

Know Your Client: Practice Tips for the Modern Litigator

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On December 31, 2008, Part III of By-Law 7.1 of the Law Society of Upper Canada came into effect. This By-Law imposes specific requirements on lawyers with respect to client identification and verification. While the prudent lawyer will have established proper client identification procedures for conflicts management, the By-Law takes aim at preventing illegal activities. The following considers the background of Part III and offers practical tips for ensuring that client identification and verification requirements are met.

Background: the New Requirements

The prevention of illegal activities was a major motivator behind the amendment to By-Law 7.1. As indicated by the Law Society of Upper Canada (the “Law Society”) “lawyers by virtue of their trust accounts are targets for those wishing to launder money.”¹ Part III is based on the *Model Rule on Client Identification and Verification Requirements* adopted by the Federation of Law Societies of Canada (the “Federation”) in an effort to fight fraud.² Mortgage and real estate fraud are particularly problematic for lawyers today; however, the issue is critical for litigation as well. The other law societies in Canada are currently implementing the Model Rule within their own provincial regimes.³ The Law Society Treasurer, W.A. Derry Millar, has noted: “By adopting the new requirements through law societies in every province and territory, a national standard will be achieved. We will have an effective, practical and enforceable tool to ensure that members of the legal professions, in serving clients, remain vigilant.”⁴

Prior to the development of the model rule mentioned above, the Federal Government introduced the *Proceeds of Crime (Money Laundering) and Terrorist Financing Act* (the “Act”). The Act requires certain persons and entities to report, among other things, “suspicious

¹ The Law Society of Upper Canada “Client Identification and Verification Requirements for Lawyers,” Appendix 7, available online at www.lsuc.on.ca/media/id_materials.pdf

² *Ibid.*

³ *Ibid.*

⁴ News Release: “Law Society to launch ‘know your client’ requirements at year-end,” October 30, 2008, available online at: www.lsuc.on.ca

transactions.”⁵ The Act became applicable to lawyers in 2001.⁶ In response, the Federation and the Law Society of British Columbia, with the support of the Canadian Bar Association, challenged the Act’s constitutionality. On November 20, 2001, the Supreme Court of British Columbia granted the applicants an interim injunction. As a result, lawyers were no longer required to report suspicious transactions, pending a full hearing.⁷ Applications for a stay of that order were denied. Meanwhile, similar orders were granted elsewhere in the country.⁸ Following these orders, the Attorney General of Canada suspended the application of the Act to all lawyers in Canada.⁹ It is the position of the Law Society that self-regulation “makes federal regulation of the legal profession on this subject matter unnecessary.”¹⁰ Accordingly, the By-Law was passed by the Law Society on April 24, 2008.

The Requirements

The Law Society has identified four main requirements embodied in Part III of the By-Law:

- 1) identifying the client and certain third parties;
- 2) verifying the identity of the client and certain third parties;
- 3) maintaining records; and
- 4) withdrawing from representation in appropriate circumstances.¹¹

While the By-Law provides various exemptions regarding certain licensees, clients and types of funds, this section provides an overview of the lawyer’s general obligations. Client identification is governed by Rule 23(1) and requires that a lawyer, when retained, obtain the following information from the client:

- full name
- business address and phone number

⁵ *Proceeds of Crime (Money Laundering) and Terrorist Financing Act*, 2000, c. 17.

⁶ Appendix 7, *supra* note 1.

⁷ *Law Society of British Columbia v. Canada (Attorney General)*, [2001] B.C.J. No. 2420

⁸ Appendix 7, *supra* note 1.

⁹ *Ibid.*

¹⁰ *Ibid.*

¹¹ “Client Identification and Verification Requirements for Lawyers,” *supra* note 1.

- home address and phone number
- occupation

When the client is an organization, the lawyer must obtain the full corporate name, address, phone number as well as the instructing individual's name and contact information.

