

# Fraud: A growing problem affecting all lawyers

*The claims reported in 2008 to date are troubling. They are troubling because of the size of the claims, and the fact that so many of them are as a result of fraud. They are also troubling because not all of the losses suffered by the lawyers involved are covered under the LAWPRO policy.*

In the first five months of 2008, more than 50 claims with a fraud component have been reported to LAWPRO, compared to 35 for the same January to May period in 2007. We estimate the cost to the program of these frauds at more than \$4 million.

In addition to this, there is no easy “quick fix” way to avoid these frauds. The reality is that, as never before, lawyers have to take control of the processes and procedures in their offices and be constantly vigilant.

Many of you will already have read about, and some of you may be the victim of, two new types of fraudulent scams.

## Business loan fraud

In the first scenario, a new client introduced to you by a broker or a former client, is in the process of setting up a business and is borrowing money to buy inventory or materials. The loan documentation looks legitimate and the deal is processed. A certified cheque is deposited in the lawyer’s trust account. The lawyer draws a certified cheque on his/her trust account as directed. Several days after that cheque is cashed, the lawyer is advised that the deposit cheque is counterfeit and there is a shortfall in the trust account.

Using this type of scheme, fraudsters successfully duped 10 lawyers over the Christmas and New Year holiday time. They struck again just before the May long weekend and four more claims were reported and four more lawyers were left with shortfalls in their trust accounts.

The lesson? Be extra vigilant during periods of time when there are banking holidays. When banks are closed for a day and offices are short staffed, the fraudsters have a bit more time to complete their plans.

## Debt collection fraud

Equally disturbing is that these fraudulent schemes are not unique to Ontario. In Nova Scotia, an alert to members of the bar described a situation in which the lawyer narrowly missed becoming a dupe in a fraud situation. This involved a UK company asking for representation in the collection of an \$110,000 debt owed by an Ontario company. The creditor offered to pay fees of 20% of the amount collected to the lawyer.

Notwithstanding that the law firm never formally agreed to represent the UK creditor, the lawyer received a telephone call from a woman who identified herself as being the accounts payable department of the debtor company. A \$110,000 certified cheque from the company was delivered to the law firm. The cheque looked authentic, and appeared to have all the normal security features. Via email, the lawyer was directed by the creditor to send the funds, minus legal fees, to an accountant in Singapore.

This lawyer too was aware of earlier fraudulent schemes that had been reported, and before complying with the direction, he directed his staff to do some independent checking on the debtor and creditor companies.

A Google search of the debtor company revealed an Ontario company with the same name, or close to the same name; but when contacted the legitimate company advised that it did not have an office in Ottawa. A reverse phone search of the company phone number shown on the cheque showed an address for what appeared to be an apartment complex in Ottawa, Ontario. Nothing could be found about the UK company. The law firm also reviewed the bank’s website to determine if the bank address listed as a branch on the debtor cheque was shown on the bank’s website. The bank’s website did not list the address on the debtor cheque.

The lawyer then asked the local branch manager to check with the bank whose transit number was shown on the cheque, and that bank advised that they did not have a branch at the address noted. They confirmed that this was the sixth call they had received that day relating to this type of fraudulent scheme.

## Lawyers are listening

The good news is that many lawyers are reading articles like this one, and paying attention to alerts, notices and emails from trusted legal sources. Many lawyers are alert to the fact that someone might be trying to dupe them, and they are developing a heightened sixth sense. Michel Castillo of the firm Advocates LLP contacted LAWPRO and wrote us the following note:

“I recall reading the Fraud Scam Alert in the Winter 2008 edition of the LAWPRO magazine. In particular I recall reading about the fake UK business man. Sure enough, a few days ago I received an unsolicited e-mail from a UK business man calling himself Bill Stevens. With the article fresh in my mind,

I followed up with Stevens. Meanwhile, I researched the company he purported to work for. It is a legitimate company, but does not do the type of work that the Stevens described. I wrote to the company to confirm whether Stevens worked there. As it turns out, surprise-surprise, Stevens does not work for that company. And strangely enough, I never heard from Stevens again."

What protected this lawyer was not simply that he was alert to the issue, but that he took several steps to assure that he was dealing with a legitimate person. In addition, he wrote back to the potential client before accepting the retainer, and requested certain information.

