Risk Management

Royal Bank of Scotland plc v Etridge (N o.2) [2001] UKHL 44

Guidance notes and skeleton letter arising out of the House of Lords judgment

Many professional negligence claims have arisen as a result of solicitors regarding their role in advising in Etridge type situations as nothing more than a formality. It is not. The requirements on solicitors are onerous! As a result some firms have stopped advising in this field. Other firms, recognising the significant risks involved and that special expertise in this field is a prerequisite have specifically restricted who in the firm may undertake such work. What controls do you have in place to ensure that those giving advice in your firm are qualified to do so?

These guidance notes and the skeleton letter have been prepared for risk management purposes. They do not set out the law in detail and you must not assume that they set out all the matters you need to consider in any particular case.

The points covered in the skeleton letter attached were expressly stated by the House of Lords to be the core minimum requirements for advice. Further, the points below are intended only as examples of the sorts of issues which you should be aware of - they are not intended to be an exhaustive list.

The judgment of the House of Lords in Etridge has re-defined the requirements on solicitors and lenders where one individual guarantees the debts of another in the context of a non-commercial relationship. A common situation, which arose in the Etridge appeals, involves a wife giving security over her share of the matrimonial home to secure her husband’s business debts. For simplicity, all references in these notes and the attached skeleton letter assume a factual scenario involving a husband and wife.

The risk for the lender in these situations is that if the lender comes to enforce the charge and seek possession of the property, the wife argues that she entered into the charge under the undue influence of her husband or as a result of some misrepresentation by him. If that is proven, the charge is, in general, not enforceable.

The risk for the solicitor is that the wife will allege that the solicitor who was advising her gave inadequate advice as to the nature of the transaction and the risks she was running. A further risk arises as a result of the bank’s reliance on the certificate provided by the solicitor.

In every case you must consider whether or not you possess the expertise necessary to enable you to give the advice required under Etridge. For example, are you confident that you can recognise the issues and properly advise the wife so that she fully understands the risks that she is taking? Do you have the expertise to request, interpret or advise on detailed financial information? Are you confident that you will know if more information is required? Do you have sufficient expertise to negotiate with the lender if you are instructed to do so? Will you be...
Who is your client?

The wife is your client. In acting for her, your job is to protect and advance only her interests and not her husband's or the bank's.

Scope of responsibilities

You will need to explain to the wife why you have become involved in the transaction - namely, the bank's concern to receive confirmation that you have brought home to the wife the risks involved in the proposed transaction.

You should explain that the bank will rely on your involvement to counter any suggestion that the wife was overborne by her husband or that she did not properly understand the implications of the transaction.

You will need to obtain confirmation from the wife that she wishes you to act for her in the matter and to advise her on the legal and practical implications of the proposed transaction. You should make it clear that she can choose a different solicitor if she prefers.

You should treat your retainer to advise the wife as a separate client matter. It is one. Open a separate file. As always, send out a letter of engagement and record any specific instructions in writing.

Can you also act for the husband and/or the bank? Are there any conflicts of interest?

The House of Lords has not forbidden this as a general rule, but in every case where you are asked to act for the husband or the bank in addition to the wife, you have to consider whether there is a conflict of interest. If there is a risk that your duties to the husband or bank might inhibit or compromise your advice to the wife, you must cease to act for the wife and, possibly, also for the other party. You need to be vigilant - conflicts of interest can easily arise. For example:

a) a wife instructs you to negotiate better terms with the lender, whilst the husband instructs you not to do so since this might cause the deal to collapse;

b) you discover that the husband misrepresented the position to the wife;

c) you request certain information from the bank, but the husband refuses to authorise its release;

d) you have to advise the wife that she is taking a very serious risk given the level of indebtedness and the historical record of the business, but by discouraging the wife you are acting contrary to the husband's interests where the husband is extremely keen to obtain further funding.

For guidance on conflicts of interest refer to Chapter 15 of the Guide to the Professional Conduct of Solicitors, 1999 (Eighth Edition). If you are in any doubt, contact the Professional Ethics Division at the Law Society on telephone 020 7242 1222.

Financial information from the bank

You must obtain from the bank financial information sufficient for you to advise the wife. What is provided by the bank will depend upon the facts of each case but will ordinarily include:

able to recognise when specialist advice, eg from accountants, is required? If you answer “no” to any of these questions, you should not be practising in this field.
i) information on the purpose of the new loan;

ii) the current amount of the husband’s indebtedness;

iii) the amount of the current overdraft facility; and

iv) the amount and terms of the new loan and a copy of the written loan application.

