

Relationship Debt and Guarantees: Best Practice v Real Practice

Abstract:

Guarantee transactions have generated an enormous volume of litigation over the past 20 years in Australian and elsewhere. There have been numerous major reports referring to the problem of relationship debt in recent years as concern about guarantee transactions has grown.

This article outlines the major findings of the first comprehensive Australian empirical research into the law and practices governing third party guarantees. The research was directed to finding out more about the experiences of the people who agree to guarantee the loans of others. Why do they sign on, how do they get into trouble in those transactions and what might have assisted them in avoiding such difficulties?

Despite measures such as the *Consumer Credit Code* (1996) and the *Code of Banking Practice* (1993)(2003), guarantee practice shows little evidence of what either the finance industry or consumer advocates would regard as best, or even adequate, practice.

Relationship Debt and Guarantees: Best Practice v Real Practice

Jenni Millbank[≡] and Jenny Lovric^ϕ

Third party guarantees are undertaken when a credit provider will not lend money, or will not extend a loan, unless the loan is secured by a guarantee provided by a person other than the borrower. This third person may not be involved in, or benefit from, the loan transaction itself. Unlike most contractual arrangements, this transaction is not an arm's length transaction because of the close relationship between the borrower and guarantor.

Guarantee transactions have generated an enormous volume of litigation in the past 20 years. There have been numerous major reports referring to the problem of relationship debt in recent years as concern about guarantee transactions has grown.¹ This article outlines the major findings of the first comprehensive Australian empirical research into the practice of third party guarantees.²

The Research

[≡] Senior Lecturer in Law, University of Sydney.

^ϕ Project Officer, National Pro Bono Resource Centre.

¹ See for example, Australia, Trade Practices Commission, *Guarantors: Problems and Perspectives* (1992); Australia, House of Representatives Standing Committee on Finance and Public Administration, *A Pocket Full of Change: Banking and Deregulation* (AGPS, 1991); the report of the Expert Group on Family Financial Vulnerability *Good Relations, High Risks – Financial Transactions within families and between friends* (Commonwealth Attorney-General, 1996); Australian Law Reform Commission, *Equality Before the Law: Women's Equality* (Report 69, Part 2, 1994); Radmila Jukic, *Till Debt do us Part* (Consumer Credit Legal Service, Melbourne, 1994); Supriya Singh, *For Love Not Money: Women, Information and the Family Business* (Consumer Advocacy and Financial Counselling Association of Victoria Inc, 1995). For a discussion of the regulatory context in which guarantee transactions take place, see: Reg Graycar, Robyn Johansson and Jenny Lovric, "Guaranteeing Someone Else's Debts" (2001) 12 *Journal of Banking and Finance Law and Practice* 181.

² This project was carried out in partnership between the Faculty of Law at the University of Sydney and the New South Wales Law Reform Commission between 2000 and 2003 with funding made available by an Australian Research Council Strategic Partnerships in Industry, Research and Training grant. The full report appears as, *Darling, Please Sign This Form: A Report on the Practice of Third Party Guarantees in New South Wales*, NSWLRC Research Report 11, October 2003, NSWLRC/University of Sydney online at <http://www.agd.nsw.gov.au/lrc.nsf/pages/rr11toc> This research report provides empirical data to inform the NSW LRC inquiry, *Guaranteeing Someone Else's Debts*, which will report on reform of the law of guarantees in late 2004.

While we learn some things about guarantee transactions from judgments of cases that are litigated when things “go wrong”, these cases are not necessarily helpful in gaining an understanding of what is occurring more broadly. Litigated cases represent a very small percentage of disputed matters, the vast majority of which settle prior to, or during, litigation. Litigated cases also do not give any sense of transactions that are not disputed; either because they are unproblematic, or because the guarantor did not dispute the loan when it was called upon (for example if they sold their property to pay it, or went bankrupt). Therefore, drawing information only from cases that proceed to litigation may be misleading when policy-makers and researchers are trying to determine what the key issues are in guarantee transactions.

In this research we wanted to ascertain whether widespread assumptions about the make-up of guarantors – that they are largely women, predominantly the wives of men operating small businesses and frequently from non-English speaking backgrounds – could be confirmed. We also wanted to consider whether numerous solutions that have been proposed to address the problems of guarantee transactions – such as “cooling off” periods after signing a guarantee allowing for a guarantor to withdraw, or requiring the provision of legal advice or financial advice before signing – would make any difference to whether and how guarantors entered into such transactions.

In the early 1990s Belinda Fehlberg conducted the first empirical research into the issue of third party guarantees when she undertook a small-scale qualitative study in the United Kingdom. Fehlberg’s in-depth research comprised interviews with 22 guarantors (whom she refers to as “sureties”), five borrowers, nine lenders and 13 lawyers.³ Fehlberg’s research focused only upon guarantors who had supported the loan of a spouse or de facto partner. A major theme to emerge from that research was the guarantors viewed themselves as having no real choice about providing security for the borrower’s debt. Reasons for this ranged from emotional pressure to threats and physical violence, and Fehlberg noted that economic dependence on the borrower was a key aspect in constraining the guarantors’ choice.

We were particularly interested to see whether the Australian experience was similar and whether many of Fehlberg’s key findings would be repeated in a larger and more broadly recruited sample. We were also interested in determining whether there were other vulnerable groups affected by guarantees, such as elderly parents and family members in families from non-English speaking backgrounds. We considered that

³ Belinda Fehlberg, *Sexually Transmitted Debt: Surety Experience and English Law* (Clarendon Press, 1997).

issues of power, choice and economic dependence identified by Fehlberg in the context of couple guarantors may also be active in other contexts.

This research was directed to finding out more about the experiences of the people who agree to guarantee the loans of others. Why do they sign on, how do they get into trouble in those transactions and what might have assisted them in avoiding such difficulties?

The research took place between 2000 and 2003. This project sought both qualitative and quantitative data from guarantors, lenders, solicitors, barristers and judges. The data collected from guarantors and their advisers was compared with data collated from judgments from the courts (including those in published reports and unreported cases available through internet sources) in order to consider if there were significant variation between the demographics and experiences of litigants and non-litigants.⁴ The project sought information from lenders about their practice through a confidential survey, but received very little assistance or input from that sector.⁵

Qualitative data was collected primarily by interviewing guarantors. Information about guarantee transactions was also sought from legal advisers who had acted for guarantors during the transaction and also those who had acted for either guarantors or lenders when post-transaction difficulties arose. The views of barristers and judges were sought specifically about the litigation phase of guarantee disputes.⁶ Quantitative data was collected by use of tick box questionnaires which were sent directly to solicitors, barristers and judges, made available on the Commission's website, and publicised to the general community through avenues such as radio advertisements, radio talk-back and news features.⁷

⁴ The case law review comprised reported and unreported cases involving third party guarantees decided since *Garcia v National Australia Bank* (1998) 194 CLR 395. The research team developed a digest of 52 recent cases from 1998 to October 2002, summarising the facts of each case, the claims or defences and the court's decision and other key pieces of information. A set of 30 key issues were identified for inquiry, mirroring the issues raised in the guarantor, solicitor and barrister surveys

⁵ Survey documents were sent to 112 lenders including banks, building societies, credit unions and finance companies. Responses were received from only two major banks, two smaller bank lenders and three finance companies. We were also assisted by responses from two peak bodies.

⁶ Of the 89 solicitors and 47 barristers who responded to our surveys, there was an even division between those who had acted last for a guarantor and those who had acted last for a lender. The fact that we had lawyers who had acted for both sides in disputed transactions assisted us in gaining a more representative view of transactions. The fact that demographic data about guarantors drawn from legal representatives largely mirrored that drawn from guarantors themselves and from litigated cases enhances the validity of this data. A total of 46 judges responded to our judge survey, giving us a further point of comparison.

⁷ Of the 87 guarantors who responded to our survey, we had broad geographical coverage. Of 71 respondents who were resident in New South Wales, 30 came from regional NSW. If not otherwise indicated, all quotes below come from guarantor respondents.

It is relatively common for lenders to claim that while bad practices may have existed in the past, lenders are now closely regulated and are considerably more prudent in taking guarantees following various developments in court decisions on point.⁸ Over half of the guarantors who participated in our survey had entered the transaction between the years 1993 and 2002. Therefore a reasonable proportion of the data collected by the project reflects the way transactions have been conducted in recent years. Many of the transactions reported to us by guarantors were clearly undertaken since (and in spite of) significant reforms such as the Australian Bankers' Association Code of Banking Practice (1993), the introduction of the Uniform Consumer Credit Code (operative since 1996), the extension of unconscionability provisions in trade practices legislation to cover small business (1998) and the High Court decision of *Garcia v National Australia Bank* (1998).⁹

Many of our findings confirmed existing suppositions drawn from anecdotal reports and litigated cases. For example we found a high proportion of female guarantors supporting the borrowing of male partners who were engaged in small business. Some of our findings were surprising. For instance we did not expect to find such a high proportion of older guarantors, many of whom were supporting the borrowing of adult children. We were also surprised to find that a relatively small proportion of guarantors received legal advice prior to the transaction, and of the guarantors who did receive advice, they reported a high level of poor practice on the part of solicitors. A high level of reported poor practice on the part of lenders was also unexpected, given how many inquiries and reforms have been undertaken in this area in recent years.

We were interested to discover that in many ways the data we drew from our survey of guarantors did reflect that found in the available litigated cases. Our guarantor respondents were very similar to litigants in the case law pool we examined in areas such as: their gender, non-English speaking background and relationship with the guarantor. They were equally likely to have signed the guarantee documentation in the presence of the borrower. We were unable to determine the age of many litigants, but noted that many of them were guarantors for the loans of adult children; suggesting an age range of over 50, which correlated fairly

⁸ Fehlberg, n 3, Chapter 7.

⁹ *Garcia v National Australia Bank* (1998) 194 CLR 395.

closely with the large proportion of guarantor respondents over the age of 50.

The areas in which the two groups differed are also noteworthy. We found that compared to litigants, our guarantors were supporting loans for smaller sums of money, were more likely to sign the documents in informal circumstances and were half as likely to have received legal advice prior to signing the guarantee. Litigants were more likely than our guarantor respondents to be supporting a business loan, to have mortgaged the family home as part of the guarantee, and to have signed an “All Moneys” clause as part of the guarantee.

Securing Family Business Borrowing

The research found that the vast majority of third party guarantees are undertaken to support small business borrowing, primarily family business.¹⁰ Such businesses are typically owned and run by men.¹¹ Earlier research by Singh and Fehlberg has demonstrated that while a female partner may be listed as a shareholder or director in a family company, she is rarely in a position of any real control over the company.¹² Fehlberg concluded from her research that “women, and particularly economically-dependent women in middle and higher-income households, are likely to be called upon to provide security and to find it difficult to refuse if asked.”¹³

When we examined business loans specifically, we found that guarantors were typically supporting the borrowing of a business over which they had little control. Thirty-eight per cent of guarantors surveyed had “no role” in the business whose loans they guaranteed; another 9% identified themselves as having “no formal role” in the business. A further 20% of our guarantors respondents were “silent” directors of the business. Only 16% were active directors of the business whose loan they had

¹⁰ The review of litigated cases, solicitor, barrister and guarantor surveys all revealed substantial proportions of loans made for business purposes. Of the litigated cases, 94% related to a business loan. Barristers and solicitors reported 70% and 98% of guarantees were for business loans respectively the last time they dealt with a third party guarantee transaction. The survey of guarantors found 49% of loans relating to a business purpose, a lower but still considerable proportion.

