PITFALLS FOR LENDERS

PITFALLS FOR LENDERS IN ENFORCING SECURITIES

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1. INTRODUCTION

Commercial lawyers and officers of financial institutions are generally well imbued with the doctrines of contract. They are conscious of the importance of not having a contract until it is appropriate; "subject to formal contract" being a common catchcry.

Equally they would assume in most cases, that where a formal contract is entered into the terms of that contract govern their relationship.

Most would also be attuned to the nature of contract, which in our law developed on the basis of the "bargain theory", which if strictly applied, requires that promises with no benefit to the promisor are unenforceable for want of consideration: commercial people understand a bargain.

The rules governing contract have at their core a sense of certainty.

However, over the last few years certain decisions have highlighted the potential for erosion of these fundamental notions of law: highlighted but also extended so that people of commerce must now become more aware of the potential for their behaviour to limit the ability to adhere strictly to contractual principles.

This paper examines some of these areas of law and equity. That examination, if nothing else, should indicate that the comforting criteria of certainty surrounding strict contract law are not available under the "behavioural" principles guiding these areas. If contract law is, to coin a recently much overused phrase, "black letter law" then this paper could be said to deal with the "fuzzier" areas: or perhaps with what might be coined "black hat - white hat" or "black horse - white horse" law, meaning that the good guy wins. The problem seems to be a lack of clear judicial direction as to just who rides the white horse.

Nothing in this is new: however some of the more recent decisions certainly raise issues of fundamental importance and accordingly are worthy of detailed consideration.

2. WAIVER

(a) The various meanings of "waiver"

It is often said that "waiver" is incapable of precise definition and it is clear that the word has been used to describe a number of specific doctrines each of which are governed by separate legal principles and may have differing legal consequences.

The problems involved in analysing waiver are highlighted in **Commonwealth of Australia v Verwayen** ((1990) 95 ALR 321) where there was a divergence in views among the members of the High Court. Some members of the court considered that waiver was merely a collective and alternative expression for a number of independent doctrines and therefore, if the distinct elements of one of those doctrines could not be established, there could be no waiver. The other judges, although acknowledging that "waiver" has been used in a variety of contexts and as a loose collective term, considered at least as a possibility that waiver may retain some independent existence as a distinct legal doctrine. However it could not be said that these judgments assist in isolating the elements of this independent doctrine of waiver (to be referred to as "waiver simpliciter").

The terms with which the word "waiver" has been associated include estoppel, election, variation of contract (with consideration), release, laches, acquiescence, forbearance and abandonment. Given the fact that the exact nature and elements of some of these doctrines are themselves far from clear, the task of analysing the concept of waiver is a daunting and possibly fruitless task.

In a broad context it seems that in all senses of the word, waiver involves the loss of something, be it a right under contract, a right of action, or a defence. Therefore, whether or not waiver simpliciter exists the word "waiver" is useful in describing the end result of the operation of the doctrines mentioned earlier. For example:

(1) when a party makes an **election** between two alternative and inconsistent rights, the right which is not elected is permanently lost and for that reason may be said to be waived;

(2) if the equitable defence of **laches** is established the plaintiff loses its chance of success in an equitable claim by reason of its delay in pursuing that claim; and

(3) if a party is **estopped** from resiling from an assumed state of affairs it has lost the right to assert that the state of affairs is other than as assumed.

There are dangers involved in the use of the word waiver where it is applied as a basis for relief without an attempt to set out the reasoning for the decision, especially when the word is used more as a statement of a conclusion or result rather than a substantive principle. This unprincipled use of the word has been criticised as hampering the development of legal principle and it has been said that the notion of waiver has often been used "as a means of relieving parties from bargains or the consequences of bargains which are thought to be harsh or deserving of relief" (**The Laconica** [1977] AC 850 at 871).

In order to extract any sensible distinctions from the law in this area it is necessary to examine the development of "waiver" and the emergence of the separate doctrines with which the word has commonly been associated.

(b) Development of "Waiver"

A strict application of the "bargain theory" of contract would render promises without benefit to the promisor unenforceable for want of consideration (examples of such promises include unilateral rent or interest rate reductions and extensions of time for payment).

It is clear now that law and equity have developed doctrines which may have the result of enforcing promises in the absence of consideration and this development was based on recognition that in many circumstances it would be unreasonable not to recognise the parties change in position relative to the original contract.

Waiver and variation of contract

Variation of contract was referred to by Mason CJ in **Verwayen** (at p328) as one of the three components of the term waiver (the other two being election and estoppel). Strictly speaking variation, by requiring consideration, is consistent with the application of the "bargain theory" and is not of the same nature as the doctrines which will be discussed later in this paper.

Variation of contract is governed by the normal rules of contract law and consideration is required. A variation must be made in accordance with the terms of the contract if provision is expressly made for it. It is a standard term in many contracts that variation must be in writing and agreed to by both parties. It is also common to include notice provisions and other conditions for a valid variation but in all cases the effectiveness of the variation is determined according to the general principles of contract law.

One of the factors contributing to the development of the notion of waiver was the application of the Statute of Frauds which required that certain categories of contract (especially those relating to dealings with land) were required to be in writing in order to be enforceable. The same requirement extended to variation of contractual terms and accordingly certain oral alterations even in the presence of consideration might be found to be unenforceable.

To overcome this problem the concept of waiver developed with the courts initially attempting to distinguish the situation as far as possible from a contractual variation so that there could be no argument that the Statute of Frauds could apply. To avoid the argument that consideration existed this concept of waiver was confined initially to situations where an indulgence was granted by one party for the sole benefit of the other. The basis for this is the legal maximum to the effect that "any one may ... renounce the benefit of a stipulation or other right introduced entirely in his own favour".

Abandonment

This notion of waiver involves the unilateral abandonment of a right and it is this requirement which seems to be the essence of waiver simpliciter as indicated by the judgments in **Verwayen**. This early notion of waiver has also been referred to as "forbearance" but this expression appears to have largely fallen by the wayside, so, to avoid confusion it is best for the purposes of this paper to rely on the notion of abandonment as the crucial factor in determining whether waiver simpliciter exists.

Brennan J in **Verwayen** (at p340) who supports the existence of waiver simpliciter points to the case of **Banning v Wright** ([1972] 1 WLR 972) where it was noted that the word waiver is derived from the same root as "waif - thing or person, abandoned". He continues to say that:

> "A right which is susceptible of waiver can be 'confessed' by a party against whom it might *prima facie* be exercisable but that party's liability can be avoided by showing that the right has been abandoned. In other words the party waiving the right ceases to be able thereafter to assert it effectively. When a right has been waived ... it is unnecessary to consider whether any other party has acted in reliance on the release or abandonment: the right is abandoned once and for all".

Waiver (abandonment/forbearance) and variation of contract

The original conception of waiver, as a means to avoid the Statute of Frauds was limited in its scope by the courts which would not allow waiver to bring about a substantial change in the terms and operation of a contract. "Waiver" therefore developed an operation only in respect of subordinate obligations. It was stated in **Phillips v Ellinson Bros** ((1941) 65 CLR 221 at 243) that waiver would apply most notably "to the mode and manner of the performance of an existing obligation" and as such it could not alter the true nature of the obligation.

The effect of waiver was not to affect the actual wording of a contract (as is the case with variation). Rather waiver merely affects the enforceability of the rights prescribed in the wording of the contract.

This notion of waiver can operate, by way of example, to affect the means of payment under a contract, the time for notice of a claim, the size of individual instalments (but not the overall quantity required under a contract) etc. The essential requirement was that waiver could not operate to effect a substantial change in the rights and obligations of the parties.

Development of new doctrines

In time, law and equity became more receptive to this notion of waiver and began to apply it in a wider variety of circumstances. The concept of abandonment was accepted in circumstances where there was mutual benefit to both parties and concepts of reliance, knowledge, fairness etc came to be considered as relevant issues. In fact what was happening was the development of new legal doctrines (especially estoppel) but unfortunately this development occurred in an ad hoc fashion and the principles of these new doctrines become blurred, hence the present confusion with the use of the word waiver. Clearly there is considerable overlap between the various doctrines and in many cases the circumstances are susceptible to the application of a number of these doctrines with essentially the same outcome.

Instead of looking at the end result of the application of the separate doctrines it may be more helpful to consider their aim. Brennan J in **Verwayen** (at p341) drew a useful distinction by stating that:

> "These distinct doctrines serve different purposes: election ... ensures that there is no inconsistency in the enforcement of a person's rights; estoppel or equitable estoppel ensures that a party who acted in reliance on what another has represented or promised suffers not unjust detriment thereby; waiver recognises the unilateral divestiture of certain rights".

He continues to state that:

> "True it is that the divisions in nature and purpose between one of the doctrines and another have not always been expressed in the way in which I have stated

them and there have been occasions when the sterilisation of a right has been dubiously attributed to one doctrine rather than to another".

(c) Waiver and Verwayen's case

The issue in **Verwayen** on the question of waiver was whether the Commonwealth had waived its statutory right to rely on the Statute of Limitations. As outlined earlier there was not unanimity of analysis of waiver by the High Court. It is useful however to consider the judgments in turn to try and isolate the elements of waiver simpliciter (if it exists).

Mason CJ (at p327-8) expresses a clear view that waiver does not exist independently of the doctrines of election, estoppel and the law of contract (in the form of a variation or new agreement).

As indicated above Brennan J clearly envisages the existence of waiver simpliciter although acknowledging the considerable overlap and confusion surrounding the area.

Although the issue is not fully discussed, Deane J appears to consider (at p360) that in cases where waiver is alleged, in the absence of reliance, the doctrine of election is applicable, rather than there existing some independent concept of waiver.

In the opinion of Dawson J, where "waiver" is not used in the sense of election it is generally indistinguishable from estoppel.

Despite the confusion in this area Dawson J does seem to envisage the existence of waiver simpliciter but it is possible that these views are confined to the context of statutory rights with which **Verwayen** was concerned.

McHugh J does seem to contemplate the existence of an independent notion of waiver but (it seems) one confined to the area of statutory rights.

Toohey J was one of the two judges of the majority who decided the case on the basis of waiver. He considers that "waiver" has its closest affiliation with the doctrine of election. It is clear that election requires the existence of two or more alternative and inconsistent rights (in the sense that they are mutually exclusive). From the discussion on p376 Toohey J appears to propose a notion of waiver which occupies a lacuna in the doctrine of election where the elements of that doctrine are otherwise made out but the requirement of mutually inconsistent rights is not satisfied. He states that there can be no election when:

(1) in fact there is only one course to take; or

(2) there are two courses available but they are not strictly inconsistent (in the sense that the adoption of one right does not necessarily indicate a final intention to abandon the other).

Regarding this form of waiver Toohey J states that:

> "It may sometimes resemble a form of election, and sometimes be based on ordinary principles of estoppel, although, unlike estoppel waiver must always be an **intentional act with knowledge.**"

In the context of **Verwayen** in the view of Toohey J waiver could be found on the deliberate act of the Commonwealth not to rely on an available defence. The

requirement of an intentional act did not require an intention to bring about the consequences of waiver, it merely required that the conduct from which the waiver could be inferred be deliberate. He considered that detriment is not an essential attribute of waiver although it would often be found as a consequence.

For the purpose of the adjudicative process at least, Toohey J seems to support a concept of waiver in the sense of abandonment (as outlined earlier) and he states that it is enough that the defendant "renounces" a defence which is available to him and which is therefore his benefit but such renunciation must be "unequivocal" (see p378).

On this interpretation Toohey found that waiver was established in the facts in **Verwayen**. He continued to say that such a waiver could not be revoked by reasonable notice as the essence of waiver (in the sense used) was that the defendant had unequivocally renounced its right to rely on the defence and that waiver could not be withdrawn. To hold otherwise would be to move into the area of estoppel.

It is submitted that this analysis has some merit as it allows waiver to occupy an area where neither election or estoppel applies. This notion of waiver appears to require deliberate action with knowledge but inconsistent rights, reliance, detriment and unconscionability are not necessary. In view of the gymnastics employed by other judgments in **Verwayen** to find detriment necessary to found an estoppel (even where there was no evidence of it) this analysis has the added merit of easier application to proven facts.

This formulation is consistent with the notion of waiver by abandonment outlined earlier.

Gaudron J seems to develop a notion of waiver which is confined to the context of litigation and operates by reference to the taking of inconsistent "positions" and in this respect it can be isolated from election which involves assertion of inconsistent **rights** (query whether there is in fact any sensible distinction between the two).

According to Gaudron J a party will be held to a position previously taken (with intention and knowledge) if the relationship of the parties has changed. It seems that the change in position gives rise to an "equity" but there is no requirement of detriment.

Ultimately, this judgment is unsatisfactory as Gaudron J clearly avoids the issue of classifying the doctrine on which she relied as the basis for a finding in favour of the Commonwealth in this case. She states that at p386:

> "It matters not whether the doctrine is called 'waiver' or anything else. For ease of expression I shall continue to use the word 'waiver', using it in the present context to signify a deliberate action or inaction which has resulted in a changed relationship to which the parties may be held whether or not detriment is actually established."

(d) Conclusion - does waiver simpliciter exist?

Although there appears to be support for the existence of waiver simpliciter the area is subject to so much confusion that it is impossible to extract any certain principles. It is submitted that the approach of Toohey J comes closest to formulating some guide to use of the word. This line of reasoning is consistent with the notion of abandonment on which the concept of waiver was founded and also accords with Brennan J's view of the purpose of waiver which is to recognise the unilateral divestiture of rights.

The formulation of some clear principles in this area would be useful given the heavy usage to which the term has already been subjected. Otherwise the development of the separate doctrines with which waiver has been associated may be subject to even greater confusion and the catch-all term used with abandon in circumstances where parties are thought to be deserving of relief.

(e) Application

Even though the above analysis seems to suggest the possibility of waiver simpliciter applying, the context is such that firstly it may be that the doctrine only applies to waiver of statutory rights and second, if it goes further it is not clear that this would extend so far as to permit a variation of a contract which is not supported by consideration.

Thus to the extent this doctrine affects a lender the most likely application of waiver (as opposed to estoppel and election which are discussed separately) is in the context of a **Phillip v Ellinson Bros** waiver.

A lender may be found to have waived strict compliance with terms and conditions of security documents so long as no variation of contract is involved. If there is a requirement that payment be made in cleared funds but the lender accepts uncleared funds it could be said to have waived strict compliance. This sort of waiver will generally not operate to the substantive detriment of a lender except perhaps where the lender is looking to call a default. It may be that it loses some right to call default because it has waived strict compliance.

3. ESTOPPEL IN LAW AND EQUITY

(a) Introduction

Traditionally the doctrine of estoppel (whether in law or equity) is separated into a number of independent rules often with quite artificial distinctions. Pleading estoppel was a matter which involved some care in deciding the grounds upon which an estoppel could best be established within the confines of the separate categories. The dangers of this were pointed out by Kirby J in **Lorimer v State Bank of NSW** (unreported NSW Court of Appeal 5 July 1991) who stated that: "an insistence, at trial or on appeal, of undue precision in pleading may work a serious injustice. By accident one head of estoppel may not be pleaded which the facts, as they emerge at the trial will fully justify".

The problems involved in this have been exacerbated by the considerable overlap between these rules and the various expressions adopted which included common law estoppel, estoppel by acquiescence, estoppel by conduct, promissory estoppel, proprietary estoppel, estoppel in pais, estoppel by convention, estoppel by representation, estoppel by encouragement.

Some of these estoppels exist only at common law or in equity while some operate in both. (To some extent this dual operation has been overlooked since the advent of promissory estoppel and this aspect will be discussed later.) It would serve no useful purpose to try and isolate the elements of these separate categories here and this analysis will proceed in an attempt to distil the principles relevant to "estoppel in pais" at the present time. Other areas of estoppel while relevant to lenders, cover too broad an area to be adequately dealt with in this paper.

The decision of the High Court in **Waltons Stores (Interstate) Ltd v Maher** ((1988) 164 CLR 387) assisted considerably in clarifying some of the vexing issues about estoppel and advocated that various forms of estoppel existing in equity really formed part of a

single notion of equitable estoppel. There was also recognition of the underlying purpose of estoppel to present unconscionable departures from assumptions.

In **Verwayen**, the High Court in some ways went further than **Waltons** but essentially affirmed many of the principles which can be extracted from **Waltons**. However, the treatment given to the issue by the High Court does not indicate a consistent approach and to some extent the decision has "muddied the waters".

In order to extract sense from the judgments in **Verwayen** and set out the elements of estoppel as it exists today it is necessary to trace the development of the law in the area to see how the strict categorisation of estoppels has led to the establishment of certain rules which have consistently hampered the courts in any attempt to find a common basis for estoppel and to formulate some principles of general application.

(b) Traditional approach

The concept of estoppel in pais ("in pais" meaning "without document") has existed for some time. It appears that estoppel in pais existed initially in both law and equity and is often referred to merely as estoppel by representation. It is now clear that a representation for this purpose could be established by unequivocal words or conduct and the crucial element was the effect on the mind of a person relying on the representation.

For the purposes of this part of the paper, the term "assumption" will generally be used instead of "representation" to recognise that it is more the effect on the mind of the recipient that is relevant rather than the manner in which that assumption was formed, although of course the later is still relevant.

The aim of estoppel in pais has long been established and is consistent in both law and equity but it appears that for a time this purpose became obscured with the increasing categorisation and the development of the notion of promissory estoppel.

The classic statement of estoppel in pais is contained in the judgment of Dixon J in **Thompson v Palmer** ((1933) 49 CLR 507 at p547):

> "The object of estoppel in pais is to prevent an unjust departure by one person from an assumption adopted by another on the basis of some act or omission which, unless the assumption be adhered to would operate to that other's detriment. Whether a departure by a party from the assumption should be considered unjust and inadmissible depends on the part taken by him in occasioning its adoption by the other party ... he is not bound to adhere to the assumption unless, as a result of adopting it as the basis of action or inaction, the other party will have placed himself in a position of material disadvantage if departure from that assumption be committed".

This formulation was expressly adopted without qualification as the basis of estoppel (in law or equity) by 5 members of the High Court in **Verwayen** (the remaining 2 judges did not address the issue).

It is clear that estoppel requires detrimental reliance and the prevention of unconscionable conduct has been identified as the driving force behind estoppel.

It is in the application of these elements to fact situations, the nature of the relief to be granted and the manner in which estoppel can be raised in litigation in which the

approach of the various members of the High Court, and members of other courts, diverges.

