



NSW LAW REFORM COMMISSION



UNIVERSITY OF SYDNEY

## RESEARCH REPORT 11

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a report on the practice of third party  
guarantees in New South Wales



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## TERMS OF REFERENCE

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### **Guaranteeing someone else's debts**

In a letter to the Commission dated 2 March 1999, the Attorney General, the Hon J W Shaw QC MLC referred the following matter for inquiry:

... the New South Wales Law Reform Commission is requested to inquire into and report on the legal framework for the protection of guarantors of small business and other loans and in particular, to consider:

1. whether the present legal framework adequately protects the interests of personal guarantors of small business and other loans;
2. whether there is a reasonable level of satisfaction in the community with the operation and application of the existing laws protecting guarantors of small business and other loans, in particular, whether those guarantors, financiers and principal borrowers are satisfied with the present legal framework;
3. whether there are more practical and effective strategies for the provision of personal guarantees of small business and other loans that would enhance the development of conscientious lending practices while not placing undue constraints on small business lending; and
4. any related matters.

In carrying out its review, the Commission is to have regard to:

- The report of the Expert Group on Family Financial Vulnerability “Good Relations: High Risks – Financial Transactions Within Families and Between Friends” released by the Commonwealth Attorney General in February 1996, and any other relevant reviews;
- The effectiveness of current New South Wales legislation with particular reference to the *Contracts Review Act 1980* and the *Fair Trading Act 1987*; and
- The need to ensure that any legal framework governing this issue adequately and effectively protects the interests of personal guarantors; promotes commercial stability and certainty; and does not unduly restrain small business lending.



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# Executive summary

- This research
- What we found

## **THIS RESEARCH**

There have been numerous major reports referring to the problem of relationship debt in recent years, as concern about guarantee transactions has grown. Our project is the first comprehensive Australian empirical research into the law and practices governing third party guarantees.

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.

Our 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?

While we learn some things about guarantee transactions from reported 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. 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.

There is clearly a paucity of data about the prevalence and practice of third party guarantees. This study sought to address that absence, and to provide reliable data so that lenders, borrowers, guarantors, litigants and legislators alike could assess the situation with more clarity.

This report is divided into chapters that follow the inception, life and death of a guarantee transaction, beginning with the original loan and following it through to the resolution of disputes about the guarantee of the loan.

## **WHAT WE FOUND**

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, relationship with the borrower, and likelihood of having signed the guarantee documentation in the presence of the borrower. We were unable to determine the age of all 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 closely with the large proportion of guarantor respondents over the age of 50.

The areas in which guarantor respondents and litigants in case law 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.

More detailed findings set out in each chapter are summarised below.

## **Chapter 2. Securing family business borrowing: why guarantee transactions take place**

The vast majority of third party guarantees are undertaken to support small business borrowing, primarily family business. These businesses are typically owned and run by men. While a female partner may be listed as a shareholder or director, she is rarely in a position of any real control over the company.

Over one third of guarantors who responded to our survey reported that the borrowing was undertaken to expand an existing business; a quarter of loans were directed to starting a new business and around one fifth of loans were required to help an already ailing business.

Most guarantors were in a close relationship with the borrower.

The majority of guarantees were for loans in excess of \$100,000.

Because most guarantees have been undertaken to support a business loan, they are not covered by safeguards provided in the Consumer Credit Code.

The Code is enacted in legislation in each Australian state and requires lenders to provide plain language documents, cooling off periods, warnings and information to prospective guarantors for consumer loans.

### **Chapter 3. Who are guarantors and why do they sign?**

We found that a very high proportion of guarantors were women.

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.

Almost two thirds of guarantors were over the age of 50.

A disproportionate number of guarantors were from non-English speaking backgrounds and 40% of the guarantors who responded to our survey were overseas born. Guarantors from non-English speaking backgrounds appear to be least likely to receive legal advice prior to entering into the transaction.

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. Many reported that they had misgivings about the transaction from the start, but went ahead regardless.

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.

In addition, in some instances guarantors signed because they simply had no idea of the gravity of the consequences, did not understand the agreement or had been misled about the transaction.