"Thank you for your e-mail below. We do not undertake this type of work on a contingency basis. If you would like to retain our services, we will require a CAN \$10,000 retainer. In addition to the retainer we will need:

1) the names of all parties involved in the transaction/dispute so we can undertake a conflict check;

- 2) all documents relating to the sale, including correspondence, bills of lading, receipts, invoices, proof of payment, etc.;
- 3) a telephone discussion to obtain full particulars of the potential claim;
- 4) a director's resolution from (the firm) confirming (the firm) agrees to retain our services and will undertake to pay our account.

Lastly, please advise how you obtained my name and reference. Thank you."

LAWPRO has been publishing fraud alerts since 2004, but methods of committing fraud continue to evolve. There is no simple answer to protecting your clients, your firm and yourself.

But as these lawyers have demonstrated, by being alert it is possible to avoid being the victim of a fraud. Continue to educate yourself and your staff. The more people in your firm who are alive to the unusual elements in a transaction, and who are willing to ask the next question, the better positioned you and your firm are to avoid being a victim of fraud.

## Not all claims are covered

The LAWPRO policy is an errors and omissions policy and protects lawyers in the event that they have made an error in the course of providing professional services for clients. It provides coverage for claims for damages, provided that the liability of the lawyer is the result of an error, omission or negligent act in the performance of or the failure to perform professional services.

Not all claims made against lawyers are covered under the policy. If, for example, a client fell on a mat in your office and broke an ankle and subsequently sued you for damages, the LAWPRO policy would not respond. Part III (e) of the policy specifically excludes claims for this type of injury. Similarly, claims for fees and claims arising out of business ventures are among other exclusions listed in Part III of the policy.

Coverage for claims involving counterfeit bank drafts and certified cheques are not specifically insured or excluded from coverage under the Law Society insurance program policy with LAWPRO.

Under a professional liability insurance policy, LAWPRO looks to the circumstances of the claim reported to determine whether the necessary elements are there for coverage to apply, and then ensures that there is nothing within the policy that may serve to restrict or exclude coverage.

For example, this means ensuring that, under the principle insuring agreement under the program policy (Part I "Coverage

A. DAMAGES"), the claim;

- arises out of the performance of Professional Services for others,
- that the insured's liability is the result of an error, omission or negligent act,
- that Damages arise out of the Claim.

Presuming the special provisions (dealing with territory and policy period) and general conditions of the policy are met, and no exclusions apply, coverage then would be provided.

In situations in which a lawyer has suffered a shortfall in a trust account because of reliance on a counterfeit instrument, claims are likely to arise once the true nature of the instrument has become known and the instrument is declined.

To the extent that a shortfall is experienced by the lawyer's clients to whom professional services had been or were intended to be provided, coverage is generally available. To the extent that a shortfall rests between the lawyer and his/her bank, no coverage is generally available in the absence of any Professional Service having been provided to the bank.

It is very important therefore that you are alive to any potential fraud. If you have not educated your staff, please ensure that they are familiar with the indicia of fraud and that they come to you with any concerns, no matter how minor. Your trust account is the key to a successful practice.

# Fraud: The threat from within

The lawyer leaves the office on a Friday night, wishing his long-term, still hard-at-work law clerk a great weekend. He comes back to the office on Monday to a quickly unfolding nightmare. His trusted employee does not show up for work. He soon discovers that his client files and trust records are missing and ultimately realizes that trust funds are gone as well.irate mortgagors and mortgagees start calling, demanding mortgage funds and discharges but his trust account has been depleted of funds which were earmarked for those purposes. In some cases, he discovers that the mortgages are fraudulent or have never been registered. Everyone is looking to him for having breached a trust owing to his clients.

This is not the storyline of the next legal thriller. This is reality. While value, title and identity fraud are now commonplace in commercial and real estate transactions, and lawyers tend to be much more alive to these issues when meeting with new clients, they may not appreciate that long-term employees are also responsible for millions of dollars of losses each year.

## Fraud by trusted long-service employees

The time for background checks of these employees had long-since passed. They have usually been employed with the same law firm for upwards of 20 years. They have intimate knowledge of their employer's law practice, clients, schedules, signatures and trust records. They are usually relatively autonomous and are rarely supervised (if at all) by their employer.

Sole practitioners and small firms are particularly vulnerable to employee fraud. Sole practitioners, especially those with a high-volume real estate practice, often significantly rely on their administrative support team. Their clerks, bookkeepers and assistants are often the ones that "run the practice."

Generalists who do not limit their practice to real estate files but also handle litigation matters are possibly at an even greater risk. As a result of being out of the office and in court some of the time, they may give their employees authority to meet with and sign up clients, sign cheques and register documents through Teranet. The employees often have the lawyer's e-reg® passwords in order to close transactions in breach of Teranet security protocols and the Rules of Professional Conduct.

