LEGAL PRACTITIONERS' LIABILITY COMMITTEE

Swimming with sharks

Presenter's Workbook

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Content

Introduction

The *Swimming with Sharks* video explores issues relating to retainer management and communication. These materials are designed to be used with the video.

The retainer management themes raised are:

- client selection – pushy/bossy client
- taking over part of the way through a matter
- limited retainer
- scope of work – commercial versus legal work.

The communication issues raised are:

- dealing with commercially savvy or sophisticated business people
- accepting information or assumptions made by clients.

Retainer management basics

What are some of the things you think about when you hear retainer management?

A critical part of managing any retainer effectively is setting it up.

Before accepting a retainer ask yourself 'should I act for this client in this matter at this time?' In answering that question you should consider the following things.

- Who is the client?
- Can I act – is there a conflict?
- Do I have the time and the resources?
- What will the scope of the retainer be?
- Who can I delegate it to?
- How often and by what means will I communicate with the client during the retainer?

There is more to retainer management than simply complying with the cost disclosure requirements in legislation. Once you accept the retainer some of the things to manage include:

- the retainer letter
- the cost disclosure
- the cost agreement
- when to terminate the retainer
- how to terminate the retainer.

Swimming with Sharks

The video scenario

Hector, an experienced property developer, retains a new practitioner to take over aspects of a multi-million dollar property development. The ex-service station site has conditional planning approval. The limited retainer grows, with calamitous consequences arising from a misunderstanding about the terms of an environmental audit. This scenario is based on an actual claim.

You can play the video scenario all the way through and discuss the questions below at the end or pause at the indicated points to discuss what has just occurred.

Scenes 1 and 2 - Initial briefing and dictation of letter - 0:00 to 3:32

Hector and Tony meet for the first time and Tony's subsequent dictation of the retainer letter.

What has taken place in these first two scenes?

- Tony is taking over a matter from another firm.
- Hector is in a hurry to get his development moving ahead and sold.
- Hector is very sure of what he wants.
- It is a large development and Hector has several consultants doing different things.
- Hector wants Tony to speed council up so he can acquire Willow Lane by the end of the month.
- Tony does the right thing and sets out in his retainer letter his instructions to act in connection with the purchase of Willow Lane.

Scenes 3 and 4 - An accredited auditor is needed - 3:33 to 5:17

Hector and Tony discuss the contracts of sale, the sunset clause and the planning permit. There is a phone call between planning consultant, John Fish, and Tony about the environmental report and the need for an accredited auditor.

What is the problem playing out and what do you think could go wrong?

- Tony's retainer is creeping – he has drafted contracts, advised on extending the sunset clause and is now being asked to organise a new accredited environmental auditor.

Scenes 5 and 6 - There's a problem with the environmental audit - 5:18 to 7:27

A heated meeting between Hector and Tony about the new environmental audit and the changes in the guidelines followed by a hallway discussion about settlement options with the former vendor.

How do you think Tony could have avoided this situation?

- Tony tells Hector about the problem with the new environmental audit and the costs of progressing the development.
- Hector tells Tony these issues are not Hector's problem and he will not be wearing the cost.
- Six month later Tony and Hector discuss the options for settlement with the former vendor and the need to move on with remediation. Hector chooses to take the money offered and finish the project.

Final scene - Tony and the claims solicitor – 7:28 to the end

In the final scene Tony is with Anne, the claims solicitor, discussing allegations Hector has brought against Tony.

What went wrong in the scenario? More specifically, what did Tony do wrong?

- Tony failed to document his changing retainer and the advice he gave Hector.
- Tony failed to document Hector's instructions and his understanding of what was required.
- Tony failed to manage Hector's expectations.
- Arguably, Tony failed to confirm Hector's understanding of the risks of entering into the contracts before all the planning requirements were met if you accept he had an obligation/duty to do so.

How did the claim pan out?

Remediation works were required, causing extensive delays in finalising the subdivision and development. The $400,000 settlement at the end of the video was an agreement with the vendor oil company to assist with the remediation. It was also agreed the oil company would contribute more if necessary but this was subsequently reneged on. Hector left Tony's firm not long after, when he couldn't afford to pay the legal costs any more. Tony sued Hector for his fees and did recover them eventually.

Ultimately, 14 of the 30 purchasers rescinded because the project was delayed beyond the two-year sunset clause.

The development was finally finished in late 2004, although most purchasers who rescinded did so in late 2003. The original sunset clause expired in March/April 2003 and Hector actively sought to extend it.

Hector and his company brought proceedings against Tony's firm, the firm that had acted in the original sale and the vendor oil company that sold him the land.

The allegations against Tony's firm took four statements of claim to be refined. It was said that:

- the firm owed a duty, both in tort and contract, to provide all legal advice reasonable and necessary relating to the development and subdivision of the land, and the preparation of the contracts of sale
- the firm should have advised Hector that:
    - the planning permit in respect of the land stipulated the owner must obtain a favourable environmental audit before they could start development
    - if the audit was not favourable it could take some time to remediate the land
    - if Hector marketed and sold the units prior to obtaining the audit, there was a risk he would take longer to complete the development and allow the purchasers an opportunity to avoid the contracts.

Hector argued if he had been given this advice he would have held off marketing until after he obtained the audit report. He would not have sold the units until after the remediation work, which was completed in October 2002. At this time he would have received much higher sales prices. Instead he was now faced with having to sell 14 units in a deflated market in late 2004.

There were many holes in Hector's arguments on causation, however LPLC's legal advice was that there were some risks relating to the retainer/duty arguments.

There was a settlement at mediation. Tony's firm walked away bearing its own substantial legal defence costs and the other insured firm that acted in the purchase of the land contributed $120,000. The vendor oil company contributed a further $480,000.

