PERSONAL GUARANTEES

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Yesterday afternoon and this morning, I had some good news and some bad news. The good news involved listening to the illuminating and interesting discussion on the Amadio case ((1983) 46 ALR 402) and the National Westminster Bank and Morgan case ((1983) 3 All ER 85). The bad news was that that discussion covered my paper.

The fact is that the Amadio case has been the subject of discussion in three of the sessions in this conference, and that I think is an illustration of the over-reaction in the banking community to that case. I know that yesterday, Mr Sher with a prophecy redolent with doom, warned all bankers about it. But I don't really think that there is anything new in that case, and to illustrate that, I would refer you to a case decided in 1941, before the High Court, the case of Bank of New South Wales v Rogers (1941) 65 CLR 421.

In that case, a lady, an elderly spinster, who had lived with her uncle for some 47 years and relied on him for advice, an intelligent lady, well educated (she certainly spoke English perfectly) charged virtually all her property in favour of her uncle, as security for an overdraft in his favour, at a time when he was hopelessly insolvent. And when the bank called on her to pay, she attempted to set it aside.

The bank manager knew that there was a relationship of long standing between them in the sense that they were uncle and niece and that they had lived together for a long time. Simply on those facts, the High Court held that as the bank manager knew that the uncle was in fact hopelessly insolvent, and knew that there was this kind of relationship between niece and uncle, he had a duty to make further enquiries. He didn't do that, and therefore the guarantee should be set aside, on the basis that it was an unconscionable transaction.

Now that really, I suggest, is on all fours with Amadio. The niece was at a special disadvantage because she was under the influence of her uncle and she didn't know the extent of his insolvency. The bank took unfair advantage of that special disadvantage by failing to explain to her the truth about the financial situation of her uncle, and by failing to tell her to go to someone else for independent legal advice. Now that really is the same as Amadio, and the banking community seems to have

prospered since Rogers, and therefore I really don't think that Amadio is so terrible.

And if I may also quote Samuel Goldwyn, I suggest that the banking community should let Amadio run off its back like a duck.

Perhaps a feature of Amadio was that two of the five judges held that there wasn't a special disadvantage that applied to Mr and Mrs Amadio, although they really were in a far worse situation than Miss Rogers in her case. His Honour Mr Justice Dean described the Amadio's situation as being one in which they relied on their son Vincenzo for the management of their business affairs and believed that he and Amadio Builders were prosperous and successful. They were approached in their kitchen, by the bank (and I am going to refer you to two other cases where the courts seemingly have decided that the place where the guarantors are approached has some relevance). Mr Amadio was reading the newspaper after lunch and Mrs Amadio was washing dishes. They were presented with a complicated and lengthy document for their immediate signature. They had received no independent advice, they had been misled by Vincenzo. The result of the combination of their age, their limited grasp of written English, the circumstances in which the bank presented the documents to them for their signature, and most importantly, their lack of knowledge and understanding of the contents of the documents was that assistance and advice were plainly necessary if there was to be any reasonable degree of equality in bargaining power.

No one, I suggest, should have been surprised that the bank lost the case. And again, perhaps just to stress the principle that was applied in that case, the transaction was held to be unconscionable not because of undue influence as regards the bank or by the bank, but because there was undue influence by the debtor Vincenzo as regards his parents. The bank knew of that undue influence, the bank knew also that the debtor was hopelessly insolvent, didn't make full disclosure, and didn't tell the Amadios to get legal advice.

In England, a new or extended principle has been applied in National Westminster Bank, which is more worrying to the banking community, but I will come to that. I first want to deal with how the High Court dealt with disclosure in the Amadio case and the principles are clearly set out there.

Where there is a case of special disadvantage, there is a fiduciary duty of disclosure. So that if a bank knows that the guarantor is at a so called special disadvantage, has a particular relationship with the debtor, is impoverished, is aged, is ignorant, doesn't understand, there is then a fiduciary duty of disclosure. But in the ordinary run of the mill case there isn't, there is no fiduciary duty of disclosure at all.

His Honour the Chief Justice, in the Amadio case, found that there was no unconscionable transaction, but nevertheless held against the bank because of what has been termed "non disclosure". That non disclosure did not arise out of a fiduciary relationship, it was a breach of the ordinary duty

which is simply to tell the surety if there is anything in the transaction that the surety shouldn't expect.

What happened in Amadio was that the bank actively misled or helped to mislead the Amadios. First, they had selectively dishonoured cheques, thereby creating a facade of prosperity. The bank manager had participated in a birthday party for Vincenzo at which there were 2000 guests, which His Honour Mr Justice Dean termed ostentatious. It was that kind of conduct on the part of the bank which led there to being a duty to disclose the true facts.

So again, I don't think that that case is authority for anything new.

The next case to which I would like to refer, is an English case. There are no prizes for guessing who the judge is and there are no prizes for guessing who won the case. I would like to read to you the first paragraph in the main judgment. It commences like this:

> Broad Chalk is one of the most pleasing villages in England. Old Herbert Bundy was a farmer there. His home was at Yew Tree Farm. It went back for 300 years. (I may say that if this was a witness testifying, there might just be an objection on the grounds of relevance.) His family had been there for generations, it was his only asset, but he did a very foolish thing. He mortgaged it to the bank, up to the very hilt. Not to borrow money for himself, but for the sake of his son. Now the bank have come down on him. They have foreclosed. They want to get him out of Yew Tree Farm and to sell it. They have brought this action against him for possession. Going out means ruin to him. He was granted legal aid. His lawyers put in the defence. That said that when he executed the charge to the bank he did not know what he was doing. Or at any rate, the circumstances were such, that he ought not to be bound by it. At the trial his plight was plain. The Judge was sorry for him. He said he was a poor old gentleman. He was so obviously incapacitated that the Judge admitted his proof in evidence. He had a heart attack in the witness box. (Being a caring person myself, I began to feel sorry for Counsel for the bank.

