LEGAL PRACTITIONERS' LIABILITY COMMITTEE

The Three Musketeers

Presenter's Workbook

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Contents

Introduction

The Three Musketeers 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:
    - acting for family and friends
    - client due diligence – how much do you need to know about a client?
- identifying the client – acting in a joint venture
- scope of work – commercial versus legal work
- conflicts of interest.

The communication issues raised are:

- dealing with commercially savvy or sophisticated business people
- accepting information or assumptions made by clients
- channels of communication, particularly when taking instructions.

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.

The Three Musketeers

The video scenario

Trevor, a practitioner, is approached by three private lenders to document a short-term, high-risk loan to a public company to fund a joint venture. The clients are introduced by existing connections of Trevor's and he fails to exercise usual standards of scrutiny and vigilance. Despite having reservations, Trevor allows himself to be railroaded into acting on an urgent basis and in a conflict situation. He does not document his retainer or advice sufficiently to protect himself from allegations of negligence when the high-risk loan becomes unstuck. Issues of client identification and client/matter screening are also problematic.

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 interactions - 0:00 to 3:50

Mitch, a well-known lawyer and the lead investor, meets with the other two investors. Then there is a subsequent phone conversation between Mitch and Trevor.

What has taken place in these first two scenes?

- $1.5m loan split three ways for four months, starting in three weeks.
- Trevor the practitioner has been instructed to just document the loan.
- Trevor stated he usually does not act for individuals, asks about the due diligences and requests a copy of the report.
- Trevor knows these people – Clive, a former client, Morrie, a fellow member of the yacht club executive and the third, Mitch, is a well-known lawyer.
- End of late-night phone call.

Scene 3 - Voicing concerns – 3:51 to 4:31

One of the investors, Clive, discusses the venture with Trevor over the phone.

What are the concerns Trevor is raising?

- How did you hear about the scheme?
- The concerns about the due diligences
- How does Mitch know it will be a good opportunity?

- What do you know about Mitch's track record?
- Are you concerned that Mitch was a past director of the company?

Scenes 4 and 5 - Who is Trevor acting for? – 4:43 to 8:26

A meeting in Trevor's office with the three investors followed by the late night phone call between Clive and Trevor.

Who is Trevor acting for?

- All three co-investors came to the meeting. Trevor's initial understanding was only two would attend.
- Trevor seemed to be advising all three at the meeting. He raises the risks and the unusual nature of the capital-raising arrangements.
- Trevor again asks about due diligences and requests a copy of the report. He also raises some corporation act issues that need to be considered.
- Following the late night phone conversation and email to Mitch is Trevor now advising only Clive and Morrie?

Final scene - How did the claim pan out? – 8:27 to 9:55

The final scene occurs three months later. Mitch is on the phone to Trevor about the company going into receivership, a statement of claim is being drafted, and Mitch, Clive and Morrie are issuing proceeding against Trevor.

What are the allegations made against Trevor and the firm?

Mitch alleges Trevor and the firm:

- did not identify and protect the interests of its clients, particularly given Mitch's multiple roles
- did not sufficiently identify and record the scope of the retainer
- did not carry out relevant searches through organisations such as ASIC on either the borrower or lender companies prior to documenting a substantial loan
- failed to provide even short written advice summarising the oral advice outlining potential legal risks and there was also no proper record of advice on the file
- began but ultimately failed to pursue Mitch for a response to Clive and Morrie's concerns about the haste of the deal and their inability to properly evaluate the transaction.

The matter was settled for several hundred thousand dollars based on liability to Clive and Morrie but nothing offered for Mitch.

All for one yet not one for all!

Managing the legal issues

Section 588FP of the *Corporations Act 2001* provides that where a company creates a charge on property of the company in favour of a 'relevant person' and within six months of creation of the charge, the chargee purports to enforce the charge without leave of the Court, the charge is deemed to be void.

A 'relevant person' is a person who, at the time the charge was created or at any time during the previous six months, was an officer of the relevant company, or a person with whom they were associated in relation to the creation of the charge (giving effect to the respective definitions and interpretations of the words 'officer', 'person' and 'associated' under applicable provisions of the Act).

In the scenario, the financing entity associated with Mitch was a 'relevant person' for the purposes of subsection (1) and consequently the purported charge in its favour was void.

Screening clients

Acting for friends and family

Acting for friends or relatives is not necessarily negligent but can be risky. In many instances practitioners who choose to act for friends or family do so diligently and with great care and skill. However, we also see instances where that does not happen.

When acting for friends or family it is common for the practitioner to either charge very little or nothing at all. This leads, consciously or subconsciously, to the practitioner leaving the work at the bottom of their priority list and getting to it after they have done all their 'real work'.

Outside area of expertise

Also, the work required is often not directly in the practitioner's field of expertise. The result is the practitioner having to do more work to get up to speed on what needs to be done and, if they are leaving it to the last minute, never actually getting it done. Alternatively, it is delegated to a junior practitioner as a 'good learning experience' but without proper supervision, the matter stagnates in the 'too hard basket'.

In one particularly sad matter a partner was asked by a friend to act on a claim for compensation for his son's accident in which the boy was severely injured. The partner did not usually act in personal injury matters but took the matter on. He delayed in dealing with the matter, reasoning that they had six years but unfortunately the limitation period was only three years and the boy's rights were ultimately lost.

Important clients who are individuals or familiar contacts within important corporate or government clients might also be included in the 'friends' category. LPLC sees claims where the firm does not usually act in a particular area of law but when the CEO or another important client contact asks the firm for some advice or to take some action, the firm has agreed to do it.