The legal issue – a sunset clause

A sunset clause in the off-the-plan context is used to give the purchaser and/or the vendor a mechanism to cancel the contract if the plan is not registered within a reasonable, prescribed or agreed time. In Victoria, the *Sale of Land Act 1962* (Vic) specifically allows a purchaser to rescind if the plan is not registered within 18 months or the time prescribed by the contract.

Sale of Land Act 1962 (Vic) – section 9AE

(1) If the vendor under a prescribed contract of sale of a lot fails to comply with section 9AA or 9AB the purchaser may rescind the contract of sale at any time before the registration of the plan of subdivision.

(2) If the plan of subdivision is not registered within 18 months after the date of the prescribed contract of sale of a lot on that plan of subdivision, or, if the contract specifies another period, before the end of that specified period, the purchaser may, at any time after the expiration of that period but before the plan is so registered, rescind the contract.

Lawyer/client behaviour

What is Hector thinking?

- He is looking for a proactive new lawyer to move the development along quickly.
- He likes Tony's flattery.
- He is not interested in legal detail.
- His overriding priority is to get things done fast.
- He thinks he knows what he wants.
- He does not listen to Tony's early cautions.
- "I can control Tony and his costs by drip-feeding him information."

What messages is Hector conveying?

"I'm a winner", "I'm in charge", "I can send some lucrative work your way".

Communication filters:

- Hector only hears the parts of Tony's advice he wants to hear i.e. a fast-tracked development.

What is Tony thinking?

- He is flattered by the referral.
- He wants the work.
- He sees Hector as an ongoing source of work.
- He tries to impress Hector with a 'can-do' attitude.
- He focuses on what Hector wants rather than the bigger picture.
- He does not take sufficient charge of the conduct of the file and indicate what he is not doing.
- He allows Hector to run the file, allows his initial reservations to be dismissed and gets swept up in satisfying Hector.

what messages is Tony conveying?

"Look at me, I can make this happen", "I'm better than old geezer Carson", "I know people", "I'm a player".

Later in the retainer Tony acquiesces into doing what Hector dictates and is dominated by him.

Client selection – the pushy, bossy, know-it-all client

How would you describe Hector?

What was your initial reaction to Hector?

Have you seen a 'Hector' before?

What are the risks with a 'Hector'?

How would you manage a 'Hector'?

See 'Lawyer/client behaviour' (above) regarding Hector's characteristics.

Does your firm have a client selection policy?

What are the criteria – does it just relate to business type?

How would Hector be perceived under the policy?

Say 'no'

The simplest risk management lesson is don't act! Practitioners can say 'no'. They do not have to accept a retainer. For every new matter ask whether you should act for this client, in this matter, at this time.

Claims often arise because a practitioner's better judgment is clouded by a natural inclination to assist and improve the client's position.

Avoid the trap of becoming responsible for the client's predicament. Practitioners are not therapists or social workers. Irrespective of the client's demands for immediate action, there are situations where the practitioner must say 'no' including where a claim clearly has no merit, a practitioner lacks the necessary skill or experience to handle it, or if the client wants things done in an unrealistic time frame or inappropriate manner (see *May v Mijatovic* [2002] 26 WAR 95).

Use the retainer as a shield

Retainers are contracts and when carefully drafted, can limit the possibility of dispute. At the most basic level, the retainer identifies the client and prescribes the services expected of the lawyer.

Your retainer should set out, in writing and in simple terms, what you have been retained to do and the basis on which you have agreed to act.

This could be limited, in the first instance, to obtaining the file from your predecessor, after which advice will be given as to the merits of the underlying matter.

Where a practitioner is instructed by multiple parties, the retainer agreement can anticipate and avoid or limit potential conflicts. It should specify from whom instructions are to be provided, to whom the practitioner is to report, who is liable for costs and whether that liability is joint or several.

Issues such as sharing confidential information and access to the documents in the event of dispute or after the retainer is terminated can also be addressed. Where a practitioner is acting for two clients, their legal professional privilege is joint and both clients must consent to its waiver. This issue could be addressed in the retainer to avoid later disputes over documents and your continued involvement in the dispute as a stakeholder.

The lawyer advises - the client decides

Preferably your advice will be in writing, as will the client's decision.

Professional Conduct and Practice Rule (Vic) 12.2 requires that a practitioner must assist their client to understand the issues in the case and the client's possible rights and obligations sufficiently so as to permit the client to give proper instructions. You give the client the options, the advantages and disadvantages of each and possibly a recommendation but ultimately they must decide.

In the scenario Hector wanted to decide without the advice but then complained later.

Communicate key issues

Key things to communicate with the client include costs and changes to costs estimates, changes in personnel and evidence obtained that goes for or against their case. Some issues like evidence and the progress of the case need to be communicated face to face. Do not underestimate the value of face to face communication.

Communicate about costs

Where possible, obtain money up front and send accounts on a regular basis, especially in litigation matters. An account is a reality check as it reminds the client legal work, especially litigation, is expensive and also that your firm is unable to fund the matter indefinitely.

Firms that have changed their billing practice from one bill at the end of the matter to regular monthly invoices (even if just for the client's information and not necessarily to be paid at the time) have found that clients are less likely to complain about paying the bill at the end of the matter. Keeping the client informed about how the costs are accumulating and what work is being done goes a long way to managing the client's expectations about what is happening and the likely outcome.

Taking over a matter part of the way through

In the scenario, Tony came in part way through the deal. The property had been bought and much of the leg work done to get planning permission. They just had the 11 conditions to comply with (in the real case there were more than 25). Tony had not been involved in the due diligence on the purchase of the property nor the planning process. He was asked to accept what was done and move forward.

The issues that arise when taking over a matter part way through are equally relevant for transfers of files from one firm to another as well as from one practitioner to another within the same firm.

