CURRENT DEVELOPMENTS: CURRENT ISSUES ON THE LAW OF GUARANTEES

PAUL BEAR

Baker McEwin
Solicitors, Adelaide

Effect of Surety's Special Disability

It may be trite to say that a contract of guarantee can be held void as against a surety for a variety of reasons, however, of particular interest to banks and financiers, prompted by the decision of the High Court in The Commercial Bank of Australia v. Amadio [1] are the circumstances in which a creditor may lose the benefit of a guarantee because of a special disability on the part of the guarantor. The majority of the Court in that case found that the mortgagors were under a special disability when they executed the deed containing the guarantee. The disability was sufficiently evident to the bank and as such made it unfair or unconscionable for it to be allowed to rely on the guarantee.

Amadio's case [2] illustrates the necessary requirements for the surety to demonstrate the special disability. The guarantors were under a special disability because of their limited grasp of English, the circumstances in which the bank presented the document to them for their signature, and most significantly, their lack of knowledge and understanding of the contents of the document. Furthermore, this special disability was sufficiently evident to the bank to enable the Court to infer that the bank had unconscionably taken advantage of the guarantors in procuring their signatures to the guarantee. The guarantors were in a position where they lacked assistance and advice when this was plainly necessary.

The circumstances of each case must show that the surety is under a special disability or disadvantaged in respect of the creditor and that the creditor has unconscientiously taken advantage of the opportunity thus placed in its hands. The circumstances of special disability will be rebutted, if the surety has received independent advice before executing the document.

On the whole a guarantor will not find it easy to establish the criteria in order to show that the bargain was unconscientious.

Effect of Undue Influence

Closely related to the principle in Amadio's case [3], is the doctrine of undue influence. Undue influence connotes, "the improper use of the ascendancy acquired by one person over another for the benefit of himself or someone else, so that the acts of the person influenced are not, in the fullest senss of the word, his free voluntary acts"; Union Bank of Australia Ltd v. Whitelaw [4].

As one well known commentator has written "The court's general jurisdiction to upset a bargain tainted with undue influence is exercised with alacrity in relation to contracts of guarantee" [5].

Unconscionable Dealing and Undue Influence Compared

There is a distinction between the two principles. Undue influence looks to the will of the innocent party which is not independent and voluntary because it is overborne. In unconscientious dealings the will of the innocent party, even if independent and voluntary is the result of a disadvantageous position, and the other party unconscientiously takes advantage of that position [6].

Explanation and Independent Advice

Under both doctrines, the circumstances in which the contract of guarantee can be vitiated, will be rebutted if the guarantee has been fully explained to the sureties, or they have obtained independent advice.

Although the law does not insist on the necessity for obtaining independent advice [7] it is clear that once adequate steps are taken to explain to the surety the nature of the obligation and reasonably expects that the surety understands the transaction, courts will not upset the guarantee with such alacrity as may have been hitherto demonstrated [8].

What then are some of the procedural methods which can be adopted by financial institutions to ensure that the guarantor has been independently advised?

One such method which has been adopted in recent times is the use of an independent solicitor's certificate. And it is this method which I would address today.

Independent Solicitors Certificates Generally

Some of the more common elements of such a certificate are that the solicitor certifies to:

(i) be acting independently of the bank or financial institution;

(ii) having explained the guarantee to the surety; and

(iii) the surety's understanding of the transaction.

The questions exercising the minds of those involved are firstly, the effectiveness of such certificates in rebutting presumptions or later arguments of special disability and the question of the liability of those giving the certificate (we have all, no doubt, been faced with a reluctance on the part of the surety's advisers to giving such certificates). However, this latter question is beyond the scope of this paper.

Once a legal practitioner has certified in writing upon the agreement, that he is satisfied that the surety understands the true nature of the guarantee, and that the surety has voluntarily executed the agreement, one would have thought that the grounds for claiming unconscionable dealings, or undue influence would clearly be vitiated. This would be particularly so when the solicitor has canvassed the financial position of the principal debtor, and the prudence of entering into the guarantee with the surety.

McNamara's Case

The decision of the Full Court of the Supreme Court of South Australia in McNamara v. The Commonwealth Trading Bank [9] is instructive, being the only case I could find on point. In that case, a Memorandum of Mortgage contained a personal covenant by three co-guarantors that they would be liable jointly and severally for all moneys which the bank lent to the principal debtor.

The guarantee was one which was subject to section 44 of the Consumer Transactions Act (South Australia) and was required to be executed in the presence of an independent legal practitioner. Section 44 of the Consumer Transactions Act is of paramount importance where a guarantor of a consumer credit contract enters into agreements in circumstances where the obligations extend beyond those which are required to be or are capable of being performed by the consumer. In the circumstances contemplated by that section, the agreement entered into by the guarantor will be void unless it is executed by him in the presence of a legal practitioner "instructed and employed independently of the credit provider or mortgagee" and the legal practitioner provides the appropriate certificate. However, one of these guarantors did not sign the guarantee in the presence of a legal practitioner notwithstanding the provision of a printed form of certificate required to be signed by a solicitor.

The guarantee was held unanimously by the Full Court to be void as against the party who did not so execute the document and, in addition, the guarantee was held to be void as against each of the other two intended co-guarantors in accordance with the general law relating to co-sureties [10].

In McNamara's case [11], there was also an important discussion on a legal practitioner's obligations under section 44 of the Consumer Transactions Act. His Honour Chief Justice King stressed that the section emphasises the dependence of creditors upon the integrity of the legal profession, for the validity of the guarantees upon which they rely.