¹¹ See eg Kosmas Smyrnios, Claudio Romano and George Tanewski, *The Australian Family and Private Business Survey 1997* (Monash University, 1997); Price Waterhouse/Commonwealth Bank *Family Business Survey of 5000 businesses* (1995) 11 *Company Director* 20.

¹² Fehlberg, n 3; Supriya Singh, n 1.

¹³ Fehlberg, n 3 at 89.

guaranteed.¹⁴ A closer analysis of this data reveals that the largest percentage of guarantors were women with no formal role in the business for which they provided a guarantee. This accords with Fehlberg's study in the UK in which half of the guarantors described themselves as having no role in the business for which they secured a loan.¹⁵

The majority of guarantees in our study were for loans in excess of \$100,000.¹⁶ We were interested to discover whether guarantees were being sought to support finance for businesses that were starting up or expanding, or for business that was in difficulty or had loans that were already problematic. From our survey it appears that expansion, rather than start-up or later difficulties, was the principle reason for the loan. Of the guarantors who were supporting a business loan, 25% reported that the loan was for a new business, 19% reported that it was to get the business through a difficult time (although a further 8% of respondents said that it involved refinance of an existing loan), while 38% stated that the purpose was to expand or develop an existing business.

This data is somewhat at odds with that in Belinda Fehlberg's study. Although a similar proportion of loans were for business expansion, only one guarantee in Fehlberg's study involved support for a new business and the majority of guarantees were for a business in trouble.¹⁷ However Fehlberg notes that whether a business was in trouble or was new or expanding, debtors were rarely in a position to objectively present the risks inherent in the guarantee. Whether in a state of financial pressure or high optimism, borrowers were highly partial and selective in the manner in which they presented their business to the guarantor.¹⁸

We were unable to ascertain the number or proportion of guarantees that are called upon in any given period, or that result in the repossession of security such as residential homes, as lenders were unable or unwilling to disclose this information. Nor could we discover the number or proportion of debts which are disputed by guarantors.

Who are guarantors

¹⁴ Of the remaining 18%, most were partners in a partnership arrangement.

¹⁵ Fehlberg, n 3 at 138. Fehlberg also noted a distinct trend for women who were "involved" to work for the business either unpaid or paid at just below the tax threshold: at 140.

¹⁶ Solicitors and barristers reported significantly larger amounts at stake in the transactions they last dealt with.

¹⁷ Fehlberg, n 3 at 163.

¹⁸ Fehlberg, n 3 at 164.

Although it has been noted that, “Trusting wives and elderly parents from non-English speaking backgrounds are familiar characters in Australian contract law”¹⁹, there is very little information about those who guarantee loans for others beyond the law reports. A major aim of this research was to more fully investigate the extent of the experiences of, and problems faced by third party guarantors who do not appear in the litigated cases.

Gender and relationships

The survey of guarantors revealed almost two-thirds of those who guaranteed loans were women.²⁰

This research did not explicitly seek guarantors who had signed guarantees in the context of close personal relationships. However, the results did reveal that the vast majority of guarantees or joint loans were signed by close family relatives: mostly spouses, followed by parents of borrowers.

The survey of guarantors revealed that 83% of guarantors were in a close personal relationship with the borrower. Of these, 39% of loans were guaranteed by a partner or spouse of the primary borrower; 26% had signed as a guarantor for a loan for their adult child, and 18% had signed for another relative.²¹ The review of litigated cases²² and data from solicitors²³ and barristers²⁴ revealed very similar results. The graph below indicates the relationships reported according to each source of data.

¹⁹ Sue Mahalingham, “Deep and Meaningful: Dealing with Emotionally Transmitted Debt” (1999) 3(6) *Consumer Rights Journal*.

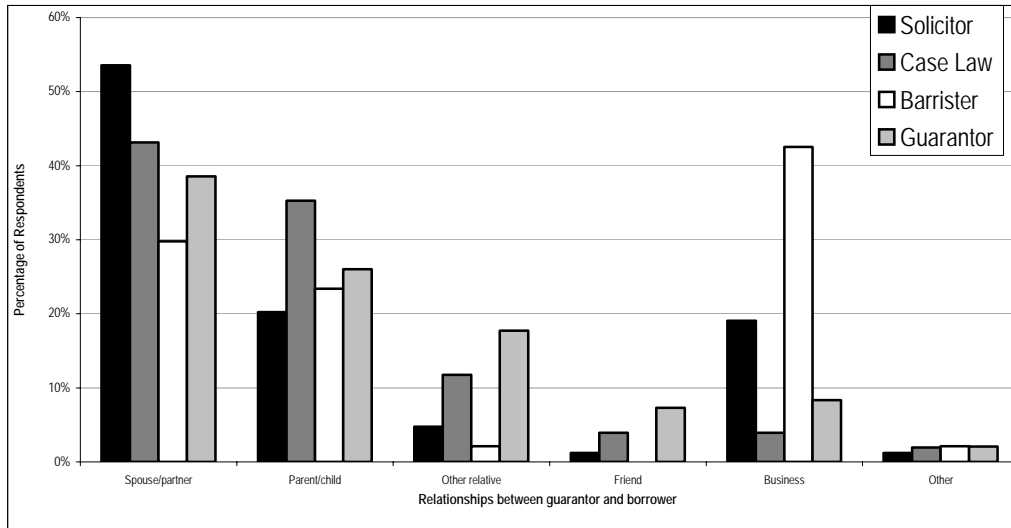
²⁰ This was very closely mirrored in the review of litigated cases which revealed that 65% of guarantors were female, while 15% were male (in the remaining 19% of cases, the guarantors were groupings of family members, predominantly husbands and wives as co-guarantors or co-borrowers).

²¹ A further 7% signed for a friend; 8% signed for a business associate and the remaining 2% signed either for a business entity or their own company.

²² Ninety per cent of the guarantors in a close relationship with the borrower.

²³ The survey of solicitors revealed that the last time they gave advice in relation to a guarantee over three quarters of the guarantors and borrowers were in a close personal relationship.

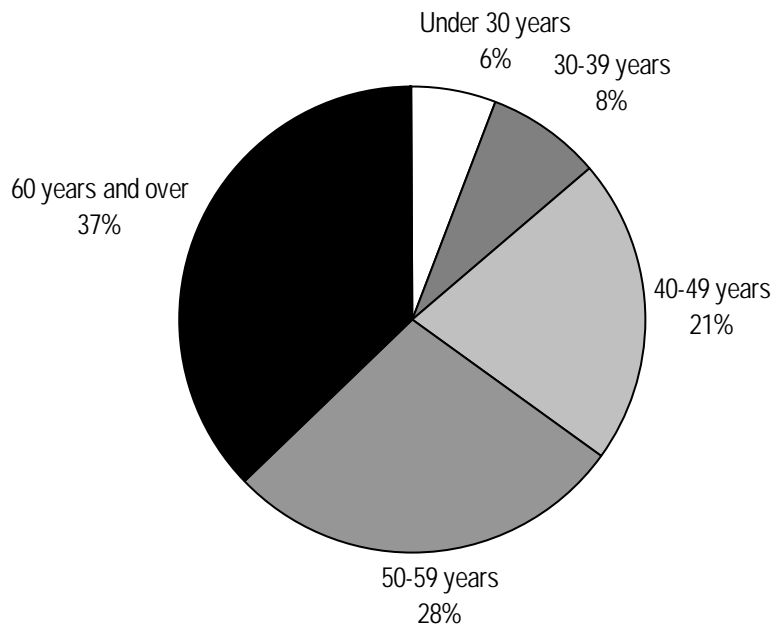
²⁴ The barrister survey statistics also revealed over half of guarantors were in close personal relationships with the borrower.



When we examined the relationship figures by gender it was clear that women principally undertake guarantees as the wives or de facto partners of male borrowers. Very few men guarantee the debts of a spouse, and those men who were guarantors were most likely to have guaranteed the loan of an adult child.

Age

The respondents to the guarantor survey were generally from higher age brackets, with 65% of respondents over the age of 50.



These statistics indicate that older people are disproportionately represented in problematic third party guarantee transactions.²⁵ Commentators have noted that older people are particularly liable to be asked to guarantee adult children's debts because they are likely to be in possession of valuable security: an unencumbered residential home.²⁶

Men appear particularly likely to be guarantors as later in life: only 8 male guarantors were under the age of 50, while 21 were over. However, it should be noted that in every age range women outnumbered men, and so men over 50 were still far less heavily affected than women over 50.²⁷

Country of birth and language background

A considerable proportion of respondents to the guarantor survey were overseas-born or did not speak English as their first language. Around 40% of our guarantor survey respondents were born outside Australia – this is around double the level of overseas-born residents in the general Australian population.²⁸

Twenty per cent of respondents to the guarantor survey spoke a language other than English as their first language. This proportion was reflected in the other data collected.²⁹ Of those who indicated that English was their second language, the majority indicated that their level of spoken English was weak or fair,³⁰ while half reported their understanding of written English was weak.³¹ This suggests significant issues for many guarantors

²⁵ According to data from the Australian Bureau of Statistics ("ABS"), 12.4% of the Australian population in 2001 was aged 65 years or older: Australian Bureau of Statistics, *Australian Social Trends 2002*, Cat. No. 4192.0 (ABS, Canberra, 2002) at 2.

²⁶ See Fiona Burns, "Undue Influence and the Elderly" (2002) 26 *Melbourne University Law Review* 499; Juliet Lucy Cummins, "Relationship Debt and the Aged: Welfare and Commerce in the Law of Guarantees" (2002) 27 *Alternative Law Journal* 63.

²⁷ 39% of the guarantors were women of fifty or over, while 24% were men of that age.

²⁸ *Guarantor Survey*, Question 1. The 2001 Census reports 22% of Australia's population is born overseas: see *Census 2001* Cat. No. 2015.0 (ABS, Canberra, 2002).

²⁹ The barrister survey data reveals that over one-fifth of their clients were from a non-English speaking background. Most judges reported that many trials had a third party guarantor from a non-English speaking background. In our review of litigated cases we found that 42% of cases involved guarantors from a non-English speaking background.

³⁰ Of 18 respondents in this category, three reported their understanding of spoken English as weak while eight said it was fair. three stated that it was good and four very good.

³¹ Of 18 respondents in this category, eight reported that their understanding of written English was weak, two reported it was fair, four good and four very good.

with language and their ability to understand written and spoken information about the guarantee transaction.

Also noteworthy is the fact that solicitors reported that the last time they gave advice in relation to a guarantor *prior* to signing the guarantee, only 5% of such clients were from a non-English speaking background. This suggests that guarantors from non-English speaking backgrounds are not receiving advice prior to signing guarantees: a time where advice as to liability under a guarantee contract is critical.

Why do they sign

Third party guarantors often have much to lose and little, if anything, to gain from entering the transaction. An important task of the research project was to try to ascertain why someone would undertake so onerous an obligation.

Guarantors generally agree to the transaction for emotional rather than financial reasons, with a significant proportion of guarantors reporting that they agreed to the transaction because they did not want to damage their relationship with the borrower by refusing. While many guarantors had some insight into the risky nature of the transaction or had misgivings, they still went ahead with it. This is consistent with Belinda Fehlberg's findings in her UK study.³²

Guarantors gave a range of reasons for signing. These included: trust in the borrower, optimism, misunderstanding or misinformation about the transaction, individual pressure from the borrower ranging from emotional pressure to threats or coercion, and more general pressures such as cultural and family pressure to support a borrower. It was clear that many guarantors signed because they felt that they had no choice but to sign, especially in situations of economic dependence on the borrower. Clearly, many of these reasons cannot be easily translated into discrete and identifiable legal claims or categories.

