RECENT DEVELOPMENTS – LENDER RESPONSIBILITIES

Personal Guarantees, Lender Responsibilities, and Independent Advice

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As Lee Aitken was unable to attend the Conference to present his paper, Professor Bryan Horrigan very kindly stepped in at only 24 hours' notice to make some brief comments to set the scene for this topic. The transcript below has been edited for clarity only and is not intended to be viewed as representing a formal paper.

TRANSCRIPT

Ladies and gentlemen: If yesterday was the magical mystery tour, where we discussed a variety of insolvency-related things, I suppose today can be characterised as the magic roundabout because, like many of you, the feeling I have about this particular topic is that we have come back to it again, and we go round and round, and sometimes we do not progress very far. The reality is that we cannot take it off the agenda for this or future years, because things keep happening on the legal front and on the practical front. So let us try to do something above and beyond what we all know already about this vexed issue of solicitor certificates, *Yerkey v Jones*, banking safeguards, and those sorts of things.

What is the context within which we are looking at this topic? Well, we have three parties: the surety, the debtor and the bank. This raises a lot of problems because it is bread and butter business for banks and it is one that many solicitors some time in their lives confront (ie advising guarantors). It often involves guarantors in some sort of relationship – married or otherwise – with the principal debtor, with the bank financing the principal debtor or the debtor's business on the strength of a third party security amongst other securities. It might be over a jointly owned matrimonial home, it might be a personal guarantee, the surety might actually be involved in the business in some way – there are countless permutations. Do we have as between the debtor and the surety, if they are in a marital relationship or some other relationship, some sort of conduct that goes on that we can fit into those legal pigeon holes like misrepresentation, unconscionability, undue influence and so on?

As between the principal debtor who is getting the money for their business and the bank, has the bank in light of some old cases effectively made the debtor their agent for the purpose of procuring the signature from the surety? Does the bank have notice on any of the various legal doctrines of what it is that the debtor has done in terms of conduct involving the surety? Does the bank have notice of the conduct that has occurred between the debtor and the surety which would effectively sheet home the deficiencies of that conduct to the bank, so that the bank is effectively on notice and cannot rely on the security? That is the first dimension of notice that can be important.

We ought not to forget this limb, as well, in the tripartite relationship, which is: is there any conduct as between the bank and the surety which might vitiate the transaction? It is one thing to say there has been some procurement by the debtor or the debtor misrepresented to the guarantor what was happening. It is another thing to ask whether the bank itself committed negligence or misrepresented the position if it asked its officers to explain something and so on.

Now the difficulty is that, from the bank's point of view, telling guarantors to go off to get a solicitor's certificate of independent advice is the lowest common denominator response, and involves minimal thought, minimal effort, and minimal risk. For banks to have anything other than a lowest common denominator response involves introducing tiered procedures. Sometimes it involves changing procedures, sometimes it involves thinking: "Well, OK. Do we have a matrix of factors that we ask our loans officers to think about depending on circumstances? Do we have one set of rules for wives and husbands? Do we have another set of rules for other guarantors?" It starts to get a bit more complex. Banks have to think about it in terms of bank officers. What is it that we expect our bank officers to understand about the legal pitfalls in this area? Do we want our bank officers explaining anything about the transaction? And different banks have different procedures now in light of some of these recent cases about whether they will even permit their bank officers to explain anything or whether they will simply send guarantors away to a solicitor.

Finally, on a cost-benefit analysis from the bank's point of view, even if you are going to get into trouble on some of these worst case situations that end up in court like *NAB v Garcia*, *Barclays Bank v O'Brien*, and *Yerkey v Jones*, do you just say that for the number of court cases that we are going to be involved in, it just is not worth it on a cost-benefit analysis to change our procedures simply to ensure a higher level of effectiveness than we need?

Taking the advising lawyer's point of view, you do not need me to tell you that you cannot charge an effective amount for giving advice to a guarantor that makes it worthwhile for the amount of work and risk that is involved. There is a problem for lawyers in having access to accurate information about the transaction, if you are going to advise a guarantor adequately about thinking about the risks before they enter into the transaction. Those risks are legal and financial. And it is very hard sometimes to explain in the abstract the meaning of a particular provision in a guarantee without understanding something about the financial background. And of course you may not have access to that information, and that raises questions like "Should I ask for that?", "What if the principal debtor will not allow it to be released?", and so on.

It is also largely unwanted advice. Some guarantors effectively are throwing their assets away for the sake of an emotional relationship, they do not want this advice, and they do not want to pay much for it, but they are told by the bank to get some independent advice before the deal is done. However much it might be for their benefit, it is viewed as an inconvenience and an obstruction to the deal. Lawyers increasingly are reminded of something we should all have known about before, which is that there is huge risk attached to this and that, for the amount involved in terms of what you can charge, it is just not worth it in terms of loading up your indemnity insurance policy premiums.