Very often practitioners do not acquaint themselves with what has happened throughout the matter and assume what was done before was done properly. The cost of going back and reviewing the matter from the start can often be prohibitive. There are often urgent things to be done on the matter once the practitioner receives the file with little, if any time to revisit the matter.

The problem is relying on the previous practitioner having done the right thing. We have had cases where crucial evidence or causes of action were missed because the previous practitioner thought certain facts were not relevant.

If the client is changing practitioner it is prudent to consider why. Did they not like the advice they received, for example their case is hopeless or were they too difficult to deal with and the previous practitioner would not do what they wanted, or could they not afford the legal fees? With any of these scenarios, consider whether the client is worth taking on.

In some instances, it can be a matter of the right personality and approach enabling a practitioner to manage a client effectively when another practitioner might not have been able to. However, you have to be wary not to fall into the trap that Tony did–of being flattered by the client and not really understanding what you are getting yourself into.

Experienced practitioners tell us they have a sixth sense about identifying potentially troublesome clients. Those practitioners come up with a reason why they cannot act for clients and refer them elsewhere. One practitioner in a mid-tier firm told us when he sees his fellow partners wanting to act for 'Hectors' , he tries to counsel them out of it because he has seen the damage they can do in other firms.

Limited retainers

In this scenario Tony started out with a limited retainer.

Is there anything wrong with having a limited retainer?

What can go wrong with limited retainers?

- Practitioners fail to document the retainer well enough, leaving room for the client to argue later certain advice that was not given, should have been given.
- The practitioner may document the retainer at the start but when retainer creep occurs, perhaps as further issues become apparent, they fail to update their documentation. This provides the opportunity for the client to later argue the retainer had changed more than was assumed by the practitioner.
- Practitioners do not always ensure they get the full picture of what is going on from the client, leaving situations where important information is not given to the practitioner.
- The practitioner attempts to stick strictly to the limited retainer and consequently misses a closely related issue that is arguably within scope.
- There is scope for misunderstanding between the client and the practitioner as to who is doing what, with allegations later that the practitioner missed an issue.

Limited retainers can cause various problems. Here are some examples.

Examples

1 Redraft MOU

A firm was asked to review a draft memorandum of understanding that had been prepared by the client to replace a now expired memorandum. The firm did what it was asked to do.

Months later one of the parties sought advice about restructuring. The restructuring exercise revealed the structure underpinning the memorandum was not tax-effective. The client complained the firm should have advised on that problem when asked to review the memorandum.

The firm said it had not been asked to go behind the memorandum and look at the structure; rather, it was asked to advise only on the wording of the new memorandum. The structure had already been set up by previous practitioners. However, the underlying assumptions were flawed, resulting in the memorandum not achieving what was intended. The client argued that the firm should have satisfied itself about those

assumptions in order to give the advice. This was clearly not what the firm thought it was retained to do at the time.

2 Review employment agreement

An employment agency instructed a firm to act in a limited capacity relating to the purchase of another agency. At the end of the transaction the firm was also asked to ensure that certain employment agreements conformed with the sale of business agreement it had just entered. The firm reviewed the agreements and made some amendments. It was subsequently discovered that some of the employees were not being paid the appropriate award rates of pay.

The client alleged the firm should not have approved the employment agreements where the conditions did not meet award standards. The firm said they had been specifically instructed not to undertake any due diligence relating to the purchase of the business as the client intended to do it. They believed the later instruction was confined to ensuring the employment agreements complied with the client's obligations in the sale agreement and nothing more. The instructions and retainer were not adequately documented.

3 Slipped between the cracks

While in some cases a firm effectively specifies the matters it is not advising on such as tax, it can still get into trouble when advice from other experts is received by the firm and then not acted on or clarified with the client.

A client asked a firm to establish a new entity and advise on the transfer of assets into the new entity. The firm specified what it was retained to do and early in the transaction recommended the client obtain independent accounting advice about CGT, stamp duty, income tax and GST. The firm received a short email from the client's accountant later stating GST was payable on the sale of the assets. The firm took no action relating to that advice and made no recommendations as to what steps should be taken.

The client later argued the firm should have advised that a 'plus GST' clause be added to the agreement. The firm said they were not retained to deal with the tax issues. The practitioner handling the matter went on holidays the day after the advice was received from the accountant and, although he was back in the office before the matter settled, the issue seems to have been overlooked by everyone.

4 Acting for borrower and lender

In June 1995, the practitioner acted on what he described as an 'intra-client' loan−the practitioner had probably acted for lender and borrower in a loan transaction.

The lender was persuaded to borrow funds to make the loan and the loan agreement drafted by the practitioner provided for payment of all the lender's holding costs, interest and an attractive facility fee of $56,000.

The loan for $565,000 was to be repaid in 60 days with interest. It was secured by a debenture charge over the borrower company's assets and an assignment of $1 million

worth of shares in an associated company when those shares were issued. The lender was anxious to ensure the loan was secure and the practitioner allegedly assured the lender it would be.

The borrower paid the first installment of interest and then nothing else. The date for repayment was extended several times and the lender was allegedly warned by the practitioner against taking any 'precipitous action'. However, in June 1997 when the lender finally insisted the practitioner commence recovery proceedings:

- the practitioner said he would not act against his other client, the borrower
- the $1 million share issue had never been made and the substituted shares were worthless
- the debenture charge had not been registered and by that time, the company's major assets had evaporated.

By way of defence, the practitioner maintained his retainer was limited to preparing the necessary documents in respect of a 'done deal'. Whether this was the case, the lender's principal allegation was that the practitioner had also acted for the borrower (and the company director of the borrower) in this transaction in an obvious conflict of interest, in circumstances where the borrower's interests were preferred over the interests of the lender.