Informal retainer

Clarifying the retainer for friends and family is often not done properly. The retainer is usually arranged on an informal basis, after 'can you help me out with these documents' type conversations and there is no written confirmation of what will or will not be done.

Delay

Procrastination is easier with friends and family as it can be justified by thoughts of 'they'll understand' or 'they know I'm busy and really just doing them a favour, so they can't expect too much'. However, as the delays get longer and a sense of foreboding descends, it becomes harder to face the matter and deal with the difficult situation, especially as they are friends or family.

Examples

1. No family law practice but draft pre-nup anyway

A very wealthy client asked the firm to prepare a financial pre-nuptial agreement. The firm had no family law practice but the partner reasoned it could not be too hard or much different to drawing a will and referred it to a senior associate in the wills and estates section.

The lawyer drafted an agreement strong on estate planning points but invalid on a threshold issue. There was no solicitor's certificate as to independent legal advice, a pre-condition to making a binding agreement under the *Family Law Act 1975*.

There was also some drafting an experienced family lawyer would not have used, for example the husband was to make 'reasonable provision' for the residential accommodation and maintenance of the wife 'having regard to her station in life'.

Which station were we talking about? And what was reasonable when the wife had nothing to start with and the husband had $11 million?

The husband and wife separated two years later when the husband's health began to fail. The husband claimed he was obliged to pay his ex-wife a greater sum than would have been the case had there been a valid, competently drafted pre-nuptial agreement in place.

2. Lack of retainer between friends

The client was a friend of the partner advising on a joint venture involving the purchase of land and the construction of townhouses. The two families shared weekend beach holidays together.

From the start the terms of engagement were plagued by ambiguity. Unsurprisingly, when the development went awry and the client lost his $450,000 investment, a stark difference in understanding as to the start and scope of the retainer emerged.

Had the retainer started before or after the client signed up for the doomed joint venture?

How broad was the scope of the retainer?

The client claimed to have delivered a copy of the joint venture agreement to the practitioner at home and discussed its terms in the weeks before he signed. The practitioner said he was not retained until a month later, being the day he opened his file and the first date he recorded time on the matter.

Unfortunately, most of meetings between the practitioner and his client were informal, often conducted by telephone and were mostly not documented by file notes. There was

no engagement letter or file notes documenting the scope of the retainer and, in particular, when it started.

The dispute was clouded by familiarity and it is difficult to reconcile judgments the practitioner made about his client's character with the way the professional relationship was conducted. For example, the practitioner commented the client was fiercely bright and commercially astute but was not prepared to take advice. Despite this, he had advised the client in an informal manner on a joint venture involving considerable outlay and risk. In a relationship with someone less familiar, these character traits would likely put a practitioner on guard, prompting cautious advice and particular care in documenting the retainer.

- **What policies does your firm have relating to acting for friends and family?**
    - not permitted
    - can be done, but only by someone with the right skills and expertise
    - where permitted, file must be opened and treated like any other matter.
- **Are there areas of law or legal practice in which the firm will not act?**
- **How rigorously is the policy applied? Are the rules bent where the 'friend' is an important client or contact within an important client?**
- **How are cross-referrals handled within the firm?**
- **How well does the firm monitor file-opening and compliance with relevant policies in each practice group?**
- **Could someone, for example in the commercial litigation practice area open a lease-related file for a friend?**

Client due diligence

In the scenario Trevor thinks he knows Mitch, a well-known legal figure by reputation at least. But does he really?

It turns out Mitch is a wheeler and dealer who does not know applicable provisions of the Corporations Act. More importantly, although he had stepped down from the board, he was still Progene's general counsel, which Trevor could have discovered with some due diligence. These were facts that brought the relevant Corporations Act provisions into play in this instance.

- **How well do you know your clients?**
- **What sort of due diligence do you do on clients?**

- **How well has your firm documented its policies and procedures concerning client due diligence?**
- **How well does your firm educate practitioners and other staff about these policies and procedures?**

Who is the client? – acting in a joint venture

In this scenario 'joint venture' means an arrangement where two or more parties get together to undertake a commercial venture. Sometimes these business arrangements are documented in a joint venture agreement, sometimes they involve a partnership arrangement or a unit holders agreement, or there could be a combination of agreements. Sometimes there is no written agreement at all. The point is there are several different interests coming together with a mutually agreed purpose.

The parties are not antagonists or adversaries. They appear to be in furious agreement about what everyone is contributing to the arrangement and how they are all going to work together to make this enterprise successful. Therefore, it is often the case that one lawyer will end up acting for all of the parties.

What could be the problem?

- The parties may have very different interests, be in different positions and may all need very different advice.
- They may be getting different things out of the deal.
- They may have different amounts or types of assets at risk.
- Misunderstandings about who the practitioner is acting for – by the practitioner and the client(s).

In the video the three venturers were all lending the same amount and receiving the same interest and fees. Why was there a conflict?

- Mitch had much more knowledge than the others about what was going on in the company.
- Mitch also stood to gain his $100,000 termination payment from the loan amount.
- Mitch was the related party, which caused the problem. An independent practitioner acting for only the other two may have been more careful in checking that issue.

It is easy to see that unrepresented parties in a joint venture may think the practitioner acting for the joint venture is also looking after their interests. Even in situations when all the parties have their own legal representation, opportunities still arise where parties misunderstand what the lawyers are doing and who they are acting for. At the end of the day many practitioners are left feeling incredulous that they could be found to have acted for, or at least owed a duty to parties for whom they did not consider they were acting.

Mitch was a lawyer and so Trevor did not consider he was acting for him. Trevor blurred the line a bit because he did appear to give Mitch advice about the Corporations Act, did not clarify in writing who he was acting for, allowed Mitch to attend the meeting and a number of other actions.

