceptive conduct in this regard.

[44] It was not until 25 February that ADN issued instructions to Mr WY as attorney for ADL. Up until that time, Mr WY's instructions came from the directors of ADL themselves, either jointly or individually.

[45] Mr WY could be said to have misled ADN by his use of terminology when he stated in his letter of 1 March that:

> "We no longer hold the balance of the deposit in our trust account as this was previously paid out in accordance with our client's instructions."

[46] This statement gives the impression that the funds had been paid out to an external payee, instead of being used in payment of outstanding costs.

[47] Again, Mr WY is evasive when he states in his letter of 3 March to ADN that:

> "We are not holding funds here for our client. You might think it reasonable to assume that we followed our client's instructions when the balance deposit was paid to us and paid those monies out in accordance with those instructions."

[48] Reference to "payment out" of monies again gives the impression that the funds have been paid to an external payee.

[49] It was not until Mr WY's partner responded on 15 April that it was made clear that the funds had been used to pay outstanding accounts.

[50] With regard to the two letters dated 1 and 3 March, I agree with Mr KC that the impression given by Mr WY was that he had paid the funds out to an external payee. Mr KC also stated in his complaint that:

> "[ADL] confirmed to [KB] that no instruction was given to [ADM] to disburse the balance of deposit to [ADL] or otherwise. [ADL] then made enquiry of the position of the balance of deposit with [ADM], who advised [ADL] that the funds were paid to the first mortgagee, Bank of New Zealand. The directors of [ADL] and also [ADN] had then inquired with Bank of New Zealand, which confirmed no funds were paid to it."

[51] When questioned at the review hearing, Mr KC acknowledged that the reference to "ADL" in his complaint, referred to Mrs PC.

[52] In paragraph 13 of her affidavit, Mrs PC states that:

> "[WY] left me with the very clear impression that all deposit monies had also been transferred over to the bank."

[53] She then advised that the bank told her the balance of the deposit was still held by ADM.

[54] Rule 7 of the Lawyers and Conveyancers Act (Conduct and Client Care) Rules 2008 provides as follows:

> "A lawyer must promptly disclose to a client all information that the lawyer has or acquires that is relevant to the matter in respect of which the lawyer is engaged by the client."

Mrs PC says that she was "left with the clear impression ...". That would indicate that she did not directly ask Mr WY what had become of the deposit. I have noted that email correspondence from Mrs PC on 12 March requests an explanation of "the procedure re the deposit and settlement balance". This again, was not a direct inquiry as to where the funds were. In the circumstances, it cannot be stated on the balance of probabilities (which is the standard of proof required in disciplinary proceedings) that Mr WY misled Mrs PC. To the contrary, the letter of engagement included specific notification that all outstanding costs would be deducted from the sale proceeds.

[55] Rule 11.1 of the Conduct and Client Care Rules provides that:

> "A lawyer must not engage in conduct that is misleading or deceptive or likely to mislead or deceive anyone on any aspect of the lawyer's practice."

[56] These statements gave the impression that the funds had been paid out to a third party, and were no longer held by ADM. They were certainly not held by ADM on trust for ADL. To that extent, the statement by Mr WY that "we are not holding funds here for our client" was correct. Similarly, it can be argued that the earlier statement that the balance of the deposit "was paid out in accordance with our client's instructions" was also correct.

[57] When these statements are analysed, it is clear that Mr WY was not answering the inquiries from ADN directly. He did not say "the funds have been used in payment of our outstanding costs "in the way that [Mr WY's partner] did subsequently. He was evasive and ambivalent. Another view is that he was playing semantics with ADN. Whichever way it is viewed, it would be something of a misdescription to categorise the statements as misleading or deceptive, or likely to mislead or deceive. At most they were as noted, evasive ambivalent or semantic.

[58] On balance, I do not consider that Mr WY has breached Rule 11.1, although I do not think he has enhanced his own reputation or that of the Profession by engaging in these tactics.

[59] In reality, neither ADN nor KB were, or were likely to have been misled or deceived by Mr WY's statements. He had communicated to ADN from the outset that he intended to apply the funds to the firm's outstanding costs and both of those parties would have deduced readily that this was how the balance of the deposit had been applied.

The authority to deduct fees

[60] Mr WY included in his letter of engagement a statement that he intended to deduct all outstanding costs. This reflected the arrangement that he had with his client that when sales were achieved, his costs would be paid. As noted, that letter was sent to the company, care of the address where Mrs PC was residing.

[61] Mr WY then obtained an authority from Mr PC that reflected that intention. Mr KC and Mrs PC in her affidavit, state that Mr WY was aware of a resolution that the signatures of both directors were required for all matters involving the company. Mrs PC alleges that Mr WY had constructive knowledge that instructions should not be taken from one director only.

[62] It is commonly accepted that an authority such as that obtained by Mr WY needs only to be signed by one director, unless the person acting in reliance of it has

actual knowledge that the authority of both directors was required. There has been nothing provided by Mr KC or Mrs PC to show that this was the case. Instead, Mrs PC refers to a constructive and deemed knowledge.

