

A warning to solicitors on their penumbral duty to clients – the more you know, the more you owe

Provident Capital Ltd v Papa [2013] NSWCA 36

Insurance Update

The NSW Court of Appeal recently held that a solicitor providing legal advice to a client in respect of a mortgage transaction had a penumbral duty to the client that went beyond the scope of the solicitor's retainer. The unanimous finding was that the solicitor had a duty to advise its client to seek independent financial advice given the circumstances of the transaction and the knowledge held by the solicitor.

Facts of the case

In April 2007, the respondent (**Mrs Papa**) mortgaged her home, in which she lived and operated a business selling children's and babies' clothes, to the appellant (**Provident**). The mortgage she gave secured an advance of \$700,000, which she obtained for the purpose of assisting her son. Mrs Papa's son operated a gymnasium business and required the money to purchase new equipment and to provide working capital. In April 2008, a further advance of \$125,000 was given by Provident to Mrs Papa and again these funds were put towards her son's business.

On both occasions, Provident required Mrs Papa to obtain legal advice on the mortgage transaction documents and provide a declaration to that effect. On both occasions Mrs Papa sought legal advice from the cross-respondent (**Mr Caramanlis**). Mr Caramanlis provided legal advice on the effect of the mortgage documents to Mrs Papa and she was made aware that should payments not be met, there was a possibility that Provident would issue proceedings to possess her home.

Unfortunately for Mrs Papa, the reason her son required her assistance was that his business was struggling and he was unable to raise the necessary finance to save his business without Mrs Papa's help. Even after the injection of capital, the gymnasium business continued to falter and Mrs Papa's son was unable to meet mortgage repayments. By October 2008, Provident commenced proceedings for possession.

Who does this affect?

- Insurers
- Legal service providers

Article Highlights

- It was found that the solicitor giving legal advice in respect of a transaction had a penumbral duty to advise its client to seek independent financial advice.
- A solicitor's knowledge of a client's individual facts and circumstances can give rise to, and inform, a penumbral duty beyond the scope of the solicitor's retainer.



In her defence, Mrs Papa claimed that the loan agreements were unjust contracts under s7 of the *Contracts Review Act 1980* (NSW) and cross-claimed against Mr Caramanlis, alleging he had breached his professional duty of care to her. At first instance Mrs Papa succeeded against Provident but failed against Mr Caramanlis. Provident appealed and Mrs Papa appealed the decision in the cross-claim. This note focuses on the cross-claim.

The decision

Whilst the Court recognised that it was well established that solicitors are not ordinarily required to give advice on the wisdom of a transaction, a reasonable solicitor in the position of Mr Caramanlis would have formed the view that Mrs Papa's home would be significantly endangered by her entry into the loan agreements with Provident. A reasonable solicitor having formed such a view, would have recommended that Mrs Papa obtain independent financial advice. The Court said that a solicitors' obligation is not simply to explain the legal effect of documents but to advise a client of the practical implications of the client's entry into a transaction the subject of advice.¹

In coming to that view the Court considered what facts were known to Mr Caramanlis when he provided legal advice to Mrs Papa in respect of the first mortgage, which included that:

- Mrs Papa was a mature lady who owned a property, which she also conducted a business from, and her only other asset was her car;
- She was proposing to borrow \$700,000 to assist her son with a gymnasium business (buying new equipment) and to repay an earlier debt;
- She had no involvement in the business, but might be acquiring one in the future;
- Her son would be making all repayments of the loan out of the income of the gymnasium business;
- Through dealings with other clients, Mr Caramanlis was aware of other loans Mrs Papa's son had taken out and that the son had required an extension to meet rent;
- The loan agreement sought by Mrs Papa did not require the lender to identify or verify the means of repayment of the loan and payment of interest.²

By the time Mr Caramanlis gave legal advice in respect of the second loan agreement, he was aware that Mrs Papa's son defaulted in respect of a number of other loans.³

¹ *Provident Capital Ltd v Papa* [2013] NSWCA 36 at [75], [80], per Macfarlan JA; Allsop P and Sackville AJA agreeing.

² Above n 1, at [79].

³ Above n 1, at [92].

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The Court found that had Mr Caramanlis advised Mrs Papa to seek independent financial advice, she would have done so, and in the circumstances, any reasonable independent financial advisor would have told her that she was “*facing a high risk of disaster in entering into the transaction*”. The Court said that on the balance of probabilities such financial advice would have deterred her from entering into the transaction, so that Mr Caramanlis’s breach had caused Mrs Papa’s loss.⁴

Implications of the decision

Although the issue of conflicting duties was not specifically considered by the Court, Mr Caramanlis was said to have knowledge of financial information relating to Mrs Papa’s son which may have been relevant to the prudence of the loan agreements. This knowledge was considered by the Court as a relevant circumstance when determining the scope of Mr Caramanlis’s duty to Mrs Papa. Arguably the position Mr Caramanlis found himself in gave rise to the penumbral duty in this matter.

This case is a warning to solicitors to not always assume that their duties are confined to the four walls of their retainer. The more a solicitor knows about a client and the circumstances surrounding the transaction, the greater the scope for a finding that the solicitor owed a penumbral duty to the client.

Solicitors when giving advice should attempt to place themselves in the mind of their client and consider the bigger picture beyond the legal advice that is being given. The question a solicitor should ask oneself is, if I was seeking this advice from a solicitor, in this client’s circumstances, what could I expect to be told in the circumstances to make an informed decision? If a solicitor can sense a vulnerability in a client’s position that cannot be overcome by providing legal advice, the solicitor should consider what advice the client should seek and recommend the same.

It goes without saying that whenever a solicitor offers to give advice outside the scope of its retainer to a client, or when it recommends that a client seek financial or other independent advice, proper records should be kept so that a solicitor has evidence to support themselves should they be accused in the future of being too narrow-minded in their advice (or perhaps a better term would be retainer-minded).

⁴ Above n 1, at [85], [88] and [89].

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