LCRO 123/2014

CONCERNING	an application for review pursuant to section 193 of the Lawyers and Conveyancers Act 2006
AND	
CONCERNING	a determination of [Place] Standards Committee [X]
BETWEEN	**JZ** Applicant
AND	**[PLACE] STANDARDS COMMITTEE [X]** Respondent

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

Introduction

[1] This review engages the question as to whether or not the Nominee Company Rules[1] apply to client funds received by a lawyer for investment in an unsecured contributory loan.

Background

[2] Mr JZ was/is the sole principal of ABC Ltd. It is assumed he was the sole director of the firm's nominee company at the relevant times.

[3] Pursuant to instructions (presumably from Mr XT) Mr JZ prepared a term loan agreement to record an advance to Mr SQ. Mr SQ is the son of Mr XT.

[4] The agreement was signed and dated 1 December 2008. It recorded the lenders as being XT and XT as trustee B Trust and as trustee C Trust. Consequently Mr XT was the common lender for himself personally and as trustee of the two trusts.

[1] Lawyers and Conveyancers Act (Lawyers: Nominee Company) Rules 2008.

[5] The contact details for the lenders were recorded as being those of ABC Ltd. and it is accepted that the firm was to receive payments from the borrower and distribute these by way of journal to the lenders.

[6] The loan was unsecured and repayable on demand. Interest was payable from 1 April 2008 at intervals during the term of each year.[2]

[7] In June 2013 Mr DR, a New Zealand Law Society inspector, conducted a routine audit of the firm and in his report to Mr JZ Mr DR commented about the loan: [3]

> This private loan is a contributory loan (three contributors) and thus falls into the Nominee company regime by dint of Trust account Regulation 39. You have not it seems advised those contributors of the interest arrears of $26,775, which on a $90,000 loan is considerable. Again there is no evidence that you mentioned these arrears in your certifications nor complied with Rule 13. You advance some argument that the loan is not subject to the Nominee company rules but I cannot follow that argument.

[8] Rule 13 of the Nominee Company Rules set out procedures to be followed on default.

[9] Mr DR's report was referred to the Standards Committee which determined to commence an own motion investigation of the issues raised.

The relevant Regulations

[10] The relevant Regulations referred to in this decision are:

Lawyers and Conveyancers Act (Trust Account) Regulations 2008 – Reg 39:

> **Contributory mortgages**
>
> (1) If money is received by a lawyer from a client for the purposes of investment in a contributory security other than through a lawyers nominee company, the lawyer must ensure that the provisions of any applicable rules concerning lawyers nominee companies relating to the following matters are complied with as if the investment were to be made through a lawyers nominee company:
>
> (a) the authorities to be given by investors:
>
> (b) the information to be given to investors:
>
> (c) registration of securities:

[2] Different copies of the term loan agreement on the Standards Committee file have different advance dates and dates for payment of interest. This does not affect the nature of the loan as an unsecured loan.

[3] Letter DR to ABC Ltd (19 June 2013) at [5].

(d) the prohibition against the taking or holding of a security from an associated person and the disclosure required before an associated person can be a guarantor or indemnifier:

(e) default procedures:

(f) the restrictions relating to advancing moneys on the security of development mortgages.

(2) Subclause (3) applies if a lawyer is instructed to apply money under a loan agreement on behalf of a lender under that agreement, and—

(a) the lender has specified the borrower to whom the money is to be lent; and

(b) the lender has not been introduced to the borrower by the lawyer for the purpose of making that loan (other than, where the lender is a financial institution within the meaning of the Reserve Bank of New Zealand Act 1989, by means of an application for the loan); and

(c) the lawyer has not made or participated in the decision to approve the making of the loan, other than by advising in respect of the terms and conditions of the loan agreement; and

(d) the lender has acknowledged in writing that all or some of the provisions of subclause (1) of this regulation are not to apply in respect of that loan.

(3) If this subclause applies, the provisions of subclause (1), or those of them that have been specified under subclause (2)(d), do not apply in respect of the loan.

Regulation 17(2)

(2) Every trust account supervisor (other than a trust account supervisor of a practice comprising conveyancing practitioners) must certify to the New Zealand Law Society in writing, by the tenth working day after the end of each of the quarters of March, June, and September and the 15th working day after the end of the December quarter in each year, the following information in respect of the quarter concerned:

(a) whether the collection of interest on any loans or other debt securities was undertaken on behalf of lenders by the practice during the quarter:

(b) the number and total dollar amount of those loans or securities, and of each group of loans or securities specified by the relevant society from time to time:

(c) whether any of the borrowers are in default for more than 30 days in payment of any principal, interest, or other moneys payable under any of those loans or securities, and if so, the total amount of –

(i) interest in default; and

(ii) principal in default; and

(iii) other moneys in default.