The practitioner's file was poor and showed:

- no attempt had been made to document any limited retainer, if there was one
- no investigation into the company was made or suggested
- no guarantees were obtained, with the practitioner saying "it would be normal to have guarantees but X (company director of the borrower) hates personal guarantees and in the circumstances I don't feel it is necessary"
- the security provided was unsatisfactory and inadequate, the shares were never provided and the practitioner failed to register the deed of charge for two years.

It was not clear who the practitioner was acting for. The practitioner's files and accounts mixed all the issues up but it did appear his first contact was with the company director of the borrower rather than the lender. The lender said the practitioner had told him "X (company director of the borrower) has asked me to draw the documents and I'll be acting for both of you". This was denied by the practitioner but there was certainly no other practitioner acting in the transaction. The borrower considered the practitioner to be its lawyer. It was not difficult for the lender to make a case that the practitioner was acting for both parties in a position of conflict.

Some major risks for limited retainers are:

- practitioners not documenting the retainer well enough, leaving room for the client to argue later that certain advice that was not given should have been given
- practitioners may document the retainer at the start but when the retainer creeps they fail to update their documentation, leaving it open for the client to argue later that the retainer had changed more than was assumed by the practitioner.

Risk management strategies

When it comes to limited retainers, practitioners need to think laterally and consider what they are **not** asked to do as well as what they are asked to do.

Clarify the extent of any limited retainer, confirm it in writing and where necessary, say what the firm is not going to do.

Where some of the work is being undertaken by the client or by another advisor, confirm that in writing. You may also need to inform the client of the risks of not doing the work.

Closely monitor the retainer as the matter progresses so if things change the retainer can be updated in writing.

Scope of work – commercial versus legal work

This topic is related to the limited retainer topic. One of the issues raised in the scenario is where to draw the line between giving the client legal advice and giving the client commercial advice.

In his meeting with the claims solicitor Tony is accused of not telling Hector about the need to comply with the environmental report condition in the planning permit before he could obtain registration of the plan of subdivision. It was argued Tony should have told Hector not to sell any units until he obtained the all-clear on the environmental audit.

What Tony needed to have understood and explained to Hector was the potential risk the contamination report may not have been adequate. This was because the guidelines for contaminated sites had been changed and a new report assessing contamination to a deeper level was required to comply with the guidelines. There was a possibility that testing to a deeper level may show contamination that would take time and money to clean up.

Is this legal or commercial advice?

- The fact the environmental audit requirements had changed may be a legal issue.
- The need to comply with all of the council's conditions in the planning permit in order to have the plan of subdivision registered would be legal advice.
- Delay in selling may be a commercial issue.

There are cases where the whole question is whether the practitioner should be advising their clients that the transactions are so improvident or reckless they should not be doing it.

Look before you leap, an article by LPLC Chief Risk Manager Heather Hibberd published in the June 2010 edition of Law Institute Journal discusses how practitioners should be alert to risk management strategies when dealing with clients looking to invest in improvident transactions. See Appendix One for the complete article.

Do you face situations where there are legal issues with commercial implications such as the environmental audit issue in the scenario?

How do you differentiate and handle the issues?

Risk management strategies

In situations where the client is borrowing money for investment or providing guarantees or third party security, consider the following.

- Choose your clients carefully. We recommend advising on mortgages and giving solicitor's certificates only to existing clients. People who walk in off the street and who are unknown to you are a much higher risk.
- At the start of the first meeting insist upon identification and do not proceed unless it is produced. Keep copies of the identification documentation. Consider using the ARNECC 'safe harbour' provisions to identify clients as contained in the Model Participation Rules.
- Prior to the meeting determine whether an interpreter is required. Use an independent interpreter when appropriate. Never use the person who is seeking to gain from the provision of the security as interpreter.
- Develop a policy for handling practitioner certificate matters based on the list referred to in the LPLC *Managing Mortgage Risk – Amadio and Beyond* practice risk guide[1]. Consider including the following items in the protocol.
    - Allocate one person in the office to give solicitor's certificates.
    - Never act for both the borrower and a third party security provider.
    - Consider whether there are issues of capacity, undue influence or duress.
    - Always advise the security provider client without the borrower present.
    - Use the LIV/ABA solicitor's certificate even if the financier has provided a different form of certificate.
- Include in your firm policy the requirement to consider whether the transaction seems manifestly ridiculous or improvident. If so, ask the client:
    - why are they doing this?
    - what they hope to gain from the transaction?
    - do they know how much they have to pay?
    - how will they fund it?
- If they tell you they are investing the money, ask:
    - what they know about the investment?

[1] available on the Legal Practitioners' Liability Committee's website at www.lplc.com.au

- is it a managed investment scheme?
- what security is there?
- what is it is worth?
- what safeguards are there?

Inform the client there are things they should get advice about.

- Keep comprehensive file notes of all attendances on your client, whether in your office or elsewhere including what was said, who was present, what the client's responses to your questions were and how long it took.
- Check your file notes:
  - are dated
  - identify the author
  - record the duration of the attendance
  - record who was present or on the telephone
  - are legible to you and someone else
  - record the substance of the advice given and the client's response/instructions
  - are a note to the file rather than a note to you.
- Do not provide financial advice.
  - Advise your security provider client in strong terms they should obtain independent financial advice about the ability of the borrower to repay the loan. Refer your client to a qualified accountant or financial adviser. Ensure they have enough time to obtain this advice.
  - Advise your borrower client of the interest rates applicable to the transaction. Advise them in strong terms to obtain independent financial advice about the loan and the investment for which they are borrowing the money. Refer your client to a qualified accountant or financial adviser and ensure they have enough time to obtain this advice
- For unrepresented surety mortgagors or guarantors:
  - tell any security providers in writing that you are not acting for them and they should seek independent legal advice
  - do not prepare answers to requisitions on the security provider's behalf

- never use the borrower as an agent to reach the security provider
- ensure the security provider signs the disbursement order and you bill the borrower direct
- be clear about who you are acting for in your correspondence with the other side.

