HOW TO AVOID THE PITFALLS ATTENDING INDEPENDENT LEGAL ADVICE

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Independent legal advice - when is it required, what are the consequences for a lender or a solicitor in not ensuring that it is provided in certain circumstances and how is it properly provided. These are the issues that are touched upon in this paper[1].

Traditionally the failure of a party to receive independent legal advice has not, in and of itself, been sufficient to invalidate a transaction. Rather as was established in the Ontario Court of Appeal's decision in **Bank of Montreal v. Featherstone**[2], the mere lack of independent legal advice will not invalidate a transaction in the absence of proof of *non est factum*, unconscionability, fraud, misrepresentation or undue influence. This still stands as good law in Ontario and likely across Canada. What has changed is the extent to which the Courts are placing responsibility on lending institutions to ensure that a surety to a principal debtor, or a principal debtor who is not receiving the benefit of a loan, either receives independent legal advice or is advised to obtain such advice, with dire consequences when adequate steps are not taken in this regard.

MacKay v. Bank of Nova Scotia

The necessity for a lender to not only refer but actually insist that a borrower or a guarantor, in some circumstances, obtain independent legal advice has become an issue of significant discussion and speculation following the decision of the Honourable Mr. Justice Lederman in **MacKay v. Bank of Nova Scotia**[3]. In **MacKay**, the Court held that where the transaction being entered into by the plaintiff, Thelma MacKay, was entirely improvident the bank had a positive obligation not only to advise the plaintiff to obtain independent legal advice but also to insist that she do so failing which it must refuse to process the loan. Because in **MacKay** the bank had not done so, the Court held that the mortgage between the plaintiff and the bank was invalid and of no effect.

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[1] In preparing this paper reference was made to the following article: Paul Pere **Competent Independent Legal Advice** (1988-89) 9 Estates and Trusts Journal 225.

[2] (1989), 58 D.L.R. (4th) 567

[3] (1994), 20 O.R. (3d) 698 (Gen. Div.)

While **MacKay** appears to be an extreme case and one that was met with some shock and disbelief amongst the legal and banking community upon its release, it in fact mirrors the type of reasoning expressed by the English Court of Appeal beginning in 1985 with **Avon Finance Co. Ltd. v. Bridger**[4] and culminating in the decision of the House of Lords in **Barclays Bank plc v. O'Brien**[5]. This line of authorities has imposed increasingly onerous obligations on lenders to ensure that persons who are granting security, or otherwise indebting themselves to the creditor in circumstances where they may not directly benefit from the funds being advanced, or where they may be subject to undue influence, receive independent legal advice.

In **MacKay**, the plaintiff was approached by her daughter to co-sign a loan for $20,000.00 to permit the daughter and her husband to purchase a new recreational trailer. The plaintiff agreed to assist them as she apparently was their last hope. The plaintiff's daughter and son-in-law had previously run up significant debts and it was eventually agreed between the daughter, son-in-law and bank that the loan would be increased to $45,000.00 to consolidate those debts with the trailer loan. The son-in-law's creditworthiness was so poor that the bank would not approve his previous request for over-draft protection to the extent of even $250.00. The transaction was ultimately structured as a direct loan to Mrs. MacKay, to be secured by a mortgage on her condominium.

While there was some disagreement in the testimony about what took place in a conversation the plaintiff had at the bank with her daughter and son-in-law and the bank's representative, it was agreed that the plaintiff was advised to seek independent legal advice. In dispute was the extent to which the bank's representative explained the nature and consequences of the documents which the plaintiff was being asked to execute. It was clear that the bank's representative did not provide any advice about whether or not the transaction was prudent from the plaintiff's point of view. Furthermore, the bank's representative did not focus the plaintiff on the fact that it was not necessary for her to sign on for a loan for $45,000.00 if her sole intention was only to assist her daughter and son-in-law in acquiring the house trailer. That larger amount was only necessary to cover all of her daughter and son-in-law's debts. Further, she was not advised that she should be taking security

[4] [1985] 2 All E.R. 281 (C.A.)

