THIRD PARTY SECURITIES AND GUARANTEES

THE HONOURABLE MR JUSTICE PAUL DE JERSEY

Supreme Court of Queensland, Brisbane

In apparently less enlightened times, we were taught that save in exceptional cases, persons of full age and capacity who sign a contract are bound by its terms. Lord Scarman was still confidently asserting that proposition as recently as 1985, in *National Westminster Bank v Morgan* ((1985) AC 686 709). But the last decade has seen important attempts to redefine the field of exceptions. On one view, the result has been some expansion of the field and some blunting of its bounds. If you see that view as correct, then you may also see it as a reflection of the courts' largely unapologetic reliance on considerations of policy and their own perceptions of "commercial morality".

Last year, in *Barclays Bank v O'Brien* ((1994) 1 AC 180, 188), Lord Browne-Wilkinson spent three paragraphs dilating on "policy considerations" before he began to discuss the law. Four years earlier, in the very important case of *Northside Developments v Registrar-General* ((1990) 170 CLR 146, 165), Mason CJ spoke of "enhancing the integrity of commercial transactions and commercial morality". The then Chief Justice admonished us extra judicially the following year to "depart from legal formalism ... and consider the substantive issues and interests which lie behind the legal forms"((1991) *Australian Law News* 14, 15-16).

A focus on just outcomes is certainly dimming traditional "black letter" considerations, and financiers must be prepared for this. The recent cases throw up strategies which should give the lender basic protection. But the modern judicial approach will usually necessitate value judgments where accuracy cannot be guaranteed in advance.

Three cases illustrate the current vulnerability of third party securities: *O'Brien* in the House of Lords in 1994, *Northside* in the High Court in 1990, and the somewhat older *Amadio* (*Commercial Bank of Australia v Amadio* (1983) 151 CLR 447), reaffirmed in 1992 by the High Court in *Louth v Diprose* ((1992) 175 CLR 621). I deal with each to highlight potential problems for the lender and the practical solution, so far as it can be spelt out.

BARCLAYS BANK PLC v O'BRIEN

This landmark case concerned a wife's providing security for her husband's separate debts. The House of Lords held that this put the bank upon immediate enquiry, *ipso facto* obliging it to take reasonable steps to ensure that there would be no ground entitling the wife to avoid the proposed security. In practical terms, the bank should at least have met with the wife in the absence of her husband, explained the extent of her intended liability, warned of the risks, and urged her to seek independent advice.

Before I explore the decision, I should deal with the parallel Australian case, *Yerkey v Jones* ((1939) 63 CLR 649), because it is after all the case which binds here.

YERKEY v JONES

Mr and Mrs Yerkey sold a poultry farm to Mr Jones for £3,500 - it was 1939. Mr Jones had no means and a very limited income. The Yerkeys therefore insisted that he secure payment of most of the purchase price with a mortgage over Mrs Jones' separate property. She agreed to give the mortgage, although reluctantly. Default occurred and the Yerkeys sued for the moneys secured by the mortgage. The trial judge relieved Mrs Jones on equitable grounds of undue influence, misrepresentation and mistake. But the Yerkeys succeeded in the High Court, really on the ground that those defences were not established on the facts. There was no evidence of undue influence, it was found, or of mistake or misrepresentation, and the Yerkeys' solicitors had explained the terms of the mortgage to Mrs Jones "in considerable detail" (p 664) before she executed it.

The case is nevertheless extremely important in principle. That is because of the analysis, by Dixon J especially, of the status of guarantees given by a wife to secure the husband's "private" debts. This is the ratio of the case (p 683):

> "... if a married woman's consent to become a surety for her husband's debt is procured by the husband and without understanding its effect in essential respects she executes an instrument of suretyship which the creditor accepts without dealing directly with her personally, she has a prima facie right to have it set aside."

Note when the prima facie right of avoidance arises: the husband procures her assent to give the guarantee or mortgage; it is to secure his own debt, not hers, and not one they share jointly; the creditor does not deal with the wife personally; and the wife does not understand the essentials of the transaction.

One asks why a wife should receive this special protection, absent defences like *non est factum*, mistake, misrepresentation, undue influence. Why should a bona fide creditor suffer?

Dixon J explains that equity has traditionally looked with "jealousy" at dispositions by a wife of her separate property in favour of a husband. He quotes rather quaint language from 1835 that courts of equity examine such transactions "with an anxious watchfulness and caution, and dread of undue influence" (p 674). In his own terms (p 675):

> "... while the relation of a husband to his wife is not one of influence, and no presumption exists of undue influence, it has never been divested completely of what may be called equitable presumptions of an invalidating tendency."

