A Lawyer's Duty to Non-Clients - *The "Budrewicz"* case revisited

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1. INTRODUCTION AND OVERVIEW

The law of Ontario generally permits a lawyer to act in the sole and exclusive interests of his or her client, without regard to the interests of (or the resulting consequences to) unrepresented non-clients with whom the lawyer has no contact or dealing, provided the lawyer does not violate any professional codes of conduct, nor knowingly engages or participates in any illegality on the part of the client. However, in limited circumstances, the law will impose a duty of care (and sometimes a higher fiduciary duty, in even more limited circumstances) upon the lawyer in favour of the non-client, irrespective of the lack of a traditional lawyer-client relationship between them (supported by consideration or evidenced by a retainer agreement). This paper is intended to focus on the scope and boundaries of those limited circumstances in which a lawyer may be held liable or accountable to third parties who are not such lawyer's clients.

At the outset, it is important to keep in mind that a lawyer should be cognizant of the potential for prejudice to non-clients, arising from (or in connection with) the lawyer's retainer with his or her client. A quick review of the rules of professional conduct promulgated by the Law Society of Upper Canada (hereinafter collectively referred to as the "**Rules**") provide three examples in which a lawyer may be forced to terminate his or her retainer with a client, depending on the degree of prejudice occasioned to non-clients, namely:

- **Rule 4.01(2)**, which prohibits a lawyer, when acting as an advocate for his or her client, from knowingly assisting or permitting the client to do anything the lawyer considers to be dishonest or dishonourable;
- **Rule 2.03(3)**, which permits a lawyer, where the lawyer believes upon reasonable grounds that there is an imminent risk to an identifiable person or group of death or serious bodily and/or psychological harm, to disclose confidential information pertaining to his or her client where it is necessary to do so in order to prevent such

death or harm; and

- **Rule 2.02(5)**, which prohibits a lawyer from knowingly assisting in or encouraging any dishonesty, fraud, crime, or illegal conduct, or instructing the client on how to violate the law and avoid punishment.

While a breach of the Rules could expose a lawyer to disciplinary proceedings, nothing in the Rules *per se* imposes civil liability upon the lawyer directly in favour of the non-client, thereby leaving the matter to an aggrieved non-client to seek his or her remedy in a private tort action against the lawyer. The fact scenarios described in such actions typically involve a transaction completed by the lawyer on the instructions of the client (such as the advance of a mortgage loan against the security of real estate, the execution of a loan guarantee, or the entering into of some form of obligation) which ultimately results in economic loss being incurred by the non-client. The non-client is usually a party with some relationship to the client, and who alleges that they have relied upon the client (acting as a trustee, agent, or in some other representative capacity on behalf of the non-client) to protect or safeguard the non-client's interests in the transaction in question, and who further alleges that the lawyer either owed the non-client a minimum duty to warn the non-client of the potential for loss, or in the alternative, should have ceased to act for the client prior to the completion of the transaction.

Since there is an almost irresistible urge to claim against a lawyer who is obliged to maintain mandatory insurance coverage, it should come as no surprise that there is no shortage of litigation instituted by non-clients against lawyers. Practitioners are often confronted with scenarios similar to the following, on a regular basis, which have given rise to litigation, namely:

- in the course of a mortgage loan transaction, the lawyer discovers that the lender-client is, in fact, acting as a trustee for an underlying investment syndicate;
- prior to the completion of the transaction, the lawyer becomes aware that the client is an agent, acting for a principal whose identity may or may not be disclosed;
- the lawyer is advised that the client is a partner of a general partnership, purporting

to act for the partnership and intending to bind all partners;

- a client attends at the lawyer's office with an unrepresented non-client who has some involvement in the transaction being undertaken; or
- the client delivers monies to the lawyer (drawn on the bank account of an unrepresented third party) with which the client instructs the lawyer to complete the purchase of an investment property, or to complete and register a mortgage against the subject property, in a market where the potential for the property's value to significantly decline is likely.

To make matters worse, it can be difficult for lawyers in some cases to implement effective practical preventative measures to disclaim, avoid or circumscribe their liability to non-clients, simply because the lawyer may not even be aware of (or have access to information regarding) the existence or identity of the potential non-clients.

Some of these thorny issues were reviewed in the decision of Mr. Justice Webber of the Ontario Court (General Division) in the case of Budrewicz v. Stojanowski et. al. [1], which serves as a starting point for our analysis of a lawyer's duty to non-clients. While the *Budrewicz* case arose out of a specific fact scenario, this paper attempts to reach some general conclusions regarding the factors that the courts will consider relevant in determining whether a lawyer will be found to owe a duty of care to a non-client, in the hope of assisting the real estate bar in recognizing and defusing potentially problematic situations in the future.