Communication: dealing with experienced business people

Hector was an experienced business person who was not interested in the legal niceties of what he wanted to do. Let's explore what the communication issues were.

Effective communication

A basic model of effective communication is:

- right messages (content/ideas)
- sent and received (intention/interpretation)
- by the right people (channels)
- by the right means (interpersonal/technology)
- at the right time (time).

It sounds simple but if any element of the communication fails there is a risk the whole communication will be ineffective. Also, there are so many factors that influence the effectiveness of the communication it is impossible to predict and control them all.

Things can go wrong with:

- the sender's reasoning, formulation and selection of the ideas to be sent, for example poor thinking or understanding of what needs to be communicated, poorly expressed ideas or missing or inappropriate content
- the receiver's understanding and interpretation of the sender's meaning due to lack of capacity, education or experience
- the sender/receiver's recall of messages due to issues such as limits of human information processing and memory or capacity for distraction
- selection, formality or authority of the communication channels by which messages are sent or received such as communicating with the wrong person
- matching the medium to the message−selection of face to face, phone, fax, email or writing for the nature and purpose of the message
- efficiency and reliability of the delivery system, for example the message not despatched or delivered in time to be useful whether due to oversight, flaws in system design or external factors like a power outage or mail strike.

Communication challenges for practitioners

In addition to the everyday barriers to effective communication, practitioners face particular challenges in their efforts to communicate. Some of these challenges are:

- how to build trust and rapport quickly with clients and others who may not be motivated to communicate openly
- overcoming barriers arising from client characteristics such as a client's emotional distress, physical or mental impairment, language, cultural, gender, personality or age differences
- finding out enough about a client's situation, motivations and expectations to be able to give useful advice and recommendations
- managing the volume and variety of communications that need to be processed in order to understand what facts are relevant and irrelevant to the client's position and to implement legal strategies
- how to explain abstract, complex legal concepts, arguments and uncertainties to non-lawyer clients to ensure understanding and informed decision making
- dealing with clients who make it difficult to communicate with them such as clients who don't want to hear bad news, who won't take advice, who disappear or are otherwise inaccessible
- compliance with increasing regulation of communications such as professional conduct rules about costs and other disclosures
- adoption and mastery of new communications technologies
- how to communicate effectively in the face of time pressures and the economic realities of legal practice.

[Above sections came from workbook with DVD *A stitch in time* – written by Ronwyn North]

Experienced business people

Practitioners face hurdles when trying to communicate with any clients and communicating with experienced business people has its own challenges and issues.

- These clients think they know a lot more than they might about particular areas of law and the impact of various laws or consequences of doing or not doing something. As a consequence they often don't actively listen to what is said.
- The practitioner does not explain the full consequences/meaning because they assume the client knows a lot more about a particular area of law and the impact of various laws or consequences of doing or not doing something.

- The type of work the practitioner does for these clients is often repeat work. The practitioner's guard is often down about how they manage the retainer with the client because they feel the client understands how these things work. They may not document the retainer properly because they have done the same thing for the client before.

The problem is that in some instances the client does not know about the impact of a law or a certain legal requirement and the practitioner fails to properly inform the client about an issue. Worse still, the client may know it but because the practitioner didn't explain it and document that explanation, the argument is open to the client to say they didn't know.

It could be commercial suicide to assume your important sophisticated client has no knowledge and tell them absolutely everything. It is a fine line to walk to ensure you are giving the client the right advice, pitched at the right level.

How do you handle this type of situation?

Do you ask for feedback from your clients?

See *Marplace* v *Chaffe* [2006] EWHC 19191 (Ch) at [404] it quotes *Pickersgill* v *Riley* [2004] UKPC 14 where it says 'the scope of the duty depends on the characteristics of the client. A client, unversed in business affairs, might need explanation and advice from the solicitor before entering into a commercial transaction which it would be pointless, or even sometimes an impertinence, for the solicitor to offer to an obviously experienced businessman.'

Example

5 Assumed too much

A firm was asked to advise on the contractual obligations and the appropriate process for removing several senior employees from a local council. The advice was given in terms of the employees' contracts of employment. It transpired that one of the employees was not yet 55 years of age and had been employed by the council for a long period of time. As a result, he was entitled to a defined benefit scheme superannuation payout and the council was required to repay a significant amount of that payout to the superannuation fund.

The council complained the practitioners failed to advise about this liability. The firm replied that it was not part of its retainer to advise on that issue and in any event, they did not have sufficient information about the employee to know he was entitled to a defined benefit. The firm assumed the council's CEO would know about the issue and look into it. This was such a well-publicised issue for local councils that it went without saying, so the firm thought the council would manage it.

Risk management strategies

- Get to know the level of understanding the client has of the legal issues involved. Don't take for granted what the client does or does not know.
- Develop systems to ensure the required information is covered in regular transactions with the clients. Don't take for granted that because you have done it before you don't need to explain it again.
- Carefully document the scope of the retainer agreed upon with the client, making it clear what you are doing and not doing as well as what the client is doing. Ensure follow up documentation if anything changes during the retainer.

Accepting information or assumptions from clients

One of the communication challenges for practitioners is knowing what information from clients to accept and what to challenge. The client may make assumptions about facts and circumstances that can lead the practitioner down the wrong track so it is dangerous to always take the client's instructions at face value.

Tony accepted everything he was told by Hector about how Hector was project managing the development, what was important and what was not. Hector did not know about the change to the environmental audit requirements and assumed everything was fine. While you would not want to 'second guess' everything Hector said, Tony's antennae was clearly up about the contamination issue. However, he allowed himself to be deflected and did not protect himself enough.