Hundreds of thousands of dollars of client trust funds often pass through their trust accounts each month. Based on LAWPRO's claims experience, the relatively easy access to these funds becomes irresistible to their employees.

## Warning signs

There are often warning signs which are overlooked or even ignored. Lawyers are often reluctant to accept that an employee, especially a long-term one, has done any wrong.

But the signs are there: The employee's opulent lifestyle, for example, may not accord with what he is earning. The employee may be acting erratically or in a manner different from his previous behaviour. He may find himself explaining away or apologizing for numerous inconsistencies in the books and records when they are brought to his attention by the lawyer. He may be meeting or associating with people who are known to the lawyer to be of unsavoury or suspicious character. He may take few, if any, days off so that a replacement cannot find out what he has been up to.

If enough indicia of fraud are present and the lawyer fails to turn his or her mind to it or take steps to question or deal with the employee, the lawyer's conduct may amount to wilful blindness and may jeopardize any coverage that may have been otherwise available to that lawyer under the LAWPRO policy.

How can you avoid becoming a victim of employee fraud?

1. Start by being mindful of Rule 5.01 of the Law Society Rules of Professional Conduct and the commentary to that Rule which deals with supervision of employees and the electronic registration of title documents. **Never give anyone your Teranet PSP and password.**
2. Never authorize your employees to sign cheques on your behalf and never sign blank cheques for any reason. If you do, you will be in breach of Part IV, section 11 of By-Law 9 which deals with Trust Account Transactions. Only your partners should have authority to sign your trust cheques. Your surplus trust cheques should be securely stored where no employees can access them. Large trust cheques should require the signature of two partners.
3. Implement internal controls and safeguards in your law practice. Although by no means an exhaustive list, the following controls should be implemented to protect yourself from employee fraud:
  - When something seems out of place or unusual, ask questions until you get to the bottom of the inconsistency.
  - Fraudulent employees often work alone and are protective of their "turf." Avoid having one employee responsible for all accounting and bookkeeping functions. Inconsistencies are more likely to be discovered if multiple employees are handling the banking and bookkeeping entries.

- If vacation or illness forces you to be away from the office, your office should either be shut down or another lawyer should be engaged to monitor your practice and staff while you are away.
- Other employees may have significant insight into a particular employees' behaviour. Listen carefully to what your other employees may be telling you ... and trust your instincts.
- Stay involved in the reconciliation of your accounts and reconcile your accounts on a monthly basis.
- Consider whether fidelity insurance or bonding your employees would protect you.
- Purchase excess insurance.
- Consider hiring a consultant to review your internal controls and suggest changes.

Lawyers who carefully supervise their staff are less likely to be caught by surprise by employee fraud. A sloppily-run practice is a breeding ground for employees who may feel they are underpaid or have a real or perceived grievance which they may wish to remedy by biting the hand that feeds them.

No matter how busy your practice, do not abdicate responsibility for running your office to your staff. Take an active role in managing your risk by implementing as many internal controls as is practical. It is ultimately each and every lawyer's responsibility to manage and control their own practice in order to protect themselves and their clients from dishonest employees.

See page seven of the *Managing the Finances of Your Practice* booklet for a more complete list of internal controls ([www.practicepro.ca/financesbooklet](http://www.practicepro.ca/financesbooklet))

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*Karen Granofsky is claims counsel at LAWPRO.*

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# Avoiding the bad apple

## Screening new staff during the hiring process

Productive and honest staff are a critical part of every law firm. From an internal control and fraud prevention point of view, you want to make sure from the very start of the hiring process that you avoid hiring anyone that has skeletons in the closet.

To help you arrive at your shortlist, consider searching the Internet via Google and other search tools for information on job candidates that look promising. Don't overlook checking MySpace, Facebook, LinkedIn or other similar Web 2.0 social networking type sites for information.

Ask everyone you interview for multiple and appropriate references that will allow you to make all necessary inquiries into the candidate's background, both in respect to skills and experience, but also with respect to issues that may be of concern. Don't stop at just reading over the list of references – no matter how impressive it may be. Contact all references and make appropriate enquiries of them.

In addition to reference checks, other background checks to be considered are:

- education verification
- employment verification
- proof of eligibility to work in Canada.

If you are hiring a lawyer, check that he or she is a member in good standing of the Law Society, and has an appropriate level of competence, as confirmed by checks of discipline and claims records.

