

Solicitors' responsibility when advising about directors' guarantees

By TONY CAVANAGH

Ask for security for any 'ephemeral' guarantee, such as directors' guarantees, or risk a claim for breach of duty.



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On 13 December 2013 the NSW Court of Appeal handed down its decision in *Takla v Nasr* [2013] NSWCA 435, which looked closely at the obligations of solicitors who advise on directors' guarantees. To an extent, the decision turns on its facts, but it does provide some guidance on how prudent practitioners may need to adjust their practice to avoid the risk of a claim arising.

Facts

The appellant, Takla, was renting an apartment in a partially completed unit development in Sydney in 2005. The developers offered to sell her the unit, on unusual terms, viz, that the deposit was 80 per cent of the \$500,000 price and that it be released to the developer on exchange. In addition, she was offered 12 months' rent free (after which settlement would occur) and the refund, on settlement, of rent paid previously. Takla made a number of enquiries. As a result, she believed the price offered to her was significantly less than market value. She also knew the financial stability of the developer – a company, MTK Pty Limited – was questionable as it had at least some cash flow difficulties. She was offered personal guarantees by each of the three MTK directors to address this concern.

She later consulted the respondent solicitor, whose employee conducting the matter gave express oral advice that the transaction was unusual; that it was not in Takla's best interests to agree to the substantial deposit being released to the vendor, and that she may not recover her deposit if there were difficulties with the transaction including,

relevantly, if the vendor became insolvent. The employee later asked for personal guarantees from the directors but it was not in dispute that the directors' guarantees were never, in fact, obtained.

MTK was placed into receivership in March 2006, after exchange but prior to the scheduled settlement date. The receivers refused to complete. A prior secured creditor ultimately sold the apartment Takla had contracted to purchase, under a power of sale. Takla lost her \$400,000 deposit. She sued the solicitor for it, and for interest, on the basis that, had she been properly advised she would not have exchanged contracts.

The primary judge found there was no breach of duty on the part of the solicitor and that, even had there been, Takla had not established that any breach caused her loss. Takla appealed.

Content of duty

Takla argued, both at trial and on appeal, that it was a duty of the solicitor to "safeguard her interests" in relation to the purchase including, relevantly, obtaining 'effective' (in the sense of providing financial protection) personal guarantees from the vendors' directors. She argued the obligation of the solicitor in respect of directors' guarantees included investigating the directors' financial position to ensure the efficacy of any such guarantee.¹

McCull JA, who delivered the principal judgment, rejected that formulation of the solicitor's duty. It was not a duty to "safeguard interests" but a duty to act carefully and competently or a duty to act in accordance with the standards of skill and competency that might reason-

ably be expected of a qualified practising solicitor.²

Her Honour accepted that on facts such as those before the court, it was part of the duty of a careful and competent solicitor, acting in accordance with the standards of skill and competency that might reasonably be expected of a qualified practising solicitor, to procure enforceable guarantees from the directors of the vendor company. She did not accept the proposition that it was part of a solicitor's duty to investigate the financial position of the directors to ensure any such guarantees were efficacious.³

Her Honour considered the primary judge had misdirected himself on the question of breach of duty in relation to directors' guarantees and that there had been a breach because of the failure to obtain directors' guarantees. However, despite this, McCull JA considered the primary judge to have been correct in his view there was no 'factual causation' within the meaning of s.5D(1) (a) of the *Civil Liability Act*.⁴

Advising on guarantees

Basten JA in his additional reasons made an obiter comment to the effect that: "the relevant advice in the present case might have been that the client should take the usual steps adopted by financiers, that is to require directors' guarantees supported by security. A request for security from a director of a company involved in land development may reveal an absence of capacity, because secured guarantees of the company's debts would already have been provided to the company's financier. Accordingly, in one sense, the proper advice and consequent instructions would be calculated to reveal

the financial status of the prospective guarantors."⁵

Although His Honour ultimately agreed with the other appeal judges that, on the facts of this case, the appeal must fail, his comments possibly indicate that it may be part of a practitioner's duty either to procure a guarantee supported by security or to advise the client to request a guarantee supported by security.

Conclusion

Whether his Honour intended to go that far or not, it would be prudent for practitioners retained in matters involving directors' guarantees to give careful consideration to asking for security for any guarantee, or to clearly advise their client of the risk of accepting an 'ephemeral'⁶ guarantee, not supported by security of some kind.

It is clearly foreseeable that, if no security is asked for or given, and if the client is not clearly informed of the risk that the (unsecured) guarantee may be practically valueless at some future point in time, the advising solicitor may be faced with a claim for breach of retainer or of duty. □

ENDNOTES

1. *Takla v Nasr* [2013] NSWCA 435 at [78].
2. *Ibid*, at [60].
3. *Ibid*, at [79].
4. Interested readers can find this part of the rationale at [95] of the judgment and in the primary decision, *Takla v Nasr* [2011] NSWDC 169, at [71].
5. *Ibid*, at [90].
6. That is, even if the guarantor was solvent at the time the guarantee was given, there could never be absolute certainty that they would remain solvent for an extended period of time. Consequently, when called upon, a guarantee may turn out to be valueless, regardless of the position at the time it was given. □