2. SYNOPSIS OF BUDREWICZ V. STOJANOWSKI

In the *Budrewicz* case, Mr. Justice Webber found that the defendant lawyer, who had registered a fourth mortgage against a particular property in favour of his lender-client in a mortgage loan transaction, could not be held liable to the plaintiff-investor who had lost her savings which had been

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[1] (1999), 41 O.R. (3d) 78 (Gen. Div.) (hereinafter referred to as "***Budrewicz***"). At the time *Budrewicz* was reported, an appeal had been filed, but the writers have been advised that same had subsequently been withdrawn.

entrusted to the lawyer's client, when no equity remained in the mortgaged property to satisfy the outstanding mortgage indebtedness. The lawyer in that case, a Mr. Boguski, did not know of the plaintiff's existence, identity or status with respect to the loan monies, until after the loan had been advanced by the lawyer, although the lawyer subsequently became aware that the plaintiff was the true owner or source of the mortgage funds (after having been requested by his client to prepare a promissory note in favour of the plaintiff).

In *Budrewicz*, the Court rejected the plaintiff's argument that the lawyer owed a duty of care to the plaintiff, who was a non-client, and furthermore found that there was not only no lawyer-client relationship between them, but also that no trust or fiduciary obligations arose by or against the lawyer in favour of the plaintiff. After a broad review of the applicable case law, Mr. Justice Webber concluded that a lawyer cannot be expected to protect the economic interests of a non-client, unless the non-client reasonably relied upon the lawyer, and the lawyer knew or ought reasonably to have known of such reliance. The following facts and circumstances that existed prior to the advance of funds were cited in support of the Court's conclusion regarding the non-existence of a duty of care, or a fiduciary duty, to the non-client, namely:

a) the lawyer gave no advice or undertaking to the plaintiff/investor;
b) there was no evidence that the plaintiff/investor relied upon the lawyer to protect her interests, inasmuch as the plaintiff had no knowledge of the lawyer's identity at the time of the mortgage loan transaction, and had placed full reliance on the lawyer's client, rather than on the lawyer, to protect her interests;
c) there was no direct contact or dealings between the plaintiff/investor and the lawyer, other than the fact that the certified cheque for the mortgage loan received by the lawyer was drawn on the account of the plaintiff/investor and duly executed by her; and
d) had the lawyer informed the plaintiff/investor of any concerns regarding the mortgage loan or the security therefor, out of a sense of duty or obligation to her, without his client's consent, then the lawyer would have breached lawyer-client privilege, which Mr. Justice Webber considered (at page 94) to be "entirely inappropriate".

In addition, the plaintiff in *Budrewicz* had argued that the circumstances of the transaction should have raised "warning lights" to the lawyer, due to the "higher than prevailing rate of interest" secured by the mortgage, the low equity in the subject property, and the haste in which the lawyer's client wished to complete the transaction. However, the Court adopted the opinion of the defendant's expert witness, Mr. Brian Bucknall, who had argued that the aforementioned circumstances did not trigger any "warning lights" until the lawyer, in actual fact, realized that the mortgage monies were owned or sourced by a party other than the client, which occurred after the funds were fully advanced. The court also adopted Mr. Bucknall's opinion that while there would be an ethical (but not necessarily a legal) obligation to cease acting for the client if there had been an undispelled suspicion that the lawyer's acts would be unfair to an unrepresented third party, the court would not impose a fiduciary duty on the lawyer in those circumstances. Mr. Justice Webber specifically concluded that:

> "The fact of preparing the promissory note and the acknowledgment and direction does not create a trust relationship which is actionable at law. As stated by Mr. Bucknall, Bogusky [the lawyer] was simply carrying out the instructions of Stojanowski, who was his client, not Mrs. Budrewicz [the plaintiff]. No trust relationship nor a fiduciary relationship can arise in this fact situation."
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> [emphasis added]

The balance of this paper will review the legal and equitable principles underlying the decision in the *Budrewicz* case.

3. ANALYSIS OF THE RELEVANT PRINCIPLES REGARDING LIABILITY TO NON-CLIENTS

The decision of the House of Lords in Hedley Byrne & Co. v. Heller and Partners Ltd.[2] confirmed the basic proposition that a lawyer owes a duty of care (in tort) to a third party (who is not a client of the lawyer) to whom the lawyer makes a representation, knowing that such third party may place

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[2] [1964] A.C. 465 (H.C.).

reliance on it, in those circumstances where the third party ultimately relies on the representation to his or her detriment. In the context of a lawyer's liability to non-clients in an action founded in tort (and more specifically, in negligence), the jurisprudence has taken the basic *Hedley Byrne* principle, and has reinforced it with a requirement on the part of the plaintiff to establish "reasonable reliance" in the context of the specific facts and circumstances faced by the particular lawyer whose conduct is under examination. Judicial consideration appears to focus upon the following elements, namely:

a) whether the **reliance** purportedly placed by the non-client upon the lawyer was **reasonable**, in light of the particular circumstances at hand;
b) whether the lawyer's client had **apparent authority** to act for the non-client, where applicable;
c) whether the lawyer acted reasonably, having regard to the **scope and substance of the lawyer's retainer to his or her client**; and
d) whether the lawyer was a participant, either directly or indirectly, in the **breach of fiduciary duty** committed by the lawyer's client.

(A) **Showing that reliance upon the lawyer was reasonable**

As summarized above, any reliance allegedly placed by a non-client upon a lawyer must be reasonable under the circumstances of the particular case under consideration. In *Budrewicz*, Mr. Justice Webber expressly confirmed that:

> "An analysis of all these cases cited leads me to the conclusion that on the fact situation that exists, the presence or absence of reasonable reliance is critical."