For those who are advising guarantors and looking for ways to challenge these things, we need to understand the recent cases in light of the increasing grounds for challenge. There is unconscionability in the *Amadio* sense. One of the developments to highlight here is the *Yerkey v Jones* doctrine of special treatment for spouses (ie husband and wife situations) and the status of that in a case currently reserved before the High Court (ie *NAB v Garcia*). Next are the provisions in the Trade Practices Act, the existing misleading and deceptive conduct provision (section 52), but also section 51AA on unconscionability, and some other provisions (eg new section 51AC). Next are the Fair Trading Acts of the various States, the Contracts Review Act in New South Wales, undue influence, constructive notice, misrepresentation, the Consumer Credit Code provisions, negligence and other torts, constructive trusts, agency, and breaches of the Banking Code of Conduct or breaches of requirements of solicitors' certificates that have been sanctioned by various State organisations.

I mentioned that *Yerkey v Jones* is currently subject to review by the High Court, in *NAB v Garcia*. Let us focus on the elements here because what we are talking about is a High Court decision on whether or not this decision remains as part of the law – if it is part of the law at the moment. This is about equity looking at husband and wife situations where security is offered by one spouse for the debts of another. Equity presumes that these sorts of special relationships might have an invalidating tendency. Part of the significance of this doctrine is that, unlike the general *Amadio* unconscionability doctrine, potentially a different set of rules applies. On one view, it is the mere fact of the relationship plus maybe a few other factors that can put the bank on notice and can result in the bank not being able to rely on the transaction even if the situation would not fit within the *Amadio* principles. Given that these are standard arrangements for small business and other things, you can see the significance of this doctrine and the significance of a case deciding whether or not it should remain in our law.

In strict terms, you still need the *Yerkey v Jones* elements. You need spouses (so far it is confined to spouses), you need one spouse guaranteeing the debts of another, the spouse going on the hook as guarantor or surety has to receive no interest or benefit, etc. There are some cases on what "benefit" means. If they are a director of a company and actively involved in the business, then obviously they are getting some benefit. What if they are only a director in name, they are a passive director and they do not really take part in the business except signing when they are told by the other spouse to sign? What if they are simply a person who in conjunction with their spouse has decided to look after the domestic arrangements and that is their part of the relationship? Do we say that they receive a benefit from a loan being made to the other spouse and their business because the fruits of that loan will in some sense flow back to the marital relationship and the family? That might make sense from a legal or financial point of view but not from a social policy point of view when the situation of control and dependence in some of these relationships is considered. Other elements might also be necessary. Is there any procurement by the principal debtor of the guarantee? Is there any misconduct that has occurred as between the debtor and the surety? Has there been some misunderstanding by the surety of what it is that is happening in an essential respect? Has the bank failed to check and has there been no explanation? Those sorts of elements can give rise to a claim based on *Yerkey v Jones* for invalidating the transaction.

Something that Mark Sneddon reminded me of this morning is that lots of people talk about *Yerkey v Jones* and focus on whether or not the relationship of husband and wife of itself is enough to set up the preconditions for a special doctrine attaching which, if certain other things happen, can result in the security being overturned. But there are some other comments in *Yerkey v Jones* which have been discussed in the High Court in the special leave application in *Garcia* about when it is that a bank is going to be put on notice.

Now that takes us to *NAB v Garcia*. All that I can really do to set up the discussion that will follow about lenders and the developments in New Zealand and elsewhere is to highlight for you what I see as five scenarios that could result from *Garcia*.

Garcia could say, first of all, that there is no distinct *Yerkey v Jones* doctrine. Some people think there is. Some people say that Dixon's judgment was not a judgment of the whole court. The New South Wales Court of Appeal, which is the one appealed from, thought there was not a distinct *Yerkey v Jones* doctrine, a distinct equitable doctrine fixing on husband and wife transactions, because otherwise they would as a matter of precedent supposedly have been bound by a High Court authority saying that there was such a thing. That is the first thing the High Court could do.

Secondly, they might decide to keep the status quo. The reality is that there are many spousal securities, whether it is given by a wife or given by a husband, where we might still need a special rule.

They could say thirdly that they will maintain the *Yerkey v Jones* doctrine but will extend it – it will apply to other relationships whether based on emotional dependency or cohabitation or familial relationships or whatever. That is where much of the doctrine in *Barclays Bank v O'Brien* from the English jurisdiction can be relevant because it is a case which has extended these sorts of principles to other relationships – heterosexual or homosexual cohabitees and possibly others.

The fourth option is that the High Court could say that because of the particular unconscionability doctrine in Australia, everything is covered by *Amadio*. *Amadio* came after *Yerkey v Jones*, and maybe it is time we just subsumed it all within *Amadio*. Whether that is the same as unconscionability under section 51AA of the Trade Practices Act we do not know yet, but there are some Federal Court cases which have flagged the possibility that the Trade Practices Act provision may actually be wider than unconscionability in the *Amadio* sense.

The fifth option would be to replace the *Yerkey v Jones* doctrine with something like a *Barclays Bank v O'Brien* doctrine of constructive notice.