### **Chapter 4. The lenders**

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.

There was some evidence suggestive of the fact that some lenders had engaged in asset based lending, where they assess the risk of the loan by reference to the value of the security rather than on the ability of either the borrower or the guarantor to repay the loan.

While there are a wide range of common law and legislative avenues available to challenge unjust transactions after the event, there is relatively little external regulation of the conduct of the finance industry in taking guarantees. The Consumer Credit Code provides a range of protections for borrowers, but it is limited in its application to “consumer” transactions. Most guarantees are given to support small business borrowing and so are not currently covered by the Consumer Credit Code.

The finance industry’s conduct in taking guarantees is therefore largely self-regulated. The Code of Banking Practice is the main self-regulation mechanism. However, this Code only applies to banks that adopt it. Banks who are part of the Code agree to investigate disputes internally, which can also be referred to the Australian Banking Industry Ombudsman. While the Code was originally limited to consumer guarantees, following a comprehensive review, guarantees of small business loans are included in the scheme from August 2003. The revised Code of Banking Practice contains far more wide-reaching constraints on the taking of guarantees than have existed to date.

## **Chapter 5. The guarantee transaction**

Guarantors often had little or no knowledge of the financial situation of the borrower or the borrower’s business.

There was a widespread lack of understanding among guarantors about the obligations that they had undertaken. Very few guarantors were aware of the commercial or legal implications of the transaction when they executed the guarantee.

We found that guarantee documentation is lengthy and complex, often involving a bundle of several interrelated documents that combine to create legal liability which is not apparent on the face of any one document separately.

“All moneys” clauses extend the liability of a guarantor to future as well as present loans up to an unlimited amount. Such clauses are still in common use despite widespread concern about their potential to cause unfairness and lender assertions that their use is rare. The revised Code of Banking Practice, which applies from August 2003 prohibits the taking of “all moneys” guarantees in a wider variety of circumstances than it previously did.

We found a trend towards a restructuring of guarantee transactions to place the guarantor on paper as a borrower or co-borrower in order to conceal the reality of the situation and avoid regulation or legal liability.

Our survey of guarantors revealed that over one quarter of them entered into the transaction in informal circumstances, with one fifth of them executing the guarantee in their own home. A lesser, but still significant, proportion of guarantors in the litigated cases we reviewed also signed at home.

Given the potential for influence or pressure to be brought to bear in these situations, we were disturbed to find that almost half of guarantors who responded to our survey reported that the borrower was present when they signed, while nearly a quarter reported that both the borrower and the lender were present. This was also reflected in the litigated cases.

Many guarantors reported that they did not have time to consider the contract. Over half felt that the provision of a “cooling off” period prior to the contract coming into effect would have helped them, while a third did not think such a provision would have made any difference to their situation.

Few guarantors received independent legal advice prior to entering into the guarantee. While legal advice had been given in 29% of the litigated cases, only 14% of surveyed guarantors reported that they had received legal advice prior to entering into the transaction. Moreover only 20% of guarantors reported that anyone, including the lender, suggested that they obtain such advice prior to signing.

Of those few guarantors who did receive legal advice, most did not find it adequate, nor did it have any significant impact upon their decision to enter into the transaction. Advice was often cursory, and usually took place shortly before the documents were signed.

The fact that in many instances the legal advice was organised by the borrower and sometimes was given in the presence of the lender or the borrower raised issues about the independence of the advice and, in some cases, about conflict of interest.

Most solicitors reported that their role was to explain the effect of the documents and give advice on the legal risks of the transaction such as the nature and extent of liability. While a quarter of solicitors saw their role as ensuring that a guarantor understood the transaction, and a few saw themselves as protecting the guarantor’s interests, none saw their role as ensuring that the guarantee was freely entered into.

Legal advice does not include advice on the financial implications of the transaction, or an assessment of risks. This is beyond the role of solicitors,



and in any event, in most cases there was insufficient information on the borrower's finances to enable such an assessment.

While independent legal advice ought to ensure a guarantor is better able to understand the transaction, many lawyers also remarked upon the fact that such advice really works to protect the interests of lenders, by making disputed transactions much harder to challenge.