But why should that affect the stranger, the creditor? Interestingly, no particular reason of legal theory is advanced. The matter is rather one of assertion based in social conscience. As he says (p678):

> "Although the relation of husband to wife is not one of influence, yet the opportunities it gives are such that if the husband procures his wife to become surety for his debt a creditor who accepts her suretyship obtained through her husband has been treated as taking it subject to any invalidating conduct on the part of her husband even if the creditor be not actually privy to such conduct."

How then does the prudent creditor avoid these difficulties? *Yerkey v Jones* provides the answer: insist on dealing with the husband **and wife** and in the course of that, explain the transaction to the wife, to the point of assurance that she has a reasonable understanding of the obligations she will be undertaking. She need not be seen to understand **every** detail, as emerges from this passage (p 685).

> "If the creditor takes adequate steps to inform her and reasonably supposes that she has an adequate comprehension of the obligations she is undertaking and an understanding of the effect of the transaction, the fact that she has failed to grasp some material part of the document, or indeed, the significance of what she is doing, cannot, I think, in itself give her an

> equity to set it aside, notwithstanding that at an earlier stage the creditor relied upon the husband to obtain her consent to enter into the obligation of surety. The creditor may have done enough by superintending himself the execution of the document and by attempting to assure himself by means of questions or explanation that she knows to what she is committing herself. The sufficiency of this must depend on circumstances, as, for example, the ramifications and complexities of the transaction, the amount of deception practised by the husband upon his wife and the intelligence and business understanding of the woman. But, if the wife has been in receipt of the advice of a stranger whom the creditor believes on reasonable grinds to be competent, independent and disinterested, then the circumstances would need to be very exceptional before the creditor could be held bound by any equity which otherwise might arise from the husband's conduct and his wife's actual failure to understand the transaction."

In summary, to displace the wife's prima facie right to have the transactions set aside, the creditor must show that it took adequate steps to inform her, and reasonably supposed that she had an adequate comprehension of the obligation she was undertaking and of the effect of the transaction. Ideally, though not necessarily, she should be separately advised.

STATUS OF DECISION

This is a controversial decision, but it does state the law in Australia. Dawson J referred to it, on the basis it was binding, in *Amadio* (p 486), and Deane J also referred to it there without disapproval (p 475).

On the other hand, the President of the New South Wales Court of Appeal has strongly criticised the decision as being inconsistent with the modern status of women (*Warburton v Whitely* (1989) 5 BPR 11, 628); and that brings to mind Professor Cretney's criticism of the philosophy underlying *O'Brien*, expressed in an article entitled "The Little Woman and the Big Bad Bank" (109 LQR 538):

> "A rule which will require banks to treat married women, regardless of the particular facts, in a manner appropriate to children not yet emancipated from their father's control ... seems totally inappropriate in this state in the evolution of family structures."

Even in 1939, as a party to the decision in *Yerkey v Jones*, Latham CJ implied his own scepticism, describing the rule enunciated in the case as (p 663):

> "A rather vague and indefinite survival from the days when a married woman was almost incapable in law and when the courts of equity gave her special protection in relation to transactions affecting her separate property."

Though *Yerkey v Jones* binds in Australia, *O'Brien* is the modern exposition of "its" rule, and the ultimate positions adopted in the cases are practically the same. So one may usefully dwell on *O'Brien*; doing so amply demonstrates that the lender's **modern** position is really no less "vague and indefinite" than it was in 1939.

O'BRIEN

The facts were essentially these.

Husband and wife jointly owned the matrimonial home. Husband had a separate interest in a company. The company was in financial difficulties. Husband persuaded his bank manager to extend the overdraft provided he and his wife gave a second mortgage over the home. Husband arranged wife's attendance at the bank and she signed the documents without reading them. She was given no explanation of their effect. Husband had falsely represented to her that it was a short term security to secure a limited amount. The company failed and the bank sought possession of her house. The wife failed at trial, but succeeded on appeal. In Australia the wife would succeed under *Yerkey v Jones*, successfully invoking the equity to avoid the security because the bank could not discharge its obligation to prove that she was adequately advised about the nature and terms of the transaction. In the House of Lords, however, she succeeded on a different basis.

The former Vice Chancellor, Lord Browne-Wilkinson wrote the only judgment, and it is a comprehensive and illuminating account of this area of the law. Notably for us, he debunks the *Yerkey v Jones* "special equity" concept. He suggests that it is at least an oddity. He points out that in the ordinary case of principal and surety, the creditor owes no duty to the surety. The surety has to satisfy himself or herself of the nature and extent of obligations undertaken. What special feature of the case where a wife stands surety for her husband's debt operates to create an equity in her to avoid the transaction unless the creditor has adequately advised her? To find such an equity would impose an obligation on a creditor towards one particular class of surety, where the creditor has no duty otherwise; and would burden the creditor in fact more substantially than the husband would be burdened. A wife could not set aside a transaction against her husband simply because the husband failed to explain its terms to her (p 193). There is, His Lordship held, no such special equity.