Some women who provide guarantees for the business enterprise of their husband are likely to be influenced in their decision making by their economic dependence on their spouse, particularly where they primarily perform unpaid work and the spouse performs more or better-paid work. Belinda Fehlberg argues that economic dependence in heterosexual couples, particularly when women are primarily involved in child-care, means that "men are both likely to have greater control over domestic

³² Fehlberg, n 3 at 165.

financial arrangements, and to feel more entitled to mobilize the available resources for their personal use.”³³ Fehlberg found in her UK study that non-income earning wives with children had the least power over family finances.³⁴

While we did not specifically ask guarantors about whether they were economically dependent upon the borrower, or about whether the borrower controlled family finances, it was clear from several responses, discussed below, that this was the case. Almost one-third of the respondents to the guarantor survey reported that they signed because the borrower made the financial decisions in their relationship and that they just did as they were told with respect to these transactions. A further 17% reported that they were partners and it seemed right to share – of these the great majority were women.

The factors explored below reflect the categories that we asked guarantors to respond to as reasons why they entered into the transaction. While focusing upon these specific responses we do not mean to suggest that structural inequalities are not present.³⁵ Indeed, they inform many of the comments made by guarantors. Structural gender inequalities include a greater likelihood of women’s economic dependence upon a male partner who is the primary borrower engendered typically by prime responsibility for child care and consequent broken workforce participation. Structural inequalities arising from economic imbalance and dependence many also be present in other types of relationship, for instance to the large number of elderly guarantors who were supporting the borrowing of adult children. Although elderly guarantors are comparatively asset rich – often it is an unencumbered home that is the security for the loan – they are liable to be income poor. In such situations, adult children may be an important source of income support or future security.

Trust and Optimism

“My role was a housewife. I had to trust my husband and I did.”

³³ Ibid at 85.

³⁴ Ibid, Chapter 4.

³⁵ For a discussion of structural inequality and gender in guarantee transactions see eg: Paula Barron, “The Exercise of Her Free Will: Women and Emotionally Transmitted Debt” (1995) 13 *Law in Context* 23; Miranda Kaye, “Equity’s Treatment of Sexually Transmitted Debt” (1997) 5 *Feminist Legal Studies* 35; Kristie Dunn, “Yakking Giants: Equality Discourse in the High Court” (2000) 24 *Melbourne University Law Review* 427; Nicola Howell, “Sexually Transmitted Debt: A Feminist Analysis of Laws Regulating Guarantors and Co-Borrowers” (1995) 4 *Australian Feminist Law Journal* 93.

“I trusted my husband and the bank officer to do the right thing.”

The decision to enter into a guarantee to secure a family member’s loan is often informed by factors other than sound commercial ones, and undertaken without any assessment of risk. Three-quarters of guarantor respondents reported one of the reasons they signed the guarantee was because they trusted the borrower. Notably, many guarantors reported that they wouldn’t think of openly questioning the request to act as guarantor because this would indicate a lack of trust.³⁶

Optimism in the other person’s ability to repay the debt is often informed by the desire to help another family member get ahead, a high degree of personal trust in the borrower or a desire to affirm a developing relationship.³⁷ Belinda Fehlberg noted in her UK study that when the loan was to support a new business, there was a high degree of optimism both from the borrower and their guarantor spouse, most of whom described themselves as, “happy to support the debtor because they believed in his or her abilities and therefore believed that the business would be successful.”³⁸

In our survey of guarantors the respondents were not asked specifically whether they were optimistic about the transaction. However, 44% said they didn’t think signing involved any serious risk and the same portion responded that they thought the transaction was for the family’s financial benefit.

The Australian Banking Industry Ombudsman (“the ABIO”) states that:

“The experience of the ABIO is that a common response to a guarantee being called up is one of shock on the part of debtors and guarantors. It is rare to find a case where a guarantee has been signed with any expectation that it will be called upon or with any financial planning being done to prepare for this occurring...[t]his may be influenced in particular cases by statements by the debtor or the lender or both that “your house is not at risk”. It may result

³⁶ In its submission to New South Wales Law Reform Commission, *Guaranteeing Someone Else’s Debts* (Issues Paper 17, 2000), the Country Women’s Association of NSW noted that “all too often the guarantee is between family members and asking for this information may be seen as distrusting or doubting the family member. This can be a very emotive issue and one sometimes hears a party state ‘Well, I didn’t like to ask him for that information in case he thought I didn’t trust him’”: Country Women’s Association of NSW, *Submission* at 2.

³⁷ See Expert Group on Family Financial Vulnerability, n 1 at 10.

³⁸ Fehlberg, n 3 at 131. See also 185-188.

*from a natural unwillingness on the part of the guarantor to believe that the worst will happen.”*³⁹

This was confirmed in our research. Eighty-two per cent of respondents to our guarantor survey reported that when they found out there was a problem with the debt, it came as a big shock for them.

Choice

“I felt I was in a trap. I felt I had no choice. Finally I reluctantly agreed to provide a mortgage to secure the loan.”

Whether the guarantor actually had a choice about whether they signed is not a straightforward issue. While there may ostensibly be a choice about whether someone signs a guarantee, the choice may be often more notional than real.

Over one-third of respondents said they did not feel that they had a choice about whether they signed the documents. Of those who reported this as a reason they signed, the great majority were women.⁴⁰ This is consistent with the findings of Belinda Fehlberg’s UK study, which found that “Sureties consistently said that at the time of signing, they felt they had no choice about whether or not to sign.”⁴¹

The absence of choice must be broken down to better understand what people meant when they say they didn’t feel they had a choice. Sometimes it meant that they were under pressure or duress to sign, such as facing threats of physical violence. Sometimes it referred to an overbearing sense of obligation, such that the guarantors feared that a relationship would be irreparably damaged if they refused.

Fehlberg noted that for five of her guarantors, “the idea that they had a choice had never entered their minds. It was just assumed by themselves, and by all around them, that they would sign. In the context of their relationship with the debtor, signing was an automatic reaction.”⁴² Likewise, our review of the litigated cases found that it was not

³⁹ Colin Neave, *Australian Banking Industry Ombudsman*, AFC Conference Paper, February 2000 at 13-15; see also Australian Banking Industry Ombudsman, *Report on Relationship Debt* Bulletin No 22, September 1999.

⁴⁰ Five men and 24 women said that they didn’t think they had any choice when they signed.

⁴¹ Fehlberg, n 3 at 181.

⁴² *Ibid* at 181.

uncommon for women sign guarantees for their husbands, in particular, for no other reason than that they were asked to sign. In these cases there was clearly no consideration of the merits or benefits of the transaction. Such unquestioning acquiescence tends to indicate that any choice, or any discussion about the matter, may be more apparent than real for those women – they did as they were told. For example, in *Commonwealth Bank of Australia v Stavrianos and Ors*, Mrs Stavrianos gave evidence of how she would be asked to sign documents by her husband: “*He was asking me to sign it, not whether I would. "Darling, please sign this form" would be the way he would put it.*”⁴³ (emphasis added)

In some instances, there was really no other option but to sign if the guarantor wished to remain in their relationship with the borrower. One barrister commented:

“for the sake of domestic harmony there is usually irresistible pressure on the guaranteeing spouse to sign.”

Fehlberg notes that this can entail a combination of both economic and emotional pressure which means that for the guarantor the question of choice became “largely irrelevant”.⁴⁴

Dependency, vulnerability and absence of real choice do not always fall into the neat legal category of “undue influence;”⁴⁵ nor does it necessarily fall within the parameters of unconscionability. Several respondents felt that they were under an emotional or moral obligation to help family or repay assistance from other family members.

The guarantor survey found that many parents who assisted their children with loans did so out of a sense of moral obligation. Comments included:

“It was for my daughter and I would do anything for my children.”

“we are family. It is the right thing to do for your family.”

The issue of choice was also connected to pressure and threats of violence. Vulnerability to pressure was implicit in many of the responses from guarantors in our surveys.

⁴³ *Commonwealth Bank of Australia v Stavrianos* (Unreported, NSW Supreme Court, No 12224/94, Graham AJ, 17 October 1997).

⁴⁴ Fehlberg, n 3 at 181.

⁴⁵ See Janine Pascoe, “Wives, Lenders and Guarantees – New Law in the UK and Lessons for Australia” (2002) 17 *Australian Banking and Finance Law Bulletin* 117 at 124.

Pressure

“I was too scared not to sign – he’d leave or kill me.”

In Fehlberg’s UK study, she found that pressure ranged from actual physical violence to more subtle forms of emotional pressure.⁴⁶ Our observations were consistent with these findings; many guarantors reported they felt signed because of a range of pressure of various kinds.

Guarantors reported a large amount of emotional pressure.

“I felt embarrassed and foolish. I was on my own at the time and probably vulnerable trying to do things on my own. Very emotionally drained, under pressure from the other person who harassed me for a further guarantee for funds. I felt bullied.”

“My husband and I worked our whole life...my husband died and almost immediately my son began pestering me for a loan...my son was putting highly intense pressure on me...”

Solicitors also commented that family pressure is one of the main why guarantors sign, despite being advised against doing it. Such emotional pressure is also reflected in the reported cases.⁴⁷

Guarantors also reported pressure that amounted to harassment or direct threat:

“I had one week to sign but I was hassled every day. Even the neighbours knew what was going on we were yelling so much. What could I do? I had 2 small children and he’d leave if I didn’t sign.”

“I was really harassed. Fearful of physical threats, and I lost sight of perspective. He [the borrower] was aggro – out of control.”

Of 16 guarantor respondents who reported that they were “too scared not to sign”, 14 were women. Among other comments offered by guarantors to explain why they signed, several women but only one man reported threats, harassment or pressure to sign.

Culture and Ethnicity

⁴⁶ Fehlberg, n 3 at 267.

⁴⁷ See eg *Pasternacki v Correy* [2001] ANZ ConvR 240; [2000] NSWCA 333.

Cultural factors concerning the way people perceive their role and responsibilities within their community and family are significant. The Expert Working Group on Family Financial Responsibility and the Australian Law Reform Commission identified cultural attitudes and immigration as further complications in guarantee transactions.⁴⁸ Cultural obligations and responsibilities mean that a guarantor may feel obliged to provide assistance to family members and other members of their community with no consideration of the commercial viability of the transaction.

These issues were clearly borne out in a number of responses from guarantors. For example, Mr V a 74 year old pensioner, with a University education in Vietnam reported that he mortgaged his home to assist his son-in-law develop a shopping centre. When the son-in-law didn't make his repayments, the bank claimed possession of Mr V's home. The son-in-law had sponsored Mr V to Australia many years ago. Because of this Mr V felt "indebted to him and felt obliged to help him" to repay this "debt" of sponsorship. Even though the son-in-law subsequently left his daughter and became a successful businessman, Mr V said that he would do the same again "because of the family situation and especially the sponsoring".⁴⁹ Another guarantor of non English speaking background agreed to provide security over his home to guarantee a loan for the benefit of some friends because the friends were new immigrants.

Misunderstandings and misinformation about the transaction

Our research confirmed the findings of earlier reports that many guarantors sign without an understanding of the nature of the transaction.⁵⁰ Guarantors experience both factual and legal misunderstandings about the transaction as a result of misrepresentations, failure to read or understand the documents, lack of competent legal and financial advice, lack of business experience and different cultural expectations.