Lawyers were very concerned about what they saw as a rising tide of claims against them in the context of third party guarantees. Many perceived independent legal advice as a risk shifting exercise, rendering solicitors responsible for the loss that ought rightly to rest with borrowers or lenders. In fact we found very few claims against lawyers, and no instances in our pool of cases in which lawyers were held liable for a guarantor's or lender's loss.

## **Chapter 6. When the loan went wrong**

Most guarantors reported that they received no information about the loan until their guarantee was called upon.

When the guarantee was called upon the vast majority of guarantors were shocked to find that they were wholly liable for the debt. Most were taken by surprise by the amount of the debt, which included interest and other charges. Several guarantors reported that this was the first time they discovered their guarantee extended to cover "all moneys".

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. These may account for such under-use.

The Consumer, Trader and Tenancy Tribunal was also very little used, and likewise this appears to be related to its limited jurisdiction, which by virtue of the Consumer Credit Code does not include guarantees that support loans for business purposes.

While the majority of disputes about guarantees settled, we found that it was quite common for settlement to occur only once litigation was already underway. So in a sense litigation could still be regarded as a, if not the, primary dispute resolution process in this area.

Of matters that settled, the majority were on terms that were more favourable to the lender than the guarantor.

## Chapter 7. Litigation

Litigation is marked by a complex maze of claims and cross claims on a variety of common law and statutory bases. We found that it was common for three or more grounds of defence to be relied upon in any single matter and late amendments to pleadings were a regular event.

The views of lawyers about the conduct and efficiency of litigation were coloured by whether they acted predominantly for guarantors or lenders. Lawyers who acted for lenders tended to think that the law provided too many avenues to challenge guarantees. These lawyers and several judges, suggested that guarantors often raised a desperately wide raft of barely arguable claims that simply delayed the inevitable. Lawyers who acted for guarantors were of the view that lenders unconscionably increased their own costs, were quick to move for default judgment and used procedural manoeuvres to prevent claims being properly heard.

Legal costs are obviously high. The high cost of legal services impacts disproportionately on guarantors as they have both fewer financial resources and less experience compared to lenders. We were unable to determine clearly how many guarantors were proceeding to litigation without legal representation, although several judges stated that they saw a significant portion of unrepresented litigants.

There is a perception among some commentators that there has been an explosion in successful litigation by guarantors and as a result, the law has gone “too far”, such that commercial certainty in this area has been undermined. This concern was not borne out by our research. While guarantors were partially or fully successful in 35% of the litigated cases we reviewed, these cases represent only a small fraction of the overall pool of disputed transactions. Most disputed cases settled, and of those we found that the majority were on terms that favour lenders. Solicitors reported that even in disputed transactions, the most common result for their clients was that they repaid the loan with interest, with only a very small portion being partially or wholly released from the debt.

We also examined the impact of the *Contracts Review Act 1980* (NSW) and the High Court decision of *Garcia v National Australia Bank* (1998) 194 CLR 395, 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 also confirmed a trend noted by other researchers, towards partial rather than complete relief under the Act.

The 1998 High Court decision of *Garcia* revived a “special protection” for volunteer wives even in the absence of unfair dealing. 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 legal advice be sought. While *Garcia* was raised in 58% of litigated cases we analysed, litigants were successful in only around a quarter of these cases. Solicitors and barristers did not think the decision had a large impact upon the law.

We found considerable uncertainty about the scope and application of the principle. While some decisions have applied the principle to de facto spouses, others held that only formal marriages are covered by the principle. There has been similar division over whether the principle extends to elderly parents, 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.

We found even greater variation over courts’ interpretation and application of the *Garcia* requirement that the claimant be a “volunteer” to the transaction in order to be entitled to relief.

Other issues explored in this Chapter include: the very slight consideration of violence as an issue in litigated cases, the use of lenders “usual practice” as evidence, the importance of determinations of credibility in determining outcomes in litigation, and the role of gender and cultural stereotyping.

## **Chapter 8. Implications of this report**

This chapter outlines some of the implications of this research in two areas: firstly, pre-transaction conduct, and secondly, dispute resolution once a guarantee is disputed.