Regulation 3(1) – definition of "contributory security"

> **contributory security** means a security (including a mortgage of land, charge, or other security interest) granted in favour of more than 1 person, each of whom is named, and whose share is specified in the security (and for the purposes of this definition, persons acting jointly must be treated as 1 person)

Mr JZ's submissions

[11] Mr JZ disagreed with Mr DR that the advance was to be treated as if it were an advance through the firm's nominee company in accordance with Reg 39. He argued that as the loan was not secured by mortgage or otherwise neither Reg 39 of the Trust Account Regulations or the Nominee Company Regulations applied. He noted that while Mr DR did not "necessarily concur" with his submissions he nevertheless deferred to the Committee's view. [4] In other words, Mr JZ submitted that Mr DR had no firm view.

[12] Mr JZ did not agree the firm was responsible for collecting interest. He says that "it simply offered to the lender to issue invoices for interest"[5] for the following reasons:

- The two trust lenders had no physical or postal address.
- ABC Ltd prepared tax returns for the trusts and the address for the trust shown in those returns was ABC Ltd.
- Mr XT did not want to issue the invoices for himself and agreed for ease of administration that payment would be receipted into the firm's trust account and distributed between the three lenders by journal entry.
- No collection commission was charged or costs rendered of any kind.

[13] Mr JZ noted that seven paragraphs of the quarterly certificate to be provided to the New Zealand Law Society referred to "mortgages" and the reference to "securities" in three other paragraphs "is obviously intended to refer to the mortgages previously entered".[6]

[4] Letter DR to Standards Committee (13 September 2014).
[5] Letter JZ to NZLS (18 November 2013).
[6] Letter JZ to NZLS (18 October 2013).

[14] Mr JZ requested the Standards Committee to provide an explanation as to why it considered the references in the certificates imposed "an obligation on a trust account partner to report to the Society in respect of an unsecured loan".[7]

[15] He submitted the New Zealand Law Society should provide an authoritative ruling as this was a "matter of considerable importance to all law practitioners in New Zealand and it should be absolutely clear why references to mortgages can be interpreted as references to unsecured loans".[8] He submitted the matter should not be determined by "the [Place] Standards Committee".[9]

The Standards Committee determination

[16] The Standards Committee identified the following issues to be addressed:[10]

a. Does the contributory loan constitute a *contributory security* for the purposes of Regulation 39 of the Trust Account Regulations?

b. Does the unsecured contributory loan to Mr SQ constitute a loan or other debt security for the purposes of Regulation 17(2) of the Trust Account Regulations?

c. If the answer to question b. is Yes, should Mr JZ, as Trust Account Supervisor of ABC Ltd, have identified the SQ loan when completing the quarterly certificates to 31.12.12 and 31.03.14 [sic]?[11]

Two sub-issues apply to c.:

d. Was Mr JZ or ABC Ltd responsible for the collection of interest under the SQ loan on behalf of the lender contributors?

e. Was the borrower in fact in default in the payment of interest as at 31.12.12 and 31.03.13?

Then:

f. If the answer to issue c. is 'Yes', does the incorrect certificate constitute unsatisfactory conduct?

[7] Above n 7.
[8] Above n 7.
[9] Above n 7.
[10] Standards Committee determination 14 April 2014, at [8].
[11] Paragraph [8](c) of the Standards Committee determination refers to certificates dated 31.12.12 and 31.03.14. The latter date should refer to the certificate dated 31.03.13.

Was the loan a contributory security in terms of Regulation 39?

[17] The Committee noted that the terms "contributory security' is defined in Reg 3(1) of the Trust Account Regulations. The Committee said:[12]

> … for the purposes of the interpretation exercise, [the Committee] has relied on the wording of the Regulation itself, read in the context of the Regulations as a whole, against empowering provisions in the Lawyers and Conveyancers Act 2006.
>
> The Committee reads *contributory security*, as it appears in Regulation 39(1), to be restricted to forms of secured loan, viz mortgage of land, charge or other security interest identified by Regulation 3. A common feature of all the forms of contributory security, given in the definition Regulation involve a form of security interest, charged against land or other property. The definition does not extend to encapsulate an unsecured loan advance.

[18] The Committee did not therefore consider the unsecured loan to be a contributory security for the purposes of Reg 39(1).

Was Mr JZ required to include the loan in his quarterly certificates in accordance with Reg 17(2)?