How could Tony have handled it better?

By:

- clarifying the retainer along the way
- giving Hector a warning about the contamination issue in writing, even though he was not retained to advise on it.

Risk management lessons

Client acceptance

The firm should act only for clients that satisfy the firm's business strategy criteria, including:

- correct identification of the prospective client
- no conflicts of interest or duties
- no impediment to any contractual arrangements with other clients
- no damage to any commercial relationships with other clients
- the prospective client's reputation and creditworthiness is acceptable (consider AML, anti-terrorism and other compliance issues)
- the client does not otherwise pose any unacceptable risks.

Approval for taking on a new client of the firm (or even the relevant office) should involve not just the responsible partner. In some cases it might be the practice group head, the managing partner, a specific new client review committee or designated business intake personnel.

Matter acceptance

The firm should only accept matters that satisfy the firm's business objectives and meet the following criteria.

- The matter must be within the scope of the firm's practice.
- The firm must have the required expertise and resources to handle the matter and, in particular, the matter must be within the scope of expertise of the partner responsible.
- The matter must meet any size requirements, such as a minimum fee threshold.
- Conflicts of interest and commercial relationships (as with new clients) must be considered with each new matter.
- The risk profile of the matter must be considered and the matter rejected where the risk is unacceptable. Where the risk is considered high (but acceptable), another partner should be appointed to review the work.

There should be clear protocols to ensure that for every proposed matter, all of these factors are given due consideration by someone with appropriate expertise and experience.

Approval for accepting any new matter should be given at least by the responsible partner/principal. Where significant risk exists, the responsible partner/principal should be able to identify it and there should be a mandatory escalation process whereby a specified partner/partners/committee considers whether the proposed mandate should be accepted.

Taking a matter over part way through

Probe with the client and think carefully about why the client is leaving their previous practitioner and coming to you.

Do not take anything for granted. Make sure you know what has happened on the matter before you took it over.

Limited retainer

When it comes to limited retainers, practitioners need to think laterally and consider what they are **not** asked to do as well as what they are asked to do.

Clarify the extent of a limited retainer and confirm it in writing. Where necessary, say what the firm is not going to do.

Where the client is undertaking some of the work themselves, confirm that in writing and in some instances you may even need to confirm the risks of the client not doing the work properly and on time.

Keep an eye on the retainer as it progresses so if things change, the retainer can be updated in writing.

Conflicts

When thinking about conflicts of interest you need to consider:

- what confidential information might you have about another client that could put you in a position of conflict
- how can you comply with your duty of loyalty to all clients if something goes wrong?

There is more to acting for multiple parties than meets the eye.

- Just because they appear to be in heated agreement, it does not mean a conflict will not arise in the future. By the time the conflict is spotted, the damage is usually already done.
- If a conflict does arise, the firm must send both parties away, thus losing them both!
- Practitioners have obligations under common law, equity, the conduct rules and sometimes contract–accordingly, it is not just about having 'the form' signed.

- Very often practitioners/firms are not as careful/thorough/adversarial when acting for more than one party in a transaction, and things get missed.

Communicating with sophisticated clients

Get to know the level of understanding that your client has of the legal issues involved. Don't take for granted what your client does or does not know.

Develop systems that mean you cover all of the required information in regular transactions with your clients and don't just take for granted that because you have done it before you don't need to explain it again.

Carefully document the scope of the retainer you have agreed upon with your client, making it clear what you are doing, what you are not doing and what the client is doing. Ensure you follow up by documenting any changes during the course of the retainer.

Appendix one

Look before you leap

by LPLC Chief Risk Manager Heather Hibberd

Published in the June 2010 edition of the Law Institute Journal

A spate of recent cases in NSW has involved lawyers retained to give limited advice in relation to mortgage and loan documents. The lawyers were later accused of not giving proper advice to the clients about the risks involved in the subsequent investment of the borrowed money. The central question in these cases was did the lawyer's duty of care extend beyond the limits of the retainer to give further legal and arguably financial advice.

The cases

***Ibrahim v Pham* [2007] NSWCA 215**

Ibrahim v Pham is a Court of Appeal decision handed down in August 2007. In this case two clients attended a practitioner in relation to a refinance of an existing mortgage. The clients had previously mortgaged their home, owned by one of them, Ms Ibrahim, to invest in Karl Suleman Enterprises ('KSE'). The clients intended to refinance the existing loan and increase it from $70,000 to $120,000 to invest further money with KSE.

The practitioner had one meeting with the clients where she explained the documents to them and made it clear that she was not giving financial advice and that they should obtain independent advice from a lawyer and an accountant about the investment.

The Court found that the practitioner's retainer was limited and she had no obligation to do more than she had done, particularly in light of the fact that the clients were found to have "emphatically" rejected her advice to obtain independent legal and financial advice.

Riz & Anor v Perpetual Trustees Australia Ltd & Ors [2007] NSWSC 1153

This is a first instance decision of Justice Brereton in the NSW Supreme Court, handed down in October 2007. Mr and Mrs Riz, refinanced their existing mortgage and intended investing the extra $150,000 from the refinance with KSE. They went to see a practitioner, in fact the same practitioner as in *Ibrahim*, to have the mortgage and loan documents dealt with. They told the practitioner that they expected to receive a return of $12,000 per fortnight from their $150,000 investment and that the practitioner should fill out the direct debit for repayment of the loan at $10,000 per fortnight.

The Court said that it ought to have been clear to the practitioner that the clients' expectations of their investment were "absurd". In such a situation, it was not enough for the practitioner to tell the client she was not advising on the financial aspects and they

should get financial advice when she knew that they would not do so. It was also not enough for her to say that her retainer was only to advise on the mortgage and loan transaction.