The objectives of law and policy reform in this area involve a tension between the need to protect guarantors, secure finance for small business, and provide some measure of certainty in procedure, practice and outcome for all parties concerned. This report does not suggest particular reform measures. Rather, it highlights key findings of our research and suggests how these findings need to be considered by, and may impact upon, future developments in law and policy.

### ***A. Signing***

**Guarantors in positions of vulnerability.** The evidence from this report clearly shows 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 target them specifically 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 inequalities. 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.** Men 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 misinformed 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.

**Legal advice.** There appears to be 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 have the transaction set aside, 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.

### ***B. Later 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.

**The costs of dispute resolution.** 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 1980* (NSW) and the “special equity” for wives in *Garcia* – in decided cases has been inconsistent and further contributed to uncertainty. It appears that there are too many legal principles that 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.

# 1. Introduction

- This research
- What we wanted to discover
- What we didn't explore
- How we went about looking

“In general, the public should be discouraged from giving guarantees. In the case of families and friends it is usually particularly harrowing...I think that commercial lenders often seek guarantees where it is not necessary and adds little to the real likelihood of closure/recovery of the debt. Often it adds to the expense of recovery without doing more than employing more lawyers and accountants. That is quite apart from the public resources consumed by the fierce/desperate resistance from a guarantor who stands to lose everything ...”<sup>1</sup>

## THIS RESEARCH

1.1 Third party guarantees are often 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. Third party guarantors are typically the wives, partners or parents of borrowers and often undertake the obligation due to their close relationship with the borrower. Borrowers are frequently involved in running small businesses, including family businesses.

1.2 A guarantee may be a personal guarantee, or it may be secured over property by a mortgage, or both. If the borrower defaults on the loan, the guarantor then becomes liable to repay all or part of the loan. The guarantor is very often also liable to pay for transaction costs – such as interest, and the bank’s recovery fees and legal fees – in addition to the principal sum.

1.3 Guarantor transactions are considered to be at high risk of unfair dealing for a number of reasons.<sup>2</sup> Such contracts are typically undertaken in a relationship of emotional interdependence with the borrower of the primary loan. Unlike most contractual arrangements, this transaction is not an arm’s length transaction because of the close relationship between the borrower and guarantor. The existence of a relationship of interdependence may mean that the guarantor will become a guarantor without engaging in the usual inquiries that a person entering a business arrangement would; and instead agrees for “unbusinesslike” motives such as emotional attachment; or optimistic affirmation of the borrower’s decision. One judge who responded to our survey stated:

“Contracts of guarantee are the only contracts which parties enter into on the assumption that they will not be required to perform the

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1. *Judge Survey*, Respondent 1.

2. Reg Graycar, Robyn Johansson and Jenny Lovric, “Guaranteeing Someone Else’s Debts” (2001) 12 *Journal of Banking and Finance Law and Practice* 181.



contract. They accordingly give rise to human and psychological issues which are not present in other contracts.”<sup>3</sup>

1.4 Yet guarantees are clearly contracts with commercial implications, regardless of whether they were made for any commercial reason, or with the awareness that entering such a transaction entails an intention to be legally bound by the contract’s terms.<sup>4</sup>

1.5 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.<sup>5</sup> In March 1999 the New South Wales Attorney General asked the New South Wales Law Reform Commission (“the Commission”) to undertake a review of the law relating to third party guarantees. In 2000 the Commission released an *Issues Paper* that outlined the state of the law on guarantees, the operation of guarantees including the regulatory framework and industry practice, and identified a number of issues for consideration.<sup>6</sup> It is expected that following the publication of this empirical research, the Commission will issue a final report which makes use of this research to formulate law reform proposals.

1.6 This project was carried out in partnership between the Faculty of Law at the University of Sydney and the Commission between 2000 and 2003 with funding made available by an Australian Research Council Strategic Partnerships in Industry, Research and Training grant.

1.7 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

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3. *Judge Survey*, Respondent 36.

4. Mary Keyes and Kylie Burns, “Contract and the Family: Whither Intention?” (2002) 26 *Melbourne University Law Review* 577.