[19] The Committee noted that:[13]

> The key words for the Committee in sub-clause 2 are *any loans or other debt securities*. Mr JZ argues that the word *loans* is restricted to a form of debt security. He suggests that "*the only logical and reasonable* (*sic*) *plain meaning of 'loans or other debt securities' is that the loan must be a debt security in order to give rise to an obligation to report on it in the quarterly certificates".*
>
> None of the terms are defined in the Trust Account Regulations and no direct guidance can be taken from any other provision in the Regulations, nor the Act. The Committee has noted that the use of the phrase varies across the three sub-paragraphs of Regulation 17(2), viz: *any loans or other debt securities* in sub-clause a.; but *loans or securities* appears in sub-clauses b. and c. The latter presents as a reduced or condensed form of the full description used in sub-clause a. and therefore has the same meaning and scope of application.
>
> The word *any* appearing in sub-paragraph (4) is important, and signifies to the Committee that all forms of loans and all forms of debt securities are encapsulated. That fits with the basis and purpose of the trust account reporting regime, where each trust account supervisor is required to certify as to the compliance and correctness of all trust account transactions. The monthly and quarterly certificates are the corner stone of the regulatory regime. The certificates must be accurate and correct, and the associated disclosure fulsome, to the extent that if there is any doubt over a point of detail, or whether an element is actually captured by the Regulations, then as wide a net as possible should be applied and a purposive approach taken to ensure the integrity of the scheme.

[12] At [15]–[16].
[13] At [19]–[22].

> The Committee perceive no reason to read the word *loans* as limited to secured loans. The conjunction 'or' should be read to express an alternative or to list different examples. Both secured and unsecured loans, including *other debt securities* are captured.
>
> The Committee therefore interprets Regulation 17(2) as requiring a trust account supervisor, in this instance Mr JZ, to disclose each and every loan the practice is responsible for the collection of interest under, whether a secured or unsecured loan or other debt security.

Should Mr JZ have included the loan in his certificate?

[20] Question four of the certificate for the quarter ended 31.12.12 required a response to the question as to the amount of interest in default under any "loans or other securities" collected on behalf of any lender. Mr JZ responded with the word – "nil".

[21] Following the reasoning in [21] and [22] of the determination, the Committee determined that Mr JZ's response to the question should have been to include reference to the SQ loan.

[22] The Committee noted that the wording of the standard form certificate required for the period ending 31.03.13 had changed and the question asked in that form of the trust account supervisor was to advise of the "total number of mortgages in default". Mr JZ's response was "0".

[23] The Committee acknowledged that answer was correct.

Was Mr JZ responsible for collection of interest?

[24] The Committee concluded that "ABC Ltd took responsibility to collect interest on behalf of the contributors".[14]

Was the borrower in default at the time the certificates were provided?

[25] The evidence is that Mr SQ was in default in payment of interest at the time the certificates were provided.

If Mr JZ had provided an incorrect certificate is that unsatisfactory conduct?

[26] The Committee determined Mr JZ had provided an incorrect certificate for the period ending 31.12.12 but the certificate for the period ending 31.03.13 was correct.

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[14] Above n 11 at [10](c).

[27] The Committee's determination reads: [15]

> The Committee views a lawyer's failure to accurately complete a quarterly certificate as Trust Account Supervisor, seriously. Quarterly certificates, as well as the monthly certificate under Regulation 17(1), are fundamental mechanism to the Trust Account regime. The responsibilities of each trust account supervisor when completing his or her certificate is reflected by Regulation 16(4)(c) which obliges the trust account supervisor to take *appropriate measures to verify the correctness of, and sign, all reports required by these regulations.* A lawyer, when completing a quarterly certificate, must also be mindful of their obligations under Rule 2.5 of the Lawyers and Conveyancers Act (Lawyers: Conduct and Client Care) Rules 2008):
>
> > *A lawyer must not certify the truth of any matter to any person unless he or she believes on reasonable grounds that the matter certified is true after having taken appropriate steps to ensure the accuracy of the certification.*
>
> From the submissions made, it is clear to this Committee that Mr JZ relied on his personal interpretation of Rule 17(2)(a), that only debt securities were required to be disclosed in his quarterly certificate and not unsecured loans. Whilst the Committee does not accept Mr JZ's interpretation, or the basis he applied in reaching his view that the Regulation did not apply to the SQ loan, the Committee accepts that his interpretation is not unreasonable.
>
> The Committee considers Mr JZ's actions in contravention of the Trust Account Regulations, to constitute unsatisfactory conduct under s 12(c) of the Act. It is also 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 under sub-paragraph a. The Committee is satisfied that it is not misconduct, there being no evidence to suggest that his actions were in wilful or reckless contravention of the Regulations.

[28] The Committee:

- Censured Mr JZ.
- Imposed a fine of $500; and
- Ordered Mr JZ to pay costs in the sum of $1,000.

Review

[29] This review has been completed on the material to hand with the consent of the parties.[16]

[30] The Committee's determination is carefully considered. It reached the view that an unsecured loan does not fall within the nominee company regime "by dint of Trust Account Regulation 39"[17] on the basis that a "contributory security as it appears

[15] At [29]–[31].
[16] Lawyers and Conveyancers act 2006, s 206(2).
[17] Letter DR to ABC Ltd (19 June 2013).

in Regulation 39(1) [is] restricted to forms of secured loan, viz mortgage of land, charge or other security as identified by Regulation 3."[18]

[31] It also recognised the practical reality that:[19]

> … in any case a responsible lawyer receiving unsecured funds, [i.e funds for unsecured lending] could not have applied any of the Nominee Company Rules, specifically those requiring preparation of security documentation, execution and registration.