The judgment in **Thompson v Palmer** referred to above also extracts 5 grounds upon which a party may be bound to an assumption (assuming that the elements of detriment, reliance and injustice are present). These may be paraphrased as follows. A party might be required to abide by an assumption:

(1) because it formed the conventional basis upon which the parties entered the contractual or other mutual relations (such as bailment);

(2) because he has exercised against the other party rights which would exist only if the assumption were correct;

(3) because knowing the mistake the other party laboured under, he refrained from correcting the other party when it was his duty to do so;

(4) because if his imprudence, where care was required of him, was the proximate cause of the other party's adopting and acting on the faith of the assumption; or

(5) because he directly made representations upon which the other party founded the assumption.

It is worth setting out these five "grounds of preclusion" as they provide a good indication of the circumstances in which estoppel may arise and according to Kirby J in **Lorimer** provides a (non-exhaustive) list of ways in which the relevant assumption may arise and unconscionability be established.

It seems that these "grounds of preclusion" are wide enough to encompass all the separate categories of estoppel which have existed. These grounds are relevant in establishing the part in which the party estopped played in forming the assumption in the mind of the other. As such they should always be kept in mind during the course of the discussion on this topic.

(c) The traditional limitations

Common law and equitable estoppel

One obstacle to the establishment of clear rules applicable to estoppel and to either the parallel development of common law and equitable estoppel or the development of a unified doctrine has been, as stated by Dawson J in **Verwayen** (at p362) "the persistence of the view at common law that to succumb to a doctrine of promissory estoppel would be to undermine the foundations of the law of contract". In particular the doctrine of consideration has not sat well with the notion of promissory estoppel, for courts found it difficult to enforce a promise which was not given for consideration. Equally, although until recently perhaps not as commonly addressed, the core notion of intention to effect legal relations as being necessary for establishment of a contract did not sit well with promissory estoppel. That latter concept is, as shown in **Austotel Pty Ltd & anor v Franklins Selfserve Pty Ltd** ((1989) 16 NSWLR 582), now a key element in the practical application of the emerging doctrine of estoppel.

It is, unfortunately, still only an emerging doctrine for as is shown later there is still not a sufficient High Court majority to conclude its existence. However it is extraordinary that two years after **Waltons** members of the High Court still found it necessary to continue

to refer to this dilemma. It seems clear, however, that **Waltons** does at least stand for the proposition that voluntary promises can be enforceable.

The dilemma is solved by virtue of the inherent nature of estoppel. As Brennan J said in **Waltons** (at p423):

> "The object of the equity is not to compel the party bound to fulfil the assumption or expectation, it is to avoid the detriment ..."

Thus it is not the promise which is always enforced: it is the detriment which is avoided. It is of course merely coincidental that in many cases, as in **Waltons** and **Verwayen** the remedy necessary to avoid the detriment is to enforce the promise.

Representations of existing fact

Until the development of promissory estoppel in **Central Property Trust v High Trees House** ([1947] 1 KB 130) the operation of estoppel in both law and, as has perhaps only recently been rediscovered, equity was confined to assumptions of existing fact. This was conclusively decided in **Jorden v Money** ((1854) 5 HLC 185).

Estoppel therefore did not apply to representations of future fact or intention.

This limitation has been criticised as arbitrary and it was pointed out by Bowen LJ in **Edgington v Fitzmaurice** ([1885] 29 Ch D 459) that "the state of a man's mind is as much a fact as the state of his digestion".

The basis for the decision in **Jorden v Money** appears to be that to hold a person to a representation of this kind would undermine the law of contract by enforcing a voluntary promise in the absence of consideration. The High Court has clearly addressed this concern in both **Waltons** and **Verwayen** and allayed any fears that the doctrine of consideration will be "blown away in a side wind" by highlighting the basis of estoppel as avoiding detriment and unconscionability rather than enforcing voluntary promises (although this may often be the practical result).

It seems after **Verwayen** that there is some support for overruling this case (Mason CJ & Deane J) but this cannot yet be asserted as a majority view.

The distinction is clearly still important however, for even though Deane J supports a unified doctrine his finding in **Waltons** that the estoppel was based on a representation of an "existing fact" involved, in any analysis, an extremely flexible approach to the evidence. This is also highlighted in the judgment of Kirby J in **Lorimer**.

The benefit of being able to find a representation of an existing fact is that the remedy available for a common law estoppel is to be held to the assumption ie effectively to enforce the promise. But to do so by manipulation of the evidence seems to defeat the whole concept inherent in advocating a unified doctrine.

As will be seen however under a unified doctrine those who have a clearer picture of who rides the white horse can achieve a similar end by an equally flexible approach to evidence of what constitutes detriment.

Estoppel as a shield and not a sword

Acceptance of the dicta of Bowen LJ in **Low v Bouverie** ([1891] 3 Ch 81) led to the use of the expression "estoppel may only be used as a shield and not a sword". This

effectively was recognition of estoppel as a rule of evidence which would not of itself support a cause of action. In effect it operated in the words of Brennan J in **Waltons** to establish a hypothetical state of affairs by reference to which legal relations between the parties were established.

It is in relation to this aspect that some of the inconsistencies involved in classifying different types of estoppel become clear as there are a number of well established cases on "proprietary estoppel" in which estoppel was used successfully as a sword.

The original interpretation of this expression meant that estoppel could only be used defensively in an action. It is clear since **Waltons** that estoppel may be pleaded aggressively as a "sword" but whether or not it may of itself ground a cause of action is a vexed issue since **Verwayen** where there was some suggestion that, at least in equity, it may be used in this way. This will be discussed later in greater detail.

(d) Development of promissory estoppel

The doctrine of promissory estoppel was formulated by Lord Denning in **High Trees** and was accepted as part of the law in Australia in **Legione v Hateley** ((1983) 152 CLR 406). It was based on the rationale that a "promise, intended to be binding, intended to be acted upon, and in fact acted on, is binding".

This new type of estoppel existed only in equity and recognised a type of estoppel which extended beyond assumptions of existing fact.

Recognition of this does not affect the continued operation of estoppel in equity in relation to an assumption as to existing fact. However it appears that this continued operation has been overlooked in some analysis of this area and there seems to have been reliance placed on common law estoppel in circumstances where there appears to be no reason why equitable estoppel could not also be made out.

This type of estoppel was originally confined to representations about existing contractual relations and did not apply to pre-contractual statements. This view was swept away in the judgment in **Waltons** in which the relevant assumption upon which an estoppel was found to exist was that a formal contract **would** be entered. (At the time the parties had been heavily involved in negotiations.)

It is clear from the case of **Coombe v Coombe** ([1951] 2 KB 215) that in its original formulation, promissory estoppel was only to be used defensively as a shield. This too has been swept away by the recent decisions.

(e) The unified doctrine - does it exist?

Mason CJ and Deane J

As outlined earlier, a majority of five High Court judges in **Verwayen** accepted as the basis for all estoppels (whether in common law or in equity) the classic formulation of estoppel in pais as enunciated by Dixon J in **Thompson v Palmer** (and affirmed by him in **Grundt v Great Boulder Gold Mines** (1937) 59 CLR 641).

In **Waltons** it was accepted that one fused principle of equitable estoppel existed, merging all the existing separate types of equitable estoppels (particularly proprietary estoppel and promissory estoppel) and this fused estoppel could operate as a source of substantive rights between the parties as opposed to common law estoppel which operated as a rule of evidence.

Deane J went further and advocated the existence of a single doctrine of "estoppel by conduct" existing in both law and equity. This view was endorsed by him in **Foran v Wight** ((1989) 168 CLR 385) and in **Verwayen** and was combined with an apparent acceptance that common law estoppel extended to assumptions as to future events.

In their joint judgment in **Waltons** Mason CJ and Wilson J were of the view that recognition of this extension of common law estoppel would fly in the face of the repeated acceptance over the years of **Jorden v Money** by the highest courts and that to overturn this decision was too "formidable" a task and therefore they refused to do so.

However in **Foran v Wight** Mason CJ seemed to backstep from this position and in **Verwayen** he states of **Jorden v Money** that "neither the decision nor the reasoning in that case can now be sustained" and that the development of promissory estoppel had been accompanied by recognition that the "distinction between present and future fact is unsatisfactory and produces arbitrary results instead of serving any useful purpose".

In **Verwayen**, Mason CJ (it seems with the approval of Gaudron J) supported the existence of a unified "overarching" doctrine of estoppel rather than a series of independent rules. He agrees with Deane J in the sense that there exists one doctrine which applies consistently in law and equity and has as its rationale the avoidance of unconscionable conduct.

However there are significant differences in the formulation of this single doctrine. Mason CJ advocates a substantive doctrine capable of supporting an independent cause of action while Deane J's formulation of a single doctrine of "estoppel by conduct" operates as establishing an assumed state of affairs to be relied on (defensively or aggressively) as the factual foundation of an action arising under ordinary principles. It therefore does not of itself constitute a cause of action.

In terms of relief also, the Judges differed, with Mason CJ clearly indicating that the relief granted would be only that required to avoid the detriment and no more, rather than enforcement of the assumption (although sometimes this would be required to reverse the detriment). Deane J supported a notion of estoppel where a party would be held to an assumption unless this exceeded what could be justified and would otherwise be unjust to the estopped party.

Despite these views there is no clear majority in the High Court for this unified doctrine. In **Verwayen** Brennan, Dawson and McHugh JJ contemplate the continued existence of the distinction between common law and equitable estoppel (Toohey J did not deal with estoppel in his judgment).

Dawson J (at p363) acknowledges that estoppel in equity and common law has common origins but "there the similarity stopped". He states that "while the role of estoppel at common law was largely as a rule of evidence, its role has been vastly expanded in equity to raise questions of substance".

McHugh J (at p396) considered it unnecessary to decide finally on the existence of a fused system of estoppel but stated that:

> "In the present state of authority, the common law doctrine of estoppel does not, but the equitable notion of promissory estoppel does, extend to representations or assumptions concerning the future ... hence any representations or assumptions concerning the future can be dealt with, and on the traditional view can be dealt with only, by equitable estoppel."

At best, the existence of a unified doctrine has the support of three judges of the High Court, while three others support the continued separation of estoppel in law and equity. It therefore cannot be said that there is a majority on this issue and as the law presently stands in Australia there exists no single unified doctrine of estoppel. However the future of the law of estoppel must be viewed as uncertain and liable to change.

The present law

In **Lorimer v State Bank of New South Wales** (unreported, NSW Court of Appeal 5 July 1991) Kirby J expressed a clear view that the distinction between common law and equitable estoppel remains. This is the same view taken by Gray J in **McGraith v Frazer & Ors** ((1991) 6 ANZ Insurance Cases 61.061) and by Leopold in "Estoppel, A Practical Appraisal of Recent Developments" ((1991) 7 *Aust Bar Rev* 47 p47) who states that, despite the logic underlying the approach of Mason CJ and Deane J in **Verwayen**:

> "The law in Australia remains that:
>
> 1. there are separate and distinct doctrines of common law and equitable estoppel; and
>
> 2. common law estoppel is confined to assumptions as to existing facts or events, whereas equitable estoppel can **also** operate where there is an expectation as to a future event."

Interestingly both Kirby J and Leopold indicate support for the concept of a fused doctrine but acknowledge that in the absence of a conclusive statement from the High Court on this issue the law remains as stated above. Kirby J states (at p23) that "clearly, the issue calls for an authoritative statement by the High Court to remove the confusion and uncertainty which have followed the divided opinions" (in **Waltons**, **Foran v Wight** and **Verwayen**).

He continues to say that "were I free to do so I would unhesitatingly follow the single substantive doctrine" which he sees as "conceptually simpler and easier of practical application".

After **Waltons** it seems that the law in this area has been substantially clarified and despite the unsatisfactory aspects of **Verwayen** it seems that the propositions established in **Waltons** were largely affirmed.

In summary the legal propositions to be extracted from the judgments in this case are as follows:

(1) Common law and equitable estoppel are separate categories but have the same underlying rationale (see **Thompson v Palmer**).

(2) Common law estoppel is limited to representations of existing fact and operates as a rule of evidence or procedure to establish a state of affairs by reference to which the legal relationship between the parties is to be determined. No right is created against the party estopped and therefore common law estoppel can never ground an independent cause of action although it may be used aggressively by a plaintiff in an action on another ground.

Rights may be affected but this flows from the court's decision on the assumed state of affairs (eg in **Waltons** at first instance and initially on appeal, the assumed state of affairs was that a binding contract existed and when the legal

relationship was viewed on that basis the Mahers were awarded damages for breach of contract. The estoppel worked to prevent Waltons from denying the existence of the contract for the purposes of an action for damages or specific performance).

(3) There is one doctrine of equitable estoppel which operates on assumptions of future conduct (as well as existing fact although this concurrent application of common law and equitable estoppels was not referred to explicitly).

(4) Equitable estoppel may create an "equity" which is a source of legal obligation. It may be used as a **sword** but there is no authority in this case for the proposition that it may found an independent cause of action.

(5) Equitable estoppel requires creation or encouragement by a defendant of an assumption in a plaintiff which the plaintiff relied on in certain instances where departure from the assumption by the defendant would be unconscionable.

(6) The remedy granted for equitable estoppel is the minimum relief necessary to prevent the detriment resulting from the unconscionable conduct.

It is submitted that the decision in **Verwayen** leaves the above legal principles extracted from **Waltons** largely intact. However, the decision is unsatisfactory from the point of view of setting out a consistent approach to estoppel by the High Court.

(f) The dual operation of estoppel in law and equity

While it seems that there is no unified concept of estoppel in the Australian law at present, Kirby J in **Lorimer** and Leopold propose an approach which has the practical effect of a fused system without the difficulties in reasoning posed by a unified doctrine.

It was stated earlier that in the development of promissory estoppel the traditional existence of estoppel in pais as a creature of both law and equity seemed to be overshadowed. In cases where promissory estoppel was not relevant because the representation was one of existing fact it seemed to be assumed in some cases that only common law estoppel was founded and hence the more flexible relief afforded by equity was not available.

As indicated by Leopold (at p51) the equitable doctrine is available in virtually identical circumstances to common law estoppel but it has an additional operation in that it applies to assumptions about future conduct as well as existing fact. With the recognition in **Waltons** that all equitable estoppels are governed by the same principles, there is no logical reason why the principles governing equitable estoppel (including promissory estoppel) should not also apply in circumstances where, on the facts a common law estoppel would also be established.

In the view of Leopold:

> "There is no arguable area of the operation of common law estoppel into which equitable estoppel cannot travel. It is highly likely that, as has already been accepted by Mason CJ and Deane J, common law estoppel will come to be regarded as an irrelevance, and that estoppel in Australia will be comprised of equitable estoppel as we now know it."

This approach is consistent with the judgment of McHugh J in **Verwayen** who states that, as far as the doctrine of estoppel in pais is concerned it was applied by both

common law and equity so that "if a person made a false representation to another about a present or past (and therefore existing) fact and the representee acted upon it, the representor was not allowed to assert the truth of that representation". Insofar as law in equity covered the same grounds he concludes that the rules of equity must prevail.

This is clearly the case as provided for in each state in Australia by statute. McHugh J points to the Victorian Supreme Court Act s62 which provides that in all matters in which there is a conflict or variance between the rules of equity and common law **relating to the same matter**, the rules of equity shall prevail.

Leopold refers to this as a "collision" between the doctrines of common law and equitable estoppel.

He states (at p56) that:

> "Accordingly, if *both* common law and equitable estoppel have an operation, the court needs to determine what relief ought to flow from the equitable estoppel. If that produces a 'collision' with the evidentiary operation of the common law estoppel ... the equitable remedy will prevail."

As an example of when such a collision may occur, Leopold gives this situation of where the operation of common law estoppel would give the "innocent" party damages flowing from the breach of an assumed contract, whereas the most appropriate relief for the equitable estoppel may be a much more limited compensation.

The application of the "collision" theory - Lorimer v State Bank of NSW

The minority judgment of Kirby J in **Lorimer's** case is an example of exactly this situation of a collision between common law and equitable estoppels.

The case involved a cotton farmer (Lorimer) who in the face of financial difficulties was faced with two options: to sell his property ("Option 1") or to increase existing liabilities and invest in irrigating equipment to improve productivity and generate higher income ("Option 2").

The facts were disputed, but Kirby J found that Lorimer had honestly believed and relied on the assumption that the bank would fully fund Option 2. In reliance on this assumption Lorimer had purchased equipment and incurred further liabilities. When the bank subsequently restricted Lorimer's borrowings and suggested he take immediate steps to repay his indebtedness, Lorimer claimed :

(1) the bank was bound by contract to provide the funds; or alternatively

(2) because of the assumption of Lorimer the bank was estopped from denying the existence of a binding agreement to fund Option 2.

The trial judge held that there was no contract and that there could be no estoppel because:

(1) the parties had not acted on any common basis as to the making of advances by the bank; and

(2) the bank had not acted unconscionably.

Priestley and Handley JJ in the majority, dismissed Lorimer's appeal but did not deal fully with the estoppel aspect as they came to a different view on the facts from Kirby J on the existence of the relevant assumption in the mind of Lorimer.

Although in the minority, the discussion of Kirby J in this case has great appeal as it deals directly with the unsatisfactory position in **Verwayen** and attempts (it is submitted, successfully) to set out a practical solution to some of the difficulties in application of common law and equitable estoppel.

This case illustrates the arbitrary nature of the existing fact versus future fact distinction. Lorimer argued that the relevant mistaken assumption was that Option 2 would be funded and therefore the case involved an assumption as to future conduct. However Kirby J reclassified this as an assumption that an agreement to fund existed and therefore it was an assumption as to an existing state of affairs and not future conduct.

On this basis, according to Kirby, the concept of estoppel in pais, as enunciated in **Thompson** v **Palmer** and **Grundt**, might be made out.

Kirby J clearly states that equitable estoppel continues to have operation in relation to assumptions as to an existing state of affairs. He cites Brennan J in **Waltons** as approval for this and the proposition that estoppel in pais "at common law" may be founded on an assumption that a certain legal relationship exists between the parties.

In accepting the clear view in **Verwayen** that common law and equitable estoppel have a common purpose (to avoid the detriment which would result if assumptions were retreated from) Kirby J stated that the same assumption could conceivably found an estoppel in pais at common law and an equitable estoppel.

Kirby J then sets out the differences between common law and equitable estoppel acknowledging (as outlined earlier) that the unified approach is not yet the law in Australia.