5. See for example, Australia, Trade Practices Commission, *Guarantors: Problems and Perspectives* (Discussion Paper, 1992); Australia, House of Representatives Standing Committee on Finance and Public Administration, *A Pocket Full of Change: Banking and Deregulation* (AGPS, Canberra, 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, Melbourne, 1995).

6. New South Wales Law Reform Commission, *Guaranteeing Someone Else’s Debts* (Issues Paper 17, 2000).

“sureties”), five borrowers, nine lenders and 13 lawyers.<sup>7</sup> Fehlberg’s research focused only upon guarantors who had supported the loan of a spouse or de facto partner.

1.8 Fehlberg noted that the most common situation in the reported case law on disputed third party guarantees was that of a wife who:

“under some emotional pressure or misunderstanding caused by her husband, signs a charge over the family home in order to provide financial assistance to a business, usually conducted by her husband, but often providing the family’s income.”<sup>8</sup>

Fehlberg’s research found that this scenario was borne out by the guarantors she interviewed. A major theme to emerge from the interviews was that 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. Fehlberg noted that third party guarantees sit at an uncomfortable intersection of the private sphere (family and relationships) and the public sphere (business, law, finance), and argued that the perspectives of guarantors must be more thoroughly integrated into legal and policy reform of this area.

1.9 Our project is the first comprehensive Australian empirical research into the law and practices governing third party guarantees. 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 issues of power, choice and economic dependence identified by Fehlberg in the context of couple guarantors may also be active in other contexts.

1.10 This report is divided into chapters that follow the inception, life and death of a guarantee transaction, beginning with the original loan and following it through to the resolution of disputes about the guarantee of the loan. Chapter 2 discusses who is borrowing and why, Chapter 3 gives an overview of who is providing guarantees and why, Chapter 4 outlines the context in which credit is provided, what regulation governs credit providers and available information about lending practices. Chapter 5 considers the form of guarantee documents and the process of the

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

8. Belinda Fehlberg, *Sexually Transmitted Debt: Surety Experience and English Law* (Clarendon Press, 1997) at 2.

guarantee transaction, Chapter 6 gives information on what happened when the loan went wrong, including non-litigated dispute resolution, while Chapter 7 discusses what is occurring in litigation. Chapter 8 discusses the implications of the research findings.

## WHAT WE WANTED TO DISCOVER

1.11 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?

1.12 While we learn some things about guarantee transactions from reported 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. Reported 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.

1.13 This research sought to learn as much as possible about the practice of guarantee transactions from those who had undertaken them. The project sought to gauge the experience of guarantors through the life cycle of the transaction. We sought demographic information about guarantors and their relationship with the primary borrower, their age and the cultural backgrounds. We also wanted information on the “point of sale” – that is, how the transaction was executed, who organised the guarantee, where it was signed, who was present, what information the guarantor had and the guarantor’s understanding of the transaction at the time they signed. We elicited information on how the guarantor found out there were problems with the transaction, what they did, who they sought assistance from and what kind of dispute resolution mechanism (if any) they pursued. As a fundamental question, we also wanted to know, from the guarantors themselves, why they entered into this kind of inherently risky transaction.

1.14 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.

1.15 There is clearly a paucity of comprehensive statistical data about the prevalence of third party guarantees. This study sought to address that absence, and to provide reliable data so that lenders, borrowers, guarantors, litigants and legislators alike could assess the situation with more clarity. It has been remarked that in the absence of solid statistics, courts and policy-makers have relied on partial, anecdotal or qualified data.<sup>9</sup> Certainly, the lack of solid empirical data has, in no small way, led to reliance on stereotypes about strong and weak parties or outdated assumptions about “special protection” which should be afforded to married women. The research team was aware that in collecting empirical evidence about the gender breakdown of those involved in guarantee transactions, we should be mindful that we not simply reify the gender stereotyping that has, to date, been problematic.<sup>10</sup>

1.16 There has been considerable concern within the legal profession about the duties owed by lawyers engaged to advise guarantors in these circumstances. The researchers considered it important to understand what is occurring in practice in the provision of legal advice. This is particularly important as we expected more lenders to rely on the provision of independent legal advice as a defence to claims from guarantors following the High Court’s decision in *Garcia v National Australia Bank Ltd*.<sup>11</sup> The research set out to analyse the extent and nature of legal advice, including situations where advice was given before people enter into such transactions, and also advice received after guarantees were called upon. We also sought opinions from lawyers on what they perceive to be their role and obligations in relation to the provision of legal advice about third party guarantees.