The bank will have to obtain the consent of its customer (ie the husband) before disclosing this confidential information. If you do not receive this information, ask for it. If you receive it but it is incomplete, ask for the missing parts. If you receive it, but it becomes clear that there is further information, for example, about the borrower’s ability to repay the loan, which you require to be able to advise properly, ask for that information. In some cases, you may need to refer the matter to another professional, eg an accountant, for specialist advice.

You should not confirm to the bank that you have advised the wife until you are satisfied that you have all necessary financial information, have advised fully and have obtained the consent of the wife to give that confirmation.

Face to face meeting

The House of Lords has made it very clear you must meet "face to face" with the wife to give the advice required.

Your meeting should be with the wife only. The husband must not be present. Even if she requests that he attend the meeting your duty is to advise her that he should be excluded.

Advice

Part 3 of the skeleton letter sets out the core minimum requirements for advice as laid down by the House of Lords. It will not necessarily be an answer to a negligence claim that you have complied with the core minimum. The requirements in any one case will depend upon the specific facts of that case and need to be carefully assessed by you. Your advice is not a mere formality. The wife needs to understand the risks she is taking including the loss of her home if the loan repayments are not kept up. You must advise in non-technical language. And be aware of your particular client’s level of understanding – is it affected by infirmity, language difficulties, or lack of education? If for any reason you consider that the wife has not fully understood the risks then no confirmation should be given to the bank.

Undue influence?

If you are on notice of undue influence or possible undue influence, it is not enough simply to advise the wife of the risks of the transaction. Such an approach is likely to be negligent. For example, if she were to break down at your meeting and tell you that she is being bullied, it would not be a good defence to say that you complied with the Etridge duty to explain the risks.

You must cease to act if you know or suspect that your client is giving instructions under duress or undue influence - ie that she is not acting of her own free will but under the domination or influence of another. If you ought reasonably to have identified this (but have not done so), a court may well hold that you have breached your duty if you continue to act. See principle 12.04 of the Guide to the Professional Conduct of Solicitors, 1999 (Eighth Edition). If you require guidance, contact the Professional Ethics Division at the Law Society on telephone 020 7242 1222.
Limited retainer

In some cases, a wife may say that she does not want to go into the matter in detail. She may even refuse to enter into a discussion of the core minimum requirements for advice. This is clearly a difficult situation and will require careful handling.

You should first try to explain the reasons why she should be concerned and why she needs to discuss the matter with you in greater detail and to listen to your advice. If you cannot persuade her, you cannot provide the confirmation requested by the bank that you have advised the wife and brought home to her the risks of the transaction. You will have to tell the bank of this and they will have to consider whether they still wish to proceed with the loan.

Confirmation in writing

Your advice should be recorded in a full attendance note and confirmed in detail in a letter to the wife sent promptly after the meeting. The letter should be along the lines of the attached skeleton letter, tailored and expanded to reflect the advice you actually gave her at the face to face meeting on the specific facts of the case.

Written confirmation of the advice is important even if you have a written attendance note; it is difficult for a client (who has become a claimant in a negligence action) to allege that advice was not given if they have received a letter confirming it. Your letter of advice should include a separate clause for signing by the wife as suggested in the skeleton letter. **Confirmation to the lender should not be given until the wife has signed and returned a copy of the letter.**

Your fees

Your client is the wife; the person paying your fees may be another party such as the husband or his business.

You need to ask yourself whether you have obtained proper agreement to secure payment of your fees. Consider asking for money on account.

To comply with the House of Lords guidance your investigations and advice are likely to take at least several chargeable hours and they could well take longer. You need to consider what will happen in relation to payment of your fees if the transaction does not proceed. In particular, what happens if you advise a wife that there are grave risks and she then decides not to proceed?

Summary

When first receiving instructions to advise in an Etridge type case ask yourself:

i) What am I being asked to do?

ii) Does the case fall within Etridge?

iii) If so, do I have the necessary expertise? Am I aware of the core minimum requirements for advice and of the need to obtain further information where appropriate and to expand the advice to suit the particular facts of this case?

iii) Is there a conflict of interest?

iv) Am I on notice of any undue influence?

v) Do I have an effective process for recording my instructions and the advice given in writing?

If the transaction leads to the wife losing her home, will I be satisfied that I ensured she understood the risks? Will I be able to prove it?
Skeleton letter to be used in conjunction with guidance notes

Dear [    ]

I write to confirm the advice which I gave you at our meeting at [my offices] on [     ]. If there are any points you do not understand, or if you do not think this letter is an accurate record of our discussions and of my advice, please let me know.