He notes that at common law the remedy for estoppel is less flexible than in equity because at law estoppel is merely a rule of evidence which operates to establish the state of affairs by which the party's legal relationship is ascertained for the purposes of a decision on an independent cause of action.

Equitable estoppel however is a source of enforceable equitable rights. Kirby J adopts the view of Brennan J in **Verwayen** and **Waltons** that equitable estoppel creates an "equity" which can be asserted by the party claiming estoppel (the equity arising because of the element of unconscionability in the conduct of the party estopped).

Part of the relief at common law is to give the party who successfully raises an estoppel the benefit of the assumption by holding the party estopped to the assumed state of affairs. The remedy in equity is more flexible and is recognised to be that which is necessary to prevent the detriment arising as a result of the unconscionable conduct of the other party. The aim is to do the minimum equity required to do justice between the parties and therefore the enforcement of the assumed state of affairs should only occur when this is the only way to satisfy that minimum equity.

Kirby J points to the problems arising in determining what remedies should apply when common law and equitable estoppel arise in the same case as he found to be the situation on the instant facts.

He claimed that one solution was the recognition of one unified doctrine of estoppel but, as outlined earlier acknowledges that this was not yet the law. His solution to the dilemma posed in the event of a "collision of remedies" was to apply the equitable remedy in reliance on the New South Wales equivalent to s62 of the Victorian Judicature Act (s5 of the Law Reform (Law and Equity) Act (1972)).

He stated that (p24):

> "If the same assumption gives rise to an estoppel in pais and an equitable estoppel in circumstances where the rules of equity require that the party asserting the estoppel be given a remedy different from that contemplated at common law, then the court must, conformably with the statute, give the relief provided by the rules of equity rather than common law relief."

In this, his Honour expressly endorses the comments of McHugh J in **Verwayen** and Leopold, as outlined earlier.

(g) The elements of estoppel

Matters which must be established as a matter of fact in an action for both common law and equitable estoppel are:

(1) the existence of an assumption in the mind of the party claiming estoppel;

(2) reliance on that assumption;

(3) detriment as a result of reliance; and

(4) unconscionability on the part of the party estopped.

In a sense, each of the elements is interdependent making it difficult to consider the elements separately. The following discussion therefore may not fully justify the various headings used.

(1) Assumption, reliance and knowledge

The assumption formed by the "innocent" party is most usually predicated upon false representation or conduct on the part of the "guilty" party.

As was noted by Dixon J in **Thompson v Palmer** there are at least 5 types of such behaviour. Whether a relevant form of behaviour exists will almost entirely depend upon the evidence presented. It should be noted however that in some cases not much is required to constitute the relevant behaviour. Equally a finding of just what is the representation made could well affect the outcome. **Standard Chartered Bank v Bank of China** ((1991) 23 NSWLR 164) involved a claim by Standard Chartered Bank on Bank of China in respect of what was actually found to be a "forged" letter of credit purportedly issued out of Bank of China's Hong Kong branch. In normal circumstances the risk of forgery would have fallen on Standard Chartered as beneficiary of the credit. However prior to final acceptance of the credit the Sydney office of Bank of China "authenticated" the signatures on the letter of credit. It proved to be a good forgery.

The initial issue was to identify on the facts (a broad outline of which has been given) whether the representation made by Bank of China was:

(a) that the letter of credit was authentic: in which case a common law estoppel would hold Bank of China to the terms of the credit; or

(b) that the signatures on the letter of credit had been compared with specimens in the Sydney branch of Bank of China and were considered to correspond with them: this would however still leave the risk of forgery of those signatures with the beneficiary.

The trial judge Giles J found the former to be the case and Bank of China was held to the credit. On appeal however (unreported Court of Appeal judgments handed down on 16 July 1991) the court unanimously held the representation to be the latter, thus enabling Bank of China to avoid the credit.

The representation made must also be "clear and unequivocal" (**Legione v Hateley** (1983) 152 CLR 406). However it seems clear that this principle will only be applied in the representation/promise cases such as **Waltons** for a number of common law and conventional estoppel cases certainly do not on the available evidence meet those requirements.

In **Corumo Holdings Pty Ltd v Itoh Ltd** ((1991) ASCR 720) two judges of the NSW Court of Appeal, Kirby P and Samuels JA found against Bank of New York on a "conventional estoppel" based on evidence which itself lacks the requirement of clarity. In that case, even though there was a finding of common assumption it is difficult to see from the evidence that Bank of New York was actually aware that the innocent party held that assumption. This leads us to question the relevance of reasonableness and knowledge.

In **Corumo** a joint venture agreement and unit holder agreement for the development of a 3 stage real estate project was entered into by Corumo Holdings Pty Ltd, C Itoh & Co Ltd and Shimizu Construction Co Ltd. The land was owned by the trustee of a unit trust, the parties' interests being represented by their respective unit holdings. It was agreed that if Stage 2 did not proceed Corumo would buy out Itoh and Shimizu. Corumo's obligations to pay the agreed amount on a buy-out (which was defined by reference to clauses 5.2 and 7(f) of the Unitholders Agreement) was guaranteed by Bank of New York to a limit of $32,000,000.

By a deed of variation signed on 9 May 1990 to which Bank of New York was a party the term of its guarantee was extended by 6 months. On 4 May 1990 clause 5.2 of the Unitholders Agreement was varied without Bank of New York being a party and without its expressed fully informed consent. The effect of that variation was to increase the buy-out amount by $2, 000, 000 (but not Bank of New York's upper limit which, at the time of the variation was already exceeded).

There was default on the buy-out, the guarantee was called and, based on a number of defences Bank of New York, did not pay out. Rogers J in the Commercial Division held that all parties (including Bank of New York) had proceeded on a common assumption that the guarantee would continue to bind Bank of New York to the limit stated in it and thus Bank of New York was estopped from denying that.

It should be noted that the in-house solicitor for Bank of New York had a copy of the draft amendment to clause 5.2 before signing the extension but there seems to be no evidence that its real effect was brought to his attention at any stage.

Kirby P effectively found that because Bank of New York was aware that no party would proceed with the extension unless a valid Bank of New York guarantee was in place (for otherwise it would be called early) Bank of New York was held to its guarantee as it

applied to the varied clause 5.2. But there was really no knowledge of the effect of the amendment. Samuels JA says (at p741) "I take this to amount to the conclusion that Mr Kelly was aware that Mr Ahern believed that Bank of New York would honour the varied guarantee, and that this was the common assumption of which Mr Kelly was aware, and which he did nothing to correct, upon which the parties entered into the phase of the transaction". This effectively denied Bank of New York of any defence it might otherwise have had.

However both Kirby P and Samuels JA indicate that the "guilty" party must be "aware" of the common assumption (or have induced, caused or participated in the innocent party forming it). Equally, Meagher JA finds that such knowledge is required but he, it is submitted, correctly, is unable to find how Bank of New York had this knowledge.

This case indicates that awareness by the guilty party is important but it also indicates that it may not take a lot to impute that awareness.

This level of awareness in the guilty party seems important to the emerging doctrine. For example in **Waltons** Mason CJ and Wilson J place some importance on the fact that on "10 December Waltons (through its solicitor)" became aware that the Mahers were acting to their detriment. Brennan J in his 6 points (at pp428-429) clearly accepts that knowledge or intention on the part of the guilty party is essential.

It should be noted however that **Corumo** was a case of "conventional estoppel", that is the first type cited in the 5 types envisaged by Dixon J in **Thompson v Palmer**.

At first instance in **Lorimer** Brownie J found no estoppel because both parties were not under the same assumption (ie there was no conventional estoppel). It is clear from the evidence in that case that the State Bank representative did not know that the Lorimers thought they would be funded into Option 2 nor that any relevant representations or promise had been made.

Kirby P, albeit in the minority, considered it wrong to assume that it is necessary in all cases to find both parties labouring under the same mistaken assumption. This constituted only one of the 5 grounds in **Thompson v Palmer**. The fourth ground is "because if the [guilty party's] imprudence, where care was required of him, was a proximate cause of the other party's adopting and acting on the faith of the assumption" Kirby P held that this ground did not require "actual knowledge":

> "The respondent ought to have been aware from its knowledge of the appellant's financial predicament that there was a real possibility or likelihood that the appellant was acting as he did in the reasonable belief that the respondent was legally bound to fund Option 2" (at p31 of his unreported judgment).

In doing so he adopts the reasoning of Gaudron J in **Waltons** who states (at pp462-463) that "no knowledge as to the other's state of mind" is required.

The majority in **Lorimer** both seem to find differently but at p10 of his unreported judgment Priestley JA states that this test "seems to me to be bound up with the idea that it [the bank] knew **or should have known** of the appellant's assumption" and (at p14), Handley JA states "this type of estoppel depends upon findings ... that the bank knaw that this assumption was incorrect."

Both Priestley JA and Handley JA apply the facts as found by the trial judge. Kirby P reconsidered the facts. However both Kirby P and Priestley JA accepted that constructive knowledge could satisfy this head.

This is effectively the ground upon which **Waltons** is based, a form of estoppel described by Handley JA in **Lorimer** (at p14) as "estoppel by negligence or by silence where the bank had a duty to speak".

In **Waltons**, Gaudron J clearly accepts that constructive knowledge is enough. Despite the fact that she states that knowledge of the other's "state of mind" is not needed her earlier discussion indicates that she really means "actual" knowledge is not needed, for on p462, she states that **Waltons** "ought then to have been aware that there was a real possibility or likelihood that the respondents had commenced work in the reasonable expectation that exchange would take place".

However the language used by Gaudron J and the circumstances applied by Kirby P really direct themselves to actual or constructive knowledge of the innocent party's state of mind. Logic requires that for a party to be in a position where it ought to be aware of that state of mind it must have actual knowledge of the relevant facts. Gaudron J for example seems to be saying that once Waltons became aware of the fact of demolition, then they ought then to have been aware of the state of mind.

Mason CJ and Wilson J seem to make the same distinction in **Waltons** (at pp406 and 407) "was the appellant entitled to stand by in silence when it **must have been** known that ...": Brennan J at p423 states "It is essential to the existence of an equity created by an estoppel that the party who induces the adoption of the assumption knows or intends that the party who adopts it will act or abstain from acting in reliance on this assumption or expectation". However by statements on p418 and p429 he makes it clear that imputed knowledge of the assumption may be made from actual knowledge of the facts.

It seems clear therefore that actual knowledge, at least in the context of this fourth head is not necessary. It does appear however that it may be necessary for other "**Thompson v Palmer** grounds".

Since all estoppel is founded on preventing unconscionable conduct there seems nothing inherently unfair in basing an estoppel on imputed knowledge. Thus once a party receives actual knowledge of facts sufficient for it to infer that the other party must be acting under a certain assumption it becomes duty bound to speak up.

While this appears fair in the abstract it could create real practical difficulties for lenders. If **Lorimer** was decided as Kirby P would have it the bank would have been obliged to fund even though they thought they could be under no obligation to do so. This is especially problematic since the bank's knowledge is imputed through an employee who made it clear he had no authority to lend moneys of the bank. This may of course be an acceptable result if the bank failed to take the opportunity to disabuse the "borrower" of its false assumption when it had an opportunity to do so but this presupposes it is fair for the bank to be imputed with knowledge of a reasonable low level staffer. Equally Waltons gained its knowledge of the facts via their solicitor. The practical consequences of this are self-evident.

Knowledge is also relevant at the other end. It seems that the assumption or representation that the "innocent" party relies upon must be reasonably formed: presumably if it is unreasonably formed it will not be unconscionable to disregard it.

Thus if the "innocent" party becomes aware that the assumption it has made is false it would be unreasonable for it to so rely upon it. This might sensibly apply if the innocent party has "actual knowledge" of the falsity of the assumption (see Giles J at first instance in **Standard Chartered** at p180-181 which certainly found this to be so). Since a "guilty party" can act unconscionably on the grounds of constructive notice logic should lead

to the conclusion that constructive notice should also act on the innocent party. This conclusion was however rejected by Giles J at first instance in **Standard Chartered** where he found (at p178) that "in the sense of notice which it said should have caused the plaintiff to suspect the authenticity of the letter of credit even though it did not [in fact] do so" (emphasis added) such notice will not disentitle the innocent party. This inconsistent approach could be explained by the fact that the focus regarding unconscionability is on the "guilty" party. It should be noted that the Court of Appeal in **Standard Chartered** did not deal with this issue of constructive knowledge, their finding on the nature of the representation avoiding the necessity to do so.

Also in **Australian Guarantee Corporation Ltd v Benson** (unreported Court of Appeal of New South Wales delivered 12 December 1991) the Court of Appeal unanimously upheld an estoppel by convention where the "innocent" party had actual notice that the assumed fact was not as assumed. This was clearly on the basis that it was not, in all the circumstances, unconscionable: perhaps also on the basis that the estoppel was raised defensively.

This strikes as an unusual conclusion. It also seems to fail to analyse the importance of reliance. In just about all these cases it is assumed that there was reliance. Surely however where a party knows (or perhaps even ought to know) that a situation represented is not true, that party cannot have relied on the representation that it was true: it is submitted that this should be the case even if in all other circumstances it may, in looking at the actions of the guilty party, be unconscionable to deny the truth of the assumption.

One final point on the nature of the representation and reliance upon it relates to the interaction of promissory estoppel and the law of contract. It may be argued that this relates to the reasonableness of the assumption (see Leopold at p64) but it seems more fitting to deal with this question under the head of "reliance".

Austotel Pty Limited v Franklins Selfserve Pty Ltd ((1989) 16 NSWLR 582) effectively indicates that well-advised parties to substantial business matters will be less likely to be subject to a promissory estoppel.

The approach of the New South Wales Court of Appeal in **Austotel** may be viewed as providing comfort to some lenders in relation to the likelihood of a finding of unconscionability.

The case involved negotiations between a developer and supermarket proprietor in relation to a lease of property. Both parties were substantial and experienced commercial entities.

After protracted negotiations the parties had reached substantial agreement on most points but the issue of rent was outstanding. It was found as a fact that no binding contract existed because of the failure to agree on such a vital term. It also appeared that there had been deliberate reservation on the issue of rent in the hope of gaining some advantage. Priestley J made the comment at p620 that:

> "The deliberate gamble that the plaintiff had embarked on failed and it is not for equity to put the plaintiff into the position it would have been in had it never embarked on its gamble. The magnitude of the risk may not have been manifest but that is not the point. There is, in my view, a fundamental difference between the situation where the parties simply failed to address a question necessary for a complete and concluded agreement and the present where there is a deliberate and conscious decision to refrain from coming to an agreement on the term."

It seems clear in this case that, but for the nature of the parties and their deliberate "strategic" action, the required unconscionability may have been established. Priestley J confessed to an original conclusion of unconscionability but on further reflection decided otherwise.

In the words of Kirby J (at p585):

> "We are not dealing here with ordinary individuals involving the protection of equity from the unconscionable operation of a rigid rule of common law. Nor are we clearly here with parties which are unequal in bargaining power. Nor were the parties lacking in advice either of a legal character or of technical expertise. The court has before it two groupings of substantial commercial enterprises, well resourced and advised, dealing in a commercial transaction having great value ... The courts should be careful to conserve relief so that they do not, in commercial matters, substitute lawyerly conscience for the hard headed decisions of business people."

It seems therefore that the courts may be prepared to accept that the nature and strength of the parties is very relevant in a determination as to unconscionability. It is clear that in commercial negotiations even between parties who on balance have equality of bargaining power there may be particular issues on which both parties are relatively weaker. This is the reality of commercial negotiation where the goal is to extract the maximum benefit on each point and each party will have certain strengths and weaknesses in its overall position.

The decision in this case is encouraging as it expressly takes commercial reality into account. This is aptly expressed by Kirby J at (p586):

> "The wellsprings of the conduct of commercial people are self evidently important for the efficient operation of the economy. Their actions typically depend on self interest and profit making not conscience or fairness. In particular circumstances protection from unconscionable conduct will be appropriate. But the courts should, in my view, be wary less they distort the relationships of substantial well advised corporations in commercial transactions by subjecting them to the overly tender consciences of judges."

This principle was effectively also a cornerstone of the **Walton's** decision. Mason CJ and Wilson J at p403 said (in description of this principle) "a plaintiff cannot enforce a voluntary promise because the promisee may reasonably be expected to appreciate that to render it binding, it must form part of a binding contract".

Thus in circumstances where a lender is in pre-contract negotiations it is still open to it to "contract-out" of an estoppel. Thus if a lender makes it clear throughout negotiations that no promise is binding unless under a formal contract that should prevail. It is submitted that this is so even with an unsophisticated borrower: but perhaps more obvious adherence to that position may be required in such a case.

However it does seem that if the denial itself becomes treated as nothing more than a formality the benefit to be gained could be lost (see Mason CJ and Wilson J in **Waltons** at p397).

(2) Detriment

In **Verwayen** (p334-5) Mason CJ drew a distinction between "broad" and "narrow" detriment. The broad sense the detriment is that which would result if the correctness of

the relevant assumption was denied. In the narrow sense the detriment is that suffered as a result of reliance on the assumption being correct.

To found an estoppel, Mason CJ required detriment in the broad sense to be established, but he acknowledged that the practical result would often be a remedy more similar in ambit to detriment in the narrow sense. Brennan J appeared to view narrow detriment as the "relevant detriment". However Leopold (p59) interprets this merely as recognition that the remedy granted will usually "mirror" the narrow detriment.

It is clear that detriment in either sense will, as a factual issue be relevant to a finding of unconscionability. It is clear that the extent and nature of the unconscionability will fashion the remedy available for equitable estoppel and therefore the extent of the detriment suffered will necessarily be relevant to the issue of remedies.

As regards the extent of the remedy, Kirby J's observations in **Lorimer** (p39-41) are also relevant. Kirby J notes that the principle at equity will act to prevent detriment resulting from unconscionable conduct appears simple in the abstract but in practice, after **Verwayen** is unclear in application.

Kirby J extracts the following propositions from **Verwayen**:

(1) The onus is on the party asserting the estoppel to prove the relevant detriment for which it claims a remedy;

(2) As to what constitutes a relevant detriment the following are noted:

  (A) expenses or costs of a pecuniary nature already incurred in reliance on an assumption; and

  (B) non-pecuniary detriment already suffered such as an anxiety and loss of chance;

(3) The remedy must satisfy the minimum equity which may not involve making good the assumption but this may be necessary in circumstances where (for example) there has been reliance for an extended period, or where there is substantial and irreversible detriment suffered in reliance, or detriment which cannot otherwise be satisfactorily compensated or remedied.