POLICY CONSIDERATIONS

Then we turn to policy. In fact, His Lordship discusses "policy considerations" at the start of his judgment (p 188), hence my bold suggestion earlier that the judgment is almost premised on them. He makes the points that a high proportion of private wealth is these days vested in the family home, and that most family homes are in joint names of husband and wife. The home has therefore become the main source of security for finance for family business enterprises. He acknowledged the equality of the sexes but saw a residual need to protect wives. As he put it (p 188):

> "... although the concept of the ignorant wife leaving all financial decisions to the husband is outmoded, the practice does not yet coincide with the ideal. In a substantial proportion of marriages it is still the husband who has the business experience and the wife is willing to follow his advice without bringing a truly independent mind and will to bear on financial decisions. The number of recent cases in this field shows that in practice many wives are still subjected to, and yield to, undue influence by their husbands. Such wives can reasonably look to the law for some protection when their husbands have abused the trust and confidence reposed in them."

But he adds this caution or qualification in "favour" of respective lenders (p 188):

> "On the other hand, it is important to keep a sense of balance in approaching these cases. It is easy to allow sympathy for the wife who is threatened with the loss of her home at the suit of a rich bank to obscure an important public interest, viz., the need to ensure that the wealth currently tied up in the matrimonial home does not become economically sterile. If the rights secured to wives by the law render vulnerable loans granted on the security of matrimonial homes, institutions will be unwilling to accept such security, thereby reducing the flow of loan capital to business enterprises. It is therefore essential that a law designed to protect the vulnerable does not render the matrimonial home unacceptable as security to financial institutions."

Before discussing the measure of protection he then defines, it is important to acknowledge two already established avenues for relief for guarantor wives against creditors.

AGENCY

In the first place, if a wrongdoing husband is acting as agent for the bank in securing his wife's guarantee, than on ordinary principles the bank will be held to be fixed with the husband's wrongdoing, and the wife will be able to rely on that against the bank. Lord Browne-Wilkinson put it in that broad form at p 191. He may have had in mind this formulation by Neill LJ in *Shephard v Midland PLC* ((1987) 2 FLR 175, 181):

> "The court will not enforce a transaction at the suit of a creditor if it can be shown that the creditor entrusted the task of obtaining the alleged [guarantor's] signature to the relevant document to someone who was, to the knowledge of the creditor, in a position to influence the [guarantor] by means of undue influence or by means of fraudulent misrepresentation."

So if a bank leaves it to the husband to have the wife sign the guarantee, and the husband misrepresents her prospective liability, she will be able to use that misrepresentation against the creditor, on ordinary agency principles.

NOTICE

The second established avenue for avoidance is through the doctrine of notice. If a creditor has, say, actual or constructive notice that the husband has secured the guarantee from his wife by exercising undue influence over her, then the creditor cannot enforce the guarantee. What is required is actual notice of the undue influence, or constructive or imputed notice: knowledge of facts which would raise in the mind of a reasonable person the possibility that improper conduct has taken place (cf Phillips & O'Donovan: *Modern Contract of Guarantee*, Law Book Co, 1992, pp 167-8).

Those matters aside, and having discarded the *Yerkey v Jones* special equity concept, His Lordship offered this "substitute" as providing adequate, but no more than adequate, protection to wives who secure their husband's separate debts.

THE O'BRIEN SOLUTION

He requires first some sufficient wrongdoing on the part of the husband to give rise to an equity in the wife to avoid the transaction. Undue influence and misrepresentation of course come to mind. He refers then to the doctrine of notice. If it operates to alert the creditor to facts giving rise to such an equity, then the wife can raise that equity against the creditor. What facts would suffice? Merely a wife standing surety for her husband's separate debt. That is of itself sufficient to put the creditor **on enquiry**. The creditor must then take reasonable steps to investigate the possibility of there having been some wrongful conduct such as would entitle the wife to avoid the transaction vis a vis her husband. The requirement for those "reasonable steps" would be sufficiently met were the creditor to meet with the wife, in the absence of her husband, advise her of the extent of her liability as surety, alert her to the risks and urge her to take independent advice.

How does His Lordship express those conclusions? He introduced the matter in this way (p 195):

> "A wife who has been induced to stand as surety for her husband's debts by his undue influence, misrepresentation or some other legal wrong has an equity as against him to set aside that transaction. Under the ordinary principles of equity, her right to set aside that transaction will be enforceable against third parties (eg against a creditor) if either the husband was acting as the third party's agent or the third party had actual or constructive notice of the facts giving rise to her equity. Although there may be cases where, without artificiality, it can properly be held that the husband was acting as the agent of the creditor in procuring his wife to stand as surety, such cases will be of very rare occurrence. The key to the problem is to identify the circumstances in which the creditor will be taken to have had notice of the wife's equity to set aside the transaction."