[5] [1993] 4 All E.R. 417 (H.L.)

on the new trailer.

In the circumstances, Mr. Justice Lederman found that the bank's simply recommending independent legal advice was insufficient and that it must "insist" on it. If the plaintiff then refused to take ILA, her execution of a waiver of independent legal advice was deemed by His Honour to be inadequate to insulate the bank from a subsequent attack on its security. The Court found that the transaction was "unconscionably adverse to the plaintiff", that there was an inequality of bargaining power between the bank and the plaintiff and that the terms of the transaction were grossly inequitable as far the plaintiff was concerned. In the Court's view, the bank ought to have refused to make the loan if the plaintiff would not obtain independent legal advice.

In **Barclays** a second charge was secured against a matrimonial home jointly owned by a couple in order to secure an overdraft facility of £135,000.00. It was found that in obtaining his wife's signatures on the security, the husband had placed undue pressure on her and had misrepresented the effect of the charge. She believed that the loan was limited to £60,000.00 and would only be outstanding for three weeks.

The House of Lords held that the bank was put on inquiry as to the circumstances under which the wife had agreed to execute the collateral charge, and in the absence of warning the wife of the risks she was undertaking or recommending that she obtain independent legal advice, the Court ordered that the charge be aside except to the extent of the £60,000.00, the amount which the wife thought she was undertaking to pay if called upon.

It is of interest that the House of Lords rejected the "special equity" or special class designation which had been followed in the Court of Appeal's decision in **Barclays**, to the effect that wives and elderly persons dealing with their children should be afforded special protection by the Court. Rather, their Lordships found that the principles enunciated should extend generally in situations where there is a substantial risk of undue influence. These would include situations where the surety cohabits with the principal debtor in circumstances where there is likely to be an emotional relationship, or where the surety reposes trust and confidence in the principal debtor in relation to his or her financial affairs. The House of Lords held that the right of the surety to set aside the transaction against the creditor will be enforceable in circumstances where there is undue influence, misrepresentation or other legal wrong by the principal debtor and where the principal debtor can be construed

as acting as the creditor's agent or the creditor had actual constructive notice of the facts giving rise to the equitable defence. Constructive notice will be deemed to arise in circumstances where undue influence is a substantial risk.

Lord Browne-Wilkinson for the House of Lords summarized the state of the law as follows:

> Where one cohabitee has entered into an obligation to stand as surety for the debts of the other cohabitee and the creditor is aware that they are cohabitees: (1) the surety obligation will be valid and enforceable by the creditor unless the suretyship was procured by undue influence, misrepresentation or other legal wrong of the principal debtor; (2) if there has been undue influence, misrepresentation or other legal wrong by the principal debtor, unless the creditor has taken reasonable steps to satisfy himself that the surety entered into the obligation freely and had knowledge the true facts, the creditor will be unable to enforce the surety obligation because he will be fixed with constructive notice of the surety's right to set aside the transaction; (3) unless there are special exceptional circumstances, a creditor will have taken such reasonable steps to avoid being fixed with constructive notice *if the creditor warns the surety (at a meeting not attended by the principal debtor) of the amount of her potential liability and of the risks involved and advises the surety to take independent legal advice.* [Emphasis Added] (At 431 - 432)

It should be noted that the House of Lords found that even if the lending institution warns the surety of the potential liability and the risks involved, and advises the surety to obtain independent legal advice, those steps will not necessarily be sufficient to protect the creditor in "special exceptional circumstances". The Court found such "special exceptional circumstances" would exist where the lending institution has knowledge of further facts which renders the presence of undue influence not only possible but probable. In those cases, the Court found "the creditor to be safe will have to insist that the wife is separately advised" (At 430).

From this review it can therefore be seen that the **MacKay** decision is really an application of the type of reasoning expressed by the House of Lords in **Barclays**, to the extent that Mr. Justice Lederman found such special exceptional circumstances existed that the bank was obliged to "insist" that Thelma MacKay receive independent legal advice before processing the consolidated loan.