## WHAT WE DIDN’T EXPLORE

1.17 This is a research-based project which aims to present data to form a clearer picture of what is currently occurring in practice. This report does not restate in any detail the laws that govern the setting aside of unfair guarantee transactions. Legislation and common law on these issues is

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9. Richard Haigh and Samantha Hepburn, “The Bank Manager Always Rings Twice: Stereotyping in Equity After Garcia” (2000) 26 *Monash University Law Review* 275 at 303-304.

10. Richard Haigh, Samantha Hepburn, “The Bank Manager Always Rings Twice: Stereotyping in Equity After Garcia” (2000) 26 *Monash University Law Review* 275.

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

explained in detail in the Commission's *Issues Paper*.<sup>12</sup> Nor do we make recommendations about how the law in this area could or should be changed. Recommendations for change will be part of the Commission's final report, which will follow on from this project. This report will not make recommendations but will instead highlight issues for consideration, both for the Commission and for any other legal or policy body considering these issues.

1.18 During the course of this project it became apparent that problems with third party guarantees cannot be neatly defined, analysed or compartmentalised in terms of credit provision, the taking of security and enforcement thereof. Other major issues include the complex intersection of family law, bankruptcy and other aspects of relationship debt. Such problems and questions were beyond the scope of our research. While the research obtained useful data on the circumstances surrounding the signing of a guarantee, and the setting aside of third party guarantees, the scope of our research did not extend to consider in detail what happened after litigation had concluded. It is clear, however, that the difficult intersection between credit provision, debt and family law is an area warranting further investigation.

## HOW WE WENT ABOUT LOOKING

1.19 This project used a variety of methods to collect information from individuals and organisations, taking into account the objectives of the project, time frame and exploratory nature of the research. Both qualitative and quantitative data collection techniques were selected to suit the target group from which the information was sought.

1.20 A flexible approach was adopted for data collection to allow inclusion of information from a variety of sources and addition of extra respondents where early results indicated the need. Our focus was upon NSW, but responses from elsewhere were not excluded. This report also makes use of lenders' non-confidential responses to the Commission's *Issues Paper*.

1.21 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.

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12. New South Wales Law Reform Commission, *Guaranteeing Someone Else's Debts* (Issues Paper 17, 2000), Chapter 2.

1.22 Quantitative data was collected by use of tick box questionnaires which were sent directly to solicitors and barristers, 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.

1.23 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.

1.24 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 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.

1.25 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 was significant variation between the demographics and experiences of litigants and non-litigants.

1.26 The project sought information from lenders about their practice through a confidential survey, but received very little assistance or input. 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.

1.27 A detailed Methodology appears in Appendix A.

## 2. Securing family business borrowing: why guarantee transactions take place

- Small business and family business
- Women in family businesses
- Family support for family companies
- How much are they borrowing and why?
- Types of loans: the business/consumer distinction
- Conclusion

“For most home-owning couples, their homes are their most valuable asset. They must surely be free, if they so wish, to use this asset as a means of raising money, whether for the purpose of the husband’s business or for any other purpose. Their home is their property. The law should not restrict them in the use they may make of it. Bank finance is in fact by far the most important source of external capital for small businesses ... Finance raised by second mortgages on the principal’s home is a significant source of capital for the start-up of small businesses.”<sup>1</sup>

“The desirability of protecting vulnerable persons from loss of their assets, particularly their homes, must ... be balanced against the undesirability of economically sterilising those assets.”<sup>2</sup>

2.1 This chapter outlines the background social and financial environment in which guarantee transactions take place. It examines the context of family business and small business in which borrowing takes place, so as to better understand why guarantees are considered necessary and how financial risk comes to be transferred from the borrower to the guarantor. It also briefly outlines the regulatory environment surrounding consumer loans and highlights the extent to which current guarantee practice is excluded from that framework.