One such case cited in *Budrewicz* was the British Columbia Court of Appeal's decision in Kamahap Enterprises Ltd. v. Chu's Central Market Ltd.[3], which provided several persuasive reasons why a lawyer should not be found liable to a non-client in negligence, where the non-client unreasonably places its reliance on the lawyer. In *Kamahap,* the specific issue was whether a lawyer acting for a vendor in a transaction involving the sale of a commercial property was liable to the purchaser for

[3] (1989), 64 D.L.R. (4th) 167 (B.C.C.A.) (hereinafter referred to as "**Kamahap**")

losses sustained by the purchaser as a result of the vendor's lawyer's advice to his own client not to complete the sale. However, the plaintiff did not claim that it had placed reliance on the defendant lawyer, but rather argued that the lawyer owed a duty of care to the plaintiff based on the "proximity test" enunciated by the English Court of Appeal in the case of Anns v. Merton[4]. While the B.C. Court of Appeal expressly approved of the application of the *Anns v. Merton* "proximity test" in those cases involving damage occasioned to the person or physical property of others, it was nevertheless reluctant to extend same to situations involving purely economic loss, and accordingly concluded that in order to impose liability on a lawyer in such a situation as the one considered in *Kamahap*, proof of reasonable reliance on the lawyer by the non-client is essential.

In the aftermath of the *Kamahap* case, and with the exception of those cases involving claims brought by a disgruntled beneficiary (or potential beneficiary) against the lawyer for the negligent preparation of a will that resulted in negating the testator's instructions[5], the courts have generally declined the imposition of a duty of care on lawyers in situations where reliance by the non-client was neither expected nor reasonable[6]. Such factors as the absence of any communication, contact, advice or dealings between the lawyer and the non-client, and/or the lack of knowledge by the lawyer of the identity of the non-client, or the lack of dependency or reliance of the non-client upon the lawyer's advice or counsel (due to the particular experience and sophistication of the non-client), will markedly improve the lawyer's chances of defeating a "reasonable reliance" allegation by the non-client. Moreover, to the extent that a lawyer is successful in directing a non-client to procure

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4 Anns v. Merton London Borough Council [1978] A.C. 728 (H.L.), which was subsequently affirmed in Canada by the Supreme Court of Canada in Canadian National R. Co. v. Norsk Pacific Steamship Co. Ltd. (1992), 91 D.L.R. (4th) 289 (S.C.C.), which did not specifically require reasonable reliance as a precondition to extending a duty of care, but rather formulated a broader "proximity" test in determining the scope or class of persons to whom a duty of care was owed.

5 The writers note that there is an English line of cases, starting from Ross v. Caunters [1979] 3 All ER 580 (Ch.D.) and including the decision of the House of Lords in White v. Jones [1995] 1 All ER 691 (H.L.), which found that a solicitor preparing a testamentary instrument may in fact owe a duty to a proposed beneficiary if such benefit is not in fact conferred due to negligence on the part of the solicitor. This line of cases have been confined in fact situations involving wills and not extended to third party beneficiaries generally.

6 Debra Rolph's article published in the Advocates' Quarterly, vol. 15, no. 2, June 1993, pp. 129-71, entitled "Solicitors' Liability to Non-Clients in Negligence" review this issue in detail, and was favourably cited by Mr. Justice Webber in *Budrewicz*.

independent legal advice with respect to the proposed transaction (preferably evidenced by a written certificate of independent legal advice), same will obviate any argument that the non-client reasonably relied upon the lawyer, and therefore should be considered as a preventative measure, especially in those circumstances where the identity of the non-client is known to the lawyer at the outset of the proposed transaction, and the lawyer reasonably suspects that the non-client may ultimately allege reliance upon the lawyer, with the benefit of 20/20 hindsight.

The rationale of the decision in *Budrewicz*, which ultimately repudiated any finding of "reasonable reliance" (largely by demonstrating the lack of contact between the lawyer and the non-client), thankfully supports the prevailing standard of practice by commercial real estate lawyers in Toronto. For example, when acting on behalf of a mortgage syndicate, the client who is acting in a representative capacity is typically the lawyer's sole point of contact on behalf of the investors or members of the syndicate, throughout the entire loan transaction, for all purposes (including, without limitation, the provision of legal advice and the receipt of instructions), and the lawyer in such circumstances generally would not give any advice or undertaking (either expressed or implied) to the individual members of the syndicate, nor would the lawyer generally have any direct contact or dealing with the individual syndicate members. Absent any other relevant factors hereafter discussed, any reliance upon the solicitor by the syndicate members in the foregoing circumstances would not be reasonable, and any judicial ruling to the contrary would make it exceedingly difficult (if not practically impossible) for the lawyer to act for the representative client in such circumstances.

(B) <u>Whether the client had apparent authority to act for the non-client</u>

In those cases where a non-client is relying upon the client to safeguard his or her interests (e.g. where the client is a trustee or agent of the non-client), a second but equally important element of the analysis is whether the client had the apparent authority, from the lawyer's perspective, to receive advice from (and correspondingly give instructions to) the lawyer, and to concomitantly make decisions which ultimately affect and bind the interests of the non-client, irrespective of whether such instructions or decisions are ultimately beneficial or detrimental to the non-client.