The Court found that the duty of care extended beyond the limits of the retainer where the subsequent transaction was so improvident and risky [128].

The Court found that the practitioner failed to 'bring home to the client forcefully the improvidence of the transaction'. Merely advising the clients to obtain independent advice was not enough.

This was a first instance decision and the appeal was handed down in July 2009. It will be discussed later in this article.

Kowalczuk v Accom Finance [2008] NSWCA 343

The next decision, in December 2008, was *Kowalczuk v Accom Finance*.

In this case, Mr Kowalczuk took advice from his cousin on a 'sure fire' investment. As with the previous cases, he just went to the practitioner to have the mortgage and loan documents sorted out.

There were in fact two short term loans – the first was for $320,000 for one month with interest rates of 48 per cent pa and 96 per cent per annum – each was compounding with monthly rests. A second loan was entered for $807,000 at rates of 60 per cent and 120 per cent for two months – the rates were also compounding.

You could be forgiven for thinking that this man must have been an entrepreneur. In fact he was a service station driveway attendant with a salary of $14,000 and taxable income of $45,000 due to rental he received from one of the two properties he owned. However, in the loan application forms Mr Kowalczuk's salary was said to be $100,000.

It was argued in this case that the practitioner owed a "penumbral duty" that went beyond his contractual duty to just explain the documents. The Court thought that the weight of authority seemed to say that there was no duty beyond the scope of the retainer. They distinguished *Riz* because the practitioner in this case did not know what the client was doing with the money, what his income really was or his occupation. He had no knowledge that would plainly trigger a duty to give more advice outside the scope of the retainer.

Although the Court found that the practitioner had failed to explain various clauses in the loan and mortgage documents, in breach of his contractual duty, the claim against the practitioner failed on causation grounds. The Court found that there was not enough evidence to conclude that had the advice been given, Mr Kowalczuk would have pulled out of the deal.

***David v David* [2009] NSWCA 8**

The next case of *David v David* was also a Court of Appeal decision and was handed down in February 2009. This had a very similar background to the *Riz* and *Ibrahim* cases, and involved the same practitioner. The clients owned their own home and had a $55,000 mortgage. They had friends who were making lots of money with KSE and decided to refinance their home to invest.

The husband and wife had a meeting with their practitioner. That meeting took one and a half hours and the practitioner is said to have comprehensively and competently explained the mortgage and loan documents and declaration of borrower to the parties. When discussing the 'direction to pay' part of the documents the clients said they would get back to her. She explained she was not giving them financial advice and they should get their own financial advice. They then signed the documents.

Ten days later the practitioner spoke to the husband about settlement details. He told her they were investing $150,000 in KSE. She told him she hoped he had received independent advice because her firm could not give advice about KSE. She explained that her firm had acted for Karl Suleman in the past but he had been referred to another firm for advice about the structures of his business entities. He told her that they had friends who were making money and that his cousin was a top financial adviser so they just need her to finalise the mortgage documents. This was the version of events that was accepted by the Court – of course the Davids' version was different.

The practitioner was successful at first instance. It was argued on appeal that the practitioner should have stopped acting at the point that she found out about KSE or alternatively she should have given more robust direction to her client about getting financial advice.

The Court of Appeal agreed with the trial judge that the retainer was limited to giving advice on the mortgage and loan documents and did not extend to the financial and legal implications of the investment with KSE. The Court referred to *Kowalczuk* and said that the penumbral duty was doubtful, but said at [76]:

> *"If, however, the practitioner during the execution of his or her retainer learns of facts which put him or her on notice that the client's interests are endangered or at risk unless further steps beyond the limits of the retainer are carried out, depending on the circumstances, the practitioner may be obliged to speak in order to bring to the attention of the client the aspects of concern and to advise of the need for further advice either from the practitioner or from a third party."*

The Court of Appeal agreed with the primary judge, that the advice given by the practitioner was appropriate. The appeal was ultimately dismissed on technical grounds.

***Dominic v Riz* [2009] NSWCA 216**

The appeal decision in *Riz* was handed down on 29 July 2009. The appeal was unanimously allowed and the practitioner was found to be not negligent.

The Court found that the practitioner's retainer was to explain the loan and mortgage documents to Mr and Mrs Riz. She knew nothing about the investment they were planning with KSE except that the return they were expecting was very high. She had conceded on cross examination that the return was very high (but not absurd) and that made it appear risky.

The Court of Appeal found she gave Mr and Mrs Riz clear advice about the necessity of seeing someone to give them independent advice both legal and financial. Based on the evidence before the trial judge and his findings, she was entitled to reasonably apprehend that they understood what she said. She fulfilled her retainer without negligence.

The Court of Appeal went on to say it was plain on the evidence that Mr and Mrs Riz were fully aware that the returns were too good to be true and that there was a big risk, but that they chanced the investment believing in the returns to follow. They were clearly advised to obtain independent advice and chose not to do so.

It seems the Court took a very dim view of the Mr and Mrs Riz – indicating that there was a plausible conclusion that they had misused the tax and social security system for some years and the Court would be minded to direct the Registrar to make the transcript and judgments available to the relevant Commonwealth authorities.

The Court said the Brereton J had gone too far in finding that practitioners charged with explaining loan and mortgage documents will be obliged to address the fairness or reasonableness of the underlying transaction. The cases show that the circumstances in which the practitioner has a responsibility to act outside the retainer are "less than clear" and the difficulty of covering the infinite number of factual circumstances with a legal test.

Allsop P referred to the quote in *David v David* that is referred to above. He said it was not meant to be a legal principle. It was just to show the possibility that the performance of a retainer, and what is learnt during it, may affect how it is discharged.