The examples given (3) above indicate the close relationship of the element of detriment with unconscionability. The crucial element is unconscionability and it is this aspect which gives rise to and shapes the remedy available for equitable estoppel.

If we are to accept that the new estoppel is acceptable and does not undermine the notions of contract because it only focuses on avoiding "detriment to the party who has relied on the assumption induced by the parties estopped, but no more" much more does need to be made of the distinction between detriment in the broad and narrow sense. The differing views taken by the members of the High Court in **Verwayen** as to what detriment the equity was designed to avoid is indicative of this problem.

It also seems that there may have been some departure from the requirements of **Thompson v Palmer** which requires "material disadvantage". However it does appear that this has become synonymous with disadvantage other than of a "peppercorn nature" (see Handley JA in **Hawker Pacific Pty Ltd v Helicopter Charter Pty Ltd** (1991) 22 NSWLR 298).

(3) Unconscionability and the nature of the parties

Although the above analysis may seem to expose lenders to great risks, as a practical matter many fact situations which otherwise have all the hallmarks of estoppel will not have the overriding requirement of unconscionability.

As Mason CJ pointed out in **Verwayen** and **Waltons** it is not sufficient merely that a promise or assumption is "resiled from" or that the results of action or inaction by a party is unconscionable. Mere reliance on an assumption (even where detriment is occasioned) is not of itself sufficient.

It is necessary that the conduct of the party allegedly estopped is unconscionable. As to what conduct is unconscionable, this is a matter almost entirely dependent on the circumstances as indicated earlier.

What judicial comment there is by way of assistance in this determination is elaborated on later but insofar as unconscionability has been discussed in the context of estoppel it is necessary to briefly deal with this issue here.

In **Waltons** the following descriptions of unconscionable conduct were provided but ultimately are of little practical assistance:

(5) "unjust or unfair" conduct;

(6) conduct which does not accord with "basic standards of fair dealing";

(7) conduct "condemned by ordinary standards of decency and honesty"; and

(8) conduct not consistent with "notions of good conscience and fair dealing".

Deane J in **Verwayen** (at p353) stated thus:

> "Conduct which is 'unconscionable' will commonly involve the use of or insistence upon legal entitlement to take advantage of another's special vulnerability or misadventure ... in a way that is unreasonable or oppressive to an extent that affronts ordinary minimum standards of fair dealing."

He continued to say:

> "The ordinary processes of legal reasoning by induction and deduction from settled rules and decided cases are applicable but they are likely to be inadequate to exclude an element of value judgment in a borderline case such as the present."

Referring back to the five "grounds of preclusion" extracted from **Thompson v Palmer** earlier, Kirby J in **Lorimer** used these as a guide for determining whether unconscionability existed. All the "grounds of preclusion" relate to the conduct of the party against whom estoppel is alleged and it is submitted that they provide a good framework in which the surrounding facts may be analysed.

In **Lorimer** Kirby J based his decision on the fourth ground, which he considered is easier to establish than the third (which requires something in the nature of a duty to inform the other party that an assumption is erroneous). On the facts Kirby J held that

"where prudence and clear emphatic advice to observe caution where required of the respondent they were not forthcoming". This provided much of the grounds for a finding of unconscionability in that case.

It may be that unconscionability will eventually be synonymous with the elephant: difficult to describe but easy to see.

(h) Practical Aspects - Pleading Estoppel

When estoppel is used as a defence there is little distinction between equitable and common law estoppel. If common law estoppel succeeds the plaintiff, as a matter of evidence would, be prevented from denying the truth of the defendant's assumption as to the state of affairs.

With equitable estoppel the discretionary jurisdiction of equity is invoked and the court may assist the defendant as it sees appropriate in the circumstances. In many cases the most appropriate relief is to prevent a plaintiff making allegations inconsistent with the assumption on which the equitable estoppel was founded.

In the practical sense of security enforcement estoppel would most often be raised defensively by a borrower claiming that a lender was estopped from enforcing its rights in an action based on loan or security documentation.

It is in the use of estoppel as a "sword" that the differences lie. It is clear that common law estoppel cannot be pleaded as a substantive claim as such. Rather a plaintiff pleads an ordinary course of action (eg in contract) with an assumed factual basis which, the plaintiff argues, the defendant is estopped from denying. Relief is dependent on the allegations under the pleaded cause of action being established.

The use of equitable estoppel in this context is less clear. It is clear that a plaintiff succeeding on a equitable estoppel has a substantive right in equity (in that it has a right to an award of discretionary relief). It clearly can be pleaded in a cause of action but whether it can constitute a cause of action of itself is unclear.

It seems that equitable estoppel, in giving rise to a right to relief and the fact that it can affect the rights of parties and there seems no reason why it should not be available as an independent cause of action although none of the decided cases indicate that this has been done.

(i) Other applications

This analysis does not really offer a lender a greater hope or assistance if certainty is its goal. However it seems that lenders, as other commercial people, must come to grips with the fact that a more generally and less certain notion of what is acceptable behaviour is now the norm.

Since it is not possible to cover all relevant situations in discussing the general criteria applicable to estoppel, and to perhaps round out the discussion it is worthwhile to analyse a few other cases where estoppel has applied to lenders.

Walton's was a case where a voluntary promise was enforced in a situation where there never was any contract. We have seen that in some circumstances a lender, by appropriate action, can protect itself from the consequences of this doctrine (eg see **Austotel**).

One might think that where a contract is eventually entered into the terms of that contract would rule. This would be the logical conclusion of the rule in **Hoyts Ltd v Spencer** ((1919) 27 CLR 133) and the parol evidence rule.

Departure from this seems to have been accepted. In **Whittet v State Bank of New South Wales & anor** ((1991) 25 NSWLR 146) Rolfe J held pre-contract negotiations could establish an estoppel which in essence prevailed over the terms of a contract signed subsequent to those negotiations. The essence of this case is that Mr & Mrs Whittet signed an all moneys mortgage over their property in circumstances where prior to signing bank officers had stated that the amount secured would never exceed $100,000. Subsequently of course it did. The effect of the decision however was to hold them to it.

Legally the effect was to admit parol evidence to determine the effect of a written instrument under the cloak of estoppel. Admittedly the judge did require that (at p154):

> "(a) that in order to establish such an estoppel it is necessary that there should be clear and convincing proof;
>
> (b) that material giving rise to such an estoppel can arise from pre-contract negotiations".

One would hope that the former view was self evident. In any event this finding is of obvious effect upon lenders. While it is clear that **Waltons** itself was a case where there was no pre-existing contractual relationship and both Mason CJ (at p331) and Dawson J (at p364) in **Verwayen** state that no pre-existing contractual relationship is necessary to found an equitable estoppel it is not clear that they intended the parol evidence rule to be as effectively undermined as in **Whittet** (even though its reliance on **SRA of New South Wales v Health Outdoor Pty Ltd** ((1986) 7 NSWLR 170) strengthens the opposite view).

Another situation of application to lenders arises out of **Foran v Wight**. Briefly it would appear that if a lender states or represents that it is not necessary for a borrower to perform a condition precedent to a lender's obligation under a security, and if the plaintiff could otherwise have done so and does not do so in reliance on the statement or representation the lender will be estopped from relying on compliance.

4. ELECTION/APPROBATE AND REPROBATE

(a) General

The doctrine of election is clearly one of the categories of "waiver" as outlined earlier.

The purpose of the doctrine of election is to ensure that there is no inconsistency in the enforcement of a person's rights: Brennan J in **Verwayen** at p341.

The right of election is created by the existence of alternative and inconsistent rights. Once a choice between those rights is taken the other right or rights are lost and in this sense may be said to be "waived". This accords with the view outlined earlier that the general use of the term waiver describes the end result of the operation of a number of different doctrines.

An example of the operation of a doctrine of election arises in the event of a breach of contract which gives rise to a right of rescission. A party may elect to either:

(1) rescind in accordance with the terms of the contract; or

(2) treat the contract as subsisting and sue for damages.

In the case of option (1) the right to affirm the contract is permanently lost and if option (2) is adopted the right to rescind for breach is lost.

The leading cases in this area are quite clear on the broad principles of the doctrine of election and were cited with approval by the High Court in **Verwayen.** These principles were formulated by the High Court under the broad title of "waiver" in **Craine v Colonial Mutual Fire Insurance** ((1920) 28 CLR 305) ("**Craine**") and **Sargent v ASL Developments** ((1974) 131 CLR 634) ("**Sargent**") where Stephen J stated at p641:

> "The doctrine only applies if the rights are inconsistent and it is concurrent existence of inconsistent sets of rights which explain the doctrine; because they are inconsistent neither one may be enjoyed without the extinction of the other and that extinction confers upon the elector the benefit of enjoying the other, a benefit denied to him so long as both remain in existence ... by surrendering one right the elector thereby gains an advantage not previously enjoyed, the ability to exercise in full the other inconsistent right."

It is also clear that the existence of more than two "alternative and inconsistent" rights does not preclude the operation of the doctrine of election: **The Kanchenjunga** ([1990] 1 Lloyds LR 391 at 396).

It is clear that the doctrine of election is of general application and in **The Kanchenjunga** it was held that the principle of election is applicable in every class of contract.

(b) Approbate and reprobate

It appears that the words approbate and reprobate are derived from Scots Law and are generally used interchangeably with the doctrine of election. It was said in **Lissendon v GAV Bosch** ([1940] AC 412 at 429) that the phrase, that "one may not approbate and reprobate as used in England is no more than a picturesque synonym for the ancient equitable doctrine of election".

This was the view taken in **Craine** and by Toohey J in **Verwayen** (at p372). However Brennan J in **Verwayen** (at p339) referred to:

> "A doctrine closely related to election and sometimes treated as a species of election is the doctrine of approbation and reprobation."

His Honour defined the doctrine of election as a choice between rights which a person making the election knows he possesses and which are alternative and inconsistent rights. He continues to define the doctrine of approbation and reprobation as precluding a "person who has exercised a right from exercising another right which is alternative to and inconsistent with the right he exercised". For example where a person has accepted a benefit given to him in a judgment, he cannot then allege the invalidity of that judgment.

If there is a distinction between these doctrines it is a fine one, turning only, it appears, on the time at which the inconsistent rights exist. The doctrine of election would seem to require the existence of the "alternative and inconsistent" rights at the time at which the election is made. Approbation and reprobation however seem to encompass this situation where a party has exercised a right (presumably whether or not this exercise

was in itself by way of election) and after that purports to exercise an inconsistent right which did not exist at the time of the exercise of the original right.

For the purposes and in the context of this paper the doctrine of approbate and reprobate is treated as merely a synonym for election and hence the following discussions on the elements of election will be equally applicable.

(c) The Essential Requirement of Knowledge

It is quite clear that for the doctrine of election to operate the element of knowledge of the elector at the material time is required: **Kendall v Hamilton** ((1879) 4 App Cas 504 at 542). (Note that this element may not be required for the operation of the doctrine of estoppel if unconscionability could otherwise be shown).

Unfortunately the nature of the required knowledge has not yet been conclusively determined by the authorities. The issue is whether knowledge of the facts which give rise to the legal rights is sufficient or whether there is the super-added requirement that the elector know of the right of election as between two available, inconsistent rights which arises from those facts. This distinction is not unlike that between knowledge of the underlying facts and of the innocent party's state of mind under the law of estoppel.

The issue is complicated because in some cases election may take place as a matter of conscious choice whether the elector knows of the existence of the alternative right, while in others the election may be based on the conduct of the party, to which the character of an election is attributed by law.

In **Kammins Ballrooms v Zenith Investments (Torquay)** ([1971] AC 850) ("**Kammins**") Lords Pearson and Reid (although in the minority on the facts) concluded that the knowledge required to bind the elector to its election was merely knowledge of the relevant facts rather than also requiring knowledge of "the legal position arising from the relevant facts". In that case the right of a lessor to rely on a defect in its lessee's statutory application for a new tenancy was in issue. Clearly the landlord knew the application was defective (ie knew the relevant facts). However it was not certain that the landlord appreciated the legal position resulting from the relevant facts ie that they were entitled to treat the application as invalid on the grounds that it was defective.

Pearson LJ stated at p890 that to require more than merely knowledge of the relevant facts would place an unreasonable burden of proof on the tenants and concluded that only this lower standard of knowledge was required.

As authority for this Pearson LJ relied on the decision in **Matthews v Smallwood** ([1910] 1 Ch at 786, 787) which dealt with the right of a lessor to re-enter property once an unequivocal act had been taken to recognise the continued existence of the lease. In that case it was held that all that was required was "knowledge of the circumstances from which the right of re-entry arises".

However in **Kendall v Hamilton** (*supra*), Lord Blackburn stated that "there cannot be election until there is knowledge of the right to elect". This authority was accepted in **Young v Bristol Aeroplane** ([1946] AC 163 at 186) where no election was established because of the absence of the requisite knowledge. The effect of this was to preserve an injured worker's alternate rights to claim under a workers compensation statute or to sue for damages at common law when he had already received workers compensation payments in ignorance of the alternative remedy at common law.

It seems on closer analysis of the currently conflicting authorities on this point that the degree of knowledge required may vary depending on the circumstances especially the nature and source of the rights which are the subject of election.

This view is supported by both Stephen J and Mason J in **Sargent** who referred to the dicta of Herring CJ in **Coastal Estates v Melevende** ([1965] VR at 435). In that case Herring CJ drew the distinction between:

(1) rescission of a contract pursuant to a power conferred by the terms of the contract itself (in which case only knowledge of the relevant facts was required); and

(2) rescission on the basis of fraudulent misrepresentation, a right not contained in the contract (in which case knowledge of both the facts and the rights were essential to the existence of a binding election).

Herring CJ stated that where a right to rescind is contained in a contract "the parties to a contract are deemed aware of the election that the terms of the contract give them or at any rate are to be precluded from denying knowledge of them".

Therefore it could be argued on this basis that where election is between contracting parties in which the contract confers the inconsistent rights it need only be proven that the elector had knowledge of the relevant facts because knowledge of the legal rights arising from the facts is in some way assumed and is therefore not required to be proved.

In cases where the rights are not contractually conferred it may be that knowledge of both the facts and rights is required.

This approach may provide a method of reconciliation of the conflicting authorities, for example the cases involving the choice between alternative and inconsistent statutory and common law rights such as outlined above in **Young v Bristol Aeroplane**.

Unfortunately neither Stephen J nor Mason J in **Sargent** felt it necessary to decide on this approach. Stephen J stated (at p645) that:

> "I am not to be taken as concluding that where contractually conferred rights are not an issue there can be no binding election without knowledge of the right to elect."

On the facts in **Sargent** both judges held that the elector need only have knowledge of the relevant facts. The case dealt with a contract for sale of land which gave a right to rescind if the property was found to be defective in a particular way. It was found in the circumstances that the vendor could have rescinded but that it elected to treat the contract as subsisting and therefore was precluded from exercising the right to rescind.

Another argument attempting to reconcile this conflict was proposed in **Elders Trustee & Executor v Cth Homes & Investment** ((1941) 65 CLR 603) where the court expressed a clear preference for the "facts only" requirement of knowledge in cases where the conduct of the elector is **unequivocal**. In cases where the conduct amounts to no more than some evidence of election to affirm a contract the actual knowledge of the right to elect will be relevant and the conduct when viewed in the light of this degree of knowledge could be sufficient to constitute an affirmation of the contract. The nature of the conduct required for election is discussed in the following section.

In spite of the above discussion it seems that the preponderance of authority supports the view that knowledge of the relevant facts is all that is required. However the issue is not finally settled. In **The Kanchenjunga** (the most recent House of Lords case on election) Lord Goff stated at p398:

> "Generally ... it is a prerequisite of an election that the party making the election must be aware of the facts which have given rise to the existence of [the] new right."

But he added:

> "This may not always be so ... [but] ... it is not necessary for me to consider certain cases in which it has been held, as a prerequisite to election that the party must be aware not only of the facts giving rise to [the] rights but also of the rights themselves."

(d) Unequivocal words or conduct

In **Sargent** Stephen J stated that:

> "The words or conduct ordinarily required to constitute an election must be unequivocal in the sense that it is consistent only with the exercise of one of the two sets of rights and inconsistent with the exercise of the other".

It seems clear from that case that no conscious choice between alternative rights is required for election as long as there is intentional and unequivocal conduct coupled with the requisite knowledge. Stephen J at p649 confirmed that there need not be a "consciously choosing mind" unlike cases of fraud where a "wicked mind" is required.

As to what is meant by unequivocal Mason J in the same case (at p658) made some comment which seems to imply that where the conduct is **adverse** to the other party it may be considered unequivocal in its effect. It may be that this element of adversity is one of the indications of unequivocal conduct. Note that if this adversity is to be equated with detriment it seems (as will be discussed below) that detriment is not essential for the operation of the doctrine of election.

In **The Kanchenjunga** Lord Goff at p398 indicated two ways which election may be made:

(1) Firstly, where a party has **acted in a manner consistent only with having chosen one of the alternative and inconsistent courses** that party is held to have made its election. For example a party who, having a right to rescind, purports to exercise a right under the contract, is taken to have affirmed the contract. In this case it was the fact that the actions were inconsistent that gives the required "unequivocality".

(2) Secondly, the election may be **communicated** through actual words or conduct in clear and unequivocal terms.

In the previous section the possibility of knowledge of the rights being required where the conduct is less than equivocal is considered (see **Elders Trustee**). This argument appears to have the corollary that where the conduct is less than unequivocal the existence of the high level of knowledge might make it sufficient for an election.

In **Elders Trustees** the conduct was not unequivocal and was found to be merely evidence that there was election to affirm the contract. The court pointed out (at p618) that the conduct was such that it "might be considered a natural inference, if he knew that he had a right of election, that he had resolved to affirm".

(e) No need for detriment or reliance

Unlike estoppel it seems that reliance and detriment are not essential for the existence of election. However in many cases there may in fact be reliance and detriment may be a consequence of the election.

On this point also there has been some divergence of views but, given the frequent confusion involved in describing any sort of "waiver" and the incidence of cases where issues of both estoppel and election are addressed on the same facts it is possible that some of the discussion on these two doctrines has inter-mingled.

In **Sargent** Stephen J noted that the High Court had been consistent in its silence on the issue of detriment and had regarded that the elector by his unequivocal act (subject to knowledge) completed the election without anything more being required.