In the writers' perspective, there is absolutely nothing unusual or improper about a solicitor acting

for a client who, in turn, is acting in a representative capacity, nor should same necessarily trigger any alarm bells in the mind of the lawyer regarding any potential impropriety. Commercial real estate practitioners in Toronto routinely rely upon the apparent authority of agents or trustees to provide instructions, and the circumstances in which such a practitioner would be justified in questioning the apparent authority of their client, and/or confirming the client's authority by speaking directly with the beneficiaries of the trust or the principal(s) would be rare indeed. In most cases, the transaction would not proceed any differently, even if the lawyer were to obtain a waiver of privilege from the client and communicate directly with the beneficiaries or principal(s), because those underlying parties have invariably relied upon the lawyer's client (in the latter's representative capacity, as a trustee or agent) to protect their interests, and have presumably instructed and empowered the lawyer's client accordingly.

A good example of apparent authority, and the degree of latitude accorded by the courts to the lawyer in such circumstances, was illustrated in the case of Sinclair v. Smith[7], where Madam Justice McLaughlin (as she then was) dealt with the liability of a lawyer to a mortgage investment syndicate which was prejudiced by their agent, who was the lawyer's client, and who coincidentally was also a mortgage broker. The lawyer had been instructed to prepare two syndicated mortgages which would stand in second position on each of the two properties owned by the mortgagor. However, unbeknownst to the investors, the agent had loaned short-term funds to the mortgagor, and secured same by registering mortgages in his favour over each of the subject properties, in priority to the syndicated mortgages, thereby resulting in the investors' mortgages being registered by the defendant lawyer *as a fourth charge on one property, and as a third charge on the other property*. In the portion of the judgment dealing with the liability of the lawyer to the investors, and despite the fact that Madam Justice McLaughlin characterized the transaction as having "unusual and potentially problematic aspects", the court nevertheless found that the plaintiff/investors had relied throughout on the agent personally, and not on the lawyer, to invest their monies and protect their interests (as was also found in *Budrewicz*), and the court accordingly ruled that the lawyer had no duty of care, nor any fiduciary duty, to the investors whatsoever. Madam Justice McLaughlin also confirmed that a lawyer retained and instructed by an agent is not required to go behind the agency relationship, in

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[7] (1982), 41 B.C.L.R. 374 (S.C.)

order to personally assure himself or herself that the agent has conveyed to its principals the appropriate warnings and requisite advice, and/or that such principals have been made aware of the risks which they are undertaking, absent some special circumstance peculiar to the lawyer-client relationship which takes it beyond this general rule, and which would consequently require the lawyer to either deal directly with the principals, or to cease to act altogether. In concluding that the lawyer owed no duty of care to the plaintiff, Madam Justice McLaughlin applied the decision of the English Court of Appeal in Sykes v. Midland Bank Executor & Trustee Co. Ltd.[8], where a lawyer was held not liable in advising only one member of a partnership, prior to the partnership's execution of a sublease, regarding the potentially adverse effects of certain restrictions on usage contained in the sublease.

Madam Justice McLaughlin also examined the possible exceptions to the "general rule" referred to above, which were summarized as follows:

> "The example [in Sykes] suggests that if it is apparent that the representative with whom the lawyer is dealing is incapable of properly representing his principals, or is improperly representing his principals, or is failing to convey to them the solicitor's advice, the solicitor may exceptionally be obliged to communicate directly with those principals."

The plaintiff in *Sinclair* had alleged that the exceptional circumstances alluded to in the above quotation should have alerted the lawyer to a dishonest scheme on the part of his client, based on the "self-evident" nature of the inadequate security being procured for the mortgage advance, and given the conflict between the relative interests of the lawyer's client and the plaintiff/investor as competing mortgagees in respect of the mortgaged premises. Furthermore, it was argued that the change in instructions regarding the priority of the syndicated mortgages should have alerted the lawyer to either advise the investors directly, or to cease to act altogether. In response, Madam Justice McLaughlin specifically focused on the state of the lawyer's knowledge of the transaction, as it had appeared to the lawyer, and noted that the lawyer was entitled to rely upon his client because he had been a reputable mortgage broker in business for over 20 years, who had dealt with

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[8] [1971], 1 Q.B. 113 (C.A.)

the lawyer on prior occasions with no apparent complaints. The court concluded that:

> "These circumstances, taken together, preclude description of the transaction as routine. However, they did not mark it as illegal, imprudent, or even suspicious, provided the solicitor was entitled to assume, as Mr. Townsend [the solicitor] was, that Mr. Lyle had advised his principals of his interest in the transaction and had obtained their authorization to proceed, and, provided further that there appeared to be sufficient security for their investment."
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> [emphasis added]

and that:

> "I conclude that the circumstances of the transaction, while in some respects unusual, were not such as to justify deviation from the rule that a solicitor dealing with an agent is not obliged to communicate directly with his principals, but is rather entitled to rely upon the representative to pass on his advice to such persons."