For employees who will have access to financial or other sensitive information, consider doing a criminal background check and a Credit Bureau and identification verification. This task is far easier if you use a background checking service such as BackCheck, ADP or ISB Corporate Services.

Note that these background checks will require the consent of the job candidate (get a duly signed consent form). The information you obtain must be used only for employment related purposes compliant with human rights, labour, and privacy laws, as applicable.

Follow-up with the candidate on anything that raises any concerns, and do not hire the person unless any concerns you have are explained to your complete satisfaction.

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*Dan Pinnington is director of LAWPRO's practicePRO program.*

# Show me the money



## Funds handling – and the benefits of wire transfers

The recent increase in the number of frauds – many involving counterfeit financial instruments – have been a wake-up call to the bar on two fronts:

- First – fraudsters are targeting all lawyers, not only real estate practitioners. For more on this, see the article ***Fraud: A growing problem affecting all lawyers*** in this issue.
- Second – that there is some confusion about how financial instruments move through the Canadian payments system and how lawyers can verify that funds deposited to their trust accounts are “good” – that is, final and irrevocable.

The following article is based on interview responses provided to LawPRO Magazine by three experts in the field of funds transfer: Martin Scisizzi of Borden Ladner Gervais LLP, Mike Seto of Teranet, and Pierre Roach, Vice President of Payment Services with the Canadian Payments Association.

The principal conclusions to be drawn from the interviews are as follows:

### **1. FUNDS CLEARED THROUGH THE CONVENTIONAL SYSTEM – THE AUTOMATED CLEARING SETTLEMENT SYSTEM (ACSS) – ARE NOT “GOOD” THE MINUTE THEY HIT YOUR TRUST ACCOUNT.**

**IN FACT, IN CERTAIN CIRCUMSTANCES, THESE FUNDS COULD BE SUBJECT TO RETURN FOR WEEKS OR EVEN MONTHS.**

**Pierre:** There is a distinction between a payment item “having cleared” and the payment being final or good funds. Clearing refers to the exchange of paper and electronic payment items between financial institutions (FI) and the reconciliation of balances among participating FIs.

Cheques and other paper payment items are generally cleared overnight following the day of deposit (as explained above, this

does not necessarily equate to “good funds” or funds being final and irrevocable). Settlement occurs on the morning of the next business day through the major financial institutions’ settlement accounts at the Bank of Canada.

Bank drafts and certified cheques cannot normally be returned through the clearing system and are final in most instances; however, there are certain exceptions. If either of these items has been materially altered after it was issued (e.g change of payee or amount), it can be returned through the clearing system for up to 90 days after the date of receipt by the drawee FI.

An item bearing a forged endorsement can be returned for up to six years (prior to June 2008, the return period was unlimited). In the rare event of the drawee financial institution’s default, they could also be subject to return until they are settled the following morning.

**Martin:** Upon deposit of a certified cheque or bank draft for collection, the payee is normally given immediate provisional credit by his bank for the full amount of the instrument. Generally speaking, the collecting bank has the right of “chargeback” by reversing or eliminating the provisional credit where the cheque or bank draft received by it for collection has been dishonoured...

If the drawee bank wishes to dishonour a cheque or other payment instrument (other than a certified cheque or bank draft), it is required to return the item “no later than the business day following receipt by the first organizational unit of the drawee (the bank on which the cheque is drawn) that is able to make or act upon a decision to dishonour the item.” This is usually a branch. A certified cheque or bank draft, strictly speaking, cannot be returned except for “material alterations” or a forged endorsement.

As the clearing process reaches every branch of every deposit-taking financial institution in the country, the time required to present an item physically to a branch of account varies from a day or two for branches in major centres to as long as eight to 10 days for those in more remote locales. It also depends on whether there are intervening statutory holidays.

As a result, generally speaking, it would not be safe to withdraw funds which have been provisionally credited for at least 8 to 10 days. Cheques drawn on U.S. banks can take as long as 30 days to clear.

## 2. THE OTHER FUNDS HANDLING SYSTEM OPERATED BY THE CPA – THE LARGE VALUE TRANSFER SYSTEM (LVTS) – ADDRESSES LAWYERS’ NEED TO KNOW FUNDS IN THEIR TRUST ACCOUNTS ARE “FINAL AND IRREVOCABLE.”

**Mike:** LVTS was introduced in 1999 and is currently the settlement process behind all wire payments between Canadian financial institutions transacting in Canadian funds. (Care should be exercised in relation to inter-branch wires; while a financial institution may use similar message formats (SWIFT), these transactions do not typically go through LVTS and do not automatically attract the same benefits.)