Stephen J cited the case of **Newbond v City Mutual Life Assurance Society** ((1935) 52 CLR 723) which dealt with both estoppel and election and in contrasting the two made it clear that detriment was not a necessary ingredient in election.

This is supported by dicta which indicates that where a party irrevocably affirms a contract by acting inconsistently with the right to rescind there is no need to communicate the election to the other party and if communication is not required it cannot logically be argued that reliance and detriment are essential ingredients.

It seems therefore that reliance and detriment are not required for election and this conclusion is supported by the dicta by Lord Goff in the recent case of **The Kanchenjunga.**

(f) Election is permanent

Once an election is made it is final (unlike estoppel which is suspensory only, although in practice its effects may be permanent).

The right (or rights) which is not elected is permanently lost. For example where a party elects to continue performance of a contract despite a breach the right to terminate for that particular breach is lost.

However the election only relates to the set of inconsistent rights which gives rise to the election and an election in respect of one set of rights does not necessarily preclude reliance on another set of rights. An example of this is where a series of breaches occurs each of which gives rise to a right to rescind (or in the present context, accelerate and enforce security). An election in respect of the rights arising under one breach does not bind the elector in the event of later breaches (although the election is permanent in respect of the first breach).

However where there is a continuing breach, the continuing circumstances do not give rise to a subsequent (fresh) right of election.

(g) Comparison with estoppel

In election the emphasis is on the reaction of the elector to the circumstances giving rise to the alternative rights, whereas in estoppel the emphasis is on the reaction to the relevant conduct of the party alleging an estoppel.

Estoppel requires proof of reliance and detriment and unconscionability is the crucial element. Estoppel is generally regarded to be temporary in effect.

Election requires none of the above elements but proof of knowledge is essential and election is permanent in effect. Note that the crucial time for an election is when the choice between inconsistent rights is made. This aspect is important because a purported prior election is really an estoppel (assuming that the other elements of estoppel are made out).

In both estoppel and election unequivocal conduct is required and consideration is not necessary.

5. THE EQUITABLE DOCTRINE OF LACHES

As outlined briefly earlier the concepts of laches and acquiescence are among the doctrines with which the term "waiver" has been associated. There is considerable overlap in the cases dealing with concepts such as election, estoppel, abandonment, etc. However the notions of laches and acquiescence are more generally discussed in the narrower context of a defence to an equitable claim.

The phrase "laches, acquiescence and delay" often appears in statements of defence on the basis that a plaintiff is not entitled to the relief it claims because of the time taken in instituting proceedings.

Before the principles of the doctrine of laches can be set out it is necessary to examine the nature of the words "laches" and "acquiescence" - it appears that there are different senses in which these words may be used and the relationship between them is unclear.

(a) The Traditional Approach

This area of equity is underpinned by two maxims. Firstly, equity aids the vigilant and not those who sleep on their rights and secondly, delay defeats equities. The justification for the court's interference can be seen from the case **Erlanger v New Sombrero Phosphate** ((1878) 3 App Cas 128) where Lord Blackburn stated thus:

> "A Court of Equity requires that those who come to it to ask its active interposition to give them relief should use due diligence, after there has been such notice or knowledge as to make it inequitable to lie by."

On the accepted "textbook" view the equitable doctrine of laches could be stated thus - a defendant can resist an equitable (but not legal claim) if it can demonstrate that the plaintiff by delaying the institution of its suit has either:

(1) limb A - acquiesce in the defendant's conduct; or

(2) limb B - caused the defendant to alter its position on reasonable reliance on the plaintiff's apparent acceptance of the status quo or otherwise permitted a situation to arise that it would be unjust to disturb.

The view was that for limb A the word "acquiescence" was used in the first of the two following possible meanings:

(1) acquiescence where the plaintiff refrains from exercising or enforcing a right of which the plaintiff knows, thereby indicating acceptance of the contrary right which the defendant asserts - this implies that the plaintiff is aware of its rights and is in a position to complain of their infringement; and

(2) acquiescence by failure to act while rights are being violated - this is the sense in which the word has been used for the purposes of the doctrine of estoppel in **Ramsden v Dyson** ((1866) LR 1 HL 129).

Whether or not this traditional formulation is applicable today must be considered in the light of the comments of Deane J in the recent High Court case of **Orr v Ford** ((1988-89) 167 CLR).

(b) Orr v Ford - the judgment of Deane J

In **Orr v Ford** the court had to consider whether laches and acquiescence were available to defeat the claim of a plaintiff to a declaration of trust by a landowner in circumstances where the plaintiff had stood by for 8 years with knowledge of the landowner's change in attitude towards his beneficial entitlement.

Deane J took the opportunity to consider the elements of the phrase "acquiescence, laches and delay" as these are frequently pleaded together.

Acquiescence

His Honour acknowledged the criticism often levied at the word "acquiescence" as used in the context of laches and commented that the word "has a chameleon-like quality which adds little besides confusion to an already vague area of equity doctrine".

He defined the word in its strict legal sense, as that used in limb A of the traditional view outlined above and stated at p337 that:

> "Strictly used, acquiescence indicates the contemporaneous and informed ('knowing') acceptance or standing by, which is treated by equity as '**assent**' (ie consent) to what would otherwise be an infringement of rights".

He noted that the word is commonly used in the context of the more specific doctrines of election, estoppel (in the sense of a representation by silence) or waiver (in a sense described by Deane J as acceptance of a past wrongful act in circumstances which give rise to an active waiver or release of liability).

However at p338 Deane J points to the existence of an "inferior species of acquiescence" by which a plaintiff may lose its right to relief, which does not amount to estoppel, waiver, election or acquiescence in the strict sense of "assent" (as referred to earlier).

This inferior acquiescence may be used in at least three ways:

(1) firstly, acquiescence may be a loose component of a "catch-all" notion of which laches and delay are also part. Deane J considers this approach as tending to obscure principle in this area;

(2) secondly, acquiescence as an independent concept from laches with the distinction being that acquiescence refers to inaction in the face of assertion of adverse rights while laches is confined to mean inaction in prosecuting rights. In the view of Deane J this distinction is unhelpful because laches (as defined later) encompasses both types of inaction;

(3) thirdly, (and most commonly, according to Deane J), acquiescence refers to the "conduct by a person with knowledge of the acts of another person which encourages that other person reasonably to believe that his acts are accepted (if past) or not opposed (if contemporaneous)". This sense of the word acquiescence applies in the context of laches existing in the sense of inaction (as described in the following section).

Further, this meaning of the word "acquiescence" is essentially the same as that used in limb A of the traditional approach outlined above.

Laches

It seems that the concept of laches derives from the French word for "slackness or negligence or not doing". As such it connotes inaction.

According to Deane J it "comprehends silence or inaction in the face of an unwarranted assertion of adverse rights by another as well as inaction or delay in prosecuting ones own rights".

It seems that laches is often equated with delay but the weight of authority suggests that mere delay is not sufficient of itself to make out a defence to an equitable claim. The better view seems to be that delay is but one of the elements going to establish an equitable defence. Deane J states (at p340):

> "Delay is relied on in the sense of the period during which there was inaction or standing by in the face of a challenge to rights or an assertion of rights".

It appears that in this context delay refers to the period of time during which there was inaction and that it is not of itself sufficient to constitute a defence.

There are diverging views on the scope of the word "laches" and this may to some extent have contributed to the differences in usage of the word "acquiescence". Deane J refers to an old text by John Brunyate, *Limitations of Actions in Equity* (1932) which distinguishes between laches in its "narrow" and "wide" senses. In its narrow sense laches means mere lapse of time. In its wider sense however laches includes laches in the narrow sense and acquiescence and also encompasses all the rules under which lapse of time in bringing a suit can constitute a defence. On this approach laches in its wide sense will include estoppel, election, release, waiver (if it has independent existence) when relied on as a defence. Deane J refers to these as "particular" or "specific" defences which are governed by their own distinct rules.

He proposes a concept of laches which is between these two extremes and stated at p339:

> "The doctrine of laches comprises those rules which define the circumstances in which equity will, without need to resort to the rules governing other more particular defences and in the absence of applicable statutory provisions, refuse relief by reason of standing by or lapse of time before action. So understood the field of operation of the doctrine of laches overlaps the areas of operation of the

> other more specific defences. It does not, however include the particular rules governing those other more specific defences."

On this analysis it seems that laches is capable of very far reaching application. It may be capable of succeeding in circumstances where estoppel, election and other doctrines discussed in this paper could potentially have application but may be difficult to establish because of the problems in proving some of the elements of those doctrines (particularly the requirement common to estoppel and election that there be unequivocal conduct).

On this approach Deane J continues, "acquiescence" is used in the sense of deliberate and informed inaction or standing by which encouraged another to reasonably believe that an assertion of rights was accepted or not opposed.

This formulation seems to merge to two limbs of the traditional analysis by requiring reasonable reliance and the notion of "acquiescence" outlined earlier in relation to the use of that term for Limb A. Deane J does not really address the issue of practical injustice apart from expressing the view that laches is a field in which equity precludes the grant of relief on the grounds that to do so would be unconscionable.

(c) Reconciliation with tradltional view

It is not clear whether the judgment of Deane J in **Orr v Ford** operates to merge Limbs A and B and require both acquiescence and reasonable reliance as prerequisites for the defence of laches. Further, given the obvious confusion surrounding the use of the words "acquiescence" and "laches" it is submitted that it would be difficult to attempt to reconcile the two views.

However, a number of the basic principles that may be extracted from the cases on the doctrine of laches are equally applicable (it seems) regardless of which view is taken. These principles are outlined in the following sections.

(d) The requirement of knowledge

On any view it is clear that at least for the purposes of the defence of laches, acquiescence requires knowledge (on the part of the plaintiff) of the existence of the right which is not exercised.

As to the exact nature of the knowledge required the debate is similar to that outlined earlier in relation to the doctrine of election, ie is knowledge of the legal right itself required or will knowledge of the facts giving rise to that right suffice.

As with election it seems that knowledge of the facts is all that is required. This was the conclusion of Williams J in **Baburin v Baburin** ((1991) 2 Qd R 240 at pp256-7) which cited the dicta of Dixon J in **Hourigan v Trustees Executors and Agency Company** ((1934) 51 CLR 619) which stated:

> "Generally when the facts are known from which a right arises the right is presumed to be known."

Further from **Allcard v Skinner** ((1887) 36 Ch D 145) it appears that availability of the means of knowledge is as good as knowledge and possibly this implies that constructive knowledge is sufficient.

(e) Practical Injustice

It seems from the cases that the important aspect of Limb B is the notion that a person will be refused equitable relief in circumstances where it would be unjust to the defendant to grant that relief.

The fact that a defendant has "reasonably relied" or "altered its position" appear merely to be circumstances where there would be the requisite injustice. Therefore the application of Limb B would not seem to be restricted to any particular fact situation and the circumstances in each case must be examined closely.

Some guidance as to the matters which a court will take account of in deciding whether it would be practically unjust for the plaintiff to be granted equitable relief may be extracted from the cases in this area. In **Boyns v Lackey** ((1958) 58 SR (NSW) 395) the following circumstances were considered relevant:

(1) the length of the delay;

(2) the nature of the acts done in the interval;

(3) the nature of the right claimed; and

(4) the nature of the property effected by the rights.

The following passage is regarded as the "classic statement of the law as to laches" and was extracted from **Erlanger v New Sombrero Phosphate Company** (at p1279). Lord Blackburn stated thus:

> "I have looked in vain for any authority which gives a more distinct and definite rule than this and I think from the nature of the enquiry, it must always be a question of more or less, depending on the degree of diligence which might reasonably be required and the degree of change which has occurred, whether the balance of justice or injustice is in favour of granting the remedy or withholding it."

This is approved by Gibbs J in **BM Autosales v Budget Rent-a-Car System Pty Ltd** ((1976) 51 ALJR 254) who added (at p259) that:

> "It is necessary to have close regard to all the circumstances of the case; the question is one of degree and the decision involves the exercise of something approaching an exercise of discretion."

Whether this element of practical injustice is necessary for Deane J's formulation of laches is not clear, however His Honour did refer to the notion of unconscionability as the justification for precluding relief of the operation of the doctrine of laches. At p339 he stated:

> "It may well be that the developing scope and flexibility of estoppel by conduct is leading to a unification of the doctrine in those areas, **such as the field of laches**, where equity precludes relief in cases where the enforcement of rights would be unconscionable."

(Note that **Orr v Ford** was decided after the decision in **Waltons Stores v Maher** where Deane J advocated the merging of equitable and common law estoppel into a unified doctrine of "estoppel by conduct" based on notions of unconscionability.)

(f) General observations

Loss of evidence

The fact that a delay in the institution of an action has caused evidence to be lost is seen as one of the circumstances of potential prejudice to the defendant for which laches may be available. This issue was most recently considered by the High Court in **Orr v Ford** (approved in **Baburin**) where it was stated that "the issue is not whether evidence has been lost but whether evidence which may cast a different complexion on the matter has been lost".

Particular instances

Although it is clear that each case must be considered on its particular facts it seems that some situations have been the subject of consistent treatment by the courts.

Certain cases have traditionally called for special promptitude, for example cases involving constructive trusts, contracts induced by an undue influence and certain claims in mining cases. In the case of **Clegg v Edmundson** ((1857) 44 ER 593) it was stated in relation to a risky mining venture that:

> "In such cases a man having an adverse claim in equity on the grounds of constructive trust should pursue it promptly and not by empty words merely. He should show himself in good time willing to participate in possible loss as well as profit not play a game in which he alone risks nothing."

It seems that where contracts involving interests in property of a fluctuating nature or value or where a transaction is hazardous or speculative then a delay which in other circumstances would not be material may give rise to a defence of laches.

Gross laches

There is an old doctrine to the effect that the defence of laches is not available to defeat a right under an express trust. However it appears that this doctrine does not apply where there has been "gross laches". This view is supported in **Hourigan v Trustees Executors and Agency Co** ((1934) 51 CLR 619 at p650) and most recently in **Orr v Ford**. As to what constitutes "gross laches" Deane J commented in **Orr v Ford** that there is no satisfactory comprehensive description but that to exhaustively specify the circumstances in which gross laches could arise would introduce an inappropriately arbitrary and technical element into the area.

Therefore the best approach is to treat gross laches as requiring not just consideration of the particular delay but also traditional notions of equity and good conscience as general indicators of whether the plaintiff should be refused relief in the circumstances.

Application to legal rights

The traditional view is that laches is only available to defeat equitable rights and not legal rights. However there is some dicta tending to cast doubt on this. In **Shaw v Applegate** ([1977] 1 WLR 970) it was held that laches may operate to defeat a legal right where:

1. a plaintiff has engaged in conduct which has generated a **Ramsden v Dyson** equity on the basis of acquiescence; and

2. it would not be unconscionable in the circumstances to grant relief.

However given the confusion in this whole area it is possible that the decision in cases such as these were more properly suited to the application of doctrines such as estoppel.

More recently, it was stated that the doctrine of laches applies equally to legal and equitable rights in **Habib Bank v Habib's Bank AG Zurich** ([1982] RPC 1) (an estoppel case) where the distinction between the two was described as both "arcane" and "archaic" and it was stated at p33 that:

> "I believe that the law as it has developed over the last twenty years has now evolved a far broader approach to this problem ... and one which is in no way developed on the historical accident of whether a particular right was first recognised by the Common Law or was invented by the Court of Chancery".

Although this case has been followed in the UK (**Hoover PLC v George Hulme (Stockport)** [1982] FSR 565) it is submitted that the defence of laches would not so readily be established in Australia in respect of legal rights.

(g) Application to lending

It is clear from the above that diligence is required in monitoring loans and failure to take prompt action in respect of breaches may provide borrowers with a defence in the event of subsequent enforcement action. Laches will be relevant in the same types of circumstances as the doctrines outlined earlier. If the suggestion of Deane J is adopted it would seem that laches may be available in circumstances where those other doctrines may not be established and therefore is a potentially valuable doctrine although its existence is confined to operating as a defence to defeat a plaintiff's equitable claim.

6. COLLATERAL CONTRACTS

(a) Nature of collateral contracts

A collateral contract may be summarised as a contract in which the promisor makes a contractual promise and in consideration of this promise, the promisee enters into the main contract. The promisor need not necessarily be a party to the main contract.

Clearly a collateral contract exists as a separate and distinct contract from the main contract and it may be formed prior to or contemporaneously with the main contract: **Hoyts Ltd v Spencer** ((1919) 27 CLR 133).

Because of the rules on past consideration, it is not possible to infer a collateral contract where the alleged main contract is agreed prior to what is relied on as the collateral contract: **Hercules Motors v Schubert** ((1953) 53 SR (NSW) 301).

There are 2 forms of collateral contract:

(1) **"bipartite"** collateral contracts - where A enters into a contract with B (the main contract) after a statement by B which takes effect as a promise in a contract between A and B, collateral to the main contract between those parties; and

(2) **"tripartite"** collateral contracts - where A enters a contract with C after a statement by B which takes effect as a contract between A and B collateral to the main contract between A and C.

It seems from **JJ Savage & Sons v Blakney** ((1970) 119 CLR 435) that three elements are necessary in order for a collateral contract to exist:

(1) there must be a statement **intended** to be relied upon;

(2) the party seeking to show existence of the collateral contract must prove that it **relied** on that statement; and

(3) the statement relied on must be **promissory** and not merely **representational** (there must be an intention by the maker to guarantee the truth of the statement).

It seems that collateral contracts must be substantially or strictly proved although it seems that this burden of strict proof may be less in the tripartite context (see **CJ Grais & Sons v F Jones & Co** (1962) NSWR 22). Note that where a collateral contract is proved the parol-evidence rule is inapplicable.

Intention is crucial with the test of intention for the collateral contract being the same as for the main contract and the collateral contract is required to be both clear and certain.

(b) Inconsistency

It is beyond doubt that where the collateral contract is found to be inconsistent with the main contract, then the collateral contract will be unenforceable. The principal authority in this area is **Hoyts Ltd v Spencer** which establishes the following 2 propositions:

(1) Where a collateral contract is inconsistent with the main contract, the collateral contract can only be relied on to the extent that it is consistent with the main contract. Isaacs J set out the rationale for this at p146 saying that "the parties shall have and be subject to all (and not only some) of the respective benefits and burdens of the main contract".

Clearly, therefore, a collateral contract cannot operate to modify or vary the **agreement embodied in the main contract.**

(2) A collateral contract cannot interfere with, alter or impinge on the provisions or **the rights created by the main contract.**

Therefore anything contained in a collateral contract which would in any way prevent full effect being given to all the terms of the main contract would be inconsistent and therefore unenforceable since the main contract embodies the terms of the agreement between the parties. Note that where a collateral contract is only inconsistent in parts, only those parts will be unenforceable.