In the subsequent case of Luckiw Holdings (1980) Ltd. v. Murphy[9], the lawyer's son and a third party company were involved in a business deal. The son gave the lawyer a cheque drawn in favour of the solicitor, but signed by the company. The lawyer believed that the funds belonged to his son, and accordingly deposited them into his solicitor's trust account, on his son's account or behalf. On the son's instructions (but without any instructions or direction from the company), the lawyer subsequently disbursed the funds. The Alberta Court of Appeal determined that the defendant lawyer owed no duty of care, nor any fiduciary duty, to the undisclosed beneficial owner of the monies that were ultimately delivered to the lawyer, and that the lawyer was entitled to release such funds directly to the lawyer's client, with impunity, notwithstanding that the initial cheque to the lawyer had, in fact, been drawn on the account of the beneficial owner. The Court concluded that the lawyer's client had clothed himself "with apparent or ostensible authority over the disposition of the funds", and that such ostensible authority constituted a clear answer and defence to the respondent's claim against the appellant lawyer.

The principle of "apparent authority" articulated in *Sinclair* and applied in *Luckiw Holdings* was

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[9] (1986), 80 A.R. 14 (Alta.C.A.) (hereinafter "***Luckiw Holdings***")

also applied in the more recent Saskatchewan case of Feschuk v. Hudema[10], where a lawyer was alleged to have been negligent (and in breach of a fiduciary duty owed) to the non-client, by allowing the lawyer's client (who was the plaintiff's nephew) to personally withdraw and convert approximately half of the uncle's $200,000.00 investment over time for his own use, despite the terms of a written authorization agreement to the contrary signed by the non-client uncle. The lawyer had received the undated authorization, granting to the nephew broad control over the investment monies, on condition that the money be invested for "an approximate five year term deposit", with a right to withdraw same at any time. As well, the acknowledgment provided that the nephew was allowed set-up expenses "not to exceed $15,000.00". As the lawyer knew of this acknowledgment emanating from the non-client uncle, the Court found that the lawyer owed a duty to the uncle to not knowingly permit such an arrangement to be breached, to the prejudice of the uncle. In the course of the following months, the lawyer in the *Feschuk* case ended up releasing two instalments of approximately $54,000 each, to the nephew personally. The plaintiff alleged that the foregoing withdrawals, in light of the lawyer's knowledge of the terms of the authorization, should have raised "warning bells" on the part of the lawyer, and this should have justified a departure from the general rule of reliance on the agent's apparent authority, as previously discussed in *Sinclair*.

The lawyer's defence, which was ultimately upheld by the Court, essentially disregarded the significance of the written authorization, in light of the nephew's apparent authority vis-a-vis the lawyer to deal with the investment monies, and the Court agreed that by virtue of the combination of the written authorization and the nephew's *de facto* control over the money, the lawyer was entitled to assume that the nephew also had the requisite authority to direct the disposition of the funds. At a minimum, the Court held that the nephew had apparent or ostensible authority to so deal with the funds, and that the lawyer had no reason to believe otherwise. Of importance was the fact that at no time was the lawyer informed by the uncle that the nephew-client had no authority to so act, although it was always open to the non-client uncle to have done so. The Court concluded that in these circumstances, the release of the aforementioned funds to the nephew was not such an unreasonable act so as to be categorized as negligence, nor as a breach of duty or breach of fiduciary responsibilities owed to the uncle.

Before leaving the discussion of apparent authority, the writers wish to emphasize that the courts

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[10] [1995], 2 W.W.R. 103 (Q.B.) (hereinafter "***Feschuk**")*

have generally adopted or accepted the "subjective perspective" of the lawyer being assailed, in determining whether the lawyer reasonably believed that a third party non-client was relying on his or her advice, or that the non-client had given apparent or ostensible authority to the client with respect to all aspects of the transaction in question. For example, Madam Justice McLaughlin in the *Sinclair* case, *supra,* reviewed the circumstances in that case as they "subjectively appeared to the lawyer". This same approach was also adopted approximately nine years later by Mr. Justice Iacobucci of the Supreme Court of Canada in the *Air Canada* case (which is discussed hereafter), which explicitly held that in the context of finding a lawyer liable for assisting in a client's breach of trust, **the proper standard of knowledge is actual knowledge of the breach, and not merely constructive knowledge.** Accordingly, the foregoing approach imports a higher threshold before the lawyer's liability is triggered. Curiously however, although the lawyer in *Sinclair* had actual knowledge of the identity of the investors (inasmuch as their names were disclosed as joint mortgagees on the face of the mortgage itself), and while it would have been open to the Court to find that the lawyer in that case should have taken appropriate steps to contact each of the investors personally, in order to warn them about the inadequacy of the security being procured, or alternatively should have ceased to act for the lawyer's client on the file, these facts nevertheless did not persuade the Court to impose a duty of care, nor a fiduciary duty, on the lawyer whose conduct was scrutinized. On the contrary, the Court focused on the fact that the lawyer never met the plaintiff/investors, and received all instructions directly from the agent, both of which were fundamental factors underlying the ruling in the *Budrewicz* case.

(C) <u>Whether the lawyer acted reasonably in respect of its retainer to its client</u>

In conjunction with the principles of "reasonable reliance" and "apparent authority", the writers' analysis would be incomplete without reviewing the scope of the lawyer's retainer with his or her own client, as a reference point for determining whether the lawyer's actions were reasonable in the circumstances. While not conclusive as to liability, such an inquiry serves several useful functions, namely:

a) to understand the lawyer's role in the transaction as it subjectively appeared to the lawyer, with a view to determining whether or not reliance by the non-client should have been reasonably expected by the lawyer; and

b) to determine whether any alleged warning signs of a potential impropriety on the part

> of the client should have been apparent to the lawyer, given the terms and limitations of the lawyer's specific retainer with the client.

