Lawyers adjusting to know-your-client rules

LUIGI BENETTON TORONTO

Do you know your clients well enough to say that they don't launder money or finance terrorism?

To combat these and other criminal activities, upcoming federal regulations will codify the information lawyers must learn about their clients should they receive $3,000 or more for a legal service. Provincial law societies have also prepared client identification and verification rules of their own.

"Many of the know-your-client regulations are intuitive," says Melissa Babel, a Toronto-based associate at Green & Spiegel LLP. "I would think that most firms had processes in place to identify clients well before it became a rule."

But the new codified processes are puzzling some lawyers, many of whom are turning to their law societies for guidance.

"Sometimes we really had to think it through and take more steps than we initially thought we would," says Trina Fraser, a partner at Ottawa-based business law firm BrazeauSeller LLP. "If we act on behalf of a trust that has dozens of beneficiaries, do we have to verify just the trustees who are entrusting us or do we include the identity of each beneficiary?

"Suppose a company acts in trust to purchase property," Fraser continues. "It's clear in the bylaw that if somebody acts in trust for someone else, you have to identify and verify both parties. When those entities are businesses, you have to find out about the directors and majority shareholders of each of those companies.

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"You suddenly realize there's a lot of information that you must collect to make sure you're really in compliance," Fraser says. "It's like a tree branching out. It can get pretty cumbersome."

In her immigration practice, Babel claims familiarity with know-your-client principles. "Documentation is always a big issue with immigration and refugee clients," she says. "In order to open a file, we need copies of passports and all sorts of reliable documentation.

"The real issue is not clients we meet in the office, where they fill out forms and we see original documentation," Babel continues. "The issue for us is with overseas clients and implementing the rules for people we don't meet in person.

"Many of our clients are applying for permission to come to Canada, so it's impossible to meet with them face-to-face," Babel adds. "We have clients meet with lawyers in other countries who confirm that they review documentation."

Still, challenges that predate the know-your-client rules continue to plague Babel's clients. "If people live in remote areas and don't have easy access to lawyers or agents, that adds a layer of complexity," she says. "Certain people are in Canada preparing applications who don't yet have status. Some of them work without authorization or study without permission and are trying to rectify their status."

Matters like these will spur the evolution of know-your-client rules. Wire transfers, for instance, were not mentioned in the Law Society of Upper Canada's (LSUC) initial bylaw. "We knew there wouldn't be a problem between banks in Canada, because they are also subject to know-your-client requirements," Fraser says. "They would have already identified and verified their clients, so why should we?"

This thinking didn't cover transfers from banks outside Canada, where due diligence might not meet Canadian standards. Facing questions on this matter, the LSUC now exempts identity checks if banks are based in countries that claim membership in the Financial Action Task Force on Money Laundering.

"That's worked out for the most part," Fraser says. "We're pretty fresh into this, so I'm sure other things will come up. The drafters of this bylaw did the best they could, but novel and unique situations will arise that have to be addressed."

Adoption of know-your-client rules can take several forms. Fraser's firm downloaded and customized sample forms published by the LSUC, then placed templates on its computer network. Lawyers complete the forms and keep both digital and hard copies.

"Our office administrator keeps a central spreadsheet with every client whose identity we verified, with a link in the spreadsheet to the actual, scanned copy of identification," Fraser says, adding that the spreadsheet contains columns for things like document expiry dates. "That's how we're muddling through right now."

Some lawyers look to practice management software to eliminate the muddling. Ravi Puvan empathizes. "If you maintain client information in one system for billing purposes and another system for verification purposes, it doubles the work required to maintain and reconcile client records," says the product manager, practice management for LexisNexis Canada Inc. (Full disclosure: LexisNexis also owns *The Lawyers Weekly*.)

LexisNexis' PCLaw offers features meant to help lawyers comply with client identification and verification rules. Puvan points out that PCLaw can help lawyers save time since they do not have to check another physical system if a client identification has been verified — it is stored in their accounting and billing system.

"If you have more than one lawyer, are others in the firm complying with those rules? Using manual processes, it's easier to go

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Canada still leading the way when it comes to aboriginal rights

QUEBEC LE SOLEIL / THE CANADIAN PRESS

Cree Chief Billy Diamond signs a land claims agreement in 1975.

Aboriginals

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figure out what the best outcome might be, he says.

While economics are important, he says, the real question of reconciliation concerns the place that groups occupy in their communities, in their country and in the world. On more than a few occasions, he says, his assumptions have been "flipped on their head."

For Peter Hutchins, one of the country's top litigators in aboriginal cases and co-founder of Montreal-based firm Hutchins Caron and Associates, today's issues stem from "simple misunderstandings" dating back to the actual discussions that took place when historical treaties on land use were being forged. First Nations understood that they were sharing the land, he says.

Questioning received legal wisdom requires a certain type of personality. In his view, "You've got to be someone who questions and challenges authority because that's what we do day in day out. To the person who says 'you can't do this, the law says so,' you have to be able to say 'what do you mean you can't do it?'"

Hutchins was one of the negotiators for the 1975 James Bay and Northern Quebec Agreement, the first modern-day land rights settlement, which involved a $225-million payment to Cree and Inuit groups in return for allowing hydro-electric projects to go ahead in Northern Quebec. He left his first employer along with two colleagues to pursue the case.