Where does this leave practitioners?

These were New South Wales cases; each case turns very much on its facts and how it was pleaded and argued. However, doubt has been cast over the concept of a 'penumbral duty', a duty beyond the scope of the retainer. If it does exist, it seems it will be very hard to prove.

There have been no cases directly on point in Victoria at the time of writing this article, however, Mr Justice Kaye touched on the issue in *Spiteri* v *Roccisano* [2009] VSC 132 (decided before the Court of Appeal decision of *Dominic v Riz*). His Honour noted that

there is a difference of opinion in the authorities as to whether the content of the tortious duty of care might require that advice be given outside the strict terms of the retainer. He referred to the first instance decision of *Riz* on the one hand and the opposing view given by Mr Justice Whelan in *Sali v Metzke and Allen* [2009] VSC 49. Mr Justice Whelan said tort law does not place any further duty on professionals beyond that of the retainer. The case concerned an accountant and no further authority for the proposition was given.

Mr Justice Kaye in *Spiteri* did not need to decide the matter in *Spiteri* as he found that the practitioner had breached his contractual (and tortious) duty because there were clear deficiencies in the security on offer - which an ordinary prudent practitioner, exercising reasonable care and skill, should have brought to the attention of his client, before he signed the agreement.

He also went on to say that there may be no bright line of distinction between legal and commercial advice where a practitioner is acting for a client in a commercial transaction.

But that does not mean practitioners can 'turn on the blinkers'. The high rate of return in *Riz* put the practitioner on notice of a risky transaction that then required her to give the clients clear advice that they needed independent advice. To ignore that fact and think she only had to advise on the loan and mortgage documents, and say no more, may not have been sufficient to have avoided a claim.

The client's and your own interests are best protected by understanding the client's position and advising them appropriately. A good paper trial documenting this advice is also essential.

New case since the LIJ article: Provident Capital Ltd v Papa [2013] NSWCA 36

In this case the client was a well-educated woman who ran her own business selling babies' and children's wear from premises that were also her home. She was also a Justice of the Peace. She had previously mortgaged her home to assist her son buy an investment property through his company. In this case she sought legal advice from a practitioner, Mr Caramanlis, when borrowing $700,000. $180,000 was to refinance the previous loan for her son and the balance was to be given to her son to assist him with his new gymnasium business.

It was accepted by the court that the practitioner gave advice to her about the loan and mortgage documents and she understood that she could lose her home if the money was not paid back. But he did not give her any advice about seeking independent financial advice. The court found that the client was misled by her son as to financial viability of the business and that it would be able to make the repayments of $7,800 per month.

Macfarlan JA (of which Allsop P and Sackville AJA agreed) referred to the quote from *David* v *David* and said that the "proper execution of a retainer to give independent legal advice concerning a loan and mortgage transaction may, depending on the circumstances known to the practitioner, require more than an explanation of the legal effect of the documents to be executed."[75] He went on to say at [80]:

> *A reasonable practitioner giving her independent legal advice in relation to the transaction would not in my view have failed to draw to Mrs Papa's attention, in strong terms, that her home and livelihood was dependent upon the viability and prospects of the gymnasium, specifically on the ability and willingness of her son to make the loan repayments out of the income from the business, and to recommend, again in strong terms, that she obtain financial advice, independent of her son, concerning the capacity of the business to service the loan. A practitioner's obligation is not simply to explain the legal effect of documents but to advise his or her client of the obvious practical implications of the client's entry into a transaction the subject of advice.*

The practitioner had acted for the son in the previous year in relation to a short term loan at high interest rates which was not paid back in full although the court found that the practitioner did not have knowledge that the loan was not fully paid back. The practitioner had also acted for the son shortly before the loan by the client in seeking an extension from the landlord of the gymnasium premises for the payment of the bond. The court didn't consider this was material either as the loan by the client was expressed to be in part to pay the bond [69-70].

Allsop P also said at [2}:

> *If the retainer is to give legal advice, depending on the circumstances, that may (as it did here) extend to explaining the practical consequences of the legal obligations arising from the relevant document in the known circumstances. It may be apparent, as it was here, that the legal and practical consequences to a client of entering into a transaction may be significant, but are not such as can be assessed without financial or further information or advice. In such circumstances, the practitioner may be obliged to counsel in appropriate terms (perhaps strong terms) about the risks in proceeding without further information or advice. Depending upon the circumstances, such as apparent ties of loyalty, whether of blood or love, the apparent risks may have to be brought home with clarity and force.*

The court concluded that the practitioner had breached his duty to the client in failing to advise her to obtain independent financial advice about the capacity of the business to service the loan. Had he done so, the client would have obtained that advice and not have gone ahead with the loan.

Risk management strategies

In scenarios where the client is borrowing money for investment or providing guarantees or third party security consider the following.

- Choose your clients carefully. We recommend only advising on mortgages and giving practitioner's certificates to existing clients. People who walk in off the street who you do not know anything about are a much higher risk.

- Develop a protocol for handling practitioner certificate matters based on the list referred to the LPLC Managing Mortgage Risk – Amadio and beyond February 2010 booklet2.
- Include in the protocol the question — Does the transaction seem manifestly ridiculous or improvident?
- If so — ask the client: why are they doing this; and what they hope to gain from the transaction; and do they know how much they have to pay; and how will they do that etc…
- If they tell you that they are investing the money – ask them what they know about the investment – is it a managed investment scheme? What security is there? What is it is worth? What safeguards are there? Put the client on notice there are things they should get advice about.
- Keep good file notes of what was said, who was present, what the client's response to your questions were and most importantly, how long it took.
- Tell the client they should obtain independent financial advice and give them an opportunity to do so before signing them up.

[2] Available on the Legal Practitioners' Liability Committee's website at www.lplc.com.au