A lawyer's alleged failure to review certain issues may be explained, justified and/or refuted by proving that the lawyer was working under a limited retainer, which served to circumscribe the lawyer's general responsibilities toward the client. While one may be of the view that lawyers are always expected by their clients to act as the general quarterback of the deal (e.g. above and beyond the mere implementation of limited portions of the larger transaction), we do not believe that this is always the case. A competent real estate lawyer, for example, is ordinarily expected to act as the general quarterback of the overall transaction in those cases where the client is unsophisticated, or lacks the relevant skills, expertise or resources to assume responsibility for negotiating, arranging or completing any portion of the transaction. However, experienced commercial clients (such as institutional lenders or registered mortgage brokers) often ask lawyers to perform only certain specific tasks or limited services with respect to any given transaction or file, and in those cases or circumstances, it would be appropriate for the lawyer to operate under a limited retainer, and to correspondingly perform or fulfill only those tasks or obligations specifically outlined or reasonably contemplated by (or encompassed within the scope of) the limited retainer, and to do nothing more.

The "counsel of perfection" would dictate that lawyers outline the scope of their duties at the outset of every file, evidenced by a written retainer or other written confirmation to that effect. Such a practice would ultimately serve to protect the lawyer against not only the client, but against potential non-clients. Within the body of the retainer letter itself, it may also be salutary to have the client acknowledge or confirm whether the client is acting in a representative capacity (ie as a trustee, agent or partner, for or on behalf of any other parties), and if so, the lawyer can expressly confirm that he or she will not be acting for (or on behalf of) any third parties represented by the client, and that the client will be solely obliged to promptly convey this warning to all third parties relying upon the client in his or her representative capacity.

(D) <u>Whether the lawyer participated in a breach of trust by the client</u>

Despite the fact that the lawyer may not owe a duty of care *per se* to a non-client, if the client has committed a breach of trust against the non-client, it is still possible for the lawyer to be deemed to be a "constructive trustee" for the non-client, in equity, depending on the knowledge and/or the participation of the lawyer in any such breach of trust. In general, the courts have held that there

are three ways in which a stranger to a trust, including a lawyer, can be held liable as a constructive trustee for a breach of trust, namely:

a) as a trustee "de son tort", where the lawyer, while not expressly appointed as a trustee or a fiduciary, goes ahead to control and administer trust property, and to act as a *de facto* trustee thereof;

b) as a knowing assistant, where the lawyer assists or facilitates the client's breach of trust; and

c) as a knowing recipient, where the lawyer receives or applies trust property for the lawyer's own use or benefit.

While each of the foregoing theories of liability can easily form the subject of their own papers[11], the writers will simply focus on an analysis of the "knowing assistance" test, as articulated by the Supreme Court of Canada in the case of Air Canada v. M & L Travel Ltd.[12], inasmuch as this test is generally the one most frequently faced by lawyers, since lawyers are typically engaged to assist and facilitate the objectives of their respective clients.

Before summarizing the dictum in the *Air Canada* case, the writers wish to point out that the doctrine of "knowing assistance" is not a novel principle *per se,* and it is expressly reflected in Rule 2.02 (5) of the Rules, and in the commentary thereto (formerly commentary 6 of Rule 3 of the LSUC Professional Conduct Handbook), which states the following:

> "Dishonesty or Fraud by Client
>
> 2.02(5). When advising a client, a lawyer shall not knowingly assist in or encourage any dishonesty, fraud, crime or illegal conduct, or instruct the client on how to violate the law and avoid punishment."
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> [emphasis added]

The appurtenant commentary notes that the lawyer should be on guard against becoming the tool or

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[11] The reader is encouraged to review the cases of *Gold v. Rosenberg* (1997), 152 D.L.R. (4th) 385 (S.C.C.) and *Citadel General Assurance Co. v. Lloyds Bank Canada* (1997), 152 D.L.R. (4th) 411 (S.C.C.) for a discussion of the knowing receipt test.

[12] (1993), 108 D.L.R. (4th) 592 (S.C.C.) (hereinafter "**Air Canada**")

dupe of an unscrupulous client, or persons associated with such a client.

In *Air Canada*, Mr. Justice Iacobucci, on behalf of the majority of the Supreme Court of Canada, confirmed the equitable doctrine that strangers to a trust can also be personally liable to the beneficiaries for the breach of trust, if the stranger "knowingly assisted" in the trustee's dishonest and fraudulent design or scheme. The kind of knowledge required for "knowing assistance" is actual knowledge of the trust and its breach, or reckless disregard for (or wilful blindness to) the obvious. Simply put, constructive knowledge is insufficient to impose liability on the lawyer/stranger to the trust[13]. Moreover, the breach of trust committed by the trustee must be fraudulent or dishonest in the equitable sense of "morally reprehensible conduct"[14].

