Taking security for legal costs: lessons from *Malouf v Constantinou*

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Snapshot

- Solicitors are permitted by statute to take security for their costs from clients.
- However, such arrangements are susceptible to being set aside if the solicitor does not abide by applicable equitable, legal and statutory duties.
- The taking of security for costs should be approached carefully, if at all, with due attention to the special position in which a solicitor stands in relation to his or her client.

There was a time when solicitors were not permitted to take a mortgage from their clients for costs. That position was abrogated for non-contentious business in the UK in 1870 by the *Attorneys' and Solicitors' Act 1870* (UK) (33 & 34 Vict c 28) and in New South Wales by the *Conveyancing Act 1919*. It was not until 1984 that an amendment to the *Legal Practitioners Act 1998* permitted a solicitor to take security for future costs in both contentious and non-contentious matters. A right to take security has existed since that time in successive legislative provisions and is now contained in s 206 of the *Legal Profession Uniform Law* (NSW). A history of the right to take security is the subject of detailed consideration in *Malouf v Constantinou* [2017] NSWSC 923 ('***Constantinou***') at [133]–[172], from which much of the content of this article is drawn.

Identifying the scope of the fiduciary duty

A relationship between solicitor and client stands in a well-recognised category of fiduciary relationships. Nevertheless, each matter 'calls for the ascertainment of the particular obligations owed to the [client] and consideration of what acts and omissions amounted to failure to discharge those obligations' (*Maguire v Makaronis* [1997] HCA 23; (1997) 188 CLR 449 at 466). What is important in this context is to identify the scope of the fiduciary duty because 'questions of conflict can only arise in relation to some other transaction or activity of the solicitor if there is a sufficient relationship between that transaction or activity on the one hand and the tasks undertaken by the solicitor for the client under the retainer (that is, as fiduciary) on the other' (*Constantinou* at [95]). It is not in every case that a solicitor taking security for fees will be in breach of his fiduciary duty (*Constantinou* at [95]).

Informed consent

Where a fiduciary duty does arise, there will be no breach if a solicitor acts having obtained informed consent to the transaction or activity which would otherwise constitute a breach. White J explained in *Country Law Services v Duff* [2007] NSWSC 1509 ('***Duff***') that, '[t]he breach is not in failing to obtain informed consent, but in acting, when placed in such a position of conflict, where the client does not give informed consent' (at [33]). What amounts to informed consent depends, in part, on the client's level of understanding of the security transaction (see, e.g., *Troncone v Aliperti* (1994) 6 BPR 13,291). Sophisticated business people who deal with security clauses in the course of their businesses are likely to have a better understanding of such a transaction than people with no knowledge or experience of such clauses, or persons with little formal education and for whom English is not their first language. Proof of informed consent is a 'heavy burden' borne by the solicitor, who will have to establish that, 'the clients would have had to have known all the material facts, and their rights, and have given consent to the solicitor acting with a divided loyalty' (*Duff* at [35]).

Other equitable doctrines which may lead to security clauses being unenforceable

Undue influence

It is often said that there is a presumed relationship of undue influence between a solicitor and his client (see, e.g., *M J Leonard Pty Ltd v Bristrol Custodians Limited (in liquidation) & Anor* [2013] NSWSC 1734 ('***M J Leonard***') at [51]; *Brusewitz v Brown* [1923] NZLR 1106 at 1110). That presumption may be less strong in circumstances where a solicitor has stipulated a requirement for security as a condition of taking on a client (*Constantinou* at [123]), such as prior to the retainer beginning. If the presumption does arise, it can be rebutted by the solicitor if he can show that the client's grant of security was an 'independent and voluntary decision based on proper consideration of his own interests' (at [127]).

Unconscionability

Contractual arrangements which grant security may be set aside on the basis of the equitable doctrine of unconscionability or the '*statutory version*' of the doctrine under the *Contracts Review Act 1980*. Unconscionability - which 'looks to the conduct of the stronger party in attempting to enforce, or retain the benefit of, a dealing with a person under a special disability' (*Commercial Bank of Australia Ltd v Amadio* [1983] HCA 14; (1983) 151 CLR 447 at 474) – applies at the point of enforcement, not at the point of contractual formation (*Constantinou* at [129]-[130]), providing a further basis of objection to security provisions in some circumstances.

What is 'reasonable' security?