All that a collateral contract can do is add to the main contract and this is more recently shown where the collateral contract deals with a separate subject matter not dealt with in the main contract (subject to the comments on unenforceability in the following section).

It appears that inconsistency is only relevant where the collateral contract is bipartite and does not apply where the two contracts are between different parties (as in the tripartite context).

On this issue it seems that a less restrictive approach to inconsistency is taken in England (and New Zealand and Canada). The courts in these jurisdictions take the view that the intention of the parties is paramount and therefore a collateral contract will be

enforceable despite inconsistency where this constitutes the true manifestation of the parties' intention.

However despite this and the considerable criticism directed at the rule in **Hoyts v Spencer** it is still the law in Australia at the present time.

Estoppel

It seems that the inconsistency rule in **Hoyts v Spencer** may be circumvented by the doctrine of promissory estoppel. Where precontractual statements are made which, but for the fact of inconsistency would be collateral contracts, promissory estoppel may operate to preclude the promisor from resiling from the statement (assuming of course that the elements of estoppel are established). The application of promissory estoppel to precontractual statements which are inconsistent with the contract itself was recognised by McHugh J in **State Railway Authority v Health Outdoor Pty Ltd** ((1986) 7 NSWLR 170) and by Rolfe J in **Whittet v State Bank of New South Wales & anor** ((1991) 25 NSWLR 146).

(c) Enforceability

In some circumstances the enforceability of a collateral contract may depend on the time elapsing between the oral representation and the written contract, but this will depend on the facts in each particular instance. In some cases, a considerable lapse of time may give rise to the inference that the statement was no longer a factor influencing the promisee to enter the contract and could therefore hardly be seen as a promise on which the promisee has relied. In other cases, such a lapse of time may be of little or no consequence.

In relation to the bipartite context, the terms purportedly contained in the collateral contract may be unenforceable if they are of the type that would normally appear in the main contract. In **Shepperd v Council of the Municipality of Ryde** ((1952) 85 CLR 1), the High Court stated:

> "The reluctance of the courts to hold that collateral warranties or promises are given or made in consideration of the making of a contract is traditional. But a chief reason for this is that too often the collateral warranty put forward is one that you would expect to find its place in the principal contract."

(d) Agreements to extend repayment dates and similar arrangements

It is often alleged by a borrower that the lender has agreed to certain matters which would make strict compliance for the terms of the loan agreement or securities not necessary. For example:

(1) agreements to extend the date for repayment;

(2) agreements that certain defaults would not be actioned; and

(3) agreements that securities may not be enforced in certain circumstances.

It may be claimed that such "agreements" constitute collateral contracts. However it is unlikely that a court would find this to be the case if **Hoyts Ltd v Spencer** is literally applied.

In the context of precontractual statements the borrower could contend that it had entered the loan agreement in reliance on and in consideration of that statement and therefore a collateral contract existed. However on any of the earlier examples the effect would be to modify the operation of the loan agreement and the alleged collateral contract would be found unenforceable on the grounds of inconsistency.

Accordingly a borrower would have to rely on the doctrine of estoppel (if available) to prevent a lender from acting inconsistently with any such statement.

Any alleged collateral contracts in respect of statements made after entry to the loan agreement could not be collateral contracts because of the rule against past consideration. In these circumstances a borrower would have to rely on arguments that the agreement had been varied or attempt to establish the elements of estoppel or election or waiver of the **Phillip v Ellinson Bros** type each as outlined earlier in this paper.

7. ENFORCEMENT FOR TECHNICAL BREACH

The area of enforcement for technical breach is one where the law does not adopt a specific approach. In circumstances where a borrower is otherwise performing its obligations under a loan agreement it would often seem grossly unfair, on anyone's standards of fairness, to allow a lender to declare default and accelerate payments for breach of a provision which does not in any way affect the ability of the borrower to continue performing the material obligations or does not impair the lender's security in any way. For example the obligation to provide accounts or information on a certain date or late or incomplete notice of certain trivial particulars.

It is clear, at least for the moment, that there exists no general duty of good faith and fair dealing in Australia although there are some suggestions that unconscionability of itself could operate to prevent a lender acting on technical defaults or generally give equitable jurisdiction to relieve against harsh results. For example the suggestions of Story in *Commentaries on Equity Jurisprudence* (12th Ed (1877)) (cited with approval by Mason and Deane JJ in **Legione v Hateley** *supra*), which refers to the:

> "fundamental principle according to which equity acts, mainly that a party having a legal right shall not be permitted to exercise it in such a way that the exercise amounts to unconscionable conduct".

Regardless of statements such as these, it still appears to be the law in Australia that in the absence of an independent doctrinal basis, unconscionability of itself is not sufficient grounds for the grant of relief by a court of equity.

The strict application of contract theory would seem to require that where rights are expressly provided for by contract they may be exercised, no matter how unfair the result or morally reprehensible the motive for enforcement (**Allen v Flood** [1898] AC 1).

The courts are committed to enforcing bargains where possible and are concerned with maintaining certainty in commercial relations as indicated by Lord Reid in **Wyatt & Carter (Councils) v McGregor** ([1962] AC 413) who stated that:

> "It would create too much uncertainty to require the court to decide whether it is unreasonable or inequitable to allow a party to enforce his full rights under a contract."

On the application of unconscionability as a general panacea, Brennan J in **Stern v McArthur** ((1988) 81 ALR 463) stated that "Chancery mends no man's bargain" and stressed that the courts had not sought a power to destroy the rights and obligations which the parties to a contract create. He continues:

> "If unconscionability were regarded as synonymous with the judge's sense of what is fair between the parties, the beneficial administration of the broad principles of equity would degenerate into an idiosyncratic intervention in conveyancing transactions".

It seems therefore that there is no independent principle of law that would allow for the consistent application of relief for borrowers where a lender seeks to enforce for technical breach. It is clear, however, in many such circumstances that relief is in fact granted. Accordingly, it is necessary to examine other areas of the law and equity to see the ways in which specific doctrines may be involved to justify this relief.

(a) "Waiver"

In many instances where a lender seeks to enforce the technical breach the circumstances will be such that the doctrines of estoppel, election, laches, abandonment (etc) may be available to relieve the borrower on the basis that it has (in the broad sense) "waived" or lost its right to declare default. The elements of these specific doctrines have been outlined in detail previously.

Unfortunately this area is one where judges are likely to grant relief on the basis of fairness alone by deciding that a default has been "waived" without giving a full analysis of the doctrinal basis for the "waiver" (which is merely a statement of result rather than the process by which that result was achieved). The dangers of this unprincipled use of the word "waiver" were pointed out earlier.

Often in circumstances where a specific doctrine (especially estoppel) is clearly not made out (or is not pleaded) the "fall-back" position of "waiver" may be adopted to conclude that a lender had lost its right to enforce for a particular breach.

This was the situation in the recent ACT case of **Benny v Canberra Advance Bank Ltd** ((1991) 5 ACSR 55) where the breaches for which the lender purported to declare default and appoint a receiver included (*inter alia*):

(1) failure of associates to provide financial statements;

(2) late payment of land tax; and

(3) failure to complete minor landscaping work on property for which a certificate of practical completion had been issued.

Higgins J held that the lender had "waived" compliance with the provisions requiring the financial accounts because it had never requested compliance after three consecutive breaches of the provision. It seems that this "waiver" was based on the notion of abandonment as Higgins J stressed that the provision was entirely for the benefit of the bank and that failure to enforce the provision had resulted in the bank losing the right to enforce it. However Higgins J also cites in support, the case of **Sargent v ASL Developments**, *supra*, which dealt primarily with the doctrine of election. On the facts he also found that a promissory estoppel was founded but did not provide reasons for this.

It is submitted that the primary basis for the finding of "waiver" on this point is indicated by Higgins J's statement (at p62) that "to hold otherwise would, in any event be *grossly unjust*".

In discussing the late payment of land tax, Higgins J seems uncomfortable with allowing enforcement for such a minor breach and stated that there was "something incongruous" in a conclusion that mere late payment entitled the bank to enforce all of its securities against both first and third party security providers.

On the landscaping issue, Higgins J simply stated that compliance had been "waived" without any attempt to set out the relevant legal basis for the decision. This case is clearly one where the judge considered that enforcement for the breaches in question would be unreasonably harsh and therefore dismissed them as having been "waived" so that relief could be granted.

Clearly, where the elements of estoppel, election, laches etc are made out relief may be available for the injustice caused by a lender accelerating or enforcing security for technical breach. In circumstances where the elements of these doctrines are not established however there is a problem in finding a basis for relief in circumstances where enforcement clearly would be harsh and unreasonable. However it is submitted that undisciplined use of "waiver", is not the answer and recourse to an undefined catch-all concept, although often achieving a "fair" result, would ultimately hamper the development of legal principle in this area and can only lead to confusion.

There has been little discussion of the issue of enforcement for technical breach in circumstances where the elements of estoppel, election, laches (etc) are not made out.

However it is worthwhile to look at some of the other areas in which discussion may be relevant by way of analogy. These include classification of contractual terms, the law of sureties, and the law relating to penalties and forfeiture, but firstly the position in the USA is outlined by way of contrast.

(b) USA position

In the USA there clearly exists, as a principle of general application, a duty of good faith and fairness in commercial dealings. The basis of this duty is discussed later but its applications to situations of enforcement for technical breach is clear.

In **Brown v AVEMCO Investment Corporation** ((1979) 603 F 2d 1367 (9th cir)) the duty of good faith was held to apply to acceleration clauses which were triggered by a default in circumstances where there was no question of the lender's security being impaired and no implication for the borrower's continued performance.

The court decided that a lender may not exercise an option to accelerate payment for a breach unless the lender in good faith believes that the breach has impaired the prospects for payment or performance by the borrower of its obligations (see also **KMC Co v Irving Trust** (1985) 757 F 2d (6th cir)).

(c) Classification of contractual terms

In determining whether a breach of a contractual term gives a right to terminate or merely a right to damages for breach, the law initially developed the distinction between conditions (allowing rescission) and warranties (allowing damages).

The test for a condition (or "essential" term) is set out in the **Tramways** case ((1938) 38 SR (NSW) 632) and requires that the term be so important that a party would have not entered the contract unless assured of its strict performance.

The law ultimately developed a more flexible approach as set out in **Hong Kong Fir Shipping v Kawaski Kisen Kaisha** ([1962] 2 QB 26) which accepted the concept of an "innominate" term which "stands somewhere between a condition and a warranty."

According to Kirby P in **Tricontinental v HDFI Finance** ((1990) 21 NSWLR 689 at 698):

> "This flexible doctrine permits a court, giving meaning to the agreement between the parties, to decide, according to the gravity of the breach and its consequences whether a term should be classified as a condition or warranty for the purposes of the particular default relied on".

Therefore, the consequence of a default may depend on the seriousness of the breach, thus allowing the court some measure of discretion.

In relation to time stipulations the application of this approach is particularly relevant. It is generally accepted that "time is of the essence" in commercial contracts (unlike contracts for sale of land where the parties must take certain steps to make time of the essence). Whether time stipulations must for this reason be classified as conditions was addressed in **Ankar v National Westminster Finance** ((1987) 162 CLR 549) where the court did not reject the possibility of time clauses being classified as "innominate".

It seems that this categorisation has only been applied to determine the existence of a right to terminate in the absence of an express provision. Where express provision is made for termination the terms of the contract will be construed strictly. Unless a doctrine such as estoppel, election (etc) is made out the right to terminate will be upheld. There is no scope to resort to the notion of the "innominate" term even where a breach is trivial.

Although these classifications appear to be relevant only to the context of the right to terminate, the extension of this reasoning to breaches of loan agreements and the right to accelerate and enforce security has logical appeal (whether it is supported by authority is another matter and there appear to be no cases which deal with this issue).

The right to terminate a contract for breach is a right to rescission "*in futuro*" where the parties are released from future performance but any rights and liabilities accrued under the contract to the date of termination remain in existence. This is distinct from rescission "*ab initio*" which requires that the parties be put in the position they would have been in had the contract never been entered (by way of restitution).

Under standard loan and security documentation termination is not really an issue. As a general rule extensive events of default are set out which often include any breach of covenants, undertakings or representations and warranties. Occurrence of an event of default gives the lender the right to accelerate the loan (and also appoint a receiver, to avoid the effect of **Isherwood v Butler Pollnow** (1936) 6 NSWLR 363).

A lender would not want to terminate the agreement as it would desire the terms of the agreement to continue to govern the relationship as it sets out the receiver's powers, order of payment etc.

For this reason the suggestion above that the "innominate" term classification could extend to such transactions may have no application (especially as the circumstances

where a right to accelerate exists will almost certainly be expressly stated). However, to the extent that the "innominate" term classification indicates a willingness on the part of the courts to recognise that the consequences of breach may be shaped by the seriousness of the default, it is food for thought.

(d) The law of sureties

There have been several recent cases dealing with the liability of guarantors under loan facilities in the event of a technical default. Strict application of the law of guarantees operates to discharge a surety unless the terms of the contract are strictly complied with. This traditional approach is based on a recognition that a surety, as a third party security provider, generally assumes the obligations gratuitously and accepts a dangerous obligation reliant on the defaults of others over whom it may have no control.

Because of this "precarious" position equity developed the doctrine of "*strictissime juris*" which meant that a surety would be discharged by the slightest failure to comply strictly with the terms of the contract of guarantee or for the slightest modification of the primary obligation.

However there is American authority to the effect that "compensated" sureties in commercial contexts do not need the same protection as guarantors who assume obligations for other than pecuniary gain. Therefore a less stringent approach is taken by the courts in the USA.

The most recent Australian cases in this area are **Ankar v National Westminster Finance** *supra*, **Tricontinental v HDFI** *supra*, **Corumo Holdings v C Itoh** ((1991) 5 ACSR 720) and **Bond v Hongkong Bank of Australia Ltd & ors** (so far an unreported judgment of the New South Wales Court of Appeal delivered 10 December 1991).

Tricontinental v HDFI

HDFI involved a contract of suretyship (the "Underpinning Agreement") for a large credit facility for which the surety HDFI received a substantial risk fee. The Credit Facility Agreement under which Tricontinental agreed to provide certain credit facilities to Selkis Pty Ltd was conditional on and subject to the Underpinning Agreement and when events of default occurred under the facility the lender sought to recover against the surety, HDFI. The surety argued that it was discharged on the basis of non-compliance with the Underpinning Agreement, particularly:

(1) failure of the lender to give notice of default to the borrower at its Perth office (it was sent by an employee in error to the Sydney office); and

(2) failure to comply strictly with a time requirement for making a demand on the surety.

It is clear as stated by Kirby P at p692, that "it can scarcely be said that the default was any more than the most technical breach ... clearly it caused no prejudice whatsoever to the surety".

The majority of the Court of Appeal held that despite the technical nature of the breaches, strict compliance was required and therefore the surety was discharged.

Kirby P (dissenting) however, interpreted the judgments of the High Court in **Ankar** as endorsing the American approach where the surety is compensated. He argued that in

certain circumstances, less than strict compliance is required (where there is no prejudice to the surety and the breach is minor). He stated (at p693):

> "Commercial reality in contracts of compensated suretyship would suggest that in such circumstances the surety **should** be liable upon its promise. With more than $13 million at stake it is offensive to common sense to allow the surety to escape entirely from its obligations, upon nothing more than a failure to comply with provisions in the agreement between parties relating to notice of default and demand although such non-compliance has not been shown to cause any relevant prejudice to the surety".

For Kirby P to be suggesting a lenient approach to technical breach in the context of contracts of suretyship indicates that he would view with similar (or greater) leniency contracts of other kinds which have not traditionally been viewed as *strictissime juris*.

Although the majority judges did not support this view, it seems they came to a different conclusion about the seriousness of the defaults in issue. Kirby P did not classify the relevant clauses as conditions and considered them mere trivial breaches. Samuels and Waddell JJA however, considered the defaults to be more substantial. Waddell JA stated (at p718) that:

> "The clear commercial purpose of the provisions is to provide a mechanism whereby the liability on the part of HDFI can be established in a way which is unambiguous and certain. It is essential in commercial dealings that provisions of this kind should be applied strictly so that parties know exactly where they stand."

Corumo Holdings v C Itoh

The issue of the discharge of a surety for minor breach and the decisions in **HDFI** and **Ankar** were recently considered in **Corumo** by the New South Wales Court of Appeal.

The case involved a joint venture agreement under which certain moneys were guaranteed by BNY for the obligations of Corumo. The joint venture agreement was varied twice, once with BNY's consent and once without.

Corumo defaulted under the joint venture agreement and sought to avoid liability by claiming that certain loans were void under s230 of the Companies Code (relating to loans to directors). At first instance, Rogers J held that if the section had been breached it was a highly technical breach which took advantage of the section in a way never intended and held the loans were enforceable (in spite of the possible breach). On appeal it was held that there was no breach of the section and the court did not review the first instance decision on this point.

C Itoh sought to enforce the guarantee against BNY who denied liability and claimed it was discharged on the basis of the breach of s230 and the unauthorised variation of the joint venture agreement. In this respect the facts differ from **HDFI** which involved a breach of the contract of guarantee itself. In **Corumo** the breach was of the principal obligation to which the guarantee related.

On the facts it was held that BNY was estopped from denying that it was liable under the guarantee and in concluding this the court affirmed **Verwayen** and **Lorimer**.

As to the effect of the variation on BNY's liability, Kirby P and Meagher JA held that BNY was not discharged because the variation did not alter the liability in any material way

and the effect was beneficial to the guarantor and did not increase its liability in any way (Samuels JA did not address this issue).

Ankar was clearly relied on as affirming the principle that the liability of a surety will be discharged by any variation in the principal agreement unless those seeking to enforce the guarantee can discharge the onus of proving either that the nature of the variations are beneficial to the surety or, of their nature cannot increase its risks.

Accordingly the law makes some concession for minor changes in the principal obligation but it is unlikely that any breach or default under that principal obligation could ever be considered "unsubstantial" or for the surety's benefit.

Kirby P repeated his comments in **HDFI** relating to compensated sureties but acknowledged that he was in the minority in this view. He reluctantly concluded that on the present law, contracts of guarantee were *strictissime juris*. However his Honour took the opportunity for some scathing criticism of the development of the law in this area. He noted that in other areas the law had developed to acknowledge changing circumstances and new and more sophisticated transactions, where the protective function of the law was not so crucial.