A bit of a misnomer, LVTS is not limited to large value transactions. Payments of just several dollars can be made through this system. However, in 2005, the CPA reported that 89 percent of the total value of transactions cleared and settled through its systems were made through LVTS (compared to about 1 per cent of the number of transactions).

The unique aspects of LVTS are:

- 1) Funds from a completed transaction are backed by pledged collateral and ultimately guaranteed by the Bank of Canada. To participate in LVTS transactions, financial institutions must pledge security to the Bank of Canada to cover the net balances of transactions made during the day. As a consequence, the Bank of Canada guarantees all completed transactions, backed by collateral pledged by financial institutions.
- 2) Once completed, transactions are irrevocable. Each LVTS transaction passes through controls operated by the CPA, that ensure there is sufficient collateral to back it. If controls are successfully passed, including sufficient security remaining, the transaction is completed **irrevocably** (and evidenced by a Payment Confirmation Reference Number – or “PCRN”). The payment is final.<sup>1</sup>

- 3) Timeliness. Typically, it takes under one minute for the CPA to complete a LVTS transaction from the initiation by a financial institution; therefore the claim of “near real-time processing.”

In the early days of LVTS, financial institutions were batching their transactions, thereby frustrating the benefits of near real time processing to wire customers. More recently, all of the major banks have introduced online commercial banking suites that include an online wire service (i.e. LVTS) and have been processing transactions individually. However, it is important to note that all of the banks have various and differing internal regulatory processes that may result in manual processing. This may delay a financial institution in processing a LVTS transaction but regardless, LVTS processing is far faster end to end than ACSS.

### COST ISSUES

The practical disadvantage of LVTS is its cost. A transaction usually costs \$10-\$15 for the entity making the payment and another \$10 to the party receiving payments. This varies slightly between financial institutions. (Not overly onerous when compared to the cost of obtaining certified cheques – around \$12 – and potential courier costs for delivery, but many firms have successfully negotiated with their banks to waive certification fees.) Additionally, if online services are used, some institutions require set up costs (some implement security devices with users) and others have monthly service charges.

An LVTS payment will not completely assure you that the underlying transaction is good (i.e. although the payment transaction is final and irrevocable, if there is a problem with the making of the payment itself – e.g. money laundering – there could be a claim that results in a reversal outside of the actual payment process). But it should provide a situation where your trust account will not be short due to a fraudulent instrument.

**Pierre:** A clear benefit for beneficiaries is that LVTS payments are final and irrevocable, once received by the beneficiary’s FI. In addition, the receipt of “good funds” can generally be confirmed the same day (with the potential exception of payments sent towards the end of the day).

As a sender of LVTS payments, one caution is to ensure you are dealing with a legitimate party as a beneficiary. Since payments are final once sent, they could not be stopped or reversed through the clearing system in the event of a scam. However, this issue is not unique to LVTS.

<sup>1</sup> As provided under the Payment Clearing and Settlement Act, S.C.1996, c.6 and the LVTS BY Law, sections 42 and 43 (available: [http://www.cdnpay.ca/systems/lvts\\_overview.asp](http://www.cdnpay.ca/systems/lvts_overview.asp))

## RISK MANAGEMENT RECOMMENDATIONS

**Pierre:** As a payment recipient, the best option from an irrevocability perspective is to request payment by wire transfer through the Large Value Transfer System (LVTS). LVTS payments are final and irrevocable as soon as they are received by the beneficiary's FI.

At a minimum, you should be very cautious about accepting items that have been endorsed over to another party, as there could be a risk of forged endorsement. Only accepting certified cheques directly from the account holder, or confirming the key details such as payee and amount with the account holder can avoid the risk of material alteration.

**Martin:** The reality is that certified cheques will continue to be the predominant method of payment. Given this, lawyers should ask their bank to "call" certified cheques – that is, have your bank call the bank that certified the cheque to confirm the details on cheque and the certification. This is not bullet-proof, but is a measure of insurance.

**Mike:** It's all about risk. The firm must make its decision cognizant of its willingness to assume risk, its knowledge about the client/entity making the payment and the amount. Mindful that most payments do not go astray, there will be circumstances in which lawyers can continue to use certified cheques that will not be subject to return.

However, in situations involving identifiable risk factors (a new and unfamiliar client, client pushing to complete deal quickly, funds moving offshore or other circumstances that are unusual or suspicious), the minimum that should be done is to check with your financial institution as to whether it is safe to withdraw from the deposit (note the absence of reference to "clearing" or "settling"). Expect, however, a response indicating upwards of several days.