The creditor has notice if he is "put on enquiry" as we ordinarily say, and either goes on to discover the existence of the relevant wrongdoing, or fails to make the enquiry which would have revealed it.

When then is a creditor "put on enquiry" in this way? His Lordship says that that occurs (p 196):

> "... when a wife offers to stand surety for her husband's debts,"

and he adds that it occurs as the result of "the combination of two factors", which he specifies as:

> "...(a) the transaction is on its face not to the financial advantage of the wife; and (b) there is a substantial risk in transactions of that kind that, in procuring the wife to act as surety, the husband has committed a legal or equitable wrong that entitles the wife to set aside the transaction."

He then concludes that:

> "It follows that unless the creditor who is put on enquiry takes reasonable steps to satisfy himself that the wife's agreement to stand surety has been properly obtained the creditor will have constructive notice of the wife's rights."

Then the practical issue: what are the necessary "reasonable steps"? The advice is clear enough (p 196):

> "... a creditor will have satisfied these requirements if it insists that the wife attend a private meeting (in the absence of the husband) with a representative of the creditor at which she is told of the extent of her liability as surety, warned of the risk she is running and urged to take independent legal advice."

WIDER APPLICATION

O'Brien extends these principles to "all other cases where there is an emotional relationship between co-habitees" (p 198), including of course unmarried co-habitees, heterosexual or homosexual. If the creditor is aware that a surety is cohabiting with the principal debtor, these principles do therefore apply. Other cases establish that similar principles apply to other relationships, indeed to all where the creditor knows that the surety reposes trust and confidence in the principal debtor in relation to his financial affairs: the creditor is there put on enquiry, as in relation to husband and wife (cf *Avon Finance Co Ltd. v Bridger* (1985) 2 All ER 281).

BUT WITH LIMITATIONS

One should not lose sight of the fundamental limitation on the circumstances which give rise to this obligation in a creditor to "enquire": a surety transaction by a wife to secure **her husband's debt**, that is, a debt in which she has no interest, or at least no substantial interest. Rogers J made this point with emphasis, in distinguishing *Yerkey v Jones*, in *European Asian of Australia Ltd. v Kurland.* So did the House of Lords in the case reported immediately following *O'Brien*, *CIB Mortgages PLC v Pitt* ((1994) 1 AC 200).

In that case, the wife had reluctantly agreed with her husband to grant a mortgage over the jointly owned matrimonial home to secure loans from the bank. Contrary to the material put before the bank, and assurances to the wife, the husband disbursed the moneys on shares, and they were lost. But the *O'Brien* principle was of no avail to the wife, because as far as the bank was concerned, the loans were for the **joint** purposes of husband and wife. The bank was not therefore put on enquiry, and was not fixed with the consequences of the husband's misrepresentations and undue influence directed towards his wife. The same result would have arisen here in Australia by application of the *Yerkey v Jones* approach.

CRITICISM

Professor Cretney is critical of the Court of the Appeal's decision in 109 LQR 534, and his criticism would I think be equally applicable to the decision of the House of Lords, given subsequently to his article. He refers to practical ramifications (p 538):

"... it is tempting to put the consequences of the O'Brien decision in apocalyptical terms of the intolerable burdens facing banks who will have to ensure that all possible consequences of routine transactions are fully explained. The reality may be less dramatic. At the level of policy-taking all reputable lenders accept that it is desirable that wives and others should take independent advice before entering into potentially onerous transactions: see, for example, the instructions given by Barclays management to its staff in the O'Brien case itself. A more disturbing implication of the case is that it is likely to encourage borrowers and their associates to seek to escape from their obligations by putting in issue the adequacy of the explanation given to them: how many people really understand all the implications of a mortgage, for example? Only those who believe that the encouragement of litigation is intrinsically desirable would welcome such a trend."

THE POSITION IN THE TWO COUNTRIES

In Australia, a wife has a prima facie right to set aside her guarantee of her husband's debts, if procured by him, and without direct contact between the creditor and her. The creditor will save the guarantee if it has taken adequate steps to inform her of the obligations she will be undertaking and the effect of the transaction, and is reasonably satisfied that she adequately comprehends those things.

In England, when a wife is to give a guarantee of her husband's debt, the creditor is immediately put on enquiry, and must take reasonable steps to satisfy itself that there would be no ground entitling her to avoid it - that requirement being sufficiently met if the creditor meets with the wife in the absence of her husband, explains the extent of her intended liability, warns of the risks and urges her to take independent advice.

The end points are therefore not greatly different in practical terms. The juridical bases leading to them are however quite different, although probably more of interest to the academic lawyer than to the practitioner. One suspects - and hopes - that the risks to lenders in these areas are by now so well appreciated that the banks and finance companies and those who advise them have devised procedures which are in fact already well ahead of the requirements the courts are laying down.