The litigated cases and results of our surveys point to an alarming level of guarantor misunderstanding about many elements of the transaction. In many cases there appeared to be a fundamental misunderstanding about the way a mortgage operates. In our consultations consumer advocates expressed the view that there is low level of understanding about basic

⁴⁸ Report of the Expert Group on Family Financial Vulnerability, n 1 at 10; Australian Law Reform Commission, *Multiculturalism and the Law* (Report 57, 1992).

⁴⁹ *Guarantor Survey*, Respondent 72.

⁵⁰ See eg the Report of the Expert Group on Family Financial Vulnerability, n 1 at 10.

concepts such as liability (joint, several or secondary) in the general community and that some people do not understand what a guarantee is at all. It appears there is also a general misunderstanding about the obligations for contribution of co-guarantors.

The research found that there was not a simple line that could be drawn between understanding and misunderstanding the transaction; rather there was a wide range of misunderstandings, assumptions, deceptions and half-mistakes that formed a continuum of error. Such errors covers a range of issues including: the period of liability; the amount for which they could be liable; what their role in the transaction actually was (ie were they are guarantor or a borrower) and whether the loan was secured over property.

The reasons for the many varieties of misunderstanding are complex: it could be that deceit or fraud are involved, or a guarantors lack of knowledge is not remedied, or that other social or cultural factors impinged on the ability of the guarantor to make an informed decision about signing.

This range of confusion or misunderstanding evidenced in the cases and survey responses.

“I thought I was a character reference only for my son; thought I was a guarantor for my daughter and I had no idea it was a co-loan.”

“I thought that because the business was in both names just thought signature required: didn’t know severally liable... I wouldn’t have signed if I knew my liability under the partnership.”

“Actually I thought I was a co-borrower and not a guarantor. I asked several times for a copy of the contract to see whose name appeared on same. I was not sent one.”

Many guarantors were under the mistaken apprehension that they were only signing a guarantee for a limited period of time.

The guarantee transaction

If there are unjust circumstances surrounding a guarantee transaction (including the circumstances surrounding the execution of the guarantee as well as the contract itself) it may be set aside on the basis of equitable and common law principles as well as statutory provisions such as the *Contracts Review Act 1980* (NSW). Such circumstances include inequality of bargaining power, unfair tactics and pressure, the inability of the guarantor to protect their interests and lack of information or independent

advice about the financial and legal effects of the transaction.⁵¹ The research did not focus upon the application of these legal principles but instead explored the transaction from the guarantor's point of view. The following section also discusses the role of legal advice prior to the execution of guarantee transactions.

The intelligibility of guarantee documents

Our research found that guarantee documentation remains very poorly understood by guarantors. Guarantors who participated in the survey were asked whether they understood or could read the documents that they signed to give security for the loan and 27% of respondents stated that they could not. Problems identified by guarantors include the use of legal jargon and small print in contract documents and the large volume of paper. Comments from guarantors also highlight the difficulty in comprehending contracts when they do not have an opportunity to take the documents away to read and consider them.

“Documents should be easier to read. Any large company should fully explain liabilities. Very scary to be confronted by huge documents. Simplify documents. Need to make sure people read documents, and all of them, so they understand what they have signed up for. I did not know I had given a personal guarantee.”

“At time of signing they made me sign so many papers and kept turning the pages and saying sign here. No time to read the anything.”

Through the course of our consultations and surveys, the issue of providing guarantors with better documentation and information about the guarantee arose. Opinions about the benefits of more information to guarantors were mixed. The approach of protecting guarantors “by throwing more paper at them” was doubted by some; others thought that more plain language documentation with clear warnings would assist. Over half of respondents to our guarantor survey said that more written and spoken information would have assisted them at the time they signed up to be a guarantor.⁵²

⁵¹ New South Wales Law Reform Commission, n 36 at 73.

⁵² *Guarantor Survey*, Questions 15(a) and 15(f): 61% stated that more written information would have helped them and 55% reported that simple, spoken explanation of their obligations would have helped.

“All Moneys” clauses

Provisions commonly known as “All Moneys” or “All Accounts” clauses are used in mortgage and guarantee documents in order to extend the liability of a guarantor to future advances by the lender to the borrower. They are open-ended and complex and their construction may depend on reading a number of documents, such as a personal guarantee and a mortgage document, together.⁵³ The “All Moneys” clause is often a term in the memorandum of common provisions; this is a separate document to the mortgage and the guarantee also executed by a guarantor.⁵⁴ Such clauses are a major concern because guarantors may not be aware at the time they enter a transaction that they are providing a guarantee for all money owed presently *and* all money loaned in the future.

Lenders report that such clauses are rarely used. Yet data collected by the project revealed a disturbing number of guarantees for unlimited amounts. Eighteen per cent of guarantors reported they guaranteed an unlimited or indefinite amount of money. Furthermore, 27% of guarantors reported they discovered they had given a mortgage over their home that contained an “All Moneys” clause only *after* problems arose with the loan. In our review of litigated cases, we found that over half of them involved security documents that contained an “All Moneys” mortgage. It appears that guarantors who receive legal advice may in fact be more, rather than less, likely to be entering into such transactions. Nearly half of solicitors and over 80% of barristers reported that on the last occasion they gave advice to a guarantor the security documents contained an “All Moneys” clause.

Information about the borrower’s loan

Guarantors often had little or not knowledge of the financial situation of the business or the person borrowing the money prior to signing, and received inadequate information from the lender about the state of the debt after signing. We found that few people obtained a copy of the documents they signed, or a copy of the borrowers contract.⁵⁵ It is as if the borrower takes the money and ‘disappears’.

⁵³ See Berna Collier, “‘All debts’ Clauses in Commercial Contracts of Guarantee: Principles of Construction and Limitations on the Ambit of Clauses of this Nature” (1998) 24 *Monash University Law Review* 7; Robin Edwards, “Problems with “all moneys” Mortgages” (2002) 17 *Australian Banking and Finance Law Bulletin* 151.

⁵⁴ For example in *ANZ Banking Group v Capper* [2001] NSWSC 946.

⁵⁵ 37% of respondents received a copy of their contract around the time of signing, 20% received a copy of the borrower’s contract around the time of signing.

Third party guarantors are rarely in the position of a business partner who has an understanding of the business' prospects and risks. Of respondents who guaranteed a business loan, nearly half had little or no knowledge of the financial situation of the business at the time the loan was taken out. Likewise, 43% reported little or no knowledge of the borrower's personal financial situation. This is consistent with Fehlberg's findings where only four of her 22 guarantors had any knowledge of the financial affairs of the business they guaranteed.⁵⁶

The provision of more and better information for prospective guarantors has been the focus of earlier reports and inquiries into problems experienced by third party guaranteees. The Expert Group on Family Financial Responsibility recommended compulsory disclosure of information held by the lender, which a reasonable guarantor would reasonably require, in order to decide whether or not to enter into the transaction.⁵⁷

Industry codes of practice require banks, building societies and credit unions to provide prospective guarantors with written information about the liabilities of a guarantor, but these are of limited effect.⁵⁸ The revised Code of Banking Practice, effective from August 2003, requires banks complying with the Code to provide guarantors with considerably more information on the loan prior to entering into the guarantee when it is made in favour of an individual or small business.⁵⁹

Whose idea to be guarantor?

Third party guarantors appear unlikely to enter the transaction unless requested to do so by the borrower or the lender. Data collected by the project confirms that many people agree to act as a guarantor at the request of the person borrowing the money. In some cases the guarantee was provided at the request of the lender. In only a few cases was the idea to become a guarantor their own.

⁵⁶ Fehlberg, n 3 at 142.

⁵⁷ Report of the Expert Group on Family Financial Vulnerability, n1 at 1.

⁵⁸ See New South Wales Law Reform Commission, n 36 at 71.

⁵⁹ *Code of Banking Practice* (2003) cl 28.4.

In Belinda Fehlberg's UK study, she found that the vast majority of guarantors (18 of 22) were not involved in the planning or negotiation stages of the transaction. Fehlberg defined involvement as a guarantor having "the real opportunity while the transaction was being organized (not just immediately before the signing) to voice their views to those involved other than the debtor."⁶⁰ Our research confirmed these findings, with our respondents reporting that they were presented with documentation in a transaction in which their only role was understood to be signing. This had a clear impact on several issues discussed below, including whether the guarantor had time to consider the contract, any ability to negotiate the terms of the contract, or the opportunity to receive independent legal advice.

Where were the guarantors when they signed and who was present?

Our research indicates that it is fairly common for mortgage and guarantee documents to be signed in the relatively informal surroundings such as the family home. The problem with signing documents at home is that the informality of the surroundings is inconsistent with the serious and complex nature of the obligations about to be assumed by the guarantor and the pressures of home life, such as sick children, make it difficult for the prospective guarantor to give her full attention to the transaction. It may also mean that the presence of the borrower is more likely.

In our review of litigated cases, 13% involved allegations that the documents were signed at the guarantor's home. In the several instances the guarantor, often a wife, signed the guarantee documents on the kitchen or dining table.⁶¹ In one case the guarantors' signatures were procured by the borrower (their son-in-law) while they were on holiday in Sweden.⁶²

Twenty-two per cent of respondents to the guarantor survey signed the security documents at home. One guarantor said she signed the guarantee documents in her garage, while the witness to her signature had already signed on the document prior to her signature. In one instance, a

⁶⁰ Fehlberg, n 3 at 159.

⁶¹ See *Commonwealth Bank of Australia v Horkings* [2000] VSCA 244; *Commonwealth Bank of Australia v Khouri* [1998] VSC 128; *Commonwealth Bank of Australia v Liptak* (1998) 196 LSJS 466; *Charles v Parkinson* [2000] FCA 1467; *Anjoul v Westpac Banking Corporation* [2000] NSWCA 355; *Commonwealth Bank of Australia v Sarah Marie Holdings Pty Ltd* [2002] VSC 1. See also *Gough v Commonwealth Bank of Australia* (1994) ASC 56-270; *Westpac Banking Corporation v Bagshaw* [2000] NSWSC 650 (in the latter two cases the wife's evidence on this point was rejected in favour of evidence of the bank manager as to his usual practice).

⁶² *State Bank New South Wales v Watt* [2002] ACTSC 74. The Court held that even though this was contrary to the bank's own procedures nothing adverse could be drawn from that circumstance.

guarantee was signed in hospital, and in another “at the greengrocer’s down the road from the bank.” This contrasts with Fehlberg’s study, where most guarantors signed at the lender’s premises or a solicitor’s office.⁶³ A minority of our respondents signed in a solicitor’s office reflecting the fact that very few received legal advice (discussed below).

The Expert Group on Family Financial Vulnerability recommended that the law should require a lender to advise a prospective guarantor to execute the guarantee in the absence of the borrower.⁶⁴ Despite the inherent risks associated with presence of the borrower at time the guarantor signs the documents the data collected by the project indicates that the borrower was frequently present when the guarantor signed.

Forty-seven per cent of respondents in the guarantor survey stated the borrower was present when they signed the guarantee documents. Twenty-three per cent of guarantors reported that *both* the borrower and the lender were present. Similarly, our review of litigated cases revealed that the borrower was often present at the crucial time. In 60% of cases the borrower and others (such as the lender, or another guarantor) were present, while in 14% of the cases reviewed the borrower alone was present with the guarantor at the time of signing.

