Advising vulnerable borrowers on mortgage transactions

By MATTHEW BRANSGROVE

Sometimes practitioners need to make the call to "step in front" of clients and stop them making reckless financial decisions – or be prepared to bear the financial consequences themselves.

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The Court of Appeal has sounded a fresh warning to solicitors advising borrowers on security documents that they must consider whether they need to "step in front" of the client and effectively call a halt to a transaction which is objectively utterly unrealistic or potentially seriously improvident.

In *Provident Capital Ltd v Papa* [2013] NSWCA 36 (Papa) Allsopp P noted: "many clients look to and rely on an advising lawyer, not as the expounder of legal doctrine, but as the confidential adviser about the law, and its practical intersection with life. That is why they seek advice. That is why lenders require the interposition of the trained solicitor to give independent advice and, sometimes, to certify [the] same".[1]

That being the case, the decision (which was exculpatory of the lender) effectively says that, when a lender insists on evidence of independent legal advice, the loan will only proceed if a solicitor provides it. In this situation, the solicitor is thus arming the vulnerable borrower with the ability to enter into an improvident transaction. This operates (as it did in this case) to ultimately shift the responsibility for loss from the lender to the solicitor.

Background

The *Papa* proceedings had many of the hallmarks of an unjust mortgage under the *Contracts Review Act 1980*.

The borrower was a 61-year-old Sicilian immigrant whose sole asset was a house which she used to run her sewing business – her only means of support. Her son urged her to take out the loan to on lend to his company, Luxury Enterprises, which ran a Health and Fitness Club that had recently been placed in administration. The son misled her as to the financial prospects of the business and the lender made no separate enquiries about the affordability of the loan, relying instead on the fact it was a low-doc loan and the borrower's self-certification.

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The borrower sought relief under the *Contracts Review Act* and cross-claimed against the solicitor who advised her on the transaction. The trial judge found it to be a case of asset lending and granted relief under the *Contracts Review Act* while finding for the solicitor on the cross-claim. The lender appealed and the borrower appealed the decision on the cross-claim. The Court of Appeal reversed both decisions shifting the loss from the lender to the solicitor.

Liability of the solictor

The interdependence between the liability of the lender and the solicitor advising the borrower was emphasised by Macfarlan JA, with whom (on this point) Allsop P and Sackville AJA agreed: "Provident made 'low doc' loans to Mrs Papa. It was not completely unconcerned about her ability to service the loans because it required her assurance (by signed Declaration) that she could do so and undertook credit checks".[2] Importantly, Provident also stipulated that Mrs Papa must obtain independent legal advice and confirm that she had done so. Macfarlane JA continued: "[Mrs Papa] did both. That the legal advice was inadequate was not Provident's fault. It was the fault of [the solicitor] ... who bears legal responsibility for the consequences of his breach of duty."[3]

The decision to relieve the lender of liability under the *Contracts Review Act* turned, to a very large extent, on the lender requiring the borrower to obtain independent legal advice. Solicitors should anticipate that this decision will result in a surge of lenders seeking to inoculate themselves against *Contracts Review Act* liability by requiring borrowers to obtain independent legal advice.

Duty of the solictor

On the question of the solicitor's duty, the court indicated that a reasonable solicitor giving independent legal advice to Mrs Papa would have drawn her attention "in strong terms" to the fact her home and livelihood were dependent on the success or otherwise of the gym, and strongly recommended that she obtain financial advice, independent of her son, concerning the ability of the business to service the loan. "A solicitor's obligation is not simply to explain the legal effect of documents but to advise [their] client of the obvious practical implications of the client's entry into a transaction the subject of advice. The prospect of the subject transaction wreaking havoc on Mrs Papa's life was glaring, given the by no means remote prospect that the business would be unable to support the loan repayments."[4]

President Allsop, by way of elaboration on Macfarlan JA's judgement quoted Kirby P in *Cousins v Cousins* [1991] ANZ Conv R 245: "Lawyers are trained, and the law of their profession requires them to be vigilant for their clients' interests. They must sometimes step in front of their client. They must provide advice to them against the follies of plans having a legal character, the full legal ramifications of which the client may not understand."[5]

The Papa decision should be of concern to solicitors acting for borrowers. If there is one thing the reports show clearly it is that the incidence of improvident third-party mortgages given by the elderly and vulnerable has not slowed down. Previous decisions of the Court of Appeal, such as *Elkofairi v Permanent*

Trustee Co Ltd [2002] NSWCA 413, *Perpetual Trustee Co Ltd v Khoshaba* [2006] NSWCA 41 and *Fast Fix Loans Pty Ltd v Samardzic* [2011] NSWCA 260,[6] have seen the loss in such transactions born by lenders. Here the loss, which would have attracted the jurisdiction of the *Contracts Review Act* (but for the interposition of the solicitor's retainer to provide independent legal advice) has been sheeted home to the solicitor. It was for the solicitor to stop the loan by advising in the strongest possible terms that it was improvident, or must not be continued, except with independent financial advice.

The need for independent financial advice

It used to be thought that for the lender on a third-party mortgage to be entirely safe it was necessary to ensure third-party mortgagors not only obtained independent legal advice but also independent financial advice.

In *Pasternacki v Correy & Ors* [1998] NSWSC 288, Hidden J held that it should have been clear to the lender that the transaction may have been imprudent from Mrs Correy's point of view. His Honour criticised the lender for not suggesting Mrs Correy obtain additional financial advice about her son's business, as well as conventional legal advice about the mortgage.

In Papa, however, the Court of Appeal has indicated that the lender can exculpate themselves by requiring the mortgagor to obtain independent legal advice. Accordingly it has now put solicitors on notice that if a transaction could be considered improvident it would be advisable to refer the mortgagor for guidance about the financial wisdom of the contract – not just its legal effect.

Allsop P in *Papa* bolstered this noting 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 financial information or advice."[7] His Honour went on to argue that in such a situation the solicitor is obliged to strongly advise their client about the risks of proceeding without further information and pointed out that: "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."[8]

In practical terms "strong terms", "clarity and force", will often involve a refusal to continue to act. By refusing to act for a vulnerable person on an obviously improvident mortgage transaction, and by making it clear the reason for the refusal, solicitors can make the point as forcefully as possible. In doing so, they avoid arming vulnerable third-party mortgagors with the ability to act against their own best interests by carrying out a financial transaction which may be severely detrimental.□

ENDNOTES

1. *Provident Capital Ltd v Papa* [2013] NSWCA 36 at [6].
2. Ibid, at [114].
3. Ibid.
4. Ibid, Macfarlan JA at [80] with whom (on this point) Allsop P and Sackville AJA agreed.
5. *Cousins v Cousins* [1991] ANZ Conv R 245, p. 248.
6. See: "No guarantee in guarantees", *Law Society Journal*, November, 2011.
7. Above n.1 at [2].
8. Ibid. □