Speaking generally, a lender, through its solicitor, would be very well advised to check these days **in all cases** that a proposed guarantor understands the nature of the overall transaction and the effect of the guarantee if executed; preferably the explanation should be given to the proposed guarantor alone; the lender should recommend that before signing the proposed guarantor seek independent legal advice; if that option is taken, the lender should seek a solicitor's certificate confirming that the advice has been given; and the lender should never leave it to the debtor to obtain the proposed guarantor's signature or explain the transaction, lest the lender be held to any misrepresentation by the debtor. Finally, guidelines designed to identify situations of potential risk - spouses, persons under disability etc. - should be widened as necessary to cover others, such as unmarried co-habitees of whatever persuasion. (Cf Horrigan: "Contemporary Securities Issues", CLE paper of October, 1994, p 10).

NORTHSIDE DEVELOPMENT v REGISTRAR-GENERAL

My earlier mention of the doctrine of notice takes me to the second of these significant decisions, *Northside Developments*. When I last addressed this forum, I commented on the decision in some detail. I mention it again now as still illustrating well what I contend is continuing uncertainty for lenders. May I be pardoned if I recapitulate the essentials of the case?

In *Northside*, the High Court for the first time comprehensively analysed the rule in *Turquand's* case ((1856) 119 ER 886). The decision is important now for the court's good advice to credit providers anxious to extend finance to debtor companies. That advice is relevant notwithstanding section 164 of the *Corporations Law*, which sets out the well known assumptions open to persons dealing with companies.

I briefly mention those assumptions.

Section 164 is a statutory adoption of the *Turquand* rule. The section confirms the protection available to persons having dealings with companies, or with other persons who have acquired property from companies. The person having those dealings is, by force of the section, entitled to make certain assumptions in relation to his dealings. Further, if the company asserts in any proceedings that the assumptions were not correct, then the court is to disregard that assertion. What are the assumptions?

In summary, they are that the company's constitution has been complied with, that a person who appears to be a director, principal executive officer or secretary has been duly appointed and has the usual authority of a person in that office, that a person held out to be an officer or agent of the company has been duly appointed and has the usual authority of such a person, that an officer with authority to issue a company document has authority to warrant that it is genuine, that a document apparently sealed and attested has been duly sealed and attested, and that the officers of the company properly perform their duties. In short, presumptions of regularity.

But the assumptions are not available in two presently important circumstances: if the person dealing with the company, or with the other person, has **actual** knowledge that the matter which would be assumed is incorrect, or if because of the person's "connection or relationship" with the company, he **ought** to know that the matter which would be assumed is incorrect.

These provisions themselves raise the doctrine of "notice", though in a form referable to presumed knowledge by force of a connection or relationship with the company. But the point of the court's decision is more broadly significant today. The facts were briefly, these. Northside owned land at French's Forest in Sydney. Robert and Gerard Sturgess controlled Northside. Barclays Credit lent $1.4 million to companies owned by Robert Sturgess, not including Northside. To secure the loan, the Sturgesses purported to execute a mortgage in favour of Barclays, by Northside, over the French's Forest land. Northside received none of the $1.4 million and had no legal or commercial connection with the borrowing companies. Northside defaulted under the mortgage. Barclays sold the land. Northside then sued the Registrar-General under the provisions of the *New South Wales Real Property Act* (section 127). That provision entitled a person, who had lost through the registration of another as the proprietor of land, to sue the Registrar-General for damages.

Robert Sturgess had attested to the mortgage and the affixing of the Northside common seal. Gerard Sturgess purported to sign as company secretary. In fact, he had not been properly appointed as company secretary. The other problem was that the directors had not, as required, by resolution, authorised the affixing of the seal. Neither had they approved the giving of the mortgage.

The trial judge found for Northside. He held that the mortgage was not properly executed. Section 164 was inapplicable, commencing after the Northside mortgage. *Turquand* would have saved it, but for the fact that Barclays had been put upon enquiry. The assumption of regularity cannot be made "if he who would invoke it is put upon his enquiry. He cannot presume in his own favour that things are rightly done if enquiry that he ought to make would tell him that they were wrongly done." (*Morris v Kanssen*, (1946) AC 459, 475 per Lord Simonds).

Although the Court of Appeal felt differently, the High Court agreed with the trial judge.

The five judges in the High Court disagreed as to the basis of the rule, but they all agreed that Barclays had been put upon enquiry. The present significance of the case is what circumstances should put a lender on enquiry, such that if it fails to make the enquiry, it will not be protected if the security is not authentic.

The High Court judges all held that **the very nature of that transaction** should have put Barclays upon enquiry. What the Chief Justice called the "decisive consideration" was that the mortgage was given to secure an advance to a third party without any indication that that related to Northside's business. On the face of things, the transaction did not serve any interest of Northside. Barclays should therefore have looked more closely into whether the transaction was valid from Northside's point of view.

