Explanation of Loan Security Documents

Independent Solicitors' Certificates

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At the recent meeting of Australian Law Societies, I undertook to provide each Society with a summary of the position reached by the Law Society of New South Wales concerning this matter.

The topic was originally considered by a Specialist Committee of the Law Society in January, 1992. After many meetings the Specialist Committee recommended the adoption of practice guidelines to be observed by solicitors in NSW. The settled guidelines were adopted by the Council of the Law Society in July, 1992 and published to the profession in Caveat No. 111 dated 7 August, 1992.

Shortly after publication of the guidelines, institutional financiers expressed some concerns, asserting that the absence of prior consultation had led to the premature adoption of unsatisfactory advice to the profession. A Task Force was appointed to review the guidelines and recommend any amendments it considered appropriate. The Task Force included both solicitors who regularly act for institutional lenders and solicitors who routinely act for borrowers and guarantors. The Task Force met on several occasions in 1993, when it held joint meetings with representatives of the Australian Bankers' Association and the Australian Finance Conference Limited. The Task Force has continued its deliberations in 1994 and is due to meet again in the near future. The following statements record the position presently reached in the course of the Task Force's deliberations.

1. Lenders and solicitors share a common interest in the enforce-ability of loan securities. Lenders are interested in recovering their loans; solicitors have less chance of being sued for negligence when securities are enforceable.
2. Law Cover confirms that solicitors are frequently joined as parties when loan securities are challenged in litigation.
3. Lenders tend to seek recovery on the security documents and, if they fail, seek damages from the solicitors alleged to have caused the loss.
4. Numerous cases have turned upon the parties' understanding of security documents. Until BFC v Karavas, cases tended to focus on the legal implications of a transaction. Since Karavas, the focus seems to have widened and now includes financial implications as well.
5. Proof of a borrower's or guarantor's understanding of loan securities has become increasingly dependent upon expert advice provided by someone independent of the lender and certified by the provider.
6. Some lenders now insist upon mortgagors and guarantors being separately advised by different solicitors independent of the lender. Where a borrower or guarantor is a husband and wife company, both the husband and wife are sometimes required to be independently advised by a solicitor other than the solicitor who advised the company.
7. Multiple certificates, although costly and time consuming, are unlikely to result in courts finding loan securities to be enforceable where the terms of the documents are unjust, inequitable, harsh, unconscionable, deceptive or misleading.

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8. Loan security documents typically employed by several institutional lenders have been challenged successfully on several occasions. Frequently, the terms of a lender's letter of offer bear little relevance to the terms of the lender's security documents which, for the most part, are harsh and oppressive.
9. Institutional lenders' representatives have expressed the view that the problems experienced with loan recoveries could be overcome if solicitors were to amplify the explanation of the documents and expand the scope of the solicitors' certification. That view cannot be supported because it is misdirected towards the symptom rather than the disease. While institutional lenders continue to use "all-moneys" mortgages that can be called up without notice by the lender at any time regardless of whether the borrower has committed any default, and otherwise containing provisions identified by the Task Force as matters that would support legal challenge to the documents, it is quite likely that the courts will continue to find the security documents unenforceable.
10. Any insistence upon solicitors giving amplified advice and certification would only be likely to produce one or more of the following results:
    * solicitors would simply refuse to give independent advice or provide a certificate. (It is reported that security officers of institutional lenders send borrowers or guarantors to solicitors' offices saying: "Take this to Mr X, the solicitor across the road. He will witness your signature on the documents.");
    * the letter of offer (or "loan contract" or "letter of arrangement" by whatever name it is called), the mortgage or guarantee and the 30 - plus page memorandum registered in the Titles Office and usually incorporated by reference into the loan security are so long and complex that a full explanation of their terms would occupy a solicitor for up to four or five hours and be likely to cost $1000. (Lenders presently have an expectation that solicitors will provide independent certificates for $50 to $100) and;
    * some solicitors would give inadequate time and attention to the explanation of security documents and then falsely certify that an adequate explanation had been given to a signatory (see Demetrios v Gikas Dry Cleaners Pty Ltd and Mecak v Farrow Mortgage Services4). The finding that a solicitor's false certification was dishonest invoked the exclusion clause in the Law Cover policy, depriving the solicitor of indemnity — and, likewise, extinguishing the lender's prospects of recovery from that source. The commercial consequences of these anticipated results require no further examination or comment.
11. The Task Force is presently working on the third redraft of a form of solicitors' certificate with a view to submitting the settled draft in the first instance to Law Cover for comment and then to Council for adoption. The Task Force believes that the certificate in its settled form — in fact there may be two certificates, one for borrowers and a different form for guarantors — should be submitted to the ABA and FCA with an invitation for further discussion of these issues.
12. The Task Force also observed that the future direction of this project is likely to be affected by the Banking Code of Practice currently under consideration by the ABA and by the Uniform Credit legislation, whose introduction in the Queensland Parliament is now being awaited.

    There is no question that a uniform practice concerning the provision of independent solicitors' certificates of explanation of loan documents is desirable in all States and Territories.

The citations for these cases are: Demetrios (1991) 22 NSW LR 561. Mecak - NSW Supreme Court in Equity no.2173/90 - unreported judgment of Hulme J, 24 February 1994.