Kirby P used the decision in **HDFI** as a good example of the artificiality of the present law in circumstances where the defaults in question occasioned no real prejudice to the surety. He stated:

> "This is the kind of *strictissime* which in a commercial setting, makes the law look ridiculous. There is no necessity for the common law, which is the repository of reasonableness and common sense to adopt such a clownish garb".

He expressed the rationale of fairness for the rule in relation to minor variations of the principal obligations at p371 where he stated:

> "To allow a surety to walk away scot-free from its obligations because of an 'unsubstantial' variation in the liability of the principal debtor is so offensive to equity and the justice of the common law ... [that] ... mollifying relief from such consequences is afforded".

Bond v Hongkong Bank of Australia

As part of a refinancing arrangement Larobi Pty Limited (a subsidiary of Dallhold Investments Pty Limited, an Alan Bond family company) borrowed funds from the respondent banks. These debts were guaranteed by Mr Bond under a guarantee dated 20 February 1990.

Larobi defaulted in payment. A notice of demand was made on Larobi on 20 March 1991 claiming US$335,825,843.46 in same day funds by 10.00am local time in New York on 21 March 1991.

At 10.00 am (Perth time) on 22 March 1991 the respondent bank served a notice of demand on Mr Bond requiring payment of US$194,644,443.97 (Mr Bond's guarantee was subject to a limitation and thus the claim was not for the entire debt of Larobi) in New York by 10. 00 am on 25 March 1991 (New York time). Three copies of the notice were delivered to 3 different addresses. No payment was made. The banks commenced action.

Three defences were raised.

First that the notice did not provide a reasonable time for compliance: second that a claim for interest was penal and third the claim was inconsistent with assurances regarding enforcement given to Mr Bond. The second claim regarding penalties was dropped. Another defence was then raised to the effect that the notice had been improperly served as it had not been sent to the correct address. This was contested but a second notice of demand was served on 22 July 1991. Due to claims this was ineffective for unreasonable time for compliance (thirteen hours) a third notice of demand was served on 7 August 1991 giving 5 days for payment.

The trial judge found that the banks were entitled to succeed on the basis of the first demand.

By way of completeness after the financing arrangements were signed they were "amended" by a Deed of Rectification to correct errors which in essence increased Larobi's debt by US$5,002.77. Mr Bond was not a signatory to that deed and there was no proof as to whether he did or did not consent to it.

On appeal (but not at first instance) Mr Bond invoked **Ankar** to the effect that this change discharged him from liability under the guarantee.

On this point Gleeson CJ dismissed the claim on technical procedural grounds since it was not pleaded at first instance. Kirby J however gave the argument more air time. He stated that on the face of it the principle in **Ankar** would apply: for even though the alteration was minor **Ankar** does not permit a court to enquire into the effect of the alteration: it is enough that there is a mere possibility of detriment. Whilst again venting his spleen as to the sense of this doctrine Kirby J does seem to admit it still applies and dismissed the argument on the grounds that:

(1) the "variation" was a mere correction of a misdescription;

(2) **Ankar** does not forbid the consideration of whether the change of the liability was "unsubstantial": and in this case it clearly was not: the doctrine was therefore not attracted.

Interestingly, the guarantee provided expressly that in such circumstances the guarantor would not be discharged. Gleeson CJ, by implication, and Mahoney JA expressly upheld the efficacy of that provision ie **Ankar** can be contracted out of.

A couple of other points of interest emerge out of **Bond** and they are:

1. the guarantee must be strictly construed and since the first notice of demand was not served at the specified address it was ineffective (this was held unanimously);

2. in determining what is a reasonable time to afford a guarantor for payment on demand no regard is to be given to allowing time to refinance: a reasonable time was confined to the time necessary to effect mechanical arrangements for payment (and so in these circumstances thirteen hours was found to be sufficient).

Evidently, as the law stands at present, contracts of guarantee will require strict compliance and the scope for relaxing these requirements is limited even in circumstances of merely technical breach. It is submitted that the comments of Kirby J

on the need for the law to be flexible and recognise present commercial reality are eminently sensible and hopefully will at some stage be adopted by the courts. It looks as though this will not occur however until the matter is reconsidered by the High Court, lower courts finding themselves bound by **Ankar**.

The significance of the above discussion for the development of a general rule on enforcement of securities for technical breach is limited to some extent, but is useful in that guarantees are commonly provided as part of the security for a financing transaction and in this regard the treatment of technical defaults in relation to guarantees is very relevant (note that this paper does not aim to deal separately with the area of guarantees as a peculiar type of security).

(e) The background on notice

In the absence of express notice provisions in loan and security documentation it is clear law that a "reasonable time" must be provided to enable a debtor to meet a demand for payment: **Bunbury Foods v National Bank of Australasia** ((1984) 153 CLR 491). However what notice is "reasonable" is impossible to define as it is so dependent on the circumstances.

Traditionally some types of loan are by their nature repayable on demand (eg overdraft facilities). Others may become immediately payable on the occurrence of a certain event by the operation of an acceleration clause. For certain types of loan (often where a repayment term is fixed and the loan is fully drawn) the loan is technically on demand but is subject to an independent undertaking to the effect that if repayments are made as required no demand will be made.

The requirements for provision of reasonable notice developed from a reasonable approach to contractual construction of "on-demand" provisions.

In **Toms v Wilson** ((1863) 4 B and S 42) it was stated:

> "The deed must receive a reasonable construction and it could not have meant that the plaintiff was bound to pay the money in the very next instant of time after the demand, but he must have a reasonable time to get it from a convenient place."

Initially a reasonable period was considered to be relatively short (for example the time required to get money from a bank or safe) but the issue is ultimately dependent on the circumstances and in the modern context where companies may have sums readily available but not in liquid form, the access to funds is a matter to be taken into consideration.

Lord Goff in **Cripps v Wickendon** ([1973] 2 ALL ER 606) held that an interval of 1 hour between demand and appointment of a receiver was reasonable because it was established on the evidence that the company had no readily obtainable sources of funds from which to satisfy the demand.

The requirement of reasonable notice was extended to the context of withdrawal of an overdraft facility in **Williams & Glynns Bank v Barnes** ((1981) Com LR 205). Even though the facility was of itself repayable on demand the court was prepared to imply a requirement of reasonable notice into the banker-customer relationship.

Bunbury Foods

The leading Australian case on this point is **Bunbury Foods** where it was stated that the requirement of reasonable time:

> "does not mean that the notice calling up the debt is invalid unless it requires notice 'within a reasonable time'. It means no more than the debtor must be allowed a reasonable opportunity to pay before it can be said that he has failed to comply with the demand. A notice requiring payment 'forthwith' will be regarded as allowing the debtor a reasonable time within which to comply. Until a reasonable time has elapsed the creditor cannot enforce".

In determining what amounts to reasonable notice the High Court cited the comments of Piggott B in **Massey v Slayden**:

> "It is not necessary to define what ought to elapse between the notice and the seizure. It must be a question of the circumstances and relations of the parties and it would be difficult, perhaps impossible, to lay down any rule of law on the subject except that the interval must be a reasonable one. But it is quite clear that the plaintiff did not intend to stipulate for merely illusory notice, but some notice on which it might reasonably expect to be able to act".

The case of **Bunbury Foods** involved a mortgage debenture given by Bunbury Foods to the bank, in which it undertook "to pay to the bank on demand all monies which are now or may from time to time hereafter be owing and remain unpaid to the bank". It also provided for appointment of a receiver at any time after the secured monies became payable.

The bank demanded payment and after failure to receive payment appointed a receiver two days later.

The court held the notice of demand was valid of itself but required that Bunbury Foods be allowed a reasonable time in which to meet the demand.

On the facts the court held that the time given was reasonable and the appointment of the receiver was valid on the basis of a statement by the responsible company officer to the effect that the firm could not pay.

This decision has recently been applied in **Firona v CBA** (unreported decision of the Victorian Supreme Court, 25 October 1991) where a demand had been made for payment within 24 hours. McGarvie J considered that "law would treat the demand as effective but the limitation of time as ineffective". After **Bond v Hongkong Bank of Australia Ltd** this conclusion must be open to doubt.

Reasonableness

The word "reasonable" is not capable of precise definition and is entirely dependent on the circumstances. However in relation to demands for payment the courts have been able to provide some guidance as to the matters to be considered in coming to a determination on this issue.

Matters such as the ability of the debtor to pay in fact, the time required to obtain funds (for example by liquidation of assets, refinancing or alternative sources) and the relationship between the parties are relevant.

Some guidance on this issue is provided by recent Canadian dicta. The two landmark cases in Canada establish that:

(1) a debtor must be allowed a reasonable time to meet a demand after payment, whether the loan is expressed to be payable on demand or not: **Lister v Dunlop** ([1982] 1 SCR 726); and

(2) a debtor is entitled to time whether it is requested or not: **Mister Broadloam v Bank of Montreal** ((1983) 44 OR (2d) 368).

In these cases it was noted that a number of decisions suggest that where the position of the debtor is hopeless with the effect of prejudicing the security of the creditor, a shorter period of time to meet a demand will be considered reasonable.

These decisions were discussed in **Kavcar Investments v Aetna Financial Services** ((1989) 70 OR (2d) 225) where a financier demanded payment and immediately appointed a receiver in the light of the deteriorating financial position of the debtor. The receiver took possession 3 hours after the demand was made and the company was given 6 weeks to satisfy the debt before the assets were sold in the receivership process. The company contended that reasonable notice was required and had not been provided and the court accepted this argument.

The financier argued:

(1) that no time was required because the debtor was not in a position to either meet its obligations or to refinance; and

(2) notwithstanding the above, the 6 week period allowed the debtor time to satisfy the debt before a "fire sale".

The court did acknowledge that in some exceptional (and hopeless) cases no notice might be considered reasonable but found that as a general rule, some notice is required.

The court established a presumption that any period of notice less than 1 day was *prima facie* unreasonable and this placed the onus on the creditor to prove that the notice was reasonable in the circumstances. An onus such as this is heavy as it requires proof that a debtor does not have the ability to raise the required funds (the court recognised that a company even in technical insolvency could still have access to funds through related bodies).

The logic behind this decision is evident. The worse a debtor's position, the shorter the reasonable time will be. This recognises the increased risk to a creditor's security and allows them to move with haste to protect their position by the appointment of a receiver. To some extent therefore the decision as to what constitutes reasonable time in the circumstances must be based on the experience and judgment of the lenders themselves.

(f) Relief against forfeiture and penalties

Even in circumstances where estoppel and other specific doctrines outlined earlier are not available, equity has developed a jurisdiction which allows it to relieve a party from forfeiting its right or interest in property as a consequence of failure to perform a covenant.

As with some of the other doctrines mentioned earlier, the grounds for relief appear to be based on notions of unconscionability. In certain circumstances this jurisdiction may be invoked to protect a borrower from the loss of a proprietary interest or right if a lender seeks to enforce its securities for technical breaches.

Forfeiture is to be distinguished from the law of penalties with which it is often confused. A penalty is in the nature of a punishment for non-observance of a contractual stipulation and requires the imposition of an additional or different liability for a particular breach rather than the loss or determination of a proprietary right.

In some circumstances forfeiture is similar in nature to a penalty where the clause providing forfeiture is designed to ensure payment of rent or a fine (for example). However in order to find a penalty it is necessary for the result of the particular provision to be disproportionate to the loss suffered by the party who seeks to enforce it. With forfeiture, relief will be available without the need for an enquiry as to proportionality.

It is generally considered that relief against forfeiture is only available where a party stands to lose a proprietary right, in land or chattels. The cases in this area mostly relate to contracts for sale of land, often where the relevant breach is of a time stipulation, after time has expressly been made "of the essence". In many cases clauses which provide for forfeiture are inserted as a means of "securing" payment of moneys of some kind.

A good example in this area relates to mortgages where the notion of the "equity of redemption" was developed to relieve against the harsh result at common law where a mortgagor lost its right to have the property reconveyed for failure to repay moneys on a set date. However the mortgagor still had the obligation under its personal covenant to repay the secured moneys. Equity intervened to relieve against this harsh result which was occasioned by failure to observe an essential time stipulation.

Whether the jurisdiction to relieve against forfeiture is one of general application is unclear. There is dicta and commentary which attributes to equity a general jurisdiction to relieve against injustice or harshness in enforcement of legal rights on the grounds of unconscionability. However, the weight of authority does not support this view. (See later discussion in relation to unconscionability and the existence of a duty of good faith.)

The leading UK case in this area is **Shiloh Spinners v Harding** ([1973] AC) where Lord Wilberforce set out two areas (not intended to be exhaustive) where relief against forfeiture will be available:

(1) where the object of insertion of a provision is to secure payment of moneys (eg a rent or a fine); or

(2) a general ground for intervention where there exists fraud, accident, mistake or surprise (extended, it appears by subsequent cases to encompass unconscionability).

The first major Australian case in this area was **Legione** v **Hateley** *supra*, where the purchaser of land paid the deposit and agreed to pay the balance of the purchase price a year later. In the meantime the purchaser entered possession and erected a house on the property. On the due date it failed to pay the balance but paid 5 days afterwards. However the vendor had already rescinded the contract. It was found as a fact that the plaintiffs could have paid on the due date but had been told by a secretary to the vendor's solicitor that it would probably be satisfactory if they paid the following week.

The High Court held that the purchasers were relieved from forfeiting their interest in the property. Gibbs CJ and Murphy J found that it was "unjust" for the vendor to insist on the purchaser forfeiting its interest, because of the erection of the house and the explanation for late payment.

Mason and Deanne JJ took a slightly different approach and looked for "unconscionable conduct" extending the principles set out in limb (2) of Lord Wilberforce's statement above.

There has been some criticism of this decision on the basis that the issue in **Legione v Hateley** was not whether relief against forfeiture was available but whether there existed an "equity" to prevent the vendor from rescinding the contract. (As suggested in **Ciavarella v Balmer** (1983) 153 CLR 438 and **Lexane v Highfern** [1985].)

Whatever the correct interpretation it seems from all of these cases that unconscionability is a requirement for the grant of relief in this area.

The case of **Stern v McArthur** ((1988) 81 ALR 463) to some extent confuses the basis for relief in this area. The case involved a contract for purchase of land by instalments with no title passing until full payment had been made. With the vendor's knowledge the purchaser went into possession and erected a house. On missing instalments the vendor terminated the contract.

A majority of the New South Wales Court of Appeal took a novel approach and held that the purchaser's interest in the property was in the nature of a mortgage and then considered whether it would be unconscionable for the vendor to insist on forfeiture of that mortgage interest (echoing the cases on the equity of redemption).

In the High Court Deane and Dawson JJ supported the majority decision in the lower court. Gaudron J however looked to the notion of unconscionability after considering certain elements which included, the interest in land, the forfeiting of the deposit and the indefinite retention of instalments already paid. In order to ground relief on the basis of forfeiture she did not need to resort to the somewhat artificial construction of a mortgagor/mortgagee relationship. The fact that an interest would be forfeited and the existence of unconscionability, was sufficient to ground relief.

Mason CJ dissented and stated that to decide the case on unconscionability where there existed no exceptional circumstances would be to "eviscerate unconscionability of its meaning".

Arguably, in circumstances where a borrower stands to lose a proprietary right or interest as a result of the lender enforcing for a technical breach relief against forfeiture may be available. The court will consider the extent of default as a factor whereby unconscionability is determined as well as the conduct and circumstances of the lender enforcing its rights.

It is clear from both **Legione v Hateley** and **Stern v McArthur** that the extent of the forfeiture is relevant. Gibbs CJ and Murphy J in **Legione v Hateley** stated that "to enforce the legal rights of the vendors in these circumstances would be to exact a harsh and excessive penalty for a comparatively trivial breach."

(g) Conclusion

As the law stands today there is no independent basis on which relief may be granted where a lender seeks to enforce for technical breach in circumstances where its security

is not impaired and it is not otherwise prejudiced. Where the consequences of breach are expressly stated the courts are reluctant to interpret the contract otherwise than requiring strict compliance.

Fortunately for borrowers there is considerable scope in this area for the operation of the doctrines of estoppel and election (and if it exists "waiver simpliciter" or abandonment) and so in practice many instances of technical breach will not allow a lender to enforce its securities.

There does not seem to be great scope for a change in the courts approach in this area. Most recent indications are that strict compliance with express contractual terms will be enforced.

The stringent view of the courts is illustrated by the case of **McMahon v State Bank of NSW** ((1990) ACLC 310) where a receiver was appointed for alleged non-payment of interest on a loan of approximately $4 million. The demand was not complied with and a receiver was appointed. The company challenged the appointment on the grounds that the alleged non-payment of interest was not sufficient. It was held that this particular "breach" upon which the appointment made could not be supported.

However, at the time the demand was made there existed another breach, of which the bank was not aware (the company broke a covenant by leasing a vehicle without the bank's consent). Because of this the court held (taking a very strict approach) that the bank was entitled to demand full payment and appoint the receiver.

Meagher JA stated the relevant legal principle as follows:

> "a party who takes a step pursuant to a contract is entitled to justify the taking of that step if the *objective facts* which justify the taking of the step existed at the relevant time even although that party at the time the step was taken did not know of the facts."

Priestly JA justified the decisions on the basis that the borrower knew the risks of when it entered the agreement. He stated that:

> "The case presents a vivid illustration of the sweeping powers lenders obtain for themselves against borrowers of large sums of money. This is part of the price borrowers pay for use of the money."

8. THE CONCEPT OF UNCONSCIONABILITY

As mentioned earlier "unconscionability" is increasingly being used as a basis for equitable relief in a wide variety of fact situations and it is recognised as underpinning a number of established doctrines in equity such as estoppel, laches and the law on penalties and forfeiture.

Clearly, as discussed in relation to estoppel, the existence of unconscionability is highly dependent on the circumstances and therefore it is difficult to set down any principles of general application.

There is further complication added by a more restricted usage of the word in the area of harsh contracts which requires some element of inequality of bargaining power. This is to be contrasted with the broader view of unconscionability as a common characteristic of various equitable grounds of relief.

The analysis in this area will begin briefly with an outline of the requirement of unconscionability in the context of harsh contracts and continue to examine the broader notion of unconscionability and extract to the extent possible some elements which may be relevant to a finding of unconscionability. Following this, the potential for the development of a general duty of fair dealing and good faith will be considered in the light of recent developments and the position in the USA.