The particular background facts of *Air Canada* involved an action against the two directors of a closely-held incorporated travel agency, for not placing the ticket proceeds in a trust account for Air Canada, as required under the terms of an agreement signed between the travel agency and the airline. The action was precipitated by the seizure of the travel agency's general account, by its bank, in repayment of a demand loan. To complicate the relevant facts even further, while one director controlled the day-to-day operations of the travel agency, the second director had much less involvement in the business, yet possessed knowledge of the breach of the terms of the trust. As a starting point, Mr. Justice Iacobucci adopted, with approval, the seminal words of Lord Selborne in the English case of Barnes v. Addy[15], who stated that:

> "Those who create a trust clothe the trustee with a legal power and control over the trust property, imposing on him a corresponding responsibility. That responsibility may no doubt be extended in equity to others who are not properly trustees, if they are found either making themselves trustees *de son tort*, or actually participating in any fraudulent conduct of the trustee to the injury of the cestui que trust. But, on the other hand, strangers are not to be

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13 In contrast, constructive knowledge is, in fact, sufficient to find liability under the head of "knowing receipt", where the stranger takes possession of the trust property for its own benefit while possessing actual knowledge or knowledge of facts which would put a reasonable person on inquiry of a breach of trust.

14 In contrast with the analysis under a "knowing receipt" case, where the breach of trust need not necessarily be fraudulent or dishonest.

15 (1874), 9 Ch. App. 244

> made constructive trustees merely because they act as the agents of trustees in transactions within their legal powers, transactions perhaps of which a Court of Equity may disapprove, unless those agents receive and become chargeable with some part of the trust property, or unless they assist with knowledge in a dishonest and fraudulent design on the part of the trustees."
>
> [emphasis added]

Specifically, the "knowing assistance" test requires the following elements, namely:

a) actual knowledge, wilful blindness, or reckless disregard by the stranger (i.e. the lawyer) to the trust's existence and/or with respect to the terms of the trust itself;
b) actual knowledge, wilful blindness, or reckless disregard by the stranger (i.e. the lawyer) that what is being done or purported to be carried out by the trustee is fraudulent, dishonest, or in breach of the trust agreement or arrangement; and
c) the stranger (i.e. the lawyer) assists or facilitates the trustee, in some way, in carrying out the act which is ultimately characterized as fraudulent, dishonest, or in breach of the trust agreement or arrangement.

Liability under "knowing assistance" does not require a finding that the lawyer itself acted fraudulently or dishonestly.

In *Air Canada*, the factors which the court relied upon in finding actual knowledge of the breach of trust against the absentee (but complicit) director, were as follows:

a) the director knew of the terms of the agreement between the travel agency and the airline [i.e. to hold monies in trust for it]; and
b) the director knew that trust funds were being deposited in the travel agency's general bank account, which was subject to the demand loan from (and seizure by) the bank.

In order to obviate a finding of "knowing assistance", the lawyer will be obliged to prove or verify such relevant factors as the lack of knowledge by the lawyer of the terms of the trust agreement or arrangement between the client and the non-client, the lack of knowledge by the lawyer of the

identity of the non-client (or the absence of any communication, contact, advice or dealings between the lawyer and the non-client), the dependency and reliance of the non-client solely upon the client, due to the latter's reputation, experience or skills, or the fact that the transaction in question is not illegal, fraudulent or dishonest. In short, the lawyer under attack will be more likely to prove that he or she did not possess the requisite knowledge to make him or her a constructive trustee, under the rubric of the "knowing assistance" test, by validating or affirming as many of the foregoing key factors as possible. In turn, the very same exculpatory factors which have been garnered from an analysis of the cases involving the doctrine of "knowing assistance", cause us to return full circle, back to the guiding principles of "reasonable reliance", "apparent authority", and "the scope of the lawyer's retainer", as previously discussed in this paper. In other words, the same facts or circumstances that are considered relevant to negate a judicial finding of reasonable reliance by the non-client on the lawyer, or to negate a finding that warning bells should have sounded to the lawyer to do more for the non-client, all apply with equal force and effect to exonerate the lawyer from a finding of liability based on "knowing assistance", in connection with a breach of trust committed by the client-trustee[16].

(E) A final caveat regarding lawyer-client privilege

While the focus of this paper has been on the solicitor's relationship (or more specifically, the non-relationship) with the non-client, the writers would be remiss if this paper did not also highlight the lawyer's duty to maintain the confidentiality of privileged communications with his or her own client, and the serious potential for its violation, in the event that the lawyer were to embark upon independent communications with the non-client regarding the instructions, actions or decisions of the client, and specifically with respect to any concerns that the lawyer may harbour with respect to any perceived risks regarding the subject transaction. The writers also note that such concerns fuel the present consternation in the legal profession over the current requirements for lawyers to report their clients to a new governmental agency, FINTRAC, based on subjectively-determined suspicious

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[16] In the recent case of Banzon v. Madsen et al, [2001] O.J. No. 2216 (Ont.S.C.J.), the Court dismissed the non-client's allegation that the lawyer owed them a fiduciary duty, as they could not show any credible evidence that the non-clients had reasonably relied on the lawyer, and that the lawyer was aware of this reliance.

circumstances, pursuant to the provisions of the Proceeds of Crime (Money Laundering Act)[17].