In discussing the solicitors duty when called upon to give the certificate referred to in section 44, he made the observation that although it is sufficient, for the validity of the guarantee, that it be executed by the guarantor in the presence of the legal practitioner and that the legal practitioner certifies as required by the section, the duty of a solicitor to a client who consults him for advice prior to signing a guarantee extends much further. The solicitor sought to raise with the client questions relating to the prudence of entering into the guarantee or at least ascertaining whether the client wishes to be advised as to such questions in the first place. His Honour observed that the state of the financial affairs of the principal debtor as well as the extent of the assets of the guarantor/client should be discussed. His Honour also stressed that the solicitor,moreover, should be at pains to ensure that his client's decision is as free from the influence of the principal debtor as he can arrange, and in this regard, his Honour had in mind that frequently the principal debtor who desires to be guaranteed is a relative and the prospective guarantor is under considerable emotional pressure to so guarantee. It is essential here that the solicitor act and be understood to act solely for the prospective surety and take instructions from him separately.

Although his Honour the Chief Justice made these observations with particular reference to section 44 of the Consumer Transactions Act, all legal practitioners would do well to heed his comments in the wider context of advising guarantors generally and to note the following in particular [12]:

> "The legislation has placed great faith, in enacting section 44, in the integrity and competence of the legal profession. Its members are relied upon to certify truly so that the creditor is not misled into the belief that a valueless document is a valid guarantee; they are also relied upon to provide the protection to prospective sureties which the legislature understood to be necessary. If solicitors come to regard the certification of guarantees as a matter of mere routine to be performed after merely perfunctory advice and perhaps even without strict regard to the truth, the scheme of the section will fail and the legal profession will have failed the community in the discharge of the important responsibility entrusted to it."

Indeed, the bank in this case, by a separate action, sued the solicitors concerned and although the case was due to be heard last month, it was settled before the matter was heard and any

judicial pronouncement on the question of the liability of the solicitors concerned was made.

Conclusion

Can it be fairly contemplated that the rather dramatic effects of McNamara's case [13] extend to all solicitor's certificates if they were not properly given?

Creditors must be particularly wary in such special instances for the obvious reason that they can exercise no control over the circumstances relating to the giving of the certificate by the solicitor and, as his Honour pointed out, are heavily reliant on the integrity of the solicitor giving the certificate to have carried out his responsibilities properly.

If the bank is to ensure that independent advice has been given, and the purpose of the certificate is to simply evidence this fact, then, it ought to be sufficient to say that the certificate would, prima facie, evidence the requirements to vitiate the presumption or arguments of unconscionable dealing and undue influence. Some doubt must, however, remain as to whether the client has been advised properly. Should the financier deal with the apparently equally important question as to how to ensure that the certificate is given after proper advice? The adequacy of the steps taken by the creditor to inform the surety of the obligations being undertaken must, as his Honour Mr Justice Dixon pointed out (although in the context of a husband and wife relationship) depend on the circumstances of each transaction [14]. The circumstances must of necessity be quite different if the surety is a company director accustomed to commercial transactions rather than the elderly migrant father of a principal debtor, ignorant of business. In such circumstances a certificate signed by a solicitor jointly with the guarantor may be additional evidence of the surety's understanding and assist in countering presumptions or arguments of special disability.

It must be borne in mind that the Consumer Transactions Act provides that the contract of guarantee is void in the absence of such a certificate thus placing the solicitor in a possibly more onerous position than in perhaps the ordinary case where the contract is voidable at the option of the surety. Much the same provisions apply in section 230(8) of the Companies Code. Although designed for other circumstances it would be a brave financier who would not take a section 230(8) certificate in all circumstances.

One further point worth mentioning is the question of subsidiary companies guaranteeing a parent company, a problem referred to by Mr Debelle QC in his paper entitled "Corporate Guarantees" presented to the Banking Law Association some two years ago. Whilst this goes to the question of the proper exercise of the directors powers rather than any question of special disability on the part of the guarantor the taking of a solicitor's

certificate would be a prudent measure by the financier. If the surety is required to be advised independently of the principal debtor, what would the effect of such a certificate be when given by, say, a solicitor for a group of companies? If Mr Debelle QC is right and subsidiary company guarantees can be challenged on the basis that the directors have not given sufficient independent consideration to the matter, then separate advice should be taken, and the financier insist upon a separate certificate from an independent source.

Whilst by no means the only method of evidencing independent advice, such certificates may prove to be an increasingly important tool to banks and financial institutions, along with, perhaps, certificates from company directors or even statutory declarations or warranties for additional comfort.

Once again, as has already been pointed out today the financier must take the circumstances of each case into account. The words of Mr Justice Dixon must be borne in mind at all times when he said, "Equities invalidating contractual obligations effectual at law often depend upon a combination of a large number of circumstances affecting the transaction and cannot be reduced to a series of syllogistic propositions" [16].

Footnotes

[1] (1983) 151 CLR 447.
[2] Supra.
[3] Supra at page 1.
[4] (1906) VLR 711:720 per Hodges J.
[5] O'Donovan, "The Modern Contract of Guarantee" p. 101.
[6] Cf. Mason J, Commercial Bank of Australia v. Amadio (1983) 57 ALJR 359:363.
[7] See Union Bank of Australia v. Whitelaw (1906) VLR 711.
[8] See Yerkey v. Jones (1939) 63 CLR 649.
[9] (1984) 37 SASR 232.
[10] See Waker v. Bowry (1924) 35 CLR 48. Ellesmere Brewery Co v. Cooper (1896) 1 QB 75. Ward v. The National Bank of New Zealand (1883) 8 AC 755.
[11] Supra at page 4.
[12] Supra at page 4.
[13] Supra at page 4.
[14] Yerkey v. Jones Supra at page 7 at page 685.
[15] Yerkey v. Jones Supra at page 7 at page 669.