Time to consider the contract?

“The broker just put reams of paper in front of me and said sign here etc, it was all done in a hurry.”

Data collected by the project indicates that many people enter guarantor transactions in a hurry and with little or poor preparation. One guarantor who responded to our survey stated that she signed a guarantee for her husband after being taken to the bank by him without any prior notice or discussion. As she was not expecting to sign any papers she did not have her glasses with her so she was not able to read the documents.

Our research found strong support from guarantors for the introduction of cooling off period to allow time to reconsider guarantee transactions before they take effect. Fifty-two per cent of respondents said that a cooling off period would have helped them.

The following comments come from our guarantor survey.

⁶³ Fehlberg, n 3 at 167.

⁶⁴ See, Report of the Expert Group on Family Financial Vulnerability, n1 at 1.

“Cooling off period also very important. Needs to be more difficult to get into these things. Awareness is not enough. Need time to think about the consequences. Guarantors should have to sign something else acknowledging they understand documents. Signing in front of husband and credit provider very difficult. Need time to consider documents away from the other person.”

“Would like to see a cooling off period, not so much pressure to sign on the day so they can take the car home.”

“Need to explain the transaction especially for young kids. I was only 18 when I signed. Need a cooling off period. Wish I had never signed.”

Belinda Fehlberg notes that the guarantors in her study, like those in our study, were usually without commercial experience and were not involved in the business that they were supporting. Fehlberg argues that this combination of factors meant that guarantors were, “particularly unlikely to question the requirements of a bank, due to the authority and expertise that they perceived banks to have compared to themselves.” Further, she adds that even if guarantors had the confidence to question the terms of the transaction, “Due to their lack of business experience, **they did not know the questions to ask**”.⁶⁵ Our research confirms guarantors have a poor understanding of the transaction and are therefore not in a position to negotiate the terms of the guarantee contract.

Independent Legal Advice

The presence of legal advice is one factor that is listed in the *Contracts Review Act 1980* (NSW) as a consideration in determining whether a contract is unfair. Recommending independent legal advice is as a factor that may relieve a lender of responsibility for unfairness under the High Court decision *Garcia*. It is commonly thought that many lenders now insist that guarantors obtain independent legal advice.⁶⁶

The provision of legal advice has received considerable attention from professional bodies regulating the legal profession. The Banking Finance

⁶⁵ Fehlberg, n 3 at 176. Emphasis in original.

⁶⁶ See eg Anthony Duggan, “Til Debt do us Part: A Note on National Australia Bank Ltd v Garcia” (1997) 19 *Sydney Law Review* 220 at 227.

and Consumer Credit Committee of the Law Council of Australia has argued that a consistent national approach to the provision of legal advice is in the interests of credit providers, guarantors and lawyers,⁶⁷ but as yet there is no uniform national approach to the use of solicitors' certificates in guarantee transactions.

Our research indicates that many guarantors do not obtain independent legal advice and that when it was given it was often of very limited utility.

Mark Sneddon has defined *adequate* independent legal advice as,

*“truly independent informed advice which not only explains the transaction and its implications but also evaluates the risks involved and advises whether the surety should enter into the transaction.”*⁶⁸

Using this definition, we identified grave inadequacies in the legal advice in the limited number of transactions where it took place. In particular, there were problems in the limited scope of advice as well as its independence from the borrower and the lender.

Incidence of legal advice

The vast majority of guarantors who responded to our survey, and a high proportion of those in our review of the litigated cases, did not receive any legal advice prior to entering the transaction. Only 14% of the surveyed guarantors reported that they obtained independent legal advice. In only 29% of the litigated cases we reviewed had the guarantor obtained legal advice prior to signing the guarantee.

Disturbingly, only 20% of guarantors reported that anyone - including the lender - suggested that they obtain independent legal advice. A closer analysis of our survey data revealed that those from non-English speaking backgrounds were particularly unlikely to receive independent legal advice.

⁶⁷ See Elizabeth Lanyon, “Aspects of Third Party Guarantees and Solicitors’ Certificates” (2001) 29 *Australian Business Law Review* 231 at 241. See also Mark Sneddon, “Lenders and Independent Solicitors’ Certificates for Guarantors and Borrowers: Risk Minimisation or Loss Sharing?” (1996) 24 *Australian Business Law Review* 5.

⁶⁸ Mark Sneddon, “Unfair Conduct in Taking Guarantees and the Role of Independent Advice” (199) 13 *University of New South Wales Law Journal* 302 at 345.

Guarantor's perceptions of legal advice

Of guarantors who had received legal advice prior to signing, many were of the view that it had not greatly assisted them. Nor was there much chance for guarantors to reflect upon the advice they received; of the 10 guarantors in our survey who did receive advice and could recall how soon they afterwards signed the contract, five reported that they signed the same day, while another two signed within two days.

In two instances, our guarantors reported advice from lawyers that was openly partisan to the borrower. In one, only the “positive” aspects of the loan were explained, while in another the lawyer pressured the guarantor to sign during the interview by saying that if they didn’t sign quickly the loan would be reduced and the project would falter. In both of these instances, and one additional case, the lawyer was acting for the borrower.

Some guarantors indicated that the advice was perfunctory, with one guarantor noting that it took less than fifteen minutes. Another guarantor reported that the documents were only partly explained. Only one guarantor who responded to our survey reported that the advice clarified their thoughts on the document. This was consistent with Fehlberg’s finding that as solicitors restricted themselves to a brief explanation of the effects of the document, and did not offer advice in the sense of indicating whether consenting to the transaction was wise or improvident, guarantors consequently did not feel adequately advised.⁶⁹

Most of the solicitors who responded to our survey perceived their role in giving advice as involving explanation of the documents, advice on the legal risks of the transaction and the nature and extent of the liability. One solicitor stated, “*my job remains to explain the legal effect of the guarantee, not the wisdom of signing it.*”

Fehlberg argues that the term “independent legal advice” as it is understood in legal regulation of guarantees is a misnomer; she states that, “basic explanation” is a more accurate description of what takes place in practice.⁷⁰

Solicitors' perceptions of their role

About a quarter of the solicitors who responded to our survey described their role as ensuring that the guarantor understood the nature of the

⁶⁹ Fehlberg, n 3 at 171.

⁷⁰ Ibid at 227-8.

transaction or what they were doing. A few explicitly described their role as involving the protection of the guarantor's interests. Only a few described their role as actively discouraging the client to proceed with the transaction. None of the solicitors explicitly described their role as ensuring the client was not subject to any undue influence or duress. Disturbingly, two solicitors perceived their role as protecting the financial institution, and a further six solicitors described their role as formal or mechanistic, for example: "My advice was a formality – a lending requirement."

Both professional regulation and judicial decisions concerning legal advice to prospective guarantors make a distinction between legal and financial advice. Several solicitors made the point that they saw their role as providing "legal advice" only. The current professional conduct rule in NSW makes it clear that solicitors must advise the client they are not qualified to provide financial (as distinct from legal) advice and that if the guarantor has any questions about financial aspects of the transaction they should seek further advice from an accountant or financial counsellor.⁷¹

Numerous commentators have argued that legal advice on the effect of a guarantee is of very little assistance in the absence of financial information on the borrower's position and financial advice on the implications of the transaction. Our research indicates that when solicitors advise prospective guarantors they do not generally have any information regarding the financial position of the borrower. When they do have information it is often limited.⁷² Despite this, most solicitors who participated in our survey reported they had sufficient information to enable them to give the guarantor useful advice.⁷³ Interestingly, however, almost half of all the solicitors reported advising guarantors to seek further information or advice before signing the guarantee documents.⁷⁴

The "independence" of independent legal advice

⁷¹ Law Society of New South Wales, *Professional Conduct and Practice Rules*, Rule 45.6.4.1 and 45.6.4.2.

⁷² *Solicitors Survey*, Question 16: 76% of solicitors who responded stated that the last time they gave advice to a guarantor they had no information regarding the financial position of the borrower, 24% said they did have information.

⁷³ *Solicitors Survey*, Question 17: 95% of respondents stated that they had sufficient information to give useful advice.

⁷⁴ *Solicitor Survey*, Question 18: 46% of respondents stated that the last time they gave advice to a guarantor they advised them to seek further information or advice before signing.

The independence of legal advice may be affected by the solicitor's or the guarantor's perception of their role if their advice has been arranged by the lender, if they are acting for another party in the transaction, or if they provide advice in the presence of other parties to the transaction.

While Courts talk about the "scope of the solicitor's retainer", in a way that implies the solicitor and guarantor explicitly turn their minds to the role of the solicitor, there may be considerable confusion about what exactly the lawyers duty is and to whom it is owed.

In a number of the litigated cases we reviewed, the solicitor who advised the guarantor was organised by either the borrower or the lender.⁷⁵ The guarantor had no control over the content of certificates or statutory declarations supplied by the lender or the solicitor which set out the matters on which the guarantor was advised. This reflected Fehlberg's findings, that it was usually the borrower who organized the legal advice, often retaining a solicitor known to him but not to the guarantor. Even when the solicitor was not actually acting for the borrower, this gave guarantors the impression that the lawyer in question was not acting for them, but was there instead to represent the interests of the borrower or lender.⁷⁶

The potential for conflict of interest is also apparent when the lawyer is retained by a party other than the guarantor.⁷⁷ Of the 11 guarantors from our survey who had received legal advice, three reported that they were advised by solicitors acting for the borrower, and one by a solicitor acting for the lender.

The independence and utility of legal advice may also be compromised if the guarantor does not meet with the solicitor alone. In Fehlberg's study, of the 11 guarantors who received legal advice, in seven instances the borrower was also present.⁷⁸ Fehlberg found that while solicitors considered that it was not "good practice" to see guarantors in the

⁷⁵ See *Micarone v Perpetual Trustees* [2000] ANZ ConvR 597; (1999) 75 SASR 1; *Pasternacki v Correy* [2001] ANZ ConvR 240; *Sapuppo v Ribchenkov* [2002] ANZ ConvR 164; *Burrawong Investments v Lindsay* [2002] QSC 082; *Tong v Esanda Finance* (Unreported, NSW Supreme Court, No 20449/94, Grove J, April 1996); *Esanda Finance v Tong* (1997) 41 NSWLR 482; *Janesland Holdings Pty Ltd v Simon and Ors* [2000] ANZ ConvR 11.

⁷⁶ Fehlberg, n 3 at 175-176.

⁷⁷ See Law Society of New South Wales, *Professional Conduct and Practice Rules* (1995, amended 2000) Rule 45.9 and 45.4. However, note in *Lang v Licciardello* [1999] NSWSC 93, Adams J expressed the view "there is no doubt that the most desirable position is that ...a mortgagor should be given independent legal advice ... [but] the supposition that a mortgagee's solicitor is in conflict with the interests of that client if he or she gives advice to the mortgagor on the legal effect of the mortgage is a significantly over-simplification of the position" at para 25.

⁷⁸ Fehlberg, n 3 at 175.

presence of borrowers because of the opportunity for pressure or influence to be brought to bear, in practice they did little to prevent it. This was because guarantors and borrowers often “presented as a package”, and because it was usually borrowers who organised the appointment and paid for the advice.⁷⁹ While the majority of solicitors we surveyed reported to us that on the last occasion they gave advice, only the guarantor was present,⁸⁰ this may not be an accurate representation. While we did not specifically ask guarantors whether anyone else was present when they received legal advice, of the 11 guarantors who had received advice, it was clear in four cases that the borrower had been present. Moreover of all guarantors, both advised and unadvised, 47% reported that they signed in the presence of the borrower, and a further 23% in the presence of both the lender and the borrower.

