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risk watch

NEWS 2008

Advice in Financial Transactions and Guarantee Certificates

It has been just over a decade since Lawguard, Law Claims and the Law Society issued warnings and recommendations about giving certificates in financial transactions. These warnings came as a result of a run of Cases,[1] that highlighted the practical difficulties and risks of solicitors giving independent advice in financial transactions. It has been over two decades since the historic High Court judgment in Amadio, one of the effects of which was to transfer risk from a lender to a certifying solicitor. Despite the passage of time, this area of risk is still alive.[2]

The warnings regarding giving certificates in financial transactions still apply today.

The following is not an exhaustive examination of risk reduction strategies for practitioners, rather, it is a reminder that giving independent advice in financial transactions continues to be a high risk activity and should only be undertaken after the practitioner is satisfied they have the requisite experience, understanding and processes in place to support this form of legal advice.

FINANCIAL TRANSACTIONS

The need for independent advice usually arises in guarantee transactions, but it is not limited to them. It may also arise in seemingly ordinary mortgage and borrowing arrangements. Guarantee transactions often involve solicitor's certificates. However, the same principles will arise in many cases involving independent advice about financial transactions, whether or not a certificate is sought.

THE DUTY

The cases make it clear that advice on financial transactions goes beyond "traditional" legal advice on the nature of the transaction, the terms of the documents, and the rights of the parties. It extends to advice which takes into account commercial and personal matters, so that the client understands the actual legal, financial and personal risks he or she is undertaking.[3]

It may be tempting to try to limit advice to certain aspects of a transaction, for example the meaning of the legal documentation. This may or may not be appropriate with commercially sophisticated clients, and it is prudent to try to limit liability by obtaining written instructions. However the cases suggest strongly that once a solicitor undertakes an obligation to give independent advice at all, he or she cannot escape the duty to give all relevant advice. This is so whether the client wants the advice or not.[4] In effect, by taking on any part of the job, a solicitor assumes a duty to give all relevant advice.

This is combined with causation rules which may make a solicitor liable for all the losses in a transaction because he or she did not give advice on some small aspect of it. If a client says that, had the solicitor mentioned some aspect of the transaction, the client would not have entered into it, the solicitor is at grave risk of being found liable for all losses flowing from the transaction.

IN PRACTICE

The cases set such a high standard of care for solicitors that it continues to be the view of Law Claims that it is better not to give certificates of independent advice in financial transactions. Certainly, solicitors without extensive commercial experience should not attempt to advise on financial transactions, nor give a certificate.

In practice however, there may be occasions where it is it necessary to give independent advice on financial transactions, and where appropriate give a certificate of independent advice. Where that advice is unavoidable, the relevant cases make it very clear that to fulfill his or her duty, a solicitor must:

- make whatever investigations are necessary to fully understand the transaction, the interests of the parties involved in it, and the prudence of entering into it;
- give careful and substantial advice.

In many cases, this advice is likely to involve hours of work, and several appointments. It is very difficult to strike a balance between too much and too little information, and it is not enough to go through the document clause by clause. The difficulties inherent in certifying someone else's understanding ought to be obvious. Anyone giving this sort of advice should be familiar with the cases, including McNamara's case[5].

CLAIMS ATTRACTING AN EXCESS UNDER THE PROFESSIONAL INDEMNITY INSURANCE – Schedule 2 – Certificate of Insurance 2007

South Australian practitioners are reminded of the relevant provisions under their insurance.

Financial Certificate claims

2.6 If a claim arises out of or is contributed to by any matter or transaction in relation to which the Insured was retained to provide any advice to or any certification in respect of, a proposed guarantor, indemnifier, surety, mortgagor, or co-borrower who was not to derive substantial direct new financial benefit from or in respect of the said transaction of guarantee, indemnity, surety, mortgage or contract of loan respectively the Excess payable by the insured in relation to the Claim as computed in accordance with Clauses 2.2 and 2.3 shall be increased:

*(a) where the Insured was first retained after 1 January 1994 and before 31 December 1998, by **50% (emphasis added).***

*(b) where the Insured was first retained after 1 January 1999 by **300% (emphasis added).***

IN SUMMARY

If a solicitor is giving independent advice on a financial transaction, he or she must be properly satisfied:

1. That he or she in fact understands the structure and ramifications of the transaction.
2. That there is no conflict of interest between his or her clients (e.g. husband and wife, parent or grandparent and child).
3. That there is no undue influence, pressure or inequality of bargaining position involving any of the clients, or other parties to the transaction.
4. About the prudence or imprudence of the transaction (financially or otherwise).
5. That the clients in fact understand the transaction and obligations they are entering into, and the risks they face. This includes not only the legal nature and risks of the transaction, but also the actual personal and financial risks.

CONSEQUENCES

If a solicitor is **not** satisfied that all of these requirements are met, the effect of the cases is that it is his or her duty to advise the client against entering into the transaction.

If the client rejects the solicitor's advice, and wishes to enter into the transaction, difficult practical and ethical problems may arise.

1. Under no circumstances should a solicitor give a certificate where there is any doubt about the client's understanding of the full ramifications of the transaction.
2. Similarly, if there is any unresolved evidence or inference of undue influence, a solicitor should refuse to accept instructions which are not clearly the product of an independent mind, and should not co-operate in furthering the transaction.

3. In cases where any aspects of the transaction and risks are unclear, it seems that it is the solicitor's duty to refuse to act further and to refuse to assist the client to enter into the transaction. In Bechara's case,[6] the Court found that it was not enough to advise that the client get independent financial advice about an aspect of the transaction. The solicitor should have declined to provide the certificate until that advice was obtained (Judgment p94).

4. It seems that only where the solicitor is satisfied that :

   - full advice has been given,
   - the client in fact fully understands the transaction and risks, and
   - the client does not wish to substitute the solicitor's advice for his or her own judgment,

   is it the solicitor's duty to carry out his instructions, including giving a certificate where appropriate. In these circumstances, clear and detailed written instructions should be obtained that, despite the advice, the client wishes to enter into the transaction.

Unfortunately, instructions of this kind may still leave the solicitor vulnerable if the transaction turns sour. There are a large number of other factors, and individual transactions must be considered on their own facts. Some financial transactions will not be contentious, and may not involve this level of work. Even these will require investigation to establish that they do not present problems. However, there is a steady stream of difficult, complex or otherwise unusual transactions which have a high risk of going wrong. Where a solicitor attempts to give independent advice in a transaction like this, there is a very high risk that he or she, together with his or her partners, and their insurers, will become the effective guarantors of the transaction.

This article is an abridged and amended version of **"Advice in Finance Transactions and Guarantee Certificates",** authored by Mr S J White, 1998.

1. see e.g. Micarone and Bechara v Perpetual Trustees & Others 19 November 97, Judgment S6438 (Duggan J).
2. see e.g. Karam v ANZ [2001] NSWSC 709
3. see e.g. Micarone and Bechara v Perpetual Trustees & Others (Full Court) (1999) 75 SASR 1 at [312], National Australia Bank v Mitolo [2002] SASC 102 at [72].
4. see e.g. Citibank v Nicholson; Pirrotta v Citibank (1997) 70 SASR 206 (14th page of the judgement)
5. McNamara & ors v Commonwealth Trading Bank of Australia (1984) 37 SASR 232, especially at 241 et seq.
6. Micarone and Bechara v Perpetual Trustees & Others 19 November 97, Judgment S6438 (Duggan J).

For any queries about this, or other Risk Management Services offered by Law Claims, please contact the Risk Manager, Tracey Nelson on 8410 7677.