The Chief Justice spoke significantly of a **balance**. On the one hand, *Turquand* should protect and promote business convenience. Persons dealing with companies should not have to investigate their internal dealings before entering into an agreement. On the other hand, fraud may result if the protection is too wide. He concluded in this way (p 164):

> "... to hold that a person dealing with a company is put upon inquiry when that company enters into a transaction which appears to be unrelated to the purposes of its business and from which it appears to gain no benefit is, in my opinion, to strike a fair balance between the competing interests. Indeed, there is much to be said for the view that the adoption of such a principle will compel lending institutions to act prudently and by so doing enhance the integrity of commercial transactions and commercial morality."

As he also said, a court cannot give specific guidance on what circumstances should put a prospective lender on enquiry. One should look, obviously, to any relevant powers of the company, the nature of its business, any apparent relation of that transaction to the company business, the actual or apparent authority of those acting on behalf of the company, and any particular representations made by them about the transaction. If the provision of the security will not apparently promote the business of the company giving the security, or result in some other benefit to that company, then a lender would have to set about affirmatively establishing that the company's officers had authority to enter into the transaction on its behalf, and that the affixing of the seal had been duly authorised under the company's articles of association.

You will have noted that under *Northside*, the lender may be defeated if put on enquiry by **the nature of the transaction**. By contrast, section 164 will protect the lender unless its "connection or relationship" with the company ought to have alerted it to the relevant circumstance.

On the previous occasion, I adverted to an interesting divergence between section 164 and *Northside*, insofar as section 164 does not deny protection to a person dealing with a company who, because of **the nature of the transaction**, should have been put on enquiry as to its validity. The High Court will no doubt interpret section 164 at some stage. It will be interesting to see how the carefully balanced policy worked out in *Northside* may influence the interpretation of the more protective statutory provision. Brennan J, for example, altruistically expressed concern that the *Turquand* rule not become "a charter for dealings between fraudulent officers of companies and supine financiers" (p 245).

In any event, as I also said last time, whether *Northside* or section 164 apply, financiers should be very careful in investigating borrower companies. Financiers are now expected to minimise the risk that money advanced may fall into the hands of fraudulent company officers (cf Mourell: "Northside" February, 1991 *Australian Business Law Review* at p 45).

The uncertainty still therefore remains unresolved. For example, is the statutory assumption that directors "properly perform their duties to the company" wide enough to cover directors participating without disclosing their interest in a transaction, or directors seeking to commit their company to a transaction from which the company can derive no benefit? And what is the scope of the expression "connection or relationship with the company", which may operate to impute knowledge rendering the assumptions unavailable? Where the nature of the transaction itself would put a lender on enquiry, as in *Northside*, is it still relevant that the "connection" between the lender and the company, which ordinarily arises through the negotiating of the transaction, **itself** confirms an absence of corporate benefit otherwise patent? One suspects "yes". In any case, it is the dealing with a company which would ordinarily show up the nature of its business and highlight the absence of potential benefit from a particular transaction, rendering the assumptions inapplicable.

While *Northside* was primary concerned with capacity to assume due execution, and so on, there are statements in the judgments which confirm however that these sorts of issues remain unresolved;

and hint that any ultimate resolution may well involve the issues of policy and commercial morality to which I referred at the outset.

It is plainly very important for lenders that such issues be resolved by the High Court. As put felicitously last year by Professor Horrigan (p 32):

> "Future judicial settlement of this legal issue is crucial for lending practice. If section 164 completely replaces the common law 'indoor management' rule **and** the exception in the second limb of section 164(4) does not simply import all common law notions of being put on enquiry (including being put upon enquiry by the circumstances of the transaction or even the nature of the security as a third party security), the practical result will be narrower obligations of inquiry upon lenders. So, under section 164(4)(b), the focus would then be upon the narrower concept of knowledge that ought to have been acquired **because of** the lender's connection or relationship with the guarantor company."

COMMERCIAL BANK OF AUSTRALIA v AMADIO

That takes me to *Amadio.* The case is very well known, and I refer to it only briefly, to illustrate the trend for which I contend. Many lenders saw *Amadio* as the beginning of the end for certainty and predictability in these transactions - at least so far as natural person guarantors were concerned. I am not sure that the practical experience has been quite as alarming as many then foresaw. The High Court briefly revisited the case recently in *Louth v Diprose* ((1992) 175 CLR 621), but without any apparent embellishment of principle.

In *Amadio*, the High Court confirmed and exercised the equitable jurisdiction to set aside a transaction as being unconscionable whenever, as it was put, "a party makes unconscientious use of his superior position or bargaining power to the detriment of a party who suffers from some special disability or is placed in some special situation of disadvantage" (p 461). The doctrine is not a creature of Australian law, but has very old English origins. *Amadio* itself may be seen as a more recent application of the principle discussed comprehensively in *Blomley v Ryan* ((1956) 99 CLR 362).

