

Don't be a client's scapegoat

By KAVEETHA KUMAR and MATTHEW HARDING



Solicitors are increasingly at risk from clients facing liabilities to lenders who allege loan agreements are unjust under s.9 of the Contracts Review Act.

A client may seek to have a loan agreement set aside or, failing that, seek damages from their solicitor, asserting they should have received advice on remedies available under the *Contracts Review Act* (CRA).

Depending on the loan's purpose, clients could also allege a solicitor has failed to advise that the terms of a loan agreement were unfair and therefore void under s.23 of the *Australian Consumer Law*, which applies to consumer contracts for the supply of services or sale or grant of an interest in land to an individual whose interest is wholly or predominantly for personal, domestic or household use or consumption.

When asked to advise on a loan or mortgage transaction, beware of the following scenarios which are laden with risks for solicitors:

- Individuals entering into a loan or providing a mortgage for the benefit of a third party. The third party may be someone they know and in whom they have placed trust, such as a friend or family member;
- Elderly retirees borrowing money or providing a mortgage;
- Other individuals who do not have the means to repay a loan and have not received other expert advice (such as financial advice);
- Individuals who have difficulty understanding the loan and mortgage documents written in English (if an interpreter is not available).

First Mortgage v Pittman

In *First Mortgage Managed Investments Ltd v Pittman* [2012] NSWSC 1332, Garling J considered circumstances in which two individuals (the borrowers under the loan agreement), whom his Honour

referred to as entirely unsophisticated with no real experience in mortgage transactions, borrowed money on security of their properties and provided the amount borrowed to a third party for the third party's business in which they had no interest. It was the third party who had approached the lender and dealt with the loan.

The solicitor provided advice to the borrowers on execution of the security documents. His Honour found that the loan

"The client sued the solicitor alleging the solicitor had breached the duty owed in failing to provide advice on the terms of the loan."

agreement was unjust. The legal advice provided to the borrowers was wholly inadequate, and not independent of the true financial beneficiary of the loan because it did not explain the provisions of the loan transaction nor the mortgages and their legal and practical effect.

Scenarios

In the following examples, the solicitor's liability is clear.

- A solicitor was instructed to effect a loan transaction after a client entered into a series of short-term loans at very high interest rates to finance a joint venture with a syndicate of property developers. The solicitor was instructed to appear to defend proceedings brought by a prior lender following default. The solicitor was sued by the client for the amount owed under the loan agreements. The client alleged a third party arranged the loans and he did not understand any of the documents he had signed. Issues



Kaveetha Kumar is a senior associate at HWL Ebsworth and Matthew Harding a partner and a member of the LawCover panel.

included whether the solicitor ought to have advised that the client could seek relief under s.7 of the CRA, where the court finds a contract or a provision of it to have been unjust, in proceedings brought by the prior lender.

- A solicitor provided advice in conference on the terms of a loan whereby the client was providing a mortgage on several properties they owned for the purpose of a third party (who was not a party to the loan agreement) purchasing and developing another property. The lender brought proceedings seeking an order

for possession of the client's properties after the loan was not repaid. The client sued the solicitor alleging the loan agreement was unjust at the time it was made and that the solicitor had breached the duty owed in failing to provide advice on the terms of the loan.

The client alleged the solicitor was also acting in the transaction for the third party and that advice had not been provided independently of the third party.

- Clients alleged the solicitor ought to have advised they would not have any legal ownership in the property being purchased and developed.
- The solicitors had kept the third party (who had given the initial instructions) updated but did not report to the client (the borrower under the loan agreement) that the lender had deposited the principal sum and it had been transferred to the third party.

Some of these examples

have arisen when retired parents with a poor understanding of English have entered into a loan or put up their home as security for an adult child who may have persuaded them that he or she will be able to repay. Parents may feel compelled to assist a son or daughter, not appreciating the implications for themselves if the child does not repay the loan.

If requested to act or advise in these types of scenarios:

- Be aware that the features in s.9(2) of the CRA may be present (including that clients may not have been able to protect their interests because of their age, limited educational background or economic circumstances or there may have been undue influence or unfair pressure exerted by another person);

□ if the loan is for the benefit of a third party and there is no direct benefit to the client in entering into the loan or providing a mortgage on their property, do not act for both the borrower/mortgagor and third party in the same transaction. Do not advise the borrower/mortgagor in the presence of the third party;

- consider whether further instructions are necessary or highlight to the client particular terms in loan or mortgage documents if you believe that any of the matters set out in s.9(2) of the CRA are present;

□ if the client has difficulty understanding the loan and mortgage documents written in English, recommend the client use an interpreter before providing advice; and

- the terms of the retainer, instructions received and advice given to the client should be carefully recorded in writing.