There were also several reported cases in our pool of litigated cases where legal advice was clearly provided in the presence of the borrower.⁸¹ While there has been some adverse judicial comment about the impropriety of the borrower being present while the guarantors received legal advice,⁸² the practice of giving legal advice in the presence of the borrower has not been subject to significant scrutiny to date. Such practice clearly impacts upon the independence and effectiveness of any advice.

Claims against solicitors

“The legal profession should not be used by banks etc (who then sue solicitors) to provide cheap insurance for banks on loans and for risk transference. The primary risk of loans should be borne by lenders who make the profit [rather] than guarantors who gain financially or emotionally. The role of the solicitor is to oil the wheels (eg explain to the guarantor as a matter between the guarantor and legal adviser). It is not to provide cheap insurance to a bank which does not pay the solicitor and reserves the right to sue the solicitor or the client, or to force the client to sue the solicitor who has assisted by providing a certificate for which a mostly paltry payment is received.”⁸³

⁷⁹ Ibid at 224.

⁸⁰ *Solicitor Survey*, Question 13(b): 88% reported that no one else was present; 6% of respondents indicated that the borrower was present when they gave the advice.

⁸¹ See eg *St George Bank Ltd v Trimarchi* [2003] NSWSC 151; *Tong v Esanda Finance* (Unreported, NSW Supreme Court, No 20449/94, Grove J, April 1996); *Esanda Finance v Tong* (1997) 41 NSWLR 482.

⁸² *Micarone v Perpetual Trustees* [2000] ANZ ConvR 597; (1999) 75 SASR 1 at para 702.

⁸³ *Solicitor Survey*, Respondent 73.

There is a concern that the provision of independent legal advice for prospective guarantors is a mechanism to shift some of the risk of a transaction away from the lender to solicitors and their professional indemnity insurance.⁸⁴ Our survey of solicitors generally reflects this view. The focus of much of the material written about the role of solicitors is the protection of lenders and solicitors against claims rather than a concern for increased consumer understanding.⁸⁵

In 1999 the New South Wales Law Society reported an increase in the number of solicitors joined in legal proceedings as a result of providing certificates of legal advice in loan transactions.⁸⁶ Rule 45 of the Solicitors Practice Rules was subsequently amended in 2000 in a climate of great concern concerning claims against solicitors for negligent advice to guarantors. However our research suggests that this concern was somewhat misinformed. The Law Society asserted that LawCover claims arising out of the provision of certificates of legal advice rose to 15% of total claims during the year 1998-99. Investigation of this claim with LawCover reveals this figure to be erroneous. LawCover does not maintain separate statistics for losses relating to certificates, however they advised that the proportion of claims pursuant to certificates would form part of the claims made under other categories, such as mortgage and commercial borrowing. In 1999 the combined percentage of claims made under these categories was 1.5%.⁸⁷

Our review of litigated cases indicates that solicitors are rarely held to be liable for any loss suffered by guarantors. In 77% of the cases we reviewed where the guarantor did obtain legal advice, the Court held that the advice was satisfactory. In only three of the relevant cases the Court found that the solicitor's advice was inadequate in some respect, and in none of those cases was the solicitor found liable for the guarantor's or lender's loss.⁸⁸

Nonetheless, just less than half of the solicitors who participated in our survey reported that they had concerns about their professional liability in

⁸⁴ See eg Jim O'Donovan, "Guarantees: Vitiating Factors and Independent Advice" (1992) 66 *Law Society Journal* 57 at 60.

⁸⁵ John Phillips, Bryan Horrigan and Berna Collier, *Guarantees and Solicitors' Certificates Guidelines for Lawyers, Financiers and Guarantors* (Queensland University of Technology Centre for Commercial and Property Law, 1999).

⁸⁶ Law Society of New South Wales, *Caveat* 207, 30 December 1999.

⁸⁷ This includes notification of circumstances and actual claims. Email communication from Ron Shorter, General Manager, LawCover Claims, 21 October 2002.

⁸⁸ *Case Law Review*, Issue 23; *Sapuppo v Ribchenkov* [2002] ANZ ConvR 164; *Farrow Mortgage Services Pty Ltd (In Liq) v Torpey* (1998) NSW ConvR 55-857; *State Bank of NSW v Hibbert* (2000) Aust Contract R 90-119.

giving advice to a third party guarantor. Many felt that the process of sending guarantors to get independent advice from lawyers in effect meant lenders were passing off their obligations to explain the transaction on to solicitors, and exposing them to being sued by guarantors, or cross-claimed against by lenders if the guarantee goes wrong. One solicitor said lawyers “should not be made “co-guarantors” by being exposed to proceedings in this way”.

Who benefits from independent legal advice?

Do guarantors obtain any benefit from the provision of legal advice? Sue Mahalingham notes that,

“The precise role played by independent legal advice is not well understood. Independent advice has two distinct functions in loan transactions. For lenders it plays a protective role, shielding them from the effects of misconduct of a third party or countering allegations of unfair conduct. For the family security provider, it is thought that independent advice will eliminate underlying unfairness by ensuring that the family security provider has made an informed, independent and voluntary decision in providing security.”⁸⁹

Our research suggests that it is questionable whether the provision of legal advice actually deters vulnerable guarantors from proceeding with the transaction. This reflects Fehlberg’s finding that very few of her respondents would have been deterred from the transaction by even thorough and impartial legal advice.⁹⁰

Solicitors also reported that despite providing strong advice about the risks of the transaction, most guarantors proceed with the transaction.⁹¹ According to some solicitors, by the time some guarantors come for compulsory advice, they have already made up their mind. One barrister commented that while independent advice may act as a deterrent to signing, by the time the advice is given the guarantor probably already feels morally committed to the borrower to execute the guarantee. This sentiment is corroborated by other survey data which indicates that much

⁸⁹ Sue Mahalingham, n 19.

⁹⁰ Fehlberg, n 3 at 172.

⁹¹ *Solicitors Survey*, Question 22(a): of those solicitors who advised against signing 89% reported that the client went ahead despite the warning.

of the negotiating about the loan, and the exigencies surrounding the pressing need for finance have already proceeded to such a point that the only thing required, and that is inevitable, is the guarantor's signature. Only one solicitor reported the view that the client listens to the legal advice then makes a commercial decision.

The comments from solicitors who responded to our survey also point to the ways in which feelings of connection and obligation arising out of personal or family relationships govern the decision of the guarantor to proceed with the transaction rather than any objective advice about the dangers of the transaction. Family pressure, or the family relationship between the borrower and guarantor, were nominated by a number as solicitors as the reason guarantors proceeded with the transaction. Another solicitor identified "moral obligation" while another said: "family will always guarantee family".

One solicitor commented:

"Most if not all guarantors will proceed regardless of any advice given for emotional reasons, and regardless of any disclosure or information supplied. The only way to protect guarantors is to prohibit certain classes of guarantees."⁹²

Lenders benefit from the provision of independent legal advice because the certificate or statutory declaration verifying legal advice acts as a shield to deflect any later claims by the guarantor that the guarantee should not be enforced because they did not understand the transaction or were at a special disadvantage in the transaction. One respondent suggested that this is in fact the sole benefit of legal advice:

"As it stands, the requirement of independent legal advice only serves the purpose of covering and protecting the lending institutions' interests – if consumers are losing protection as a result of unrealistic and unhelpful legal independent advice then such consumer protection is meaningless and without substance."

It appears that further attention and deeper analysis needs to be directed to the provision and utility of independent legal advice.

When the loan went wrong

⁹² *Solicitor Survey*, Comments, Respondent 78.

“I kept phoning the bank to check if my son had made any payments. He had not. I always kept them up to date with his latest address. They did not try to find him and just came after me. I paid out in full to avoid further stress. Solicitor said I had to pay it anyway. Four years later I received harassing phone calls from a collection agency. It was very stressful. They would not believe I had paid it. I went to the banking Ombudsman who helped me to get [the bank] to stop the collection agency making more demands. Due to ill health I only work part time. Paying back the loan was a huge burden I still have not recovered from. I am also estranged from my son who has had a very good job these past eight years.”

Belinda Fehlberg found that most of her study participants only became aware of the extent of their liability once the bank began enforcement action, and often were unaware that there had been further advances upon the original loan until that point.⁹³ Our research was consistent with this finding; few guarantors received information about the loan during the period of the loan and guarantors generally only become aware of problems when their legal responsibilities were tested in times of trouble.⁹⁴ Around three-quarters of respondents to the guarantor survey reported that they personally received no information about whether the primary borrower was keeping up their repayments or received any information about any increase in the amount guaranteed.⁹⁵ One guarantor stated, *“I was given no information whatsoever. You are the last to know if your borrower does not tell you.”*

The data from the research points to a poor level of communication between the lender and the guarantor. These failures in communication relate to all areas of the life of the guarantee: from the basic details of the obligations under the guarantee, to informing the guarantor about the borrower’s default.

While the reach of industry codes of practice is limited, lenders are required by most codes to send the guarantor a copy of any formal demand that is sent to the primary borrower.⁹⁶ Such requirements are, however,

⁹³ Fehlberg, n 3 at 236.

⁹⁴ See, for example, Supriya Singh’s study of women and family businesses which found women generally only became aware of their liabilities in business when there were marriage and/or business difficulties or failures. Supriya Singh, n 1 at 18-19.

⁹⁵ *Guarantor Survey* Question 25(a): 74%; *Guarantor Survey* Question 25(b): 77%.

⁹⁶ *Code of Banking Practice* (1993) s 20, *Building Society Code of Practice* (1994) s 20, and *Credit Union Code of Practice* (1994) s 20. Note that *the Code of Banking Practice* has been amended to

subject to the consent of the borrower.⁹⁷ The problems associated with disclosure of information and consent have been discussed at length in the Final Report of the Review of the Code of Banking Practice.⁹⁸

Apart from the financial burden the costs of becoming a guarantor can be enormous. Belinda Fehlberg notes in her UK study that guarantors reported grave physical and emotional costs.⁹⁹ Most respondents to our guarantor survey reported that their relationship with the primary borrower had changed as a result of the loan. The responses overwhelmingly indicated the relationship had gone awry: the vast majority had divorced, separated or ceased all contact. Of the few that had maintained their previous relationship, all reported a lack of trust, a rise in antagonism, contempt or resentment. In most cases where the borrower was a spouse, the couples had separated at the time of the survey; or if still together, the relationship was strained. In most cases where the guarantor/borrower relationship was a parent/child relationship, the loan resulted in a lack of trust between family members. A great many reported that they are completely estranged from each other.

Many guarantors reported an enormous emotional strain and stress which some felt lead to serious illness; some said the transaction and stress nearly “ruined” their lives. Others reported that they felt “foolish” or humiliated by the whole experience; and stated that they now find it difficult to trust people.

Enforcement and dispute resolution

It appears that many guarantors simply pay the debts of others rather than dispute a transaction. Almost a third of respondents to the guarantor survey reported that they had paid the loan back in part or full. Twenty-four per cent still owed money to the lender, and 8% of guarantors had gone bankrupt. Eighteen per cent were disputing the debt. Of the remainder of respondents, many were trying to refinance to prevent possession of their homes, some managed to get the primary borrower to start repayments and a few had settled.

include small business transactions in its jurisdiction. Those amendments are effective from August 2003.

