THE RISKS OF MIXING LEGAL AND FINANCIAL ADVICE

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Snapshot

- Solicitors must be conscious of the difference between financial and legal advice and know when to advise a client of the need to obtain independent financial advice .
- It is important to record file notes of any advice, and for more unusual risks, to confirm that advice in writing to the client.

Most solicitors will know the rule in *Citicorp Ltd v O'Brien* (1996) 40 NSWLR 398 without any real need to refer to *Riley's*. This is because the rule in *Citicorp* has been woven into the fabric of legal training and practice in Australia since 1996.

When a client proposes to enter into a transaction, his or her solicitor should refer to the *Citicorp* case as the conduct standard, and advise the client that:

- the financial aspects of a transaction are not a matter in respect of which the solicitor can advise; and
- the client should obtain independent financial advice as to the merits of the transaction.*****

The New South Wales Court of Appeal came to reconsider *Citicorp* again in *Dominic v Riz* [2009] NSWCA 216, at [58] after a trial judge had suggested:

'... it is often difficult ... to disentangle legal and business or practical analysis, and a solicitor who is carrying out a transaction for a client is not justified in expressing no opinion when it is plain that the client is rushing into an unwise, not to say disastrous, adventure.'

The Court of Appeal in *Riz* rejected that finding and reinforced the *Citicorp* rule:

'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 ... bring to the attention of the client the aspect of concern and to advise of the need for further advice either from the solicitor or a third party ...' (at [90]).

A recent decision of the High Court of England and Wales in *Kandola v Mirza Solicitors LLP* [2015] EWHC 460 (Ch) is a very good example of the problem in practice.

The transaction was unusual because the deal involved the purchaser of a property paying the deposit to the vendor's solicitors as agents for the vendor (only). The vendor did not complete, and the deposit was lost because the vendor's solicitors disappeared amidst allegations of fraudulent misuse of client money.

The conveyancer advised the purchaser of the risk that:

- the deposit would not be recoverable if the vendor did not complete;
- the vendor might not be able to complete if the vendor could not obtain releases of relevant charges; and
- since the conveyancer did not know how much was secured by those charges, the purchaser could not know if they could be paid off from the purchase money.

Importantly, in view of the unusual nature of the transaction, the conveyancer also obtained written confirmation of the advice from the purchaser as follows:

'... I have also been advised against releasing the deposit ... to the seller. I am also aware that I risk losing my deposit if the seller is unable to complete the sale.'

The Court in *Kandola* summarised the position as follows:

'... a general duty to make checks about risk of future insolvency ... [cannot] arise merely because the client is incurring a risk of loss if the counterparty becomes insolvent. Nor in my view does such a duty arise merely because the transaction takes an unusual form which does involve a solvency risk (e.g. on release of a deposit) where the more normal form would not (deposit held as stakeholder). In such cases the duty of the solicitor is to advise of the unusual risk, but not to seek to evaluate it unless specifically instructed to do so. In part that is because the decision whom to trust in business is a commercial decision for the client to take and not the solicitor ... Just because a solicitor (or other professional) could take a particular step does not mean that it is his duty to do so' (at [51]-[52]).

Citicorp and good risk management practice

A lawyer can adopt a simple risk management practice in commercial transactions by considering the following questions:

(a) What could go wrong and what are the consequences of things going wrong?

(b) What is the likelihood of things going wrong?

Question **(a)** is a legal question, and the solicitor has a duty to advise on that. For a sophisticated client, the duty would more likely be to advise that the loan was unsecured and the client would rank as an unsecured creditor (assuming the lawyer knew the client understood these terms).

For an unsophisticated client, proper advice might extend to pointing out the practical consequences of the legal obligations arising from the document. For instance, if the borrower's business, of which the client knew nothing apart from representations made by her son (principal of the borrower) failed, the client could lose her home and livelihood, (see *Provident Capital Ltd v Papa* [2013] NSWCA 36).

Question **(b)** is a question for a non-legal expert (e.g. a financial adviser). Whether or not the client asks this question, it may be prudent to advise the client to obtain the relevant non-legal advice.

Document your advice

As usual, a lawyer should document advice in a file note. A lawyer could do worse than using the two questions in the file note. For more unusual risks, the advice should be confirmed in writing, as the conveyancer did in *Kandola*. **LSJ**

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