Channels of communication for taking instructions

To clarify who your client is, ask what your channel of communication to the client will be.

While Trevor thought he was only acting for Morrie and Clive, he took the instructions from Mitch at the meeting.

Trying to be too obliging

Often the practitioner is drawn into these situations out of a sense of obligation to the client or in an attempt to accommodate everyone. See if any of that rings true in these examples.

Examples

3. Sale of shareholding for brother

In this claim, the practitioner acted for his own brother in selling a 50 per cent shareholding in the brother's business to a third party, Paul. Acting for family is often difficult and high-risk. Paul paid over $100,000 for the half share in this business. Prior to this transaction, the practitioner had never acted for Paul but he did act for Paul on the sale of a property after the transaction.

The business went badly and eventually Paul made a complaint to Professional Standards about the practitioner. He alleged the practitioner had acted for him in the initial transaction and should have warned Paul:

- the business was in dire financial straits
- the co-director/vendor (the practitioner's brother) was a very bad businessman and had several failed businesses
- he should check the financial status of the company before committing himself.

After listing all of the problems with the brother's past business history the complaint included the following quotes from Paul.

> "*the solicitor knew all of the above and it was his obligation to advise me to get another lawyer to act on my behalf, obviously he did not have my interests at heart and deliberately withheld at the very least hid this information from me, by using his status as a lawyer. He knew beyond a shadow of a doubt my investment was very much at risk. …… the investment was bad one and could have been prevented had (the solicitor) done the right thing by me, followed the law, been honest and warned me*".

This does not look good for the practitioner but in his version of events he was contacted by his brother and asked to prepare a sale agreement which he did and faxed dutifully to his brother. A month or so later he was then asked to prepare a simpler agreement which he did and again faxed to his brother. Approximately a month after that his brother advised him the parties had settled the transaction.

Later both the brother and Paul attended the practitioner's office to have some company documents prepared. During this meeting Paul indicated he would be using the practitioner for his legal work. This was the first time the practitioner had met Paul. The practitioner subsequently acted for Paul relating to the sale of the property. At no point prior to the share sale agreement being executed by Paul had the practitioner spoken, met or written to Paul. His only contact had been with his brother.

Professional Standards dismissed the complaint and it has not been taken any further. However this illustrates how lay people can conclude that because a practitioner is involved in the transaction, that practitioner is looking after their interests. The fact the practitioner was acting for his brother may have lead him to treat the matter more casually than he would if the client had not been related. Had the practitioner written to Paul and explained he was not acting for him and Paul should get independent legal advice before entering into the contract, there would not have been any scope for Paul to have brought his allegations to Professional Standards.

4. The three amigos investing with failed businessman

In this example, the practitioner had previously acted for a collapsed group of companies of which Adam was a director. The practitioner was aware Adam had been charged with various criminal offences as a result of articles he had read in the paper. In hindsight, he thought he was also probably aware at the time the transaction occurred that Adam was bankrupt as well.

Adam approached the practitioner to set up a new company and draft a shareholders' agreement. Adam had come up with this new business idea and had found three people who were prepared to become directors and shareholders, and run the business. At least two of those people were known to the practitioner and had been recent clients of the firm. For the purposes of the example let's call them the three amigos.

The practitioner had a meeting with all four in which it was agreed who would lend money to the new company and what amounts, what the shareholdings and directorships would be, and what amount Adam would receive as a founder's fee.

The practitioner believed he was acting for the new company but wrote letters to all parties saying "thank you for consulting us and we would look forward to acting on your behalf". The letter also said "we confirm that this firm is acting on behalf of the company which is constituted by its shareholders. However, if any dispute arises between shareholders each party will be required to seek independent advice".

After the initial set up of the company was finalised, the practitioner wrote a letter to all parties with details of his account and stated he had given them a discount because they were a valued client. Later still, he sent letters to each of the directors and gave them

details of the role the director should take in a company. When one of the directors wanted to resign the practitioner did work to assist the director and then billed the company.

The new company failed and the three amigos sued the practitioner saying: "*you acted for us and you should have told us about Adam's history in failed companies and the charges against him as well as the fact that he was a bankrupt*".

The practitioner was astounded, said he never acted for the three amigos and that he thought he was only ever acting for the company despite what his letters had said.

The other defences raised by the practitioner were that the shareholders would have invested regardless of what he told them about Adam's history and even if he did act for them he could not divulge information about Adam. This argument clearly shows the practitioner was in a conflict situation. The practitioner also said he thought the three amigos would have known about Adam's history given it had been in the papers and they'd had long discussions with Adam.

While the practitioner thought he had it clear in his own mind who his client was, he did not make it clear on his file and in the minds of the three amigos.

4. Building joint venture

This joint venture involved the parties building an office block and renting it out to one of the related joint venture partners. One of the joint venturers was a company which conducted a building enterprise ('the building Co') and it owned the land on which the building was to be built. It was agreed the building Co would supply the land and build the building while the other joint venture parties (who were companies controlling super funds of three people – the superfund parties) would provide the finances.

The practitioner in this claim was the brother of two of the shareholders of the building Co (Bill and Ben). After discussions with Bill and Ben, the practitioner proposed a structure for the joint venture. The structure involved setting up a unit trust in which the building company would own half the units and the superfund parties - through their super fund companies would own the other half of the units. The practitioner drew up the required documents including a unit holder's agreement. The documents were given to the superfund parties and a date was made for a meeting to sign the unit holder's agreement.

At this point, the practitioner was aware the superfund parties had their own practitioners. On the day of the meeting, the superfund parties' practitioner could not attend the meeting and instead of postponing the meeting it went ahead. The practitioner explained to all of the parties the terms and effect of the unit holder's agreement, and it was executed.