## SMALL BUSINESS AND FAMILY BUSINESS

2.2 Family businesses comprise a significant part of the Australian economy, yet there is little available information on how they are run, the dynamics of their operation, why they borrow, and why they fail. This chapter relies upon the few research studies and surveys into family business and family finances to draw some tentative conclusions about the background in which many guarantees are likely taking place.

2.3 There are over a million small businesses in Australia. Over 96% of all businesses in Australia are small businesses.<sup>3</sup> The 1997 *Australian Family Business Survey*, conducted by Monash University, found that family business represents 83% of all private sector firms, and employ more than 59% of the workforce.<sup>4</sup> The survey found that women represent

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1. *Royal Bank of Scotland v Etridge (No 2)* [2002] 2 AC 773, per Lord Nicholls at para 34.
  2. *Garcia v National Australia Bank Ltd* (1998) 194 CLR 395, per Kirby J at para 65.
  3. Joe Hockey, “Comment: National Small Business Survey Results” *National Business Bulletin* January 2003 at 53. The 12th National Small Business Survey estimates that around 60% of small businesses are family businesses.
  4. Kosmas Smyrnios, Claudio Romano and George Tanewski, *The Australian Family and Private Business Survey 1997* (Monash University, 1997).



approximately 3% of owners. The majority of family businesses have only one or two directors<sup>5</sup> with around half having only two shareholders.<sup>6</sup>

2.4 While clearly important to the business sector, family businesses are marked by a distinct lack of longevity. The *Australian Family Business Survey* found that between two-thirds and three-quarters of family businesses either die out or are sold out of the founding family during the first generation, and only 5-15% continue into the third generation.<sup>7</sup> There is no comprehensive analysis of the reasons for poor longevity.

2.5 It is also noteworthy that family businesses are structured differently from non-family businesses. In family businesses the owner generally has a duty to look after the welfare of the business and family members and this can lead to conflict. The *Australian Family Business Survey*, found that only 22% of family business owners had a process for dealing with conflicting family and business issues. Of those, only 8% had the process documented.<sup>8</sup> In this context, there is significant potential for liability relating to the activities of the family business to be transmitted to other family members.

2.6 A recent Australian empirical study found that family businesses tend to rely on private sources of finance such as loans from family and friends for start-up and growth rather than funding via public markets. That study speculates that this proclivity is likely to be related to their intentions to retain control and minimize financial risk.<sup>9</sup> While our research did not specifically inquire into financial risks, it was clear that using private family sources as security for business loans involved high

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5. While 19% of family businesses had a single family member director, 52.8% comprised two family member directors, 14.2 % had three family directors and 10.6 % comprised four or more family members as directors.
  6. Other research on the composition of businesses found that family-owned businesses account for 83% of all businesses; and of that 83%, 79.9% are private companies. 47% of those companies have 2 shareholders, 32.6% have between 3 to 5 shareholders, 9.2% have between 6 to 10 shareholders and the remaining 4.4% have more than 10 shareholders; see Price Waterhouse/Commonwealth Bank *Family Business Survey* of 5000 businesses (1995) 11 *Company Director* 20, cited in Peta Spender, "Women and the Epistemology of Corporations Law" (1995) 6 *Legal Education Review* 195 at 197, 202, footnote 24.
  7. Kosmas Smyrnios, Claudio Romano and George Tanewski, *The Australian Family and Private Business Survey 1997* (Monash University 1997); and CPA Australia, *Submission to the Senate Employment, Workplace Relations and Education References Committee: Inquiry into Small Business Employment Issues* (16 May 2002) at 7-8.
  8. Kosmas Smyrnios, Claudio Romano and George Tanewski, *The Australian Family and Private Business Survey 1997* (Monash University, 1997) at 19.
  9. Kosmas Smyrnios, Claudio Romano and George Tanewski, "Capital Structure Decision Making: A Model for Family Business" (2000) 16 *Journal of Business Venturing* 285 at 303, 304.