There have been several decisions by the English Court of Appeal following

Barclays. Two of those decisions have found that the banks were entitled to rely upon the fact that legal advice was provided to the surety notwithstanding that such advice was not independent. In both cases the solicitor for the principal debtor provided the legal advice to the surety.[6]

In contrast, the Court of Appeal in **TCB Bank plc v. Camfield**[7] held that the bank's merely writing to its own solicitors and requesting that a separate person within the firm provide the wives of the principal debtors with "independent" legal advice did not discharge the bank's duty, and its security was set aside. (Note that the Court in **TCB Bank** also rejected the result in **Barclays** that there could be a finding of partial indebtedness up to the amount that the sureties actually thought that they were securing, when the total amount of the indebtedness has been misrepresented.)

While **MacKay** has subsequently been distinguished in three decisions of the Ontario Court of Justice (General Division)[8], the principles in **MacKay** and **Barclays** were followed by the Honourable Mr. Justice Coo in **Del Grande v. Toronto Dominion Bank**[9] where the Court found that the bank was put on constructive notice that there was trouble with respect to the manner in which the wife of the principal debtor had come to sign the security documentation. This arose as a result of undue influence and misrepresentation. In circumstances where the husband was found to be acting as agent for the bank these findings were deemed by Justice Coo to warrant setting aside the guarantee signed by the wife. This finding was made notwithstanding that the wife was a shareholder and officer in the business, because the bank's employees understood that the wife's involvement was merely nominal and that she had no active involvement in the corporate activities.

In light of these decisions, banks and other lending institutions must necessarily be much more cautious to ensure that the parties who may be deemed vulnerable are sent for independent legal advice in any circumstances where it

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[6] See **Massey v. Midland Bank plc**, [1995] 1 All E.R. 929 (C.A.) and **Banco Exter Internacional v. Mann**, [1995] 1 All E.R. 936 (C.A.).

[7] [1995] 1 All E.R. 951 (C.A.)

[8] See **Merchants Consolidated Ltd. (Receiver of) v. Team Sports & Trophies (1984), In** [1995] O.J. No. 84 (Unreported) (Gen. Div.), **Royal Bank of Canada v. Domingues**, [1995] O.J. 34 (Unreported) (Gen. Div.) and **Household Trust Co. v. Markson**, (1995), 45 R.P.R. (2d) 61.

[9] [1995] O.J. No. 2005 (Unreported) (Gen. Div.)

appears that such advice may be required.

When Is Independent Legal Advice Required?

In the preceding discussion we have been looking at circumstances where one person is guaranteeing repayment of another's debt or is providing security to a bank or other financial institution to secure an indebtedness or the advance of funds for which they did not or will likely not personally benefit to any significant degree. There will, of course, be many other situations where independent legal advice is required such as where a client intends to make a substantial gift to a relative, friend or charity, and where it would be inappropriate for one solicitor to act for both sides.

Independent legal advice will be required when the solicitor is in a position of conflict of interest either because the solicitor has a personal interest in the transaction, directly or indirectly, or because he or she is proposing to act for sides that are adverse in interest. One should be cautious in acting in matters where the parties are in a conflict of the interest even where both sides are prepared to sign an acknowledgment of the conflict of interest and waive their right to seek and obtain independent legal advice. This is particularly so in circumstances such as these described in **Barclays** above, where the nature of the relationship between the parties could give rise to risk of undue influence. Past cases have demonstrated to us that it is not an easy matter to limit the scope of your retainer in the best of circumstances, and that it can only be effective when it is done in the clearest of language[10]. It is even more difficult to effectively limit one's retainer where one or both of the parties for whom one acts likely requires independent legal advice.

A solicitor should also be cautious that there is not a party to the transaction that he or she does not believe he or she is representing, but who may reasonably perceive that the solicitor is acting on their behalf[11]. In those circumstances a clear letter should be sent to that unrepresented party prior to the completion of the transaction, confirming that the solicitor is not representing their interests and advising them that they should seek independent legal advice. This should be sufficient to protect a lawyer in

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[10] See **120 Adelaide Leaseholds Inc. v. Thomson, Rogers** (1995), 43 R.P.R. (2d) 79 (Gen. Di and **ABN Ambro v. Gowling, Strathy, Henderson** (1994), 20 O.R. (3d) 779 (Gen. Div.)