The arrangement was that once the building was built it would be leased to a related company of the superfund parties. The tenant failed to pay rent and the lease was terminated. The unit holder's agreement provided that the property would be sold in such circumstances and the superfund parties' share of the balance of the proceeds of the

sale would first be used to discharge any losses the building Co suffered. The balance would then be given to the superfund parties. The agreement was clearly advantageous to the building Co.

When the building Co sought to recover their losses from the balance of proceeds of sale of the building it resulted in litigation. The superfund parties joined the practitioner to the proceedings stating the practitioner was retained by them to advise in relation to the structure of the joint venture and to act on their behalf at the meeting where the unit holder's agreement was signed. It was also argued the practitioner owed them a duty of care by reason of the representations made by the practitioner throughout the course of the transactions.

At this point the practitioner had sent no letters to the superfund parties setting out what his role was to be. He kept no file notes of the meeting where the agreement was signed and he did send his account to the superfund parties asking for payment.

It had been agreed between the parties that the superfund parties would pay for the legal fees because they were using the more complicated superfund structure which had caused most of the legal work. The practitioner says he thought he was only acting for the building Co and Bill and Ben's interests and the superfund parties had their own legal representation. You might then wonder why he went through and explained in detail the terms of the unit holder's agreement.

This matter settled on the basis the practitioner walked away and bore his own costs, which were not insubstantial, not to mention the countless hours the practitioner had to give in order to prepare witness statements, find documents and other relevant work.

This claim may never have eventuated if the practitioner had set out clearly from the start whom he was and was not acting for as well as either adjourning the fateful meeting or declaring clearly at the meeting he was only protecting the interests of one party.

Even when you think the other parties are represented you can still get into trouble.

5. Guarantees for building company

In this case, the practitioner had acted for a builder and his company over several years and was telephoned one morning and asked if he could witness some guarantees. The builder had been in discussions with a building marketing company and in order for the builder to be able to build more houses he required increased insurance. The insurer had required extra guarantees and the directors of the building marketing company had agreed to give those guarantees.

The building marketing company practitioners were said to be unavailable so all the guarantors attended the builder's practitioner's office to have the guarantees executed. The guarantors included the builder, his wife and the three directors of the building marketing company (only one of which owned his own home). The practitioner explained the terms of the guarantee and said he explained to the three directors he had acted for the builder for some time. He also said he pointed out clearly to all of those present that the guarantees were joint and explained what that meant. It was also discussed (with a lot

of joking) that only one of the parties owned their own home and so would be most at risk. The guarantors signed and went on their way.

The practitioner did not tell the directors he was acting for the builder in two current proceedings where debts were owed by the builder and he knew the builder was in a dire financial position.

Shortly after the guarantees were signed, the builder became bankrupt and the directors made a complaint to Professional Standards. Initially the practitioner's response was that he was only asked to explain the guarantee.

At the end of the transaction, the practitioner had written to the directors and thanked them for their instructions and enclosed a memorandum of his fees for their attention. The enclosed account stated it was for "acting on behalf of the guarantors".

In this case the practitioner was trying to be obliging and failed to recognise the conflict situation he was in. It also illustrates the importance of getting the description right on accounts.

6. Purchase of property

In this case the practitioner was approached by a client and the other joint venturer to document the venture whereby one party (Bonnie) would contribute 50 per cent of the purchase price and the other party (Clyde) would have to borrow his half secured against the joint venture property. It was agreed Clyde would be solely responsible for the mortgage repayments. When Clyde was unable to continue with the payments and subsequently disappeared, Bonnie complained she had not been warned she would end up having to pay the mortgage.

It was not in Bonnie's best interest to have allowed the mortgage over the property and if the practitioner had only been acting for Bonnie he could have advised her more earnestly. There may have been other security Bonnie could have obtained from the Clyde or Clyde could have offered to the bank. At the very least, the practitioner would not have been in a position where it was easy for Bonnie to argue he preferred the rights of Clyde over her interests, assuming he documented his advice and her response!

In a similar case, the parties purchased a residence and adjoining business. The proposal was one party put up the funds to purchase the land which was in his name and the other party provided plant, equipment and expertise to run the business. At one point when the parties were arguing, the practitioner said to the party who had not previously been his client "if you want to get other advice you should".

The parties resolved their differences and the joint venture agreement was eventually signed. It was agreed the party providing the expertise would lodge a caveat over the property, which was done. Eventually the business relationship disintegrated with accusation on both sides the other party was not contributing as they should. The practitioner had copious notes of the long meetings with the clients but no file notes telling the one party to go and get independent advice.

When asked what he would do in hindsight the practitioner responded he "would send X packing", also admitting that it would have been difficult.

Risk management strategies

As some of these examples show, you do not need to have a formal written retainer agreement for a party to think you are acting for them and the courts have also ruled on this issue.

The courts have found liability can arise where:

- there is an implied retainer including evidence such as written communication between the practitioner and the other party and the practitioner assumed responsibility to the other party
- there is sufficient proximity of relationship between a practitioner and other party to give rise to a duty of care
- a fiduciary relationship exists - a relationship of trust and confidence.