[32] I agree with the Committee's reasoning.

[33] In addition to the Committee's views I note that Regulation 39(2) specifically provides that "if a lawyer is instructed to apply money under a loan agreement on behalf of a lender under that agreement and …" certain conditions apply (refer paragraph [10] above) then sub-clause 3 applies.

[34] A loan agreement can either be supported by a security or not but it is unclear why specific reference is made in reg 39(2) to money advanced under a "loan agreement" as distinct from "money received … from a client for … investment in a contributory security …" (as in reg 39(1)) if for no other reason than to distinguish between secured and unsecured advances.

[35] Sub clause 3 provides that the requirement to comply with the nominee company rules (or specified rules) does not apply if all conditions are satisfied and from the evidence provided it seems that conditions a - c of reg 39(2) were satisfied. The only condition not satisfied was that Mr XT had not acknowledged the provisions relating to nominee companies were not to apply.

[36] The specific reference to a loan agreement in reg 39(2) reinforces the Committee's determination that reg 39(1) does not apply to unsecured loans.

[37] For these reasons I confirm the Standards Committee determination in this regard.

The finding of unsatisfactory conduct

[38] The finding of unsatisfactory conduct is based on the Committee's finding that Mr JZ had provided an incorrect certificate for the quarter ending 31 December 2012. That was a breach of reg 17(2) of the Trust Accounts Regulations, and therefore

[18] Above n 11, at [16].
[19] Above n 11, at [17].

unsatisfactory conduct pursuant to s 12(c) of the Act. That is the finding recorded under the heading of "Determination" in the Committee's Notice of Determination.

[39] However, at [31] of the determination, the Committee made the statement that the breach of reg 17(2) is

> also conduct which falls short of the standard of competence and diligence that a member of the public is entitled to expect of a reasonably competent lawyer under sub-paragraph a.

[40] Mr JZ submits that this finding is:[20]

> completely unjustified…as…in the context of no client having been adversely affected, and the technical nature of the breach, it seems…that a member of the public would have no expectations of how [he] should have behaved." That is a reasonable submission, and there is no need for the further finding of unsatisfactory conduct pursuant to s12(a) when the breach as found, falls squarely within the definition of unsatisfactory conduct in s12(c).

[41] This is particularly so, when the Committee itself has acknowledged that Mr JZ's interpretation of the wording of the certificate was "not unreasonable".[21] If Mr JZ's interpretation is "not unreasonable" it can not also be said that he is lacking in competence or diligence.

[42] Mr JZ submits that the finding he has breached reg 17(2) is based on an unclear interpretation of the wording in the certificate. The Committee considered Mr JZ should have erred on the side of caution and disclosed any matter which potentially could have been included in the certificate, rather than relying on his own interpretation of the questions asked in the certificate. The Committee's comments on the purpose and importance of the quarterly certificates are extremely pertinent in that they do form the "corner stone of the regulatory regime".[22]

[43] However whilst those observations and comments are indisputably correct, the Committee itself acknowledged there is room for differing interpretations of the wording of the certificate in question. The wording was in fact changed for the following quarter and thereafter to reflect exactly Mr JZ's interpretation.

[44] A finding of a breach of the regulation should only be made where the meaning is clear. That is not the case here, and the finding rests on shaky ground. In the circumstances this is a situation where the Committee should exercise its discretion to take no further action.

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[20] Application for Review, Part 7 at [4].
[21] Above n 11 at [30]
[22] Above n 11 at [20].

[45] Mr JZ's observation that no client had been adversely affected and "the Law Society could have taken the matter no further if [he] had reported the default"[23] is also relevant. Mr XT was well aware of the defaults and in fact instructed the firm to treat the defaults (at least in part) as distributions to his son by the Trusts. This raises the question as to whether there were, in fact, any defaults to be reported.

[46] Overall the finding of unsatisfactory conduct by reason of a breach of reg 17(2) is not soundly based and should be reversed.

Decision

Pursuant to s 211(1)(a) of the Lawyers and Conveyancers Act 2006 the determination of the Standards Committee that Mr JZ's responses in the certificate dated 31 December 2012 constituted unsatisfactory conduct is reversed. In all other respects the determination of the Standards Committee is confirmed.

DATED this 16TH day of December 2016

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:

Mr JZ as the Applicant
[Place] Standards Committee [X] as the Respondent
[Place] Standards Committee
The New Zealand Law Society

[23] Above n 20, Part 7 at [2].