There are all sorts of safeguards that result from these cases. On one level, who cares about what happens in *Garcia* because, whatever they decide in *Garcia*, there is a certain set of standard safeguards that many banks are already putting into place. I cannot see that much in *Garcia* is going to change the range or the combination of known safeguards.

For some banks, depending upon their procedures, depending on whether for example they have procedures that apply to husband and wife transactions that are different from others, it might make a difference what they say. But we are talking about shifting around at the edges rather than fundamentally changing the range of safeguards that we already know about, which include plain English documents and having (according to *Barclays Bank v O'Brien* in the House of Lords) a separate interview alone with the guarantor at the bank to try to establish whether or not they are under any sort of influence from the principal debtor. Again, as a matter of social reality, you might well have that interview at the bank and be unable to establish in a legal sense whether they are under undue influence. But in social terms the reality is that someone, husband or wife, who is going to refuse to go along with this transaction has to live with the consequences 24 hours a day when they leave the bank. So there is a separation here between legal reality and social reality.

You might widen your existing guidelines to cover all cohabitees and others. You might think about bank officer procedures and file notes, and whether they are allowed to explain, or how much they are allowed to explain, or what they should be saying. You might think about whether you allow the execution of the documents at the branch or insist that they be executed somewhere else, making sure that you do not constitute the debtor as your agent (that is a pretty simple thing to achieve, although many of the cases involve banks having failed on that basic element). You might get a guarantor's acknowledgment, recommend independent advice, or make the obtaining of a solicitor's certificate an absolute precondition – commercially unrealistic, but a possibility. You might have tiered risk assessments which involve some elements of judgment by bank officers, linked to a tripartite strategy of, firstly, having uniform solicitor certificates, secondly, with adequate guidelines for the solicitors using them, and thirdly, adequate risk guidelines from the bank's side.

I will not say much about *Barclays Bank v O'Brien* except to say that its facts should be of no great surprise to anybody – security over the family home, husband and wife, security in relation to the debts of the husband's company, wife has no direct financial interest in the matter, misrepresentation from the husband about the extent to whether the guarantee was limited or not and whether it was going to be temporary in time, standard bank procedures not followed about being given an adequate warning and explanation and so on, and bank effectively held to be on notice. There is a similarity between some of the facts in *Barclays Bank* and the fact situation in the *NAB v Garcia* decision, so you see the significance of what the High Court has to do in terms of trying to pull together the strands of *Yerkey v Jones*, *Barclays Bank v O'Brien*, and the *NAB v Garcia* situation.

The only thing I really wanted to mention about *Barclays Bank v O'Brien* for an onward point of view is that there have been some cases in Australia and New Zealand, and you will hear about some of them in the second presentation, which take the *Barclays Bank* principles and look at them in an Australian or New Zealand context. My view has been that, until such time as we get a final ruling from the High Court about the status of *Barclays Bank v O'Brien*, it can be pleaded or used in correspondence as a separate ground for attacking these things. The question will be what does *NAB v Garcia* do to the status of that doctrine? Does it subsume it? Does it leave it standing as a separate doctrine in Australian law? It is very important for us to appreciate (and this was noted in the High Court comments) that when *Barclays Bank v O'Brien* talks about undue influence, English law does not have the sort of distinct unconscionability doctrine that Australian law has in *Amadio*. In the English decision of *Barclays Bank v O'Brien* there are various categories of undue influence. I am not sure of the position in New Zealand. So we have to be careful in transposing some of the guidelines from *Barclays Bank v O'Brien* and some of the doctrines based on constructive notice straight to the Australian position without some filtering.

The final thing I will do is just to highlight some developments for you on the practical front. There are a number of things happening in a number of jurisdictions.

In Queensland, the Law Society has approved a standard, uniform certificate, and is still talking to the financial sector both collectively and individually to try to deal with any concerns they might have.

New South Wales at the end of last year had a standard set of guidelines and a certificate which, in terms of what the solicitors warrant, is different from the situation in Queensland. My understanding is that the New South Wales certificates are more open-ended in what it is that the solicitor has advised.

There have been some moves towards uniformity at the Commonwealth level, but there is no such thing as a uniform certificate across the continent and that is where matters stand.

In South Australia, the most significant development has been that, because of a couple of recent cases in South Australia where the solicitors were found negligent in giving advice on these certificates, the South Australian professional body has recently warned solicitors not to sign any of these things until further notice or only under certain conditions.

That will raise the question of whether the courts are going to look at these things as a matter of substance rather than form. Are they going to second-guess the circumstances in which a financier can rely upon a solicitor's certificate? That also raises questions about what it means for the solicitor to be truly independent of the principal debtor and the financier.

That is as much as I can do on short notice to set the contemporary scene for the next presentation.

PS: *NAB v Garcia* was handed down by the High Court on Thursday, 6 August 1998. The appellant guarantor's appeal against the bank was upheld. The *Yerkey v Jones* doctrine was maintained in a form which allows for further expansion.