[63] It is not appropriate that I should stray into investigating the legal status of the authority and whether or not Mr WY had constructive knowledge as alleged by Mrs PC. Those are decisions that should be made in another forum. The Standards Committee and the LCRO are concerned with disciplinary issues. Certainly, the Trust Account Rules require that any payment out of a client's funds should only be made with appropriate authority and instructions from the client. However, it is fair to say that an authority from a director of a company with ostensible authority constitutes such an authority, unless the solicitor is on actual notice that the authority of both directors was needed to make any such payments.

[64] Mrs PC refers to "constructive knowledge". It would not be appropriate to make an adverse disciplinary finding against a solicitor based on an allegation that the solicitor had constructive knowledge of instructions. Such instructions would need to be clear and Mrs PC's affidavit does not provide any evidence that this was the case.

[65] The allegations made by ADN that Mr WY's actions constituted unsatisfactory conduct are also unsupportable. ADN assert that because Mr WY had deemed knowledge of their clients' secured status by reason of the GSA, his conduct was therefore unsatisfactory conduct in terms of the Act. That cannot be sustained. In the first instance, it would be most unusual to make a finding of unsatisfactory conduct based on a "deemed" state of knowledge. In addition, even if the knowledge existed, Mr WY had no duty to KB. His duty was to ADL and if it is accepted that the authority was valid, then it was ADL which had breached the terms of its security by authorising disbursement of the funds, contrary to ADL's obligations.

[66] ADN also assert that Mr WY was on notice that the balance of the deposit was required for part-payment of the mortgages and that therefore he was deemed to be holding the balance of the deposit as trustee for the mortgagees. They then state that by applying the funds to outstanding costs, Mr WY was in breach of a fiduciary duty to KB. None of these assertions support a finding of unsatisfactory conduct. They are all assertions that require to be tested in Court. The disciplinary process is not an alternative to court proceedings and these submissions should properly be advanced in support of a civil claim.

The events of 25 February 2010

[67] For the sake of completeness, an examination of what took place on this day should be undertaken.

[68] At 9:57 a.m., ADN wrote to Mr WY on behalf of KB, requiring ADL to settle the sale of the properties and deduct only specified amounts. These amounts did not include ADM's outstanding costs. ADN required confirmation that Mr WY had instructions from ADL by midday to proceed in this way. ADN advised if that was not forthcoming, KB intended to exercise its rights under the mortgage, which included completing the sale as the attorney of ADL.

[69] At 3:02 p.m., Mr WY's secretary advised the BNZ that settlement could not proceed as originally anticipated because they had been unable to obtain a release of the KB mortgage.

[70] At 4:03 p.m., Mr WY advised the solicitor for the purchaser that he had been unable to obtain a release of the second mortgage and that accordingly, ADL was not in a position to settle.

[71] At 5:27 p.m., ADN then advised Mr WY by fax as follows:

> "Further to our previous correspondence and telephone conversation, we advise that our client will exercise its right to complete the sale of the above properties with your client's purchaser as your client's attorney pursuant to clause 5(i) of the mortgage.
>
> Our client hereby demands the balance of the deposit of $42,350 together with all interest earned (if any) held in your trust account to be paid to us."

[72] The situation as at 5:27 p.m. was therefore:

1. The deposit had been applied 2 days previously by Mr WY in payment of outstanding costs on the basis of the authority held by him.

2. Mr WY had not accepted the terms on which ADN had indicated they would provide a discharge of the mortgage.

3. The demand for the balance of the deposit was made after the funds had been utilised in payment of outstanding costs.

[73] Mr KC, perhaps justifiably, feels cheated. However, the actions taken by Mr WY were at all times in accordance with his instructions and authority. To counter the authority provided by Mr PC, KB would have needed to issue instructions prior to 19 February as attorney for ADL, countermanding the authority that had been provided on

8 February and require the funds to be held and/or applied to payment of the KB mortgage.

[74] These steps were not taken by KB and/or ADN and, although the end result may not have been as expected by Mr KC, it is not appropriate that the disciplinary process be utilised in an attempt to rectify an outcome that is not in accordance with Mr KC's expectations.

Summary

[75]

- The evidence is insufficient to support a claim that Mr WY misled KB prior to the agreement being signed.
- He signalled to his client at the time of confirming his instructions that he intended to deduct his fees from the proceeds of sale.
- Mr WY notified ADN that he intended to deduct his outstanding costs from the proceeds of sale.
- He obtained an authority from his client to apply the sale proceeds in the manner intended.
- The authority was such as would be acceptable in usual circumstances and was not countermanded by KB as attorney prior to the funds being disbursed.
- Mr WY was not on notice that all payments on behalf of the company required authorisation from both directors.
- It was not disputed that the accounts were due and payable.
- Mr WY acted in accordance with the authority obtained.
- He was somewhat evasive in answering enquiries from ADN as to how the funds had been applied, but his statements are not such that they constitute a breach of Rule 11.1.
- KB retains the ability to pursue ADM to require that firm to repay the funds to KB as a secured creditor.
- Mr WY had no duty to KB.

[76] The result of this review is that I concur with the finding of the Standards Committee that no further action is necessary or appropriate.

Decision

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

DATED this 30th day of March 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:

KC as representative of the Applicant
WY as the Respondent
WX as representative of the Respondent
The Waikato Bay of Plenty Standards Committee 1
The New Zealand Law Society