There is no one rule that fits all in this area and the reason practitioners get caught out is because it is difficult and complex. You might have a situation where all of the joint venturers are contributing similar things, are all carrying the same risk and have similar assets at risk and so there is no apparent conflict preventing you acting, but as Justice Byrne said in a Pyramid Building Society case:

> *"How many cases like this need to come before the courts before solicitors appreciate the folly of acting for more than one party in the most innocent appearing of transactions? Judges for nearly a century have inveighed against the practice. … I am unimpressed with the argument that in a friendly and uncomplicated conveyancing transaction of whatever kind it is proper for a solicitor to act for more than one party because no conflict is apprehended. Lawyers are in a better position than others to know that in the friendliest of partnerships, commercial dealings and marriages there is always the prospect of discord and conflict….The problem with conflicts is that they tend to arise in unexpected ways and often at short notice..."*

Before you decide to act for all parties in a joint venture situation or for more than one party in a transaction you might consider whether it is best practice. You also need to:

- be clear about who you are acting for right from the start and confirm this in writing to everyone, including the parties you are not acting for
- avoid giving any advice to other joint venturers and where mortgages and guarantees are involved not sign solicitor's certificates for the other joint venturers
- recommend to unrepresented non clients they get independent legal advice
- ensure you do not put yourself in a conflict situation, no matter how obliging and accommodating you want to be.

Conflicts of interest

LPLC define conflicts of interest claims as any claim where the practitioner has acted for more than one party. As a management issue, conflict falls under both ethics and risk.

Victoria's Professional Conduct and Practice Rules 2005

A number of the Law Institute of Victoria's Professional Conduct and Practice Rules 2005 cover conflict of interest.

Duty of Confidentiality

- **Rule 3 (in Victoria)** A practitioner must never disclose to any person, who is not a partner proprietor director or employee of the practitioners firm, any information which is confidential to a client and acquired by the practitioner's firm during the client's engagement – except …
    - the client authorises it
    - the practitioner is compelled by law or would have been compelled by law and to avoid concealment of a crime
    - the information lost its confidentiality
    - the practitioner gets the information from someone else and it is not confidential.

Confidential information

Confidential information can be tangible (specific facts) as well as intangible (getting to know your facts).

Gillard J in *Yunghanns and ors v Elfic Ltd and ors* (VSC 3 July 1998 unreported) said "*the overall opinion formed by a solicitor of his client as a result of his contact may in the circumstances amount to confidential information that should not be disclosed or used against the client*" such as strengths and weaknesses, honesty/dishonesty, reactions to tension/crisis, attitudes to settlement/tactics.

An example where intangible facts are known could include where a practitioner acts on a general retainer for an insurer but in one specific transaction he acts for the claimant against the insurer. From the insurer's perspective it perceives the practitioner knows how it thinks and acts such as it only settles at the door of the court or never makes the final offer until after mediation. From the claimant's perspective it perceives practitioner is favourably disposed or biased towards the insurer and would not want to push the matter too hard. The practitioner cannot breach confidentiality owed to the insurer.

Conversely North J in *Incentive Dynamics P/L (in Liq) & anor v Robins & ors* [1997] 671 FCA said information must be sufficiently identified to enable it to be confidential information.

Impressions, beliefs, conclusions and observations are not sufficiently identified to be confidential information.

In the case of *Commonwealth Bank v Kyriackou* [2008] VSC 146 Judd J found the applicant seeking an injunction could not show there had been confidential information passed on to the practitioner who had moved firms. This is often a difficult case to make because you do not want to disclose what the confidential information is but you need to sufficiently identify it!

Fiduciary duty of loyalty

Practitioners owe a fiduciary duty to their clients. This means giving undivided loyalty to protecting their client's interests as well as acting in the best interests of their client.

If the practitioner has knowledge which would benefit a client but cannot use it because of the confidentiality owed to another current or former client, the practitioner cannot give the second client undivided loyalty. There is a conflict and confidentiality exists and continues after the retainer is finished. This raises the question of the duty of loyalty.

What if the practitioner has no confidential information about a former client? Can you act against that client? In Victoria, Brookings J said in *Spincode Pty Ltd v Look Software Pty Ltd & ors* [2001] VSCA 248 after reviewing all of the authorities that Australia had diverged from England and that "*it may be said to be a breach of duty for a solicitor to take up the cudgels against a former client in the same or a closely related matter*".

He went on to say that if the practitioner was not bound by the negative equitable obligation then the court could also consider whether "*the whole of the conduct was so offensive to common notions of fairness and justice that they should as officers of the court be brought to heel notwithstanding that they have not infringed any legal or equitable right.*"

Russell Cocks and Elizabeth Klein's article in Nov 2006 LIJ *Crossing over – the blurred line of a lawyer's duty of loyalty* gives a good summary of Brookings judgment and discusses the divergence of opinion since then among the states.

A decision in NSW *Cleveland Investments Global Ltd v Evans* [2010] NSWSC 567 Ward J found there is no continuing duty of loyalty, in line with Brereton J in *Kallinicos v Hunt* [2005] NSWSC 1181 but there is an inherent power of the court.

Inherent power of the court

In the Cleveland case the judge went to great pains to talk about the inherent power of the court to restrain a practitioner from acting. She quoted Brereton J in *Kallinicos & anor v Hunt & anor* [2005] NSWSC 1181and said "*the test is whether a fair-minded, reasonably informed member of the public would conclude that the proper administration of justice requires that a legal practitioner should be prevented from acting for his or her former client, in the interests of protection of the integrity of the judicial process and the due administration of justice, including the appearance of justice*".

This is an objective test.

Acting against a former client

In Victoria Rule 4 of the Professional Conduct and Practice Rules (the Rules) states:

A practitioner must not accept an engagement to act for another person in any matter against, or in opposition to, the interest of a person (former client):

a) for whom the practitioner (individual or firm or former firm) has acted previously and has thereby acquired information personally, confidential to the former client and material to the matter
b) if the former client might reasonably conclude that there is a real possibility the information will be used to the former client's detriment.