If timeliness is an issue, consider a wire. Return the certified cheque or other instrument and kindly ask the payor to wire funds to your account. By using LVTS, risks associated with paper instruments (e.g. forged endorsements and fraudulent instruments) are avoided. While this may not prevent a claim down the road that the payment itself should never have been made, this should prevent you from having to deal with a shortage in your trust account.

**LawPRO:** If you have decided that wiring funds as LVTS payments is the way to go, be sure to also consider the following:

- You may not be able to get confirmation of the receipt of "good funds" where the transaction is occurring late in the business day. The earlier in the day you can move funds and close your transaction, the better.
- Although the CPA can do its part of an LVTS transaction very quickly, your instructions have to be sent to your individual financial institution to initiate the transfer, and then by the FI through the LVTS. Contact your financial institution to review its on-line or other systems for initiating and receiving wire transfers, and the costs per transaction and/or per month. You need to be confident that delays or mistakes are unlikely in the handling by the financial institutions at either end of the process.
- Is it enough for you to confirm receipt of a wire transfer by reference to your on-line banking system? Ask your financial institution for advice, including whether wire transactions as line items on a statement are referenced in a specifically identifiable way on which you can rely.
- Ask your financial institution if it uses true LVTS wires for inter-branch wires or if it will offer the same protections against reversibility as LVTS regardless of the clearing system that it uses.
- Don't forget that the Law Society of Upper Canada's By-law 9 contains requirements related to electronic transfers of trust funds. You must keep those requirements in mind when evaluating any electronic system for wiring funds.

# Powers of attorney and solicitors' liability:



## The case law

The 2007 ruling in the *Reviczky V. Meleknia* case put the spotlight on questions about a solicitor's duty to "go behind" a power of attorney. The case has generated discussion within various practice sectors – and among lawyers within the same practice area – about a lawyer's obligations when dealing with matters involving powers of attorney. Some argue that the ruling suggests a new standard of care requiring lawyers not to take a power of attorney at face value; others maintain what lawyers are doing now is appropriate and sufficient.

A look at case law provides some insight and direction on this question. This Casebook column examines "power of attorney" issues confronting lawyers in two parts:

- 1) preparing and explaining powers of attorney; and
- 2) transactions carried out with a power of attorney.

### Preparing and explaining power of attorney

In *Thibeault v. Household Realty Corp.; Walsh, Greenberg and Robinson, third parties*, [1993] O.J. No. 2024 (Ont. Ct. Gen. Div.), Mr. Justice Binks severely criticized a solicitor who obtained the signature of an extremely ill and elderly woman on an unlimited power of attorney. The power of attorney allowed the elderly lady's daughter and son-in-law to place mortgages against her home as security for their indebtedness to Household.

The same solicitor acted for Household Realty, as well as for the daughter and son-in-law. The solicitor and the son-in-law went to the plaintiff's house, and obtained her signature on the power of attorney. No effort was made to explain its meaning, or the potential consequences of signing it.

The mortgages went into default and the home was sold under power of sale. In resisting Household's action for payment of the proceeds, the plaintiff relied upon the defence of *non est factum*, the failure of Household's lawyer to recommend independent legal advice, and the fact that the transaction was unconscionable. Household's solicitor was third party by Household, but settled

with it prior to trial. The plaintiff's action was upheld by Mr. Justice Binks on all three grounds.

The following expert evidence was adduced on the standard of care of a solicitor overseeing the execution of a power of attorney. Mr. Justice Binks accepted it:

"It is my opinion that any lawyer practising in Ontario in obtaining a power of attorney has a responsibility to fully explain the nature of the document to the person executing it. The lawyer must be in a position to be able to testify, if necessary at a later date, that there was no doubt of the fact that the person giving the power was fully aware of all the consequences. This statement is even of more importance when the solicitor has had no previous contact with the person involved, and is in fact acting on behalf of another client.

"In circumstances where the solicitor involved is acting on behalf of a client who will benefit from the execution of the document by being granted security for a debt which might otherwise be uncollectible, the solicitor has an even greater duty to the person granting the power and should insist upon that person obtaining independent legal advice."

The trial judge termed the solicitor's behaviour as "slipshod and appalling". His comments about Household's behaviour were also scathing.

In *Macedone v. CL Collins*, [1996] NSWSC 634, the Court of Appeal for New South Wales was sharply divided about the scope of the advice necessary when advising about the risks of giving a power of attorney to complete a corporate transaction.