By majority, the High Court held that the Amadios were in a situation of special disability or disadvantage in relation to the bank, and that the bank had made unconscientious use of its superior position to their detriment. The court therefore set aside the securities.

For the doctrine of unconscionability to apply in this context, the surety must be able to show that he or she was under a "special disability" when dealing with the creditor. Unfortunately for lenders, however one cannot **exhaustively** and precisely state when this will be the case. One must determine whether the category applies by reference to the facts of the particular case. The decided cases do give **some** help.

In *Blomley v Ryan*, for example, Fullagar J mentioned (p 405):

> "poverty or need of any kind, sickness, age, sex, infirmity of body or mind, drunkenness, illiteracy or lack of education, lack of assistance or explanation where assistance or explanation is necessary."

Kitto J (p 415) also referred to:

> "illness, ignorance, inexperience, impaired faculties, financial need."

In *Amadio*, Dawson J added unfamiliarity with the English language. Mason J emphasised that the disability must be special, one which, as he put it, would "seriously affect the ability of the innocent party to make a judgment as to his own interests".

In *Amadio*, Deane J summarised the circumstances leading to his finding that there was a position of special disability, by saying that:

> "Mr and Mrs Amadio, viewed together, were the weaker party to the transaction between themselves and the bank ... the result of the combination of their age, their limited grasp of written English, the circumstances in which the bank presented the document to them for their signature and, most importantly their lack of knowledge and understanding of the contents of the document was that ... they lacked assistance and advice where assistance and advice were plainly necessary if there were to be any reasonable degree of equality between themselves and the bank."

Against this stood the bank, a major national financial institution with full knowledge of the debtor companies' precarious financial affairs.

A position of special disability having been established by the surety, it falls then to the surety to sheet home knowledge of that position of disability to the bank.

In *Amadio* it was held that the bank knew enough of Mr and Mrs Amadio's position to warrant the manager's enquiring whether the nature and extent of their proposed liability had been properly explained to them. He did not do that.

In consequence, the onus was cast onto the bank to show that the transaction was, in fact, fair just and reasonable. How could such an onus be discharged?

Well, a bank in that position might be able to show a number of things. It might show that its own officers properly explained the transaction, and that viewed objectively, the transaction was indeed fair just and reasonable. The bank would plainly benefit from being able to show that the weaker party took independent advice, or at least, was advised to do so by the bank and was given time in which to do so.

In *Amadio*, the manager should have asked Mr and Mrs Amadio whether the transaction had been comprehensively and accurately explained to them. They would have said no. The bank manager might then have himself embarked upon such an explanation. He would of course have had to do it properly, and to be able to demonstrate that subsequently. Proof of written advice would often be the most convincing way of establishing this. The bank might alternatively have suggested that the Amadios seek independent advice, and have given them time to do so.

One of my principal interests in mentioning this case again now is to emphasise that the range of value judgments left by *Amadio* to judges at first instance must certainly still be disturbing for the lender interested in predictability and certainty. In *Louth v Diprose* we see the most unusual situation of the High Court constrained to review the trial judge's findings of fact. The appeal failed, but that the ultimate court should have felt emboldened to enter into the factual arena itself illustrates well the scope for legitimate difference of opinion and ultimate uncertainty in this area. Needless to say, *Amadio* is still a great favourite for natural person defendants seeking to avoid liability. It further emphasises the importance, perhaps signalled most recently by *O'Brien*, of offering a sufficient explanation to a proposed guarantor - interviewed alone, and should there be any doubt about his or her independence of external influence, strongly counselling that independent legal advice be taken.

A bank's duty of disclosure in circumstances like these would, on the *Amadio* judgments, ordinarily extend beyond giving details of the nature and extent of the proposed agreement, and also include details of the financial situation of the debtor company.

That is a rigorous duty. It is a consequence of the existence of the so-called "special disability". Let us remember however that ordinarily there is no general duty of disclosure of relevance circumstances, because the proposed relationship will not be one of the utmost good faith (*Hamilton v Watson* (1845) 12 Cl & Fin 109).

The usual obligation on a bank is indeed very limited. It is to disclose only this, that is, "anything that might not naturally be expected to take place between the parties who are concerned in the transaction".

In *London General Omnibus Co Ltd v Holloway* ((1912) 2 KB 72, 79), Vaughan Williams LJ said that this duty of disclosure is "only an example of the general proposition that a creditor must reveal to the surety every fact which under the circumstances the surety would expect not to exist", because, as he put it, "the omission to mention that such a fact does exist is an implied representation that it does not".