1. PURPOSE OF MY INVOLVEMENT AND MY ADVICE

As you know, [the bank] have agreed to lend [your husband/you and your husband] [£      ] to be used in connection with your [husband’s] business. In return, they will take a separate mortgage over your home to secure the loan, interest and costs. If payments on the loan are not kept up when due, the bank may, under the mortgage, obtain a Court order entitling them to evict you and to sell your home to recover the loan. You could therefore lose your home. Accordingly, the transaction and the mortgage have very serious implications for you.

I have been asked by [the bank] to advise you on your proposed involvement in the above transaction.

The bank wishes me to provide this advice. If it should ever become necessary, the bank will rely upon my involvement to counter any suggestion that you were acting under the influence of your husband or that you did not properly understand the implications of the transaction.

Although the bank therefore has an interest in my having advised you, in giving that advice I nevertheless act for you and not for the bank.

The main purpose of my advice was and is to ensure that you understand the risks involved, from your point of view, in becoming involved in this transaction.

2. YOUR INSTRUCTIONS

You have confirmed to me at our meeting that you wish me to act for you in this matter and that you wish me to advise you on the legal and practical implications of the transaction and the mortgage you have been asked to sign.

3. SPECIFIC ADVICE

[What follows are the core minimum requirements for advice to be given in every case. The specific advice given at the face to face meeting should always be tailored and expanded to reflect the circumstances of the particular case.]

3.1 Nature of documentation/practical consequences of signing the mortgage

[Set out the advice given at the face to face meeting on the nature of the documentation and the practical consequences for the wife of signing the mortgage and becoming involved in the transaction. This should include advice that the wife risks losing her home and could become bankrupt if there is default in payment of the loan.]

3.2 Risks for you
I discussed with you in detail the risks from your point of view of becoming involved in this transaction. [Set out in writing the advice given:

i. Purpose of the new facility.

ii. The amount and principal terms of the new facility.

iii. The fact, if the case, that the bank could increase the amount of the facility, or change its terms, or grant a new facility without reference to the wife.

iv. The amount of the wife's liability under the mortgage.

v. The extent of the wife's financial means and her understanding of the value of the property mortgaged.

vi. The other assets available to the wife or her husband, out of which repayment of the loan could be made if the husband's business fails.

vii. Any other matters relevant to the risks being taken by the wife.

The advice should include advice as to the seriousness of the risks for the wife.]

3.3 You have a choice

We discussed the fact that you have a choice whether or not to sign the mortgage and then to enter this transaction. You do not have to do so. The decision is for you to make.

[In so far as relevant to this choice, set out your understanding as to the current financial position of the husband and wife, including the amount of the husband's present indebtedness and the amount of the current overdraft facility. Set out any other factors which would be relevant to the choice.]

3.4 Your instructions to proceed

In the light of my advice and our discussion you confirmed that you do wish to proceed. You confirmed that you wish me to write to the bank confirming that I have explained to you the nature of the documents and the practical implications the documents may have for you. You also confirmed to me that you understood the purpose of my doing so, as explained above under the heading "Purpose of my involvement and my advice".

I advised you that you could instead instruct me to negotiate with the bank on the terms of the transaction in order to seek an improvement in the terms from your and/or your husband's point of view. We discussed the sort of improvements which could be sought. [For example, there might be negotiation as to the order in which the mortgages over the property would be called upon or as to the limit on the wife's liabilities. Any other points arising from the documentation which might be subject to negotiation should also be raised.]

However, you instructed me that you did not wish me to negotiate, but instead to provide the confirmation to the bank that you have been advised.

I have sent two copies of this letter to you, one of which is marked for you to sign and return to me. Once I have the signed letter confirming your instructions I will provide the confirmation to the bank.

If you do not understand any of the above or you have any queries on this letter, please call me.
or arrange an appointment to see me to discuss those points in more detail.

4. **NEXT STEPS**

Unless you raise any further queries with me, in the light of your instructions set out above, I am assuming that you will sign the mortgage when it is presented to you for signature and I will have no further involvement in the matter [unless you are also instructed by one of the other parties or have some other continuing involvement in the matter].

[If you have been instructed to negotiate with the bank, rather than to confirm immediately to the bank that the wife has received the advice in question, then the letter should be suitably amended. You should only give the confirmation once you have the wife's authority to do so.]

I look forward to receiving your signed version of this letter and thank you for your instructions.

Yours sincerely

………………………………….

I have read and understood this letter. It accurately records the advice which was given at our meeting. I now instruct you to tell the [bank] that I have been advised by you and have had brought home to me the risks for me in becoming involved in this transaction.

………………………………….

Mrs [ ]

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