It is a subjective assessment of the former client perception. *Adam 12 Holdings v Eat & Drink Holdings* [2006] VSC 152

The Conflict Rule in Victoria

Rule 8 of the Rules arguable muddies the conflict issue.

8.1 A says nothing in rule 8 shall limit or restrict any common law, equitable or statutory duty or obligation which a practitioner owes.

8.1B which says nothing in rule 8.1A shall be construed to prohibit the engagement by a practitioner in legal practice in which a conflict of interest may occur:

(i) where no material conflict of interest has arisen
(ii) where the practitioner is permitted to act as provided in rule 8.5 or in other circumstances where the practitioner reasonably believes that the likelihood of a material conflict of interest arising is unlikely.

Rule 8.2 says a practitioner must avoid conflict of interest between two or more clients of the practitioner.

Rule 8.3 says that if a practitioner is going to act for more than one party in a transaction they have to tell the parties you are going to do so, explain to them what that means and will have to stop acting if a conflict arises and get them to consent to all of this.

Rule 8.4 says the practitioner will have to stop acting for all of the parties if to continue acting will require them to act contrary to the interests of one of them.

Rule 8.5 says a practitioner can act for a vendor/purchaser, lessor/lessee, financier/borrower and purchaser/lender if they sign them both up to a form 1 acknowledgement after first fully informing the parties in writing of the disadvantages of the practitioner so acting

Rule 8.6 prohibits acting for guarantor where the practitioner is also acting for the borrower or the financier.

Rule 8.7 prohibits acting for builder/developer/subdivider relating to land and for anyone contracting with that person relating to the land.

Rule 8.8 prohibits acting for borrower and financier in connection with the loan of money or finance through various channels where the financier is not a bank or other recognised financiers.

Rule 8 is complex and difficult to apply as well as causing dilemmas for practitioners. A practitioner cannot continue to act if there is a conflict but very often it is too hard to determine if the conflict exists and by the time the damage has already been done.

Conflict is hard to recognise

The problem with relying on Rule 8 and acting for more than one party is you will usually not be able to stop acting before the conflict occurs because people only recognise the conflict after it has arisen. You are then exposed to a breach of the rules and allegations of preferring the interest of one client over another.

Conflict of interest is easy to recognise when parties are in **dispute**. It is harder to recognise when parties are not **in dispute** but they are simply seeking to achieve different ends.

In one example a practitioner was acting for a gay couple splitting up and had amicably worked out one would pay the other out for the apartment they had bought together. On the surface it was just a matter of doing a transfer but a year later one of the parties came back after other people told him he had been cheated and said to the practitioner 'you should have told me I had rights under the Family Law Act, if I had known that I would have …'.

In another example a mortgagor was seeking to borrow money at the lowest interest rate available and the practitioner knows that he will pay interest up to eight per cent. A mortgagee is seeking to lend money at the highest interest rate possible and the practitioner knows he will accept down to seven per cent. Not only are mortgagor and mortgagee's interests different but the practitioner is in a specific conflict situation as he can't use information he has about each of them to benefit the other.

The easiest of conveyances can result in a conflict if the parties can't agree on definitions of fixtures, damage to the property boundaries, problems with finance or failure to disclose information.

Types of conflict

Conflict of interest can arise in different and varied situations.

Direct conflict

- Out of the conduct of legal practice.
    - Putting the practitioner's concerns about their legal costs ahead of the client's interests.
- Business and personal dealings with the client.

- Conflict of interest between an organisation or company, in which the practitioner is involved, and a client.
- Conflict of interest because of a relationship or friendship. Objectivity can become blurred and practitioner may have knowledge which makes it embarrassing for them to act.

Indirect conflict

- Conflict of interest of current clients.
- Conflict of interest of current and former clients.

In many cases, the conflict is not apparent at the outset of a transaction. Conflict situations can also occur unintentionally. Often it is not the practitioner "greedily" acting for two parties as they are often trying to be too obliging.

Examples

7. Loans/guarantees

The typical scenario is the money is borrowed by the husband's company and the wife has nothing to do with the operation of the company, often not even a shareholder or director. Can the practitioner advise her and sign her up to the guarantee? If they own separate assets worth different amounts and their interests are not the same there may be a conflict. It may later be alleged the wife would never have agreed to give a guarantee if they had realised the state of the company's financial affairs.

The practitioner acts for a dental practice buying new premises. As part of the conveyance the practice was borrowing money and the bank required guarantees from both the dentists who ran the practice. Can the practitioner advise the dentists, witness the guarantees and give the solicitor's certificate? These people know what they are doing and the state of the finances of the business. Does your opinion change if you know that one dentist owns a house worth $800,000 and the other dentist has a house worth $900,000 but owned by his family trust?

The firm acts for a family company in dire financial strife. The bank had agreed to freeze any action for six months to allow the company to try and sell. Part of the deal required the various family members who had previously given security to the company to sign a deed of forbearance and confirm the validity of the security provided previously. The practitioner had been asked by the director of the company to facilitate the signing of the deeds. The bank wanted the family members to have some legal advice before signing. Time was short and it had to be done in 24 hours.

The practitioner was considering whether he could act on a limited retainer, making it clear that he was only advising the family members that they may have had rights to avoid providing the security but by signing the deed they were giving up those rights. The issues were:

- the practitioner is not independent as he is acting for the company and allegations could be made later that he preferred the interests of the company over the individuals.
- the family members may say that they didn't think they were giving anything up by signing: "if only you had told us we really did have another way out of the situation we would never have signed"
- had the family members been referred to a truly independent practitioner they may have been advised they had a way to avoid providing security such as there was no solicitor's advice before they signed the first security documents or some technical mistake in the documents
- should there have been explanations about the order of security being sold.