A company controlled by Mr. and Mrs. Collins on the one hand, and Mr. and Mrs. Wallis on the other, contracted to buy a property. A lender agreed to provide the financing, provided the Collinses and the Wallises provided personal guarantees and mortgages on their homes. Mrs. Collins intended to be on holidays in Fiji at the time set for closing. She agreed to give Mr. Wallis a power of attorney to execute the necessary documents on her behalf.

Mr. Willis, the solicitor for the borrower company, prepared the power of attorney. Mr. Wallis executed the guarantee and mortgage on Mrs. Collin's behalf, although, unbeknownst to Mr. Wallis, Mrs. Collins had by then returned to Australia

Default eventually occurred. The lender called in the guarantees and the mortgages. Mrs Collins alleged, and the trial judge accepted, that solicitor Willis was negligent in failing to properly explain the power of attorney to her. Willis told her that she risked losing her home on the basis of the documents which Wallis would sign on her behalf. Willis failed to expressly tell her that the power of attorney would be used not only to place a mortgage on her home, but also to sign a guarantee rendering her jointly and severally liable, along with the other investors, for the borrowing company's entire indebtedness. The trial judge also faulted Willis for failing to make the power of attorney time limited to the period in which Mrs. Collins would be absent from Australia.

Two of the three justices sitting on Willis's appeal agreed that his explanations were adequate. It seemed to them that a sensible way of explaining to a legally unsophisticated person the impact of granting the power of attorney was to stress the risk that her home could be lost. Mrs. Collins worked as a cleaner, and had no other assets. The temporal duration of the power of attorney was irrelevant to Mrs. Collins. The power of attorney was used for the purpose intended. The third justice on appeal agreed with the trial judge, and would have upheld the finding of liability.

## Transactions carried out with a power of attorney

A firm of solicitors came to grief in *Al-Sabah v. Ali*, - [2000] E.W.J. No. 3721 (Eng.C.A.), allowing in part appeal from Ferris, J., 22<sup>nd</sup> January 1999 (the Times 27<sup>th</sup> January 1999).

The plaintiff invested in real estate in London. His property manager, Ali, forged a power of attorney from the plaintiff to a solicitor. Ali then had the solicitor use the forged power of attorney to mortgage the property. The proceeds were evidently misappropriated by Ali. Next, Ali forged the plaintiff's signature on a transfer to himself. Ali then obtained another mortgage to pay out the first. These documents were registered on proof of the power of attorney. Ali eventually defaulted on his mortgage payments, and the "new" mortgagee carried out a power of sale.

The plaintiff successfully sued the solicitors who acted on the mortgages and on the conveyance. They accepted the instructions from a person claiming to represent the supposed client without ascertaining the true position. They did not speak with the plaintiff, or seek his written instructions. The transactions involved the transfer of the supposed client's property to his agent; thus the duty imposed on the solicitor was heavier still.

In *Carr v. Bower Cotton* [2002] EWCA Civ 1788, a British solicitor saved himself from liability by going back to the donor of a power of attorney to confirm the instructions given to him by the donee of the power.

Mr. Carr, an Australian solicitor, represented a syndicate of investors. He entered into an investment agreement with, and signed a limited power of attorney in favour of, Kelci Management Consultants. Under the agreement, \$4 million belonging to Carr and others was transferred into an account held by Bower Cotton, a respected London firm. The agreement and power of attorney authorised Kelci to ask Bower Cotton to transfer funds out of their account for the purpose of making specified investments. Carr believed that fantastic profits were in the offing. The English Court of Appeal observed that both documents were poorly drafted. Neither Carr nor Bower Cotton expressed concern.

Kelci asked Bower Cotton to transfer the money to a separate bank account in Copenhagen, controlled by Kelci. Mr. Simms of Bower Cotton was worried. Bower Cotton would have absolutely no control over the money. Bower Cotton would have no way of ensuring that the money was properly used to purchase investments. Kelci was providing no security to ensure the return of the money. Simms was concerned that the investment agreement and power of attorney did not permit this transfer. Simms contacted Carr, who agreed that the money could be sent from the solicitors' account, to Kelci's account. This was done, and afterwards the money duly disappeared.

Carr sued Bower Cotton. The judge at first instance dismissed the claim; the Court of Appeal affirmed the dismissal. Carr had instructed Bower Cotton that he wanted the funds to be placed under Kelci's control, and that he did not require any safeguard. Bower Cotton were entitled to act as they had. The English Court of Appeal was highly critical of Bower Cotton involvement in this scheme.

The most recent notorious real estate fraud case is *Reviczky V. Meleknia; Caplan (Intervenor)* 2007 Canlii 56494 (On S.C.).