A solicitor is entitled to take *'reasonable'* security for his or her fees. The question as to what is reasonable will depend upon the context of the retainer and include such matters as the quantum of fees likely to be incurred and the value, type and range of the security sought to be taken. In two decisions of the Supreme Court of NSW judges have said in *obiter dicta* that an 'all assets' security is unlikely to be reasonable (*M J Leonard* at [61]; *Constantinou* at [178]).

Should security be included in a costs agreement or in a separate document?

In *M J Leonard,* Windeyer J said: 'Security, if taken, should be by separate document making the position quite clear' (at [61]). His Honour opined that the purpose of a costs agreement was to set out the work to be done and the basis of charging and that if more was required a separate document was 'desirable' (at [61]). In *Constantinou* Parker J agreed, 'so that the client has a clear opportunity to understand the separate nature of the security obligations' (at [177]).

The caveat cases

The practical context in which security disputes often arise is one in which a solicitor has lodged a caveat against a client's property, relying on a security clause in a costs agreement (or other document) as having created an equitable interest. Where a client issues a Lapsing Notice the solicitor who wishes to extend the operation of a caveat must then commence proceedings by Summons, claiming both interim relief (to extend the caveat until further order) and final relief. Most of the decided cases relate to the application for interim relief. The question for determination by a judge hearing that type of application is whether 'the caveator's claim to an interest in property raises a seriously arguable case for final relief to justify maintenance of the caveat and that the balance of convenience favours extending the caveat' (*L J Carroll v L T Carroll* [2016] NSWSC 390 at [16]). Accordingly, theses cases do not finally determine the rights of the parties and must be understood in that light.

Nevertheless, some of the cases illuminate particular issues which arise when a client grants security to a solicitor. In *Duff* the Court refused to grant an order extending the caveat lodged by the solicitor because the absence of informed consent to the granting of security struck fundamentally at the security. In *Burrell Solicitors Pty Ltd v Reavill Farm Pty Limited & Ors (No. 2)* [2011] NSWSC 1615 the mortgage granted to the solicitor secured moneys which were 'the balance due under the said tax invoices'. White J held that as the solicitor had failed to make disclosure which was compliant with the *Legal Profession Act 2004*, the consequence was that there was no sum payable to the solicitor other than pursuant to a certificate of determination of costs as assessed. Accordingly, the obligation to pay did not arise 'under the said tax invoices' (at [72]–[76]), and the solicitor was not granted leave to lodge a fresh caveat. In respect of other agreements for security, differently worded, leave was granted to lodge fresh caveats. *Constantinou* was itself a case where a solicitor had lodged caveats relying on security agreements and a security clause in a costs agreement. By the time of the final hearing, which occurred a relatively short time after urgent relief was granted extending the caveats, the parties had agreed to settle the Summons on terms which included declarations as to the validity of the caveats. Parker J informed the parties 'that the Court would not make declarations just because they were consented to by all of the parties' (at [22]) and that the solicitor would need to persuade the Court 'that there was a proper legal and factual basis for the declarations sought, quite apart from any other discretionary factors which might intrude' (at [22]). Finding that the security provisions of the relevant agreements were unenforceable, the Court refused to make the orders.

How should a solicitor approach the taking of security?

A solicitor should carefully consider whether to take security. Other available measures, such as the assertion of an equitable line, may suffice. But if a decision is taken to require security for costs, the following matters are suggested as being prudent:

- The agreement as to security should be entered into before the retainer is entered into, or at least before work is done under the retainer;
- Information about the property against which security will be granted should be obtained for the express purpose of entering into the security transaction and not obtained as (confidential) information in the course of performing the retainer;
- The solicitor should give a clear oral explanation to the client of the nature, content and consequences of the security and meaningful advice about all circumstances which could give the solicitor a right to enforce the security;
- The solicitor should advise the client that independent legal advice would be prudent, and explain why, and allow the client a reasonable time to obtain it;
- The solicitor should expressly obtain the client's consent to him acting in circumstances where his duty and interest conflict;
- The solicitor should put the security agreement in a document which is separate to the costs agreement; and
- The solicitor should consider the reasonableness of the security sought, keeping in mind that an 'all assets' security clause is likely to be considered unreasonable.

What appears above may be a counsel of perfection, but it is an approach which would provide a substantive and meaningful response to the common bases upon which security arrangements are sought to be impugned. **LSJ**