⁹⁷ In the case of banks and building societies, but not in the case of credit unions.

⁹⁸ Dick Viney, *Review of the Code of Banking Practice, Final Report* (2001).

⁹⁹ Fehlberg, n 3 at 253-258.

Almost 60% of solicitor respondents reported that their matters settled, with almost 70% of those matters settling during litigation, and 30% settling before litigation. Of those matters that proceeded to litigation, only 5% went to ADR. Of those that settled, the majority settled on terms more favourable to the lender than the guarantor.

There was a high level of dissatisfaction with legal processes from guarantors. This was reflected in the responses of solicitors and barristers, regardless of whether they acted for guarantors or lenders.

*“Litigation is not a satisfactory process – it forces people to be defensive (ie, it’s not my fault) rather than solution oriented. It also adds a significant prospective financial burden of legal costs – both during and after.”*¹⁰⁰

Some lawyers commented that the heavy-handed methods adopted by lenders in enforcing securities mean that chances of settlement are diminished. One solicitor stated:

*“the [financial] institutions can afford to, and do in fact, work up huge costs of recovery which then form part of the principal sum, eat up any equity in the security, and kill all prospects of settlement.”*¹⁰¹

Many lawyers and judges expressed the view that litigation was expensive, complex and inefficient for the resolution of guarantee disputes and expressed a preference for more accessible dispute resolution mechanisms such as mediation, industry resolution or tribunal processes. Yet of the few such processes in existence, we found that they were very little used.

The Australian Banking Industry Ombudsman was approached by only 7% of surveyed guarantors. The ABIO’s own figures show that guarantee matters form a very low percentage of its closed complaints. There are several limitations to the jurisdiction of the ABIO, including monetary limits and the fact that commencement of litigation ousts its jurisdiction. The maximum amount in dispute that the ABIO can hear is \$150,000 – and this sum includes the costs of enforcement. Given the high costs of residential premises and of enforcement, it is very unlikely that any guarantee secured over domestic property would come within the ABIO’s jurisdiction.

¹⁰⁰ *Solicitor Survey*, Respondent 6.

¹⁰¹ *Barrister Survey*, Respondent 26.

Another accessible dispute resolution forum is the Consumer, Trader and Tenancy Tribunal (CTTT) of NSW. The CTTT only has jurisdiction over loan transactions by virtue of the Consumer Credit Code in NSW.¹⁰² The Tribunal does not have jurisdiction under the *Contracts Review Act 1980* (NSW) or any common law jurisdiction to hear claims of unconscionability. Our research found that very few third party guarantee disputes are being resolved under the Consumer Credit Code. This lack of usage is likely to be caused by the consumer/business distinction drawn in the Consumer Credit Code. Small business transactions are excluded from the Consumer Credit Code; so where the purpose of the loan is commercial rather than personal, the CTTT has no jurisdiction to hear the matter. Applications brought by guarantors to the CTTT have been dismissed on this basis.¹⁰³ Our research found strong support for increased involvement by lower cost tribunals, such as the NSW Consumer Tenancy and Trading Tribunal in cases involving third party guarantees in order to overcome some of the problems of the high cost of litigation, but this is clearly not possible under the current jurisdictional restrictions of the Tribunal.

Litigation

While a range of common law and statutory remedies may be available to guarantors who seek to challenge the enforcement of a guarantee,¹⁰⁴ these remedies are discretionary and open to a range of interpretation by the courts. The Expert Group on Family Financial Vulnerability concluded that the legal doctrines with respect to third party guarantees were highly technical and complex and expensive to litigate. The Expert Group recommended reconsideration and clarification of the common law.¹⁰⁵ Our research confirms that there is a lack of uniformity in the decided cases and that litigation in this area is expensive and complex. Delay and the high costs of litigation and enforcement of guarantees emerged from the research as issues of concern.

¹⁰² *Consumer Credit (New South Wales) Code* 1995 and Regulations.

¹⁰³ See *Park Avenue Nominees Pty Ltd v Boon* (2001) ASC 155-052; (2001) ASC 155-045.

¹⁰⁴ See generally, New South Wales Law Reform Commission, n 36; John Carter and David Harland, *Contract Law in Australia*, (4th ed, Butterworths, 2002) Chapters 14 and 15; David Harland, "Unconscionable and Unfair Contracts: An Australian Perspective" in Brownsword, Hird and Howells (eds) *Good Faith in Contract: Concept and Context* (Ashgate, 1999).

¹⁰⁵ Report of the Expert Group on Family Financial Vulnerability, n1 at 36-37.

Litigation is rarely instigated by the guarantor; in our review of litigated cases we found that in 76% of cases litigation was commenced by the lender. Litigation most commonly starts with a claim by the lender for possession of the security given by the guarantor which in most cases is the family home of the guarantor.¹⁰⁶ Guarantors are therefore almost always on the defensive, belatedly marshalling evidence as to why the guarantee should not be enforced. This has clear implications for how litigation is run, and is evident in the often disorganised and scattergun approach to defences that we found.

Our review of litigated cases indicates that a range of defences and cross claims are used by guarantors to defend claims, make cross claims and in some cases initiate claims.¹⁰⁷ The most prominent of these are unjustness under the *Contracts Review Act 1980 (NSW)*, and unconscionability, including the 'special wives' equity' affirmed in *Garcia*.¹⁰⁸ This was confirmed in barrister and solicitor surveys. Other common defences or cross claims are those based on undue influence, the *Trade Practices Act 1974 (Cth)*, the *Fair Trading Act 1987 (NSW)*, misrepresentation and *non est factum*. Our review of litigated cases found that guarantors were commonly pleading from three to six different claims or defences. Barristers and solicitors confirmed that guarantors are very likely to rely on more than one defence and cross claim. In at least half of the litigated cases in our review late amendments - either just before or during trial - were made to the pleadings. Judges confirmed that late amendments are a marked feature of third party guarantee cases.

Solicitors, barristers and judges all agreed that litigation in this area is often technical, lengthy and complex. Interlocutory applications are also common in third party guarantee matters, with many matters being subject to strike-out or summary judgment applications by lenders.¹⁰⁹ These applications can substantially increase the costs of litigation, and may serve as a serious impediment for those impecunious guarantors seeking access to the courts for redress.

¹⁰⁶ *Case Law Review*, Issue 12: in 88% of litigated cases the family home was mortgaged as security for the guarantee.

¹⁰⁷ For an overview of the requirements of common law and statutory claims of unfairness, see New South Wales Law Reform Commission, n 36, Chapter 2.

¹⁰⁸ *Garcia v National Australia Bank Ltd* (1998) 194 CLR 395.

¹⁰⁹ One judge commented that in five years on the bench, he had only presided on one trial involving a guarantee, but had dealt with between 10 to 20 applications by notice of motion to strike out or amend defences or claims, or applications to set aside judgments.

From the perspective of a guarantor who seeks to challenge enforcement proceedings simply filing a defence and cross claim and taking some initial preparatory steps in the litigation will cost around \$3,000 to \$4,000. It is not always possible to obtain a true picture of the case until well into the litigation when, according to one solicitor, costs may have ballooned out to \$30,000. Most solicitors stated that litigation is expensive for both sides, and that the enforcement process used by lender resulted in higher costs. Many guarantee contracts contain a specific provision allowing the lender to claim all reasonable costs of recovery from the guarantor.¹¹⁰

We examined the impact of the *Contracts Review Act 1980* (NSW) and the High Court decision of *Garcia v National Australia Bank* (1998), both of which are perceived as providing fairly generous avenues of relief for guarantors. In our analysis of litigated cases we confirmed that the *Contracts Review Act* does indeed provide a broader and more flexible approach to assessing unfair dealing than common law doctrines. However we also noted that the Act was applied with considerable inconsistency. We confirmed a trend noted by other researchers, towards partial rather than complete relief under the Act.¹¹¹

The 1998 decision of the High Court in *Garcia*¹¹² confirmed that the “special wives’ equity” in *Yerkey v Jones*¹¹³ had survived. This rule holds that if a wife is a volunteer to a transaction, and does not understand its effects in essential respects, she may be able to have it set aside, even in the absence of unfair dealing, if the lender did not take steps to explain the transaction or to recommend advice was sought. At the time of the decision, there were fears that *Garcia* would unleash a floodgate of claims against lenders.¹¹⁴ However such fears appear to have been unfounded. In

¹¹⁰ *Solicitor Survey*, Question 12: 91% of solicitors reported the last time they gave advice to a guarantor the contract contained a provision allowing the lender to claim all reasonable costs of recovery. Also, Question 30: 91% of solicitors said the last time they acted for a guarantor in enforcement proceedings the contract contained a provision allowing the lender to claim all reasonable costs of recovery.

¹¹¹ Tyrone Carlin, “*The Contracts Review Act 1980* (NSW) – 20 Years On” (2001) 23 *Sydney Law Review* 125 at 135.

¹¹² *Garcia v National Australia Bank* (1998) 194 CLR 395.

¹¹³ *Yerkey v Jones* (1939) 63 CLR 649.

¹¹⁴ See, for example, Steven Mackay “Banks Don’t Always Finish Last” (2002) 16 *Property Law Bulletin* 41; Anne Finlay, “Unconscionable Conduct and the Business Plaintiff: Has Australia Gone Too Far?” (1999) 28 *Anglo-American Law Review* 470; David Purcell, “*Guarantees: their facts and their validity*” (2002) NSW Young Lawyers Continuing Legal Education Seminar Papers.

58% of litigated cases in the pool we surveyed, the guarantor sought to rely on the principle confirmed in *Garcia*.¹¹⁵ Guarantors were successful on the basis of this equity in only 27% cases where it was claimed.

We found considerable uncertainty about the scope and application of the principle. While some decisions have applied the principle to de facto spouses,¹¹⁶ another held that only formal marriages are covered by the principle.¹¹⁷ There has been similar division over whether the principle extends to elderly parents,¹¹⁸ while the claims of in-laws, clients who relied upon their trust in solicitors, and close friends have all been denied in the cases reviewed.¹¹⁹

We found even greater variation over interpretation and application of the *Garcia* requirement that the claimant be a “volunteer” to the transaction in order to be entitled to relief. Our analysis of relevant decisions since *Garcia* suggests that courts have had considerable difficulty in determining who is a volunteer in guarantee transactions, particularly those for the benefit of a family business.¹²⁰

In many cases involving a wife who guarantees loans to a family company, she is also on paper a director or shareholder of the company. In many decisions the court has imputed a director with knowledge about the company, regardless of her control, involvement or understanding of the company’s affairs.¹²¹ In other cases the courts have been prepared to look at the substance rather than the form of the wife’s involvement in the company. These decisions have found that women are still volunteers and not in fact owners or beneficiaries if the wealth of the company is

¹¹⁵ *Case Law Review*, Question 27. The *Case Law Review* only considered cases decided post-*Garcia*.

¹¹⁶ *Liu v Adamson*[2003] NSWSC 74.

¹¹⁷ *State Bank of New South Wales v Hibbert* (2000) Aust Contract R 90-119; [2000] NSWSC 628.

¹¹⁸ See *State Bank of New South Wales Limited v Layoun* [2001] ANZ ConvR 487; [2001] NSWSC 113 accepting that the principle covered parents and *Watt v State Bank of New South Wales Ltd* [2003] ACTCA 7 rejecting it.