8. Small business

The sale and purchase of a small business is often an area where conflicts arise before anyone realises.

Here is a typical example. A practitioner received a call from a client he had done work for in the past regarding an urgent sale of business to another couple. He then met with both the vendor and the purchasers of the business and took instructions on the draft contract of sale.

The parties wanted the practitioner to act for all of them. When he said it would be unusual and the purchasers should get independent advice they argued that they were both members of the same community group and had faith in each other's integrity. The parties insisted the practitioner act for both so he did. The purchasers had what they called a section 52 statement of the *Estate Agents Act 1980* at that meeting but it was only the trading statement. The practitioner discussed the risk of the lack of security provided by the vendor but the purchasers were prepared to take the risk.

At a further meeting the Form 1 - *Acknowledgement in accord with Rule 8.5* of the Professional Conduct and Practice Rules 2005 was discussed and a copy of the vendor's signed form is on the file but not one signed by the purchasers.

A problem arose when the business was not as profitable as was expected and $10,000 of the purchase price was still outstanding. The parties ended up in heated dispute and escalated into a civil proceeding in which the practitioners were joined. The allegations against the firm were that they failed to advise the purchasers:

- the business should not be bought for $160,000
- they should obtain independent financial advice
- they could take some time to read the contract before signing it
- they were entitled to receive a section 52 statement and if not, could avoid the contract within three months of execution.

The purchasers also alleged there was a conflict of interest and the practitioners preferred the interests of the vendor to that of the purchasers.

9. Property

The practitioner started off acting for the vendor of the property. There were negotiations with the purchaser's practitioner and strangely it was agreed that the purchaser's practitioner would draft the sale contract. The purchaser's practitioner was unable to continue due to a health crisis and the vendor's practitioner drew the contract, had a meeting with the purchaser, exchanged contracts and then agreed to act for the purchaser. The firm opened separate files and had different people working on them.

When the purchaser indicated it was having difficulty in obtaining finance a meeting was arranged between the parties and various security options were proposed. The vendor decided not to take any of the security options and asked that a notice of default be served. At this point the firm realised there was a conflict and stopped acting for the purchaser. They said they would continue acting for the vendor unless the purchaser complained, which they didn't at the time.

The practitioner was required to write a letter explaining his behaviour to Professional Standards and confess he had mistakenly believed he could continue to act for the vendor if the purchaser consented. He said he had acted for the vendor for a long period of time and the vendor was both a personal and business acquaintance. He also felt to change practitioners at such a crucial stage would have been detrimental to the vendor.

After 36 years of unblemished practice the practitioner consented to a reprimand. The contract proceeded after some delay – part of which the purchaser's new practitioner claims is the vendor's practitioner's fault because some certificates where not obtained including a building order, which put greater requirements on the purchaser. The purchaser also alleged overcharging. The matter was settled for $5,000.

Risk management lesson

When thinking about conflicts of interest consider:

- what confidential information you may have about another client that could put you in a conflict position.
- how you can 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 parties appear to be in heated agreement does not mean a conflict will not arise in the future. By the time the conflict is spotted the damage is usually already done and the firm will face allegations of acting in a conflict situation.
- If a conflict does arise you have to send both parties away so you lose them both!
- Very often practitioners/firms are not as careful/thorough/adversarial when acting for more than one party in a transaction and things get missed.

Scope of work – commercial versus legal work

The three musketeers scenario also raises the question of where to draw the line between giving the client legal advice and giving the client commercial advice.

Trevor (the practitioner) comments that 'it's nice work if you can get it', adding it is a bit unusual to have a publicly listed company raising capital on a urgent basis like this but that is as far as he goes.

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, is about 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 Corporations Law issue here) or just commercial issues?

How do you differentiate and handle it?

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 solicitor's 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.

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

- 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?
  - 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 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.

Communications – dealing with experienced business people

Mitch, Clive and Morrie were experienced business people. It is often hard to gauge how much these sort of clients know about technical legal issues and how much to advise them. Trevor did not get the balance right here as he didn't clarify who he was acting for and what exactly he would do for them.

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, won't take advice, 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 video *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, 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

10. 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.

In the scenario Trevor accepts everything he is told by Mitch about the deal and what is happening, his relationship with the company and how to get around the corporations issue. This is particularly dangerous, especially when later he says he did not even think he was acting for Mitch.

Risk management lessons

Client acceptance

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

- correct identification of the prospective client
- there are no conflicts of interest or duties
- it will not impede any contractual arrangements with other clients
- it will not damage any commercial relationships with other clients
- the prospective client's reputation and credit worthiness is acceptable, taking into account issues/databases such as terrorist registers and anti-money laundering issues
- the client does not otherwise pose any unacceptable risks.

Approval for taking on a new client for the firm should involve more than just the responsible partner. In some cases it might be the practice group head, the managing partner or a specific new client review committee.

Matter acceptance

Approval for taking on a new matter should be made by the responsible partner and possibly the practice group head as well.

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 be of a certain size, in particular there must be a minimum fee threshold.
- Conflicts of interest and commercial relationships must be considered with each new matter.
- The risk profile of the matter must be considered and where the risk is unacceptable, the matter should be rejected. Where the risk is considered high, a review partner is appointed to review the work done by the firm.

Joint ventures

Before deciding to act for all parties in a joint venture situation, ensure the potential risks are considered including:

- being clear about who you are acting for right from the start and confirm this in writing to everyone including the parties you are not acting for
- avoiding giving any advice to other joint venturers and where mortgages and guarantees are involved, do not sign solicitors certificates for the other joint venturers
- recommending to unrepresented non clients they get independent legal advice
- using your experience and intuition to ensure you are not putting yourself in a conflict situation, no matter how obliging and accommodating you want to be.