(a) "Narrow" unconscionability and contract law

In this restricted sense equity invokes the concept of unconscionability as a ground for relief from certain contracts where the emphasis is on the relative bargaining power between the contracting parties.

In this respect there is much in common with undue influence and duress as a means for avoiding contracts, although both of these operate to destroy the element of contractual assent (on the part of the weaker party) which is necessary for the formation of a binding contract. "Narrow" unconscionability however looks more to the conduct of the stronger party in taking advantage of a special disability or disadvantage of the other.

Catching bargains and equitable fraud

The law in this area developed out of equity's traditional jurisdiction to relieve from transactions on the grounds of equitable fraud. Many of the early cases were concerned with the "expectation" interest of heirs and those entitled to reversionary interests or remainders in life estates. It was quite common for such "expectations" to be pledged in what became known as "catching bargains" in many instances there existed inequality of bargaining power as the "expectants" were often young and easily exploited.

In these cases developed the notion of equitable fraud, not in the sense of deceit but rather involving an unconscientious use of power arising out of the unequal situation. This was recognised in **Earl of Aylesford v Morris** ((1873) LR 8 CH APP 484) where it was held that if the relevant positions of the parties to a contract is sufficient to raise a presumption of "fraud", the onus is on the party who claims the benefit of the transaction to prove it to be just, fair and reasonable.

Similarly, relief came to be granted in other circumstances where the parties were of unequal strength. The types of disability for which equity intervened include poverty, age, sickness, lack of education, illiteracy, and inexperience.

Inequality of bargaining power as an independent ground for relief

There has been some suggestion in the later English cases that the basis for the grant of relief in the cases outlined above was the mere fact that equality of bargaining power was lacking. Lord Denning seems to indicate this in **Lloyds Bank v Bundy** ([1975] QB 326) where he suggested that inequality of bargaining power could constitute an independent ground for relief.

However it will be seen from the following discussion that, at least in Australia, there is no such general principle. It is submitted that the basis for relief is unconscionability in the broader sense (of unfairness, injustice, unconscientiousness etc) in circumstances where the parties are of unequal strength. The inequality gives rise to a presumption of unconscionability in the broader sense with the onus being on the stronger party to prove otherwise.

The Australian position

Equity's jurisdiction to relieve against a transaction such as outlined above has long been recognised in Australia. The seminal case in this area is **Commercial Bank of Australia v Amadio** ((1983) 151 CLR 447) affirming the earlier decision of the High Court in **Blomley v Ryan** ((1954-56) 99 CLR 362). **Amadio** has been cited with approval on numerous occasions and the facts are well known but it is worth briefly repeating them.

The case involved a mortgage given by the Amadios, (two elderly Italian migrants with a limited understanding of written English), to secure the overdraft of their son's company. The mortgage document (which also contained a guarantee) expressly secured "all moneys" owing by the company to the bank and was of unlimited duration.

It was clear from the facts that the Amadios believed their liability under the document was limited to $50,000 and was for six months duration only. They had been led to believe this by their son and the bank was aware that in this respect, the Amadios had been misinformed. The Amadios had received no independent advice and it was also clear to the bank that the transaction conferred no benefit on the Amadios.

When the company went into liquidation the bank made a demand under the guarantee for all moneys owing on the overdraft account, which at that time amounted to $239,000.

The Amadios sought relief from their obligations under the mortgage and guarantee. They succeeded at first instance and the case was appealed to the High Court where the majority dismissed the appeal on the grounds that the Amadios were under "a special disability" when they executed the mortgage document. Because of this disability it was *prima facie* unfair or unconscientious for the bank to rely on the guarantee. The onus was on the bank to prove otherwise and it failed to do so. In coming to their conclusion the majority judges were strongly influenced by the bank's knowledge that the Amadios had been misinformed as to the extent of their liability.

The comments of Deane J and Mason J (with whom Wilson J agreed) are especially useful on the aspect of unconscionability.

Mason J (at p461) notes the historical jurisdiction of the court to satisfy contracts and other dealings on a number of grounds which include fraud, misrepresentation, breach of fiduciary duty, undue influence and unconscionable conduct. He expressly refers to the different senses in which the words "unconscionable conduct" may be used. He refers to the grounds referred to above as constituting "species of unconscionable conduct" on the part of the party who stands to receive a benefit under a transaction which, in the eye of equity cannot be enforced because to do so would be *inconsistent with equity and good conscience*.

However he also points to the existence of a narrower sense of unconscionable conduct where the basis for relief is the "*unconscientious" use* by a party of its superior position or bargaining power to the detriment of a party who suffers some "special" disability or disadvantage.

Although the relief given may not necessarily be mutually exclusive this narrower sense of unconscionable conduct is clearly distinguished from undue influence. In the case of undue influence "the will of the innocent party is not independent and voluntary because it is overborne". For unconscionable conduct, however "the will of the innocent party, even if independent and voluntary, is the result of the disadvantageous position in which he is placed and of the other party *unconscientiously taking advantage* of that position".

The situations in which the "special disadvantage or disability" may arise cannot be definitively stated but the following list is extracted from the judgment of Fullagar J in **Blomley v Ryan** (at p405):

> "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 is necessary. The common characteristic seems to be that they have the effect of placing one party at a serious disadvantage vis-a-vis the other."

In that case Kitto J stressed the requirement that "the other party *unconscientiously takes advantage of the opportunity* thus placed in his hands".

Deane J (at p474) agreed with the above statements and stressed that:

> "Unconscionable dealing 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 in circumstances where it is *not inconsistent with equity or good conscience* to do so".

Deane J notes that in many cases where relief has been granted in this area there has been inadequate consideration moving from the stronger party, however he states that this is not essential. He states that notwithstanding the adequacy of consideration "a transaction may be *unfair unreasonable and unjust* from the viewpoint of the party under the disability".

From the passages extracted above it is clear that something more than the existence of a special disability or a disadvantage is required. It seems that this extra ingredient is unfairness or unconscionability in the broad sense as indicated by use of words such as "unconscientious", "unjust", "unfair", "unreasonable" etc.

This is evident from the comments of Gibbs CJ, who specifically stated (at p459) that even though the parties did not meet on equal terms "that circumstance alone does not call for the intervention of equity". In his view there was the additional requirement that the party seeking to enforce the transaction has taken "*unfair advantage*" of the situation.

Conclusion

Clearly this area is, in reality, just one of the areas where equity will intervene on the basis of unconscionable conduct in the broad sense. The existence of a special disability or disadvantage sets up a presumption of unconscionability on the part of the stronger party who must bring evidence to rebut that presumption.

Although this area is often just referred to as "unconscionability" it is obvious that the concept is not confined to situations where there exists such a special disability or disadvantage. The decision in **Whittet v State Bank of New South Wales** on similar facts (but where a solicitor was involved) is another example.

Intervention of statute

It is worthwhile to note in passing that the notions of unconscionability where inequality of bargaining power exists has been embodied by statute in the unfair contracts legislation in each state (and also to some extent in the Trade Practices Act). It is not proposed to discuss these provisions here.

(b) What is "unconscionability" in the broad sense

Apart from generalised words such as "fairness", "justice", "good faith", "good conscience" and numerous other expressions it is impossible to say exactly what constitutes unconscionability or to set down any principles of general application. It is essentially a moral concept and based on an examination of the facts in any given situation and the conduct of the parties in the light of prevailing community standards as to what conduct is acceptable.

It is often said that something is unconscionable if equity will act to provide relief but, given that the basis of a grant of relief in equity is often unconscionability itself, this explanation is circular and really of very little use.

Ultimately, the issue depends on the circumstances and will in many cases involve value judgments. Unfortunately in an area such as this there is the danger of an unprincipled use of the word unconscionability with it being used as a basis for relief without a thorough exposition of the factors upon which that conclusion was made in any particular case. This is especially important in first instance decisions where trial judges have the benefit of seeing the evidence examined and cross examined first hand. For the appeal process to operate effectively it is essential that appeal judges have a full and clear factual basis upon which to assess a trial judge's decision on the law.

Some of the areas discussed earlier have a crucial requirement of unconscionability in circumstances where there exists (for example):

(1) inequality of bargaining power;

(2) a mistaken assumption upon which reliance has been placed; or

(3) a party has delayed inexplicably in bringing an action.

It is submitted that these are examples of the types of circumstances where the courts have considered that unconscionable conduct is more likely to exist and because of this likelihood independent doctrines have developed. Although these doctrines to some extent have distinct elements they still rely on unconscionability as an overriding requirement which unfortunately is generally only referred to in the broadest of terms.

However from an analysis of the cases in relation to these specific doctrines it is possible to extract a (non-exhaustive) list of some of the considerations which a court may take into account in determining on the issue of unconscionability:

(1) the nature of the parties in terms of experience, relative bargaining power, special disabilities etc;

(2) the type and complexity of the transaction involved and the length of negotiations and any relevant time pressures;

(3) the conduct of both parties in the light of the above considerations;

(4) the reasonableness of the conduct or reliance of a party in the circumstances;

(5) the expectations of the parties whether mutually or individually;

(6) the existence of any mistake or misinformation on the part of either party;

(7) the intention of either or both parties and their expectations as to the conduct and outcome of a transaction; and

(8) the nature and extent of any detriment suffered.

Although these factors may be useful as a general guide, ultimately, as pointed out by Deane J in **Verwayen** (in the context of estoppel):

> "The question whether the departure from the assumption is unconscionable must be resolved not by reference to some preconceived formula trying to serve as the universal yardstick but by reference to all the circumstances of the case."

Whatever its elements it is clear that notions of unconscionability and fairness appear in a large number of areas of the law, extending far beyond mere commercial dealings (although this is naturally the area with which this paper is most concerned).

The South Australian case of **Diprose v Louth** ((1990) 54 SASR 450), although mentioned primarily for the purposes of light relief, provides an excellent illustration of the potential applications of the law of unconscionability.

In that case the South Australian Supreme Court applied the principles outlined in **Amadio**, on the basis that the required special disability or disadvantage existed because of the emotional dependence of one party on another who knowingly and unconscientiously took advantage of this dependence.

The facts of the case are quite extraordinary and describe a tragic scenario of unrequited love. Diprose, a Tasmanian solicitor, fell "deeply" in love with a woman whom he met at a restaurant "The Smiling Toad". The woman continually claimed that she wanted no commitment and that she had resisted his overtures, although it was admitted in evidence that the parties had occasionally been "intimate".

Diprose moved to Adelaide to be with the woman and continually showered her with expensive presents and attention. The court held that the woman tolerated Diprose's visits and took advantage of his generosity. Litigation arose when Diprose purchased a house in the woman's name and she later refused to recognise his interest in it.

The court found that the woman had deliberately manufactured an atmosphere of crisis in order to influence Diprose to provide money for the house. The court applied the principles in **Amadio** stating that emotional dependence or infatuation can constitute "pressure without adequate protection" and may in law create an unequal rational bargaining power such as to deprive a voluntary donor of proper judgment.

In concluding that the woman had taken unconscientious advantage of this emotional dependence the court looked at all the circumstances of the case, an examination which involved volumes of love poems being tendered in evidence, which according to Legoe J varied from:

> "Classical references (Greek and Latin) to some French, and finally to unequivocal sexual innuendoes displaying a passionate obsession for her."

(His Honour then quotes certain passages from these poems which do not bear repeating.)

As to the requirement of unconscionability the court looked at the woman's conduct and found that she had embarked on a deliberate process of manipulation to which he was utterly vulnerable by reason of his infatuation.

(c) A general duty of good faith and fair dealing?

As indicated through the course of this discussion so far, notions of good conscience and fairness are increasingly being relied on to relieve the parties from strict compliance with contractual terms. The emphasis seems to be moving towards consideration of nature of the relationship between contracting parties rather than simply the agreement between them as expressed in formal documentation.

Liability is increasingly reliance-based and courts are turning away from application of the strict "bargain-theory" of contract as it existed in the nineteenth century.

This area has been examined in detail in a paper by Don Robertson of Freehill, Hollingdale & Page (published in the *Journal of Banking and Finance Law and Practice* 1991 Volume 2 Nos 2, 3 and 4) and it is not intended to repeat the thorough exposition outlined there, other than to raise some of the relevant issues.

It is clear that there is not yet a fully developed doctrine of good faith and fair dealing in the Australian law, although the courts are recognising that factors other than the strict "bargain" between parties affect the enforceability of contractual arrangements.

In the context of lending and security enforcement the law is particularly receptive to such ideas (especially in cases of marginal solvency) because of the potential effects of enforcement of security on parties other than the direct participants in a transaction. Recognition is increasingly taken of the interests of third parties and the wider interests of the general community. In these days of economic downturn and an unprecedented number of business failures, we can expect further developments of the principles based on notions of good faith.

It is clear that there already exists in the USA a doctrine of good faith and fair dealing in contract performance. This has been embodied to an extent by statute and a duty of good faith and fair dealings is imposed on contracting parties by s205 of the Restatement 2(d) of Contract.

The Uniform Commercial Code ("UCC") contains provisions more pertinent to lending and security which include:

(1) s1-203 requires that "every contract or duty within this Act imposes an obligation of good faith on its performance or enforcement";

(2) s1-208 states that where a security provides for acceleration of payment "at will" or when the secured party considers itself "insecure" that acceleration must be made in good faith;

(3) "good faith" is defined in s1-201(19) to require "honesty in fact and in the conduct of the transaction concerned";

(4) "Agreement" is defined in s1-201 (3) to mean the "bargain of the parties in fact as found in their language or by implication from the other circumstances including course of dealing or usage of trade or course of performance"; and

(5) "contract" is defined in s1-201(11) as "the total legal obligation which results from the party's agreement as affected by this Act and any other applicable rule of law".

The Restatement 2(d) of Contract also refers to "faithfulness to an agreed common purpose and consistency with the justified expectations of the other party".

Comparing this with the statements on the notion of unconscionability outlined earlier especially in relation to estoppel as extracted from **Verwayen**, it is clear that virtually the same considerations apply. The difference at the moment seems to be that in the USA the duty of good faith applies generally in all commercial dealings while in Australia, at least at present, there seems to the requirement of a traditional doctrinal basis for relief (although that ground for relief is clearly based on unconscionability).

In addition to the statutory requirements, the general law in the USA has often operated to qualify express contractual terms which do not accord with the court's notions of good faith. In effect this imposes a duty to exercise contractual rights in a certain way when the interests of another party may be affected. In effect the result is to impose extra contractual regulation on the exercise of strict rights.

The application of the notion of good faith in secured lending has been recognised in the USA in relation to acceleration provisions. In **Brown v AVEMCO Investment Corporation** ((1979) 603 F 2d 1367 (9th Cir)) the lender proposed to accelerate for technical default in circumstances where the default did not impair the security or in any way affect the borrower's ability to repay or perform its obligation. The court held that acceleration clauses are not to be used offensively.

The principle of good faith was also invoked in **KMS Incorporated v Irving Trust** ((1985) 757 F 2d (6th Cir)) to require that reasonable notice be given before a lender discontinues the line of credit in order for the borrower to seek alternative finance. In that case it was held that the document making the demand was a form of acceleration of debt and therefore the provisions of the UCC applied.

Conclusion

It is hard to predict how far the Australian judiciary and legislature may go to adopting some of the USA law in this area. However there is no denying the move towards the notions of good faith and fair dealings in the recent cases and it is reasonable to expect the trend to continue.

The *laissez-faire* approach to commercial dealings can no longer be supported in many instances. It is argued that market forces produce efficient outcomes but these outcomes are not necessarily equitable. For this reason there is recognition of the need for intervention in many areas of the economy including contractual relations.

Although certainty, as reflected in commercial contracts, is desirable the trend is towards recognition of the need for intervention in a way which may alter the strict agreement between the parties and operate to reallocate the inherent risks involved in commercial dealings.

However as the law develops in this area it is hoped that it occurs in a principled manner so that the benefits of commercial certainty and commercial activity in general are not sacrificed.

9. SOME GENERAL COMMENTS

The implications of the above analysis for lenders are enormous. Given the intrusion of the doctrines of equity into the law of contract, the increasing reliance on notions of unconscionability and injustice as a basis for the grant of relief and the mumblings of acceptance for something in the nature of a general duty of fair dealing the potential risks for lenders in enforcing securities are considerable.

Clearly it is no longer possible to rely solely on the terms of the agreement between the parties as represented by formal loan documentation where the behaviour of the parties is at odds with its terms.

Gone are the days which a facility agreement could be put in a cupboard and ignored unless and until a borrower ceased to make interest payments on time.

A security is only valuable protection if it can be enforced. The above analysis indicates that matters related to the conduct of lenders and not covered specifically by contract may limit the extent to which a security can be enforced and in some cases the effect may be to make a security virtually useless.

Lenders must therefore be continually diligent in monitoring loans and must take extreme care in their reactions (or inactions) to events of default so as not to be restricted in the exercise of their rights whether at that time or at a later stage.

Lenders must ensure that representations made by their representatives are not without authority and do not convey false messages to borrowers in relation to (for example) the lender's intention regarding default, time for payment of interest or repayment of principal, strict compliance with covenants etc. Any "side-arrangements" of this kind should be formally documented where possible for the sake, firstly of certainty and secondly so that they be incorporated as part of the formal agreement between the parties as a valid variation of contract.

Any purported "waiver" (in the broadest sense) should be written and expressly restricted to the particular matter "waived".

These steps may seem unduly onerous or indeed uncommercial in many circumstances and the extent of the care taken by a lender in this regard will depend on its particular situation and will be based on an objective assessment of the extent of the risks involved. However for this to be done it is necessary that lenders be alerted to these risks and in this regard there is a role for lawyers, firstly in educating lenders and secondly in advising on ways to minimise the potential risks. In the same way that some firms set up systems to ensure compliance with certain statutory provisions (for example for the Trade Practices Act or reporting provisions under the Corporations Law) so too could systems be put in place to ensure effective monitoring of loans with the aim of preserving all rights and securities intact for those lenders who do not already have effective systems in place.

Although the risks set out above may seem horrifying there is some comfort for lenders when dealing with experienced and commercially sophisticated borrowers. In some instances, especially where issues of unconscionability may be raised, the nature of the parties will be very relevant and where parties of equal bargaining power are transacting the courts are less likely to interfere with the commercial arrangements and more likely to enforce the bargain as reflected on the face of formal documentation.

However for lenders dealing with small, inexperienced borrowers or security providers (as is the case with almost all the major financial institutions) there are considerable potential risks of which lenders should be aware (and take steps to avoid).