[11] See **Tracy and Morin v. Atkins** (1979), 16 B.C.L.R. 223 (C.A.).

those circumstances[12].

Are You Independent?

One must also ensure that when you are retained to provide independent legal advice that you are in fact "independent". In the leading case in Ontario on unconscionability and lack of independent advice, **Bertolo v. Bank of Montreal**[13], the Court of Appeal held that where the partner of the solicitor for the bank and principal debtor purported to give independent legal advice to the surety, such advice was not independent and the transaction was found to be unconscionable and set aside. Mr. Justice Robins for the Court commented upon the independence required of a solicitor who purports to be providing independent legal advice in the following passage:

> It is fundamental that a lawyer is obliged to exercise his professional judgment solely for the benefit of his client, free from compromising interest and unfettered by commitments to others. He must not place himself in a position where he may be required to choose between conflicting interests or where one client's interests may tend to dilute his loyalty to another or where advice which tends to serve one client may tend to disserve another of where the interests of one client can become an improper influence upon his fidelity to the interests of another. The partner who purported to provide Mrs. Bertolo with independent legal advice in this case ought not to have been asked to do so and ought not to have undertaken the responsibility. ... [I]t must be added that their conduct of the matter is a sad commentary on their understanding of what is meant by independent legal advice. (At 582)

Consequences for the Solicitor

It follows that if the solicitor retained to provide independent legal advice does not provide proper legal advice, he or she is exposed to liability either to the surety who is found liable to the bank or lending institution or to the lending institution directly if the mortgage or other security is not upheld as a result of failure to provide adequate independent legal advice.

In **Premier Trust Co. v. Beaton**[14] Mr. Justice Anderson found that the solicitor failed in his duty of care in that not only was he not independent, as he was

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[12] See **Gerlock v. Safety Mart Foods** (1982), 42 B.C.L.R. 137 (C.A.).

[13] (1986), 57 O.R. (2d) 577 (C.A.)

[14] (1990), 14 R.P.R. (2d) 280 (Gen. Div.)

acting for a number of other parties to the transaction, but also he failed to explain the full nature of the transaction to Mrs. Beaton. Mrs. Beaton was a 63 year old widow who was totally hearing impaired and largely unable to speak. The solicitor's evidence that he explained to her the nature of each document and the attending financial details involved, which Mrs. Beaton signed in the presence of her son who was the principal debtor, was obviously found by the Court to be of very little use in circumstances where the plaintiff could not hear, had a limited ability to read lips and there was no sign language interpreter present.

Interestingly, the plaintiff had previously received independent legal advice with respect to a prior loan transaction where a sign language interpreter was used. Mr. Justice Anderson ultimately held that Mrs. Beaton was liable to the plaintiff, Premier Trust Co. He concluded that the transaction was not unconscionable in that there was no advantage of an inequality of bargaining position taken by Premier Trust and that the transaction was not substantially unfair. In addition, Mr. Justice Anderson concluded that, based upon Mrs. Beaton's own evidence, she had a reasonable idea of what a mortgage was all about when she signed the document in favour of Premier Trust.

However, Mr. Justice Anderson also found for Mrs. Beaton on her claim over against the solicitor, finding that the solicitor did not explain to Mrs. Beaton the full nature of the transaction, did not make facilities available where such an explanation could have been given, and did not recommend to her that she receive independent legal advice. The Court found that had the transaction been adequately explained to her she would not have proceeded with it.

Competent Independent Legal Advice

It is not easy to provide a precise definition of what is required to satisfy a solicitor's duty in giving independent legal advice. In **Inche Noriah v. Shaik Allie Bin Omar**[15], Lord Chancellor Hailsham stated with respect to the quality of independent legal advice:

> Nor are their Lordships prepared to lay down what advice must be received in order to satisfy the rule in cases where independent legal advice is relied upon, further than to say that it must be given with a knowledge of all relevant circumstances and must be

[15] [1929] A.C. 127 (P.C.)

such as a competent and honest advisor would give if acting solely in the interests of the donor.