Conflicts

- When thinking about conflicts of interest consider:
    - what confidential information might you have about another client that could put you in a conflict position
    - how can you to 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 does not mean that a conflict will not arise in the future. By the time the conflict is spotted the damage is usually already done and the firm will face allegations of acting in a conflict situation.
    - If a conflict does arise you have to send both parties away so you lose them both!
    - 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 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 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 and what you are not doing, and what the client is doing. Ensure you follow up that documenting if anything changes during 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 solicitor 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 solicitor 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 solicitor'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 solicitor, in fact the same solicitor as in *Ibrahim*, to have the mortgage and loan documents dealt with. They told the solicitor that they expected to receive a return of $12,000 per fortnight from their $150,000 investment and that the solicitor 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 solicitor that the clients' expectations of their investment were "absurd". In such a situation, it was not enough for the solicitor 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 solicitor 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 solicitor 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 solicitor 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 solicitor 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 solicitor had failed to explain various clauses in the loan and mortgage documents, in breach of his contractual duty, the claim against the solicitor 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 solicitor. 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 solicitor. That meeting took one and a half hours and the solicitor 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 solicitor 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 solicitor was successful at first instance. It was argued on appeal that the solicitor 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 solicitor 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 solicitor 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 solicitor or from a third party."*

The Court of Appeal agreed with the primary judge, that the advice given by the solicitor 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 solicitor was found to be not negligent.

The Court found that the solicitor'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 solicitors 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 solicitor 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 solicitor had breached his contractual (and tortious) duty because there were clear deficiencies in the security on offer - which an ordinary prudent solicitor, 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 solicitor 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 solicitor 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 solicitor, 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 solicitor 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 solicitor, 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 solicitor 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 solicitor'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 solicitor 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

solicitor did not have knowledge that the loan was not fully paid back. The solicitor 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 solicitor 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 solicitor 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 solicitor'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 solicitor 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.

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

- 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.

Appendix two

Legal Profession Act 2009 (Vic)

3.4.9 Disclosure of costs to clients

(1)A law practice must disclose to a client in accordance with this Division—

(a) the basis on which legal costs will be calculated, including whether a practitioner remuneration order or scale of costs applies to any of the legal costs; and

(b) the client's right to—

(i) negotiate a costs agreement with the law practice; and

(ia) receive a bill from the law practice; and

(ii) request an itemised bill within 30 days after receipt of a lump sum bill; and

(iii) be notified under section 3.4.16 of any substantial change to the matters disclosed under this section; and

(c) an estimate of the total legal costs or, if that is not reasonably practicable—

(i) a range of estimates of the total legal costs; and

(ii) an explanation of the major variables that will affect the calculation of those costs; and

(e) details of the intervals (if any) at which the client will be billed; and

(f) the rate of interest (if any) that the law practice charges on overdue legal costs, whether that rate is a specific rate of interest or is a benchmark rate of interest (as referred to in subsection (1A)); and

(g) if the matter is a litigious matter, an estimate of—

(i) the range of costs that may be recovered if the client is successful in the litigation; and

(ii) the range of costs the client may be ordered to pay if the client is unsuccessful; and

(h) the client's right to progress reports in accordance with section 3.4.18; and

(i) details of the person whom the client may contact to discuss the legal costs; and

(j) the following avenues that are open to the client in the event of a dispute in relation to legal costs—

(i) costs review under Division 7;

(ii) the setting aside of a costs agreement under section 3.4.32;

(iii) making a complaint under Chapter 4; and

(k) any time limits that apply to the taking of any action referred to in paragraph (j); and

(l) that the law of this jurisdiction applies to legal costs in relation to the matter; and

(m) information about the client's right—

(i) to accept under a corresponding law a written offer to enter into an agreement with the law practice that the corresponding provisions of the corresponding law apply to the matter; or

(ii) to notify under a corresponding law (and within the time allowed by the corresponding law) the law practice in writing that the client requires the corresponding provisions of the corresponding law to apply to the matter.

Note

The client's right to enter into an agreement or give a notification as mentioned in paragraph (m) will be under provisions of the law of the other jurisdiction that correspond to section 3.4.4.

(1A) For the purposes of subsection (1)(f), a benchmark rate of interest is a rate of interest for the time being equal to or calculated by reference to a rate of interest that is specified or determined from time to time by an ADI or another body or organisation, or by or under other legislation, and that is publicly available.

(1B) The regulations may make provision for or with respect to the use of benchmark rates of interest and, in particular, for or with respect to permitting, regulating or preventing the use of particular benchmark rates or particular kinds of benchmark rates.

(2) For the purposes of subsection (1)(g), the disclosure must include—

(a) a statement that an order by a court for the payment of costs in favour of the client will not necessarily cover the whole of the client's legal costs; and

(b) if applicable, a statement that disbursements may be payable by the client even if the client enters into a conditional costs agreement.

(3) A law practice is taken to have complied with the requirement to disclose the details referred to in subsection (1)(b)(i), (ia) and (ii), (h), (j), (k) and (m) if it provides a written statement in or to the effect of a form prescribed by the regulations for the purposes of this subsection at the same time as the other details are disclosed as required by this section.

(4) A regulation prescribing a form for the purposes of subsection (3) may provide for the form to refer to fact sheets or other documents (whether as current at the time the regulation commences or any earlier time or as in force for the time being) that contain details of the kind referred to in that subsection.

(5) The regulation may—

(a) require the Commissioner to produce and maintain fact sheets or other documents that are referred to in the form and to make them available on the Internet; and

(b) require the fact sheets or other documents to be developed in consultation with the professional associations.