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> — Peter Hutchins
> Hutchins Caron
> and Associates

The final agreement was signed and concluded in two years, says Hutchins. Back then, negotiators had a direct line to senior government officials. But, as land rights cases have become more commonplace, bureaucracy has grown in response, a development that has created "a big blob, a tar baby" in the system. But, he points out, Canada is still a front-runner in the field, ahead of Australia, New Zealand and the U.S.

The Liberal government in B.C., recently re-elected last month, is set to break new ground with plans to give aboriginal groups title to ancestral lands. The controversial proposals, yet to be unveiled, would draw a line under the debate once and for all, giving native groups and business shared power of decision over land and resources. It is expected that major transferrals of wealth will eventually flow to native communities as a result.

The debate has moved faster in B.C., mainly because the absence of treaty agreements for most of the province has left the legal ownership of lands open to more question. How far the proposals will go has yet to be seen, but the mere fact that they are being considered is a measure of the lines of communication that have been established between aboriginal groups and government, in large part as a result of recent legal developments. As Alexander puts it:

"One of the positive things to come out of this is that presidents of mining companies and political leaders now spend time with aboriginal communities." ■

In tax cases court must ensure Charter rights protected

Audits

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of the subject is at stake. The courts are on high alert in criminal matters.

In an investigation, the CRA must look to s. 231.3 (warrant for search and seizure) of the *Criminal Code*. For example, for the purpose of investigating penal liability, s. 231.3 sets out an application process for an *ex parte* search warrant similar to that found in s. 487 of the *Criminal Code*.

Of course, an examination that starts out as a routine civil audit can turn into a criminal investigation. If this happens, the nature of the relationship between the CRA and the taxpayer also changes and the agency's powers become subject to Charter restrictions. Nevertheless, the CRA may still be able to use any information that it procures during the proper exercise of its audit function in a subsequent penal investigation. The use of such information for criminal purposes does not offend either s. 7 (the principles against self-incrimination) or s. 8 (reasonable expectation of privacy) of the Charter.

Under s. 7 of the Charter, there are competing principles of fundamental justice. In inquiries in income tax matters, the principle that relevant evidence should be available to the trier of fact outweighs the principle against self-incrimination.

Similarly, individuals have few privacy interests under s. 8 of the Charter in materials and records that they are obliged to keep and produce for the purposes of the *Income Tax Act*. Once an auditor has inspected or compelled the production of a document or information, the taxpayer cannot be said to have a reasonable expectation that the auditor will guard his or her confidentiality. Given the taxpayer's diminished expectation of privacy, the state's interest to intrude on the individual's privacy in order to advance its goals of law enforcement outweighs the individual's privacy interest in his or her materials and records.

> "It is not easy in practice to distinguish the divergence in powers and obligations related to civil audits and investigations... [T]here is no bright line test for determining the predominant purpose of an inquiry or when it changes.

The CRA may also conduct an audit and an investigation concurrently. However, once the CRA begins its investigation, it can use further information that it obtains under its concurrent audit powers only for the purposes of the audit and not for the purposes of the investigation.

It is not easy in practice to distinguish the divergence in powers and obligations related to civil audits and investigations. An inquiry becomes an investigation when its predominant purpose is to determine penal liability. However, there is no bright line test for determining the predominant purpose of an inquiry or when it changes.

Apart from a clear decision to pursue a criminal investigation, no single factor is determinative in every circumstance. A court has considerable latitude in its decision to admit evidence resulting from an investigation. In arriving at its decision, however, the court should consider all the circumstances to determine whether the inquiry sufficiently engages the adversarial relationship between the state and the taxpayer to warrant Charter protection. ■

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Corporate counsel scaling back

In these tough times, everyone, including corporate counsel, are looking for ways to slash their budgets. Take note of some of the ways corporate counsel who responded to a recent survey by legal management consulting firm Altman Weil said they are reining in spending this year:

- ↑ Bringing more work in-house
- ↓ Reducing training and events
- ↓ Using lower-priced outside counsel for some work
- – Delaying technology purchases
- ↓ Cutting lawyers and support staff
- ↑ Seeking more alternative fee arrangements
- ↓ Cutting lawyer and staff year-end bonuses
- ↓ Cutting back on paralegals
- – Outsourcing or offsourcing some tasks

New know-your-client rules will evolve as law firms find flaws

KYC

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off-script."

Jack Newton concurs. "It makes a lot of sense to have this kind of process integrated into the client intake workflow that you see in many practice management software products, or any customer relationship management product," says the president of Vancouver-based practice management system provider Themis Solutions Inc.

The good news, according to Newton: "Know-your-client rules shouldn't require a big software upgrade or a significant change to software lawyers already use — just some changes in workflow."

But some things are beyond software's ability to help.

"To me, the most cumbersome part comes when we deal with long standing clients and we suddenly have to say: 'We need to see your passport, we need to see your driver's license.' " Fraser says. "They may have to make a trip to our office, or if they're not in town they have to have their identity verified by a lawyer wherever they are.

"We may know who they are, but there are no exemptions for that. You still have to do it.

"Clients tend to understand," Fraser continues.

"Most people are accustomed to proving their identity to bankers, but it's still a little bit annoying to clients."

Babel's concerns reach beyond mere annoyance.

"It's important to make sure we comply with regulations," she says, "while ensuring that people have the same level of access to justice whether or not they're documented." ■