Prior to the enactment of the current Rules, commentaries 10 and 11 to Rule 4 of the former LSUC Professional Conduct Handbook contained the justified disclosure exceptions to a lawyer's duty of confidentiality of information to a client (which specifically included the commission of a fraud or a crime), and in this context, the required threshold of certainty to qualify for such an exception appeared to be actual fraud, and not simply an allegation or possibility thereof. In the case of R. v. Bennett[18], which was referred to in the footnotes in the commentaries to the Handbook, the court upheld the statement that:

> "the communication itself must be part and parcel of the fraud, and not a report of some fraud that may have taken place beforehand or a communication relating to circumstances which may or may not amount to fraud, and on which advice is being sought."
>
> [emphasis added]

The court in R. v. Bennett, *supra*, also approvingly referred to the holding of Lord Sumner in O'Rourke v. Darbishire[19], which noted that:

> "I am, however, sure that it is equally clear in principle that no mere allegation of a fraud, even though made in the most approved form of pleading, will suffice in itself to overcome a claim of professional privilege, properly formulated."
>
> [emphasis added]

More notably, however, the successor provisions in the Rules, namely sections 2.03(2) and 2.03(3), only allow justified disclosure in cases involving death or serious bodily or psychological harm, but

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17 S.C. 2000, c.17 (hereinafter referred to as the "**Proceeds of Crime Act**"). As of the date of publication of this paper, the writers have been informed that Mr. Justice Marion Allen of the British Columbia Supreme Court has issued a temporary injunction against the application of the reporting requirements of the Proceeds of Crime Act to lawyers, calling the legislation an unprecedented intrusion into the traditional solicitor-client relationship, and raising constitutional issues which deserve careful consideration by the court.

18 (1963), 41 C.R. 227 (B.C.S.C.)

19 [1920] A C. 581

do not appear to do so in cases involving a fraud or other economic crime, and accordingly, the current rules do not justify a lawyer contacting an unrepresented third party to warn them that they may face an impending economic loss, due to the actions of the lawyer's client. That contact would also place the lawyer in a conflict of interest position, as between the client and the non-client, and along those lines, the Ontario Court of Appeal in the case of Anand v. Medjuck[20], carefully considered the effects of such a conflict, and correspondingly declined to impose fiduciary duties upon the lawyer outside of the lawyer-client relationship, particularly where the lawyer was simply engaged in the delivery of legal services to his or her own client.

4. CONCLUSION

The *Budrewicz* case is illustrative of the prevailing theme in the relevant case-law which, in turn, is consistent with the standard of practice amongst lawyers practicing in the field of commercial real estate in Toronto. In short, the Court is unwilling and reluctant to impose a duty of care, or a fiduciary duty, upon a lawyer towards a non-client in those circumstances where there is no reasonable reliance by the non-client on the lawyer, where the agent/trustee has apparent authority to give instructions and deal with the lawyer exclusively, and where the lawyer has no actual prior knowledge or reasonable suspicion of the dishonesty, fraud, or breach of trust committed (or intended to be committed) by the client towards the non-client[21].

The judiciary's reluctance to erode the policy reasons that allow representative parties to act on behalf of third parties (whether disclosed or undisclosed) in a variety of situations and contexts, is entirely consistent with the standard of practice of commercial real estate lawyers. As a general proposition, the writers do not believe that it is appropriate for lawyers to challenge the authority of their respective clients who may be acting in a representative capacity, and/or to make inquiries (from either the principals or beneficiaries who are being represented by such clients) with a view to substantiating or verifying the client's instructions or authority, or confirming that the nature and risks associated with the transaction are clearly conveyed to (and understood by) those being

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[20] [1994] O.J. No. 2571 (Gen. Div.), affirmed by the Court of Appeal at [1998] O.J. No. 101

[21] See the case of Filipovic v. Upshall (1998), 19 R.P.R. (3d) 88 (Ont. Ct. Gen. Div.), affirmed by the Court of Appeal at [2000] O.J. No. 2291, which dismissed an action by the non-client investors in a real estate syndicate against the lawyer, primarily because the investors relied upon the promoter of the syndicate for information and advice as to the nature and risks inherent in the investment, and the lawyer reasonably believed that the promoter had the necessary authority to act on behalf of the investors at all relevant times

represented, unless and until the lawyer is faced with actual notice of a fraud or dishonest act (or an imminent fraud or dishonest act) being perpetrated, or has a reasonable suspicion regarding same, or is met with blatant incompetence on the part of the client. Short of these limited exceptions, any inquiry on the part of the lawyer, with a view to detecting fraud or dishonesty on the part of the client, would likely be met with self-serving responses at best, or at worst, would severely erode the confidence that underscores the lawyer/client relationship. As so astutely noted by Brian Bucknall, as expert counsel in the *Budrewicz* case, forcing the lawyer to by-pass the client and make inquiries of the underlying parties being represented by the client (in order to ascertain or confirm any of the foregoing matters) may quickly turn into an impractical or impossible task, without the cooperation of the client (e.g. in terms of identifying the third parties being represented by the client, and endeavouring to contact each of them directly), knowing full well that in doing so, the lawyer risks breaching the duty to maintain the confidentiality of privileged communications with his or her client, absent the client's express consent or cooperation.