When the client is an organization *other than* a reporting issuer, financial institution or public body, the information to be collected is more extensive. The retained lawyer must also obtain:

- the incorporation or business identification number and the place of issue of its incorporation or business identification number, if applicable
- the general nature of the type of business or businesses or activity or activities engaged in by the client
- the name and occupation(s) of each director of the organization, (except where the organization is a securities dealer)
- the name, address and occupation(s) of each person who owns 25% or more of the organization or of the shares of the organization

Third parties must also be identified if they are directing or instructing the client, or if they have the *authority* to do so. This applies equally to verification requirements.¹²

For its part, client verification is governed by Rule 23(1)(4), which provides:

When a licensee is engaged in the activities described in clause 22 (1) (b), the licensee shall take reasonable steps to verify the identity of the client and any third party that the client is acting for or representing using what the licensee reasonably considers to be reliable, independent source documents, data or information.

The activities referred to in the above passage are: engaging in or giving instructions regarding “the receiving, paying or transferring of funds.”¹³ For instance, verification is triggered when a client’s money is put in trust to be paid out to a third party. However, verification is not needed when the client’s money will be applied towards legal fees and disbursements.

¹² “Client Identification and Verification Requirements for Lawyers,” Appendix 9.

¹³ Rule 22(1)(b)

Acceptable forms of “independent source documents” for individual client verification include, but are not limited to, a driver’s licence, birth certificate, health card, and passport.¹⁴
For an organization:

...such as a corporation or society that is created or registered pursuant to legislative authority, a written confirmation from a government registry as to the existence, name and address of the organization, which includes the names of the organization's directors, if applicable, such as,

- i. a certificate of corporate status issued by a public body,
- ii. a copy obtained from a public body of a record that the organization is required to file annually under applicable legislation, or
- iii. a copy of a similar record obtained from a public body that confirms the organization's existence.

If the client or third party is an organization other than a corporation or society, such as a trust or partnership which is not registered in any government registry, a copy of the organization's constating documents, such as a trust or partnership agreement, articles of association or any other similar record that confirms its existence as an organization.¹⁵

When a client does not reside in the same city as the lawyer, there are two options for verification – termed “non-face-to-face” verification. First, when the client is present in Canada, his or her identity may be verified by a guarantor who can provide an attestation. Rule 23(9) provides a list of eligible guarantors (e.g. a lawyer, doctor, notary, etc.) When the client is not in Canada, an agent will be required. Requirements respecting the use of an agent are outlined in the By-Law.

Practice Tips

What exactly constitutes “reasonable” steps, or efforts, for client identification and verification purposes? It would seem that the lawyer’s aim in collecting and verifying client data ought to be two-fold: complying with the By-Law and maintaining proper conflicts management practices. Most counsel will already have proper client identification measures in place, to ensure that he or she is not in a position of conflict with various clients. From this perspective, the By-Law does not impose new or onerous standards. What is *reasonable* may be no more than what is *practical* in order to run a smooth, conflicts-free practice. In light of these goals, the

¹⁴ Rule 23(1)(7)

¹⁵ *Ibid.*

following are a selection of practice tips for complying with the new requirements and avoiding conflicts of interest in your practice:

- Get all of the necessary client information at the initial intake interview. This ensures immediate compliance with the By-Law and prevents inadvertent conflicts of interest from arising.
- Take a copy of the client's driver's licence or other picture identification at the initial intake interview or at the meeting to sign a retainer agreement. This is an important document for your records and also makes the verification process easier down the road.
- Have a standard form for client identification purposes and fill it out yourself to ensure completeness. [An example of such a form has been attached as Appendix A.]
- Consider sending a letter to your clients regarding the new requirements to help ensure client co-operation. [An example of a letter has been attached as Appendix B.]
- Remember that if a court action has begun, only client identification is necessary – 'if in litigation, perform identification, not verification.' Settlement funds constitute an exemption under the By-Law.
- In the case of a class action, there is no need to identify every class member; it is sufficient to identify only the representative plaintiff, according to the Law Society.¹⁶
- Always check the status of a corporation to determine if it is active. Articles of incorporation will not give you this information. You should therefore obtain the corporate number and name, and perform a search on systems like Nuance or Cyberbond.
- Do not rely solely on the information given to you by the client – make sure that the corporate number corresponds to the corporate name. For instance, a company could have changed names or amalgamated, rendering the information provided by your client out of date.