Justice Macdonald voided the HSBC Bank's mortgage because it did not take steps to scrutinize the power of attorney pursuant to which its chargor took title. Fraudsters forged the power of attorney, and used it to sell the house they did not own to an innocent purchaser. The HSCB funded the purchase.

Caplan, the lawyer representing the fraudulent seller, sent a copy of the forged power of attorney to the lawyer acting for both the purchaser and the Bank. Both lawyers were unaware the document was a fake.

At this point, the second lawyer failed to "inform himself about the terms, conditions or validity of the power of attorney." The power of attorney was ostensibly dated only one month before the

transaction closed. The power of attorney stated on its face that the donor of the power of attorney was over 88 years old, that the power could be revoked at any time, and was valid until the donor's death. The power of attorney was witnessed by only one person, instead of the two mandated by the *Substitute Decisions Act*.

The Court suggested that the Bank's solicitor should have made inquiries as to whether the donor was still alive, had ever revoked the power of attorney, or was mentally competent when the power of attorney was signed. The lack of proper witnessing might also have been questioned. Had the Bank's solicitor made inquiries on these points, it is likely that the fraud would have been prevented.

Since HSBC, through its lawyer, had an opportunity to avoid the fraud and did not do so, the court decided it could not succeed in its claim that the mortgage was valid.

This case raises difficult issues about a solicitor's duty to "go behind" a power of attorney. Where a power of attorney has ostensibly been signed very recently, but the donor is elderly, must a solicitor really make inquiries about the donor's mental capacity at the time of signing, and whether the donor is dead or alive? And what sort of evidence is adequate to satisfy these inquiries? What if the donor is out of the country, or has become mentally incompetent in the meantime? Must the donor be contacted to see if he has revoked the power of attorney?

*Shiokawa v. Tohyama; Woods Adair* (T.P.), [2005] B.C.J. No. 294 (B.C.C.A.), Dismissing Appeal From [2003] B.C.J. No. 1997; [2004] B.C.J. No. 230 (B.C.S.C.) ended more happily for the solicitors involved.

A firm of solicitors which represented a lender and a purported borrower in a transaction were not negligent in failing to detect that the powers of attorney presented by the "borrower's" fraudulent agent were forgeries. The borrower was later successful in having the mortgage expunged from title. The lender lost its security and its money.

The standard of care for this transaction was stated to be:

"... a reasonably competent solicitor in dealing with documents executed out of the province, having determined that the form of documentation meets the criteria of due execution will accept those documents for the purpose intended without making further inquiry of the witnessing lawyer unless circumstances relating to the documentation suggests that further inquiry would be warranted."

The facts surrounding the transaction were not sufficiently suspicious to put the solicitors on inquiry. The power of attorney initially presented contained certain errors, e.g., legal descriptions, which were corrected.

The lender made no inquiries of its own concerning the authenticity of the power of attorney. It did not instruct the solicitors to make any inquiries. Solicitors are not expected to authenticate legal documents, unless instructed to do so. There was no reason to believe that if the initial errors were reported to the lender, it would then have made inquiries which would have disclosed the forgery.

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## Lessons to be learned

What do these examples show us? A review of the current case law provides some guidance on how lawyers may want to approach clients and files involving powers of attorney. Lawyers should take note that the following are not intended to be a projection of where a court may say the standard of care is or what the lawyer best practices should be.

- Fully explain the nature of the power of attorney to the person executing it. Make sure that the person giving the power is fully aware of all the consequences. This is even more important when you have had no previous contact with the person involved, and are in fact acting on behalf of another client.
- Where you are acting on behalf of a client who will benefit from the execution of the power of attorney, because it will be used to grant security to the client for a debt which might otherwise be uncollectible, insist upon independent legal advice for the person being asked to execute the power.
- Where the power of attorney is given for the purpose of executing documents in an upcoming commercial transaction, consider whether you ought to advise the donor about the consequences of the documents to be executed under the power. This may or may not be practicable, depending on whether you have personal knowledge of the transaction.
- Consider making the power of attorney time limited, and its terms no broader than absolutely necessary.
- Be VERY concerned if the donee of the power of attorney proposes to take the donor's property for himself or herself. Seriously consider confirming the propriety of the transfer with the donor, unless the power of attorney expressly allows for the donee to take the property.
- Scrutinize the power of attorney for irregularities on its face. Was it signed by two witnesses? Are there any suspicious circumstances, i.e., was the document witnessed overseas, yesterday?