That is the opening paragraph. The judge was of course Lord Denning, and the bank of course lost. Lord Denning brought down his judgment on exactly the same basis as Amadio. That is, there was a special relationship between old Mr Bundy and his son. Mr Bundy was an aged man, he was not a man of any education, he was a simple man and the bank manager didn't tell him that the son was in serious financial difficulties. He didn't tell him to get independent legal advice. So there is nothing remarkable about Lord Denning's judgment, except perhaps the first paragraph.

But the other judgment, which I suggest poses a more serious threat, if I may use that word, is the judgment of Sir Eric Sachs, and he put his judgment on an entirely different basis. He put his judgment on the basis of the relationship which had

developed between the bank and Mr Bundy, and he said that relationship gave rise to a relationship of trust and confidence.

Now in all the other cases it has not been the relationship between the bank and the guarantor which gave rise to the setting aside of a transaction. The other cases involved banks acting unconscionably where there was undue influence as between the principal debtor and the guarantor. The other cases did not involve relationships between the bank and the guarantor.

Sir Eric Sachs however, referred to what he termed the second principle in Allcard and Skinner (1887) 36 Ch D 145, a case which deals with undue influence. The first category of undue influence is where the intent of a party is so dominated, that he is regarded as not having any intent. The second category is where as a matter of public policy, the court will interfere because the relationship is being abused.

Now because Mr Bundy was a trusting man and had had a relationship with the bank for many years, Sir Eric Sachs said that gave rise to a relationship of trust and confidence. He said further that it not infrequently occurs in provincial and country branches of great banks, that a relationship is built up over the years, and in due course the senior officials may become trusted counsellors of customers of whose affairs they have an intimate knowledge. Confidential trust is placed in them because of a combination of status, goodwill and knowledge.

Mr Head, the manager concerned, was the last of a relevant chain of those who over the years, had earned or inherited such trust, whilst becoming familiar with the financing business of the Bundys. Now it is because of that, that Sir Eric Sachs found that Mr Bundy should succeed. Because when there is such a relationship, the bank has to refer the guarantor to someone, to give him independent advice. This is not what the bank did.

In the course of his judgment, Sir Eric Sachs referred to an argument by counsel who said that even if he had taken independent legal advice, that advice would have been to enter into the guarantee, because he wanted to do it for his son. However, Sir Eric Sachs said that didn't matter as a matter of public policy, once this relationship of confidence accrues and once it is breached, the court will not examine the position to see what would have happened had independent advice been taken. The bank simply fails.

Sir Eric Sachs' view was taken to its logical conclusion in National Westminster Bank v Morgan. That is a case of a husband and wife, and may I stress that there is no question of undue influence as between husband and wife, that is not one of the categories which is normally regarded as giving rise to undue influence. The husband and wife were to be ejected from their house because they owed money to a building society on a mortgage.

The husband wanted to borrow money from the National Westminster Bank to replace the mortgage, the bank manager came into the lounge room of the Morgans' house - (I forgot to tell you, by the

way, in the Bundy case the bank manager came into the sitting room of the Bundys, it wasn't the kitchen - it was the sitting room). He spent five minutes talking to Mrs Morgan, five minutes, that's all. And she said to him, "what should I do?" and he said "sign the mortgage".

On that basis, the Court of Appeal held that there was a relationship of confidence and trust, simply because Mrs Morgan asked "what should I do?". A further factor which one of the judges regarded as important was that Mrs Morgan was a customer of the bank generally, so there was an added duty perhaps that applied to the bank there. But mainly because of a five minute conversation and a request "should I sign?" and the answer "yes", the court held that the mortgage should be set aside.

It was argued by counsel for the bank that the giving of the mortgage was really the very thing that Mrs Morgan wanted. She was desperate not to get out of her house. The only way she could avoid getting out of the house was to borrow the money from the bank. There was nothing wrong with the terms of the mortgage. The Morgans weren't being over-reached in any way. But the Court of Appeal followed National Westminster Bank and Morgan by saying that there was a relationship of confidence and trust. When that arises there is then a duty to call for independent professional advice: it was wrong for the bank to advise Mrs Morgan without that advice. As a matter of public policy, the court would not investigate the transaction to see what she would have done, and whether it was indeed unfair or unfavourable. The bank lost.

Now that, I suggest, is a fairly scary situation, because it could happen very often. As far as I know Sir Eric Sach's principle has not been followed yet in Australia. However as regards personal guarantees, the banks should always be aware of the need to give a full disclosure in appropriate circumstances, ie where a guarantor is under a special disadvantage and also where there is a relationship of trust, and also of course independent advice must be taken.

I should mention that independent advice alone will not always excuse the bank. It is all very well for the bank to tell the guarantor to go elsewhere for advice, but if the bank knows information which it doesn't disclose and the circumstances are such that it should disclose, independent advice alone will not help the bank.

And finally, I would suggest that bank managers be told not to get signatures in the guarantors' houses.