The following is an outline of some of the steps that could be taken when providing independent legal advice:

1. At the time of the initial retainer prior to providing independent legal advice, be certain that you discuss the proposed transaction with the solicitor or officer from the lending institution who is referring the client to you for independent legal advice to ensure you understand the transaction and that you will be receiving and reviewing all documents which are relevant to the transaction. If you do not have all relevant material information regarding the transaction and all pertinent documentation, then it will be difficult for you to ensure that you are in a position to provide full and competent independent legal advice.[16]

2. When you meet with a client to be independently advised, you must ensure that you meet with that person alone and not in the presence of any other party to the transaction who might unduly influence the person being advised.

3. When you meet with an individual to provide independent legal advice, you must satisfy yourself that he or she knows what you are saying and that barriers of age, language or physical limitations (e.g. hearing impairment such as in **Beaton**) are not rendering your advice useless. If there is any doubt as to the ability of the client to understand what you are saying because of language or other limitations, then you should ensure that an interpreter or intermediary whom you have independently retained, and can therefore trust, is present. One should therefore avoid having a family member or other interested party interpret for you.

4. Carefully explain the nature and effect of each of the documents which the client is being asked to sign and all the potential risks and consequences which flow from the execution of those documents; for example, on the execution of a guarantee you will want to explain that the failure to honour the obligations could mean the loss of that person's house, business and all other property. If the wording of the instrument so specifies, you should explain that the creditor is not required to exhaust its remedies against the primary

[16] See for example **Wright v. Carter**, [1903] 1 Ch. 27 (C.A.) where the Court found that in absence of full knowledge of the client's financial position, the lawyers were not in a posit to give proper legal advice regarding the granting of two reversionary gifts.

debtor before looking to the guarantor and that any indemnity obtained from the primary debtor may be worthless if the primary debtor declares bankruptcy.

5. You should canvass the state of a client's relationship with the primary debtor, or beneficiary in gift situations, to satisfy yourself as much as it is possible that the client is not subject to duress or undue influence from the primary debtor and that the client is signing the documents freely and voluntarily and without pressure from anyone. In completing this task, you should inquire as to whether or not there is any domestic violence and ask the client to provide you with a cogent reason why they are proceeding with the transaction.

6. It is always useful to remind the client that you are not providing business advice warranting the viability of any underlying security that may be involved or the credit worthiness of co-guarantors etc.

7. Make sure that you take detailed notes of your meeting and that these notes are kept in a file that you have opened for this client.

8. Have the client sign an acknowledgement of independent legal advice being provided and include a clause that they are proceeding with the transaction against your advice if that is the case.

9. Docket your time and bill this client directly. Accept payment from that client only and not from any other interested party to the transaction.

10. You should send a detailed reporting letter outlining the terms of the agreement or obligation assumed, the advice that you provided with respect to that transaction and the client's decision in the face of that advice together with your account. A reporting letter and account should be sent directly to the client and not care of any other interested party.

To some extent, these comments are the counsel of perfection and may not be applicable to every transaction you encounter. Furthermore, while following these steps will not necessarily prevent allegations from being raised against you that you have failed to complete your task in accordance with the standards of a reasonably competent solicitor it will certainly be of tremendous benefit in defending any action against you with respect to the advice provided. Needless to say, your recollection of the advice that you provided to any client will be diminished with the passage of time. Although Courts have been

prepared to accept evidence of a solicitor's standard practise in providing independent legal advice over the evidence of other less than credible former clients, it will undoubtedly be to your great relief if faced with a claim when you are able to retrieve a specific file from storage with respect to ILA given to a client which will contain detailed notes of the advice provided and a detailed reporting letter.

While the steps required to provide competent independent legal advice will require more time on your part and, consequently, a higher charge to the client they are steps which should be taken to protect yourself. If the client is not prepared to pay for you to take the time required to provide competent independent legal advice then you should not accept the retainer.

- Robert J. Potts