¹⁶ Appendix 9.

- When clients come in, ask if they have moved recently to ensure that their information is up to date.
- Always insist on the client's full legal name (i.e. Michael not Mike) and ensure proper spelling – cross-reference against photo identification for verification purposes.
- Make a note or memo to file (and to the File Opening Department, where applicable) if a client refuses to provide certain information. Indicate the nature of the information and the reason for the refusal, if possible. This may constitute proof that “reasonable efforts” were made, if compliance with the By-Law later becomes an issue.

Some have reported that clients may be reluctant to disclose certain information. Most amusingly, some clients have tried to avoid disclosing their middle names for the sole reason that they do not like the names bestowed upon them! Those in charge of conflicts management and file opening will confirm that middle names, as well as birth dates, are sometimes crucial for distinguishing between clients with identical first and last names.

One can imagine other situations where simple errors could yield unfortunate consequences. For instance, a client's corporate number may no longer match its corporate name, if the company changes names without notifying the law firm.

More troubling consequences have resulted from the failure to identify and verify the identity of clients. Consider the following scenario: a U.K. company contacts a Canadian law firm and asks that the firm write a demand letter on its behalf. The company claims that a Canadian corporation, the defendant, owes it \$20,000.00. The company identifies itself as *Conor Enterprises Inc.* but does not provide any documentation. When the law firm performs a quick background search, it finds that *Connor Enterprises Inc.* is a real, U.K.-based company, and assumes this is the correct spelling of its new client. The firm sends the demand letter, then receives a bank draft for \$20,000.00, which the client asks the firm to send via wire immediately. Convinced that there are urgent circumstances, the unsuspecting law firm transfers the funds from its trust account before the cheque has cleared. As it turns out, the bank draft is fake and the defendant Canadian company does not exist.

One need only surf the internet to discovery that law firms have fallen prey to e-mail scams as well. As technology evolves, so too do the tactics employed by criminals. The following online blog was posted on August 12, 2009, and serves as yet another cautionary tale:

Fraud and the Attorney Victim!

The other day I received an email supposedly from a Dr. Jia Boa, in Canada, asking me to take a case to recover \$370,000 paid for equipment purchased, but never delivered.

I asked a few questions and received very vague answers. Then I received the exact same email request from someone identifying himself with a different name [...]

They even provided me with a web address of the company that had their money [...]

One of the bad things is that even if one out of ten thousand emails gets an attorney to go along, it is a problem. This is another reason to be diligent. Attorneys beware. Know your client.¹⁷

Concluding Remarks

As previously noted, lawyers are often targets of money laundering schemes because of their trust accounts. Requiring clients to provide identification may act as a deterrent to terrorists or other criminals seeking to launder the proceeds of crime. Of course, sophisticated “clients” may get around these hurdles by using counterfeit identification. At a minimum, however, complying with the By-Law means that the funds received by the lawyer can be traced back to the criminal’s photo identification.

The By-Law imposes requirements that will already have been reflected in many of our internal conflicts management policies. Compliance with the By-Law helps to protect legal professionals not only from conflicts of interest, but also from becoming the unwitting pawns of criminals who are becoming more and more creative in this era of high technology.

¹⁷ Twin Cities Business Litigation Blog: “Fraud and the Attorney Victim”, posted August 12, 2009, at: <http://www.twincitiesbusinesslitigation.com/2009/08/articles/lawyer/fraud-and-the-attorney-victim/>