¹¹⁹ See *National Australia Bank v Starbronze Pty Ltd* (2001) V ConvR 54-640; [2000] VSC 325; *Australia and New Zealand Banking Group Ltd v Alirezai* [2002] ANZ ConvR 597; [2002] QSC 175; *Equitiloan Securities v Mulrine* [2000] ACTSC 48.

¹²⁰ For an outline of the principles and relevant cases see: *State Bank of NSW v Chia* (2000) 50 NSWLR 587 at 601.

¹²¹ *State Bank of NSW v Watt* [2002] ACTSC 74; *Commonwealth Bank of Australia v Ridout Nominees Pty Ltd* [2000] WASC 37.

controlled by the husband and any benefit comes to her as a result of his “discretion” rather than as a right.¹²²

If a guarantor has received benefit from the loan transaction then she is not a volunteer and the protections of *Garcia* do not apply. The difficulty facing the courts is in determining what constitutes a benefit. In some cases, Courts have assumed that a benefit for one partner in a relationship, or to a family company, necessarily translates to a benefit for the guarantor. In other cases, benefit is construed less strictly: sometimes the court considers who makes the decisions about where funds from an enterprise are directed. There is considerable uncertainty: an intangible benefit which flows through a family unit from a spousal guarantee will not necessarily undermine reliance on *Garcia* principles,¹²³ although it has been held to in several cases.¹²⁴

The perception that banks and other lenders “always finish last” when a guarantor challenges the enforcement of a guarantee was not confirmed in our research.¹²⁵ While guarantors were partially or fully successful in 35% of the litigated cases we reviewed, these cases in themselves represent a very small fraction of disputed transactions. Data from the solicitor’s survey confirms that in most cases the lender is largely successful in pursuing the guarantee, even in disputed transactions.¹²⁶

Implications of this research

The objectives of law and policy reform in this area involve a tension between the need to protect guarantors, secure finance for small business,

¹²² See eg, *Commonwealth Bank of Australia v Horkings* [2000] VSCA 244; *Commonwealth Bank of Australia v Khouri* [1998] VSC 128; *Armstrong v Commonwealth Bank of Australia* [2000] ANZ ConvR 470; [1999] NSWSC 588; *Cranfield Pty Ltd v Commonwealth Bank of Australia* [1998] VSC 140.

¹²³ *Bylander v Multilink* [2001] NSWCA 53. See Bryan Horrigan, “Unconscionability breaks new ground – avoiding and litigating unfair client conduct after ACCC test cases and financial services reform” (2002) 7 *Deakin Law Review* 4.

¹²⁴ *Commonwealth Bank v Liptak* (1998) 196 LSJS 466; *Radin v Commonwealth Bank of Australia* [1998] FCA 1361. Susan Barkehall Thomas reviews several cases and is critical of *Radin*, see: “*Garcia v National Australia Bank: Would the Real Volunteer Please Stand Up?*” (1999) 14 *Journal of International Banking Law* 319.

¹²⁵ Mackay states “Over the last few years, most banks could be forgiven for thinking that they were unlikely to succeed in any action against them by a disgruntled borrower.....”: Mackay, n 114 at 41.

¹²⁶ *Solicitor Survey*, Question 40: 50% of respondents reported that in the last case they acted in, the guarantor paid the debt with interest, 5% said the guarantor paid most of the debt, 9% said the guarantor was partially released from the debt and 9% said the guarantor was wholly released.

and provide some measure of certainty in procedure, practice and outcome for borrowers, guarantors, lenders and legal advisers. This research does not suggest particular reform measures, but rather highlights key findings and suggests how these findings need to be considered by, and may impact upon, future developments in law and policy. Implications of this research are divided into two areas: firstly, pre-transaction conduct, and secondly, dispute resolution after a guarantee is disputed.

Pre-transaction conduct

Guarantors in positions of vulnerability

This research clearly indicates that women, elderly people and those from non-English speaking backgrounds are disproportionately affected by third party guarantees. This highlights the need to consider these groups as the prime demographic of guarantors, and to specifically target them in any reform or education measures.

Many guarantors we surveyed were in positions of vulnerability, either because of their emotional connection with the borrower or because of structural factors. These findings suggest that there are significant issues of power imbalance in guarantor/borrower and guarantor/lender relationships that may not necessarily be resolved by the provision of more or better information.

Guarantor relationships and gender

While women are mostly involved as guarantors of their male partner's borrowing, the smaller number of men who are involved as guarantors tend to be the parent of the primary borrower. Women and men noted many of the same reasons for entering into the transaction, such as trust and optimism, but there were very marked differences in key areas. Women were far more likely to report that they entered the guarantee because they were pressured, scared or felt that they had no choice. Women also appear far more likely to be economically dependent upon the borrower, such that their choices are constrained.

Men's and women's experiences of guarantee transactions appear to be quite different, and any reform and education measures need to be careful to identify guarantor needs and experiences by gender.

Informational disparity

It appears common for guarantors to sign in situations where they have little information or are mis-informed about key aspects of the transaction. Guarantors rarely have any information about the borrower's loan or about the health of the business they are supporting and so are unable to assess the risk they are taking. Such information is clearly necessary to enable even the possibility of an informed choice about the transaction.

Guarantee documentation is lengthy, complex and on occasion incomprehensible even to the legally trained. While plain language

documentation may not prevent guarantors from entering into improvident transactions, it would, like the provision of other information and advice, assist in giving at least the opportunity for some real choice to be exercised.

The inclusion of “All Moneys” clauses is still apparently occurring in guarantee transactions. Such clauses in and of themselves enhance the likelihood that guarantors will be placed in an ill-informed and disadvantaged position in the guarantee process.

The circumstances of signing

It appears disturbingly common that guarantee transactions are carried out in informal surroundings and/or in the presence of the borrower. It was very common for our surveyed guarantors to have little time to consider the terms of the agreement. The guarantee transactions in our study almost always took place in the absence of adequate legal or financial advice. These factors contributed to guarantors’ poor understanding of their obligations and to depriving them of an opportunity of informed choice.

These findings contradict what is understood as good practice – and commonly assumed to be typical practice - in this area. Good lender practice, as set out in lenders’ own policy manuals, requires guarantors to sign at the lender’s premises in formal circumstances, in the absence of the borrower and following the receipt of independent legal advice.

These findings suggest that more attention must be given to compliance with good practice in the taking of guarantees at both an industry and regulatory level. If self regulation measures do not have sufficient industry coverage or are ineffective, increased regulation should be considered.

Legal advice

There is a sharp disparity between what courts, lenders and policy-makers understand to be the scope and content of independent legal advice and what is delivered in practice. “Independent legal advice” is in practice merely a “basic explanation” of the content of legal documents.

These findings have serious implications in terms of the development of guarantor protections, which until now, have contained a heavy focus upon independent legal advice as a cure for unfair dealing, a source of information or empowerment for the guarantor, and as a protection against lender liability. While the presence of legal advice may protect a lender from an action to set aside the transaction, such advice as it is currently typically provided does not appear to offer the guarantor very much in terms of information on the loan, advice on the transaction, or empowerment to refuse or renegotiate the terms of the transaction.

Lack of regulation

The pre-transaction conduct of the taking of guarantees still appears largely unregulated and shows little evidence of what either the finance industry or consumer advocates would regard as best, or even adequate, practice.

There appears to be a need for clear and consistent standards of conduct across the entire lender industry.

Post-transaction disputes

Litigation is inadequate

If there is any dispute over the guarantee transaction, the available avenues for redress are clearly inadequate. Informal and accessible dispute resolution mechanisms that currently exist are very limited in their operation and utility. Litigation, with its associated expense and complexity, still remains the principal focus of dispute resolution in this area.

Litigation is complex, protracted, expensive and often poorly conducted. Litigation is fiercely and desperately fought in many matters, and may often add considerably to the final costs even when settlement is achieved at some stage in the process.

Costs

The inclusion of “all reasonable costs of recovery” clauses is very common in guarantee transactions. These costs are in addition to the principal sum and interest, and include legal costs and the costs of pursuing the borrower and the guarantor. They can amount to many tens of thousands of dollars before litigation has even commenced. These clauses transfer a significant portion of the risk of lending – the transaction costs of recovery - from lenders to guarantors.

Such clauses act as a powerful disincentive for lenders to negotiate, to settle claims or engage in lower cost forms of dispute resolution, as their legal costs and costs of recovery are contractually borne by the guarantor and can be automatically deducted from secured assets.

Need for certainty

The current array of common law and legislative avenues to challenge unfair transactions has contributed to the complexity of litigation.

The application of legal principles – particularly the *Contracts Review Act* and the “special equity” for wives in *Garcia* - in decided cases has been

inconsistent and further contributed to uncertainty. It appears that the range of legal principles are too uncertain in their application for any degree of predictability in this area.

Greater certainty in the operative law in this area could reduce litigation and provide both lenders and guarantors with a better sense of what conduct and factors will render a transaction unenforceable.

The need for accessible dispute resolution

While many matters settle in negotiation between lawyers, there are very few structured avenues of accessible or informal dispute resolution in this area.

The industry and tribunal level dispute resolution processes that do exist are very little used. This under-use appears to be principally caused by jurisdictional limits such as low monetary limits on the value of the dispute and limited application to “consumer” rather than “business” transactions. As a large portion of guarantees are secured by residential properties and are undertaken to support small business borrowing, the jurisdictional limits of current avenues render them virtually useless.

There is a clear need for a relatively even playing field in which disputed transactions can be heard and adjudicated, in addition to avenues for mediated or negotiated settlements.

Conclusion

Despite protections such as the Consumer Credit Code (in operation since 1996) and voluntary self-regulation mechanisms such as the Code of Banking Practice (in place since 1993 and widely adopted),¹²⁷ guarantors continue to enter into transactions with a very poor understanding of what their obligations are. Lenders also continue to provide funds to borrowers supported by guarantees when neither the borrower nor the guarantor, upon a careful assessment, is able to repay the amount. The pre-transaction conduct of the taking of guarantees still appears largely unregulated and shows little evidence of what either the finance industry or consumer advocates would regard as best, or even adequate, practice.

¹²⁷ *Code of Banking Practice* (1993). Banks that had adopted the Code as at August 2002 were: Adelaide Bank Limited, AMP Bank Limited, Arab Bank (Australia) Limited, Australia and New Zealand Banking Group Limited, Bank of China, Bank of Western Australia Ltd (Bankwest), Bank of Queensland Limited, Bendigo Bank Limited, Citibank Limited, Colonial State Bank, Commonwealth Bank of Australia, HSBC Bank Australia Limited, ING Mercantile Mutual Bank (Australia) Ltd, Macquarie Bank Limited, National Australia Bank Limited, Primary Industry Bank of Australia Limited, St George Bank Limited, Suncorp-Metway Limited, Westpac Banking Corporation.

Some of the problematic areas relating to guarantee practice *may* be assisted by the new provisions of the Code of Banking Practice.¹²⁸ From August 2003 the Code of Banking Practice has greater coverage and enhanced guarantor protections. The Code now covers guarantees for small business transactions in addition to consumer transactions, and has enhanced requirements for the provision of pre-transaction information to guarantors.¹²⁹ However the Code will continue to be a voluntary source of regulation so it remains to be seen what impact it will have upon the pre-transaction conduct of bank lenders.

Clearly, although many steps have been taken to improve policy and best practice in this area, this research demonstrates that much remains to be done.

¹²⁸ See Murray Brown, "The Garcia Code" (2003) 14 *Journal of Banking and Finance Law and Practice* 17.

¹²⁹ *Code of Banking Practice* (2003), in particular C1 28, C1 40.