THE LENDER'S ORDINARY DUTY OF DISCLOSURE

It is interesting then, in conclusion, to turn back for a moment to the old "black letter" formulations and examples of what need, and need not, be disclosed, still relevant in the absence of situations of special disability, or notice, including the *Yerkey v Jones* "special equity" or *O'Brien* notice/equity/enquiry situations.

Ordinarily, for example, a bank is not obliged to tell an intending surety that a customer is in the habit of overdrawing, or for that matter, to give any information as to the state of the account (*London General Omnibus Co Ltd v Holloway*). This sort of limitation would seem remarkable, no doubt, to many social reformers, and to those generally disenchanted with banks. But the limitation simply assumes that people exercise their commonsense.

As another example, a bank has been held not obliged to disclose to a prospective surety that the husband of the borrower was an undischarged bankrupt empowered to draw on her account (*Cooper v National Provincial Bank Ltd* (1946) KB 1).

In *Hamilton v Watson*, Lord Campbell listed some other examples of matters which need **not** ordinarily be disclosed: how the principal debtor's account had been kept, whether he was in the habit of overdrawing, whether he was punctual in his dealings, whether he met his promises in an honourable way, and so on. Such matters may be of critical importance to a prospective surety, but it is for him to find them out, not for the bank to volunteer them.

Likewise, a bank is not bound to disclose information it has about the financial standing of a co-surety (*Behan v Obelon Pty Ltd* (1984) 2 NSWLR 637; 59 ALJR 790). The New South Wales Court of Appeal's decision in that case was to the effect that a creditor is not bound to tell a prospective surety that an existing surety has no assets, with the consequence that the prospective surety will likely have to meet the entire outstanding debt of the principal debtor. The majority of the judges disposed of the case essentially by holding that a creditor has no greater duty of disclosure where there are multiple guarantors, than it has when there is just one surety. The High Court dismissed an appeal from the Court of Appeal's decision. Although saying it was unnecessary to deal with the point of legal principle because of the facts, the High Court expressed views which I would think clearly support the Court of Appeal's conclusions on that point of principle.

What then **should** be disclosed? The answer, in practical terms, is "very little". What will "not naturally be expected to take place between the parties" obviously depends on the particular facts of the case. But against the background I have established, one might confidently conclude that the court would not in some expansive way be ferreting out the unusual.

As I have suggested, law and other social reformers often criticise this limitation on a banker's duty of disclosure. There is a **contrary** view. Any greater disclosure could involve breaching the bank's duty of confidence to its customer, and I suggest, though with some trepidation, that it would be commercially unrealistic to expose banks to the potentially very substantial duty of disclosure which would undoubtedly be erected were this current limitation to go. There is in the end a simple solution for a party who would otherwise feel uninformed and insecure.

That course is to **ask** for the relevant information. If a prospective surety wants to know details of the debt he is to secure, then why not ask the banker? If he does, the bank may be able to obtain the customer's authority to release the information, if it does not already have that authority. A debtor might usually be expected to give the permission. The bank may then confidently give out the information.

At that stage, the bank becomes subject to an obvious duty to give accurate information, as confirmed in Queensland by *Potts v Westpac Banking Corporation* ((1993) 1 Qd R 125): see also *Cornish v Midland Bank PLC* ((1985) 3 All ER 513). The questions must however be "particularly put", in Lord Campbell's words from *Hamilton v Watson* (p 1343), for the bank to be obliged to answer them. One could not I think successfully impose on a bank a wide ranging duty of disclosure by putting a very generally cast enquiry.

What of the position after a security like this has been given? Well, a guarantor for, say, an overdraft, may properly require a bank to disclose the amount of the guarantor's then liability. But the surety cannot at that later time require further information on the guaranteed account, or demand inspection of it (*Hardy v Veasay* (1868) LR 3 Exch 107). He may, however, demand to know, in addition to the amount of his own current exposure as surety, any amount realised by the bank in respect of collateral securities: *Ross v Bank of NSW* ((1982) 28 SR (NSW) 539).

The basis of a bank's obligation to give accurate information in response to queries like this, is of course the now aging case of *Hedley Byrne & Co Ltd v Heller & Partners* ((1964) AC 465).

CONCLUSION

But against that background generally comfortable to lenders, beware the existence of special disability, and be acutely alert to circumstances putting the lender on notice, or "enquiry". Then the duty of enquiry and assistance, though judicially expressed in clear language, may sometimes be thought beguilingly simple. That is the time for the utmost of caution, highlighted perhaps when a solicitor's certificate is required - with which the commentators will deal.

Of course, in lots of these case, the likely outcome has always been somewhat blurred: it must be where questions of degree and complexion play such a large part. But our highest court's overt reliance these days on matters of policy and commercial morality - on which individual views notoriously differ - does to my mind erode further such certainty as there has been in these areas. That is not to decry the trend as socially undesirable. What is means for lenders, however, is that they must set in place strategies to forestall problems so far as possible: this undoubtedly involves being over-cautious.