risk which in many instances lead to disastrous results, such as the loss of the family home.<sup>10</sup>

## WOMEN IN FAMILY BUSINESSES

2.7 Much of the decided case law on third party guarantors of family business debts involves an analysis of the roles of family members in the relevant business. This is because in many cases involving women who guarantee their husband's business debts, the **benefit** that spouse receives, or expects to receive, from an enterprise is a critical issue in determining whether relief will be given.<sup>11</sup> In third party guarantee litigation, the lender may claim that even if a woman has no participatory or decision-making role in the company activities or where its profits are directed, she nonetheless obtains an indirect benefit as a shareholder or director or because the company provides income to the family.<sup>12</sup>

2.8 There is comparatively little known about the dynamics of family businesses.<sup>13</sup> Courts have tended to assume that benefits to one party in a marriage automatically flow to the other, or that if a woman has a formal role in the business, then she is actively involved in the decision-making within that enterprise. This approach does not take into account economic research that questions such assumptions.<sup>14</sup> Two studies which investigate how domestic decisions impinge on family business decision-making are relevant to this research. In Australia, Supriya Singh researched how women participate and inform themselves in family businesses,<sup>15</sup> and in

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10. *Guarantor Survey*, Question 24(b): around 33% of those who guaranteed a business loan for someone else lost their home as a result.

11. The issue of benefit is discussed in further detail in Chapter 7: Litigation.

12. See Radmila Jukic, *Till Debt do us Part* (Consumer Credit Legal Service, 1994) at 23-24.

13. See Kathy Marshack, "Copreneurs and dual-career couples: Are they different?" (1994) 19 *Entrepreneurship Theory and Practice* 49.

14. Supriya Singh found that 12.8% of married people with joint accounts did not know their total household income and 16.3% did not have any information on their bank deposits. Singh concluded that "anywhere between 13% and 16% of persons with joint accounts could not exercise joint control, or even any control over their money". Supriya Singh, *Marriage Money: The Social Shaping of Money in Marriage and Banking* (Allen and Unwin, Sydney, 1997) at 87 and 108. See also Meredith Edwards, "Individual Equity and Social Policy" in Jacqueline Goodnow and Carole Pateman (eds), *Women, Social Science and Public Policy* (Allen and Unwin, 1985).

15. See Supriya Singh, *For Love Not Money: Women, Information and the Family Business* (Consumer Advocacy and Financial Counselling Association of Victoria Inc, 1995).

England, Belinda Fehlberg undertook a detailed empirical study of women's involvement in family businesses.<sup>16</sup>

2.9 In the Fehlberg study, a large proportion of those women who identified themselves as having no day-to-day involvement in the family business nonetheless provided significant financial support by way of third party guarantees.<sup>17</sup> Furthermore, those “non-participating” women were also often company directors, secretaries or shareholders. For such women their formal position in the business did not correlate with their actual participation; and certainly none had considered exerting their formal legal rights (as directors or shareholders) to obtain a direct financial benefit.<sup>18</sup>

2.10 A comparative analysis of the data from the English and Australian surveys reveals that while most women surveyed in the Australian study described a high level of involvement in the family business compared to the English study,<sup>19</sup> this did *not* translate into equal power within the business. Singh describes this situation as “informed powerlessness”, that is, where a woman is informed about the finances and business, but is still unable to influence or be active in final decision-making. This inability to influence strategic decision-making is consistent with the English study, and Fehlberg observes that collectively these studies undermine the assumption that non-participation or lack of information of themselves explain women's lack of power in family businesses.<sup>20</sup> This dichotomy between information and decision-making power is evidenced in the casework of financial counselling services.<sup>21</sup> Other research in the United States also confirms the entrenchment of gendered roles in business and business decision-making.<sup>22</sup>

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

17. See Belinda Fehlberg, “Women in ‘Family’ Companies” (1997) 15 *Companies and Securities Law Journal* 348 at 360.

18. See Belinda Fehlberg, “Women in ‘Family’ Companies” (1997) 15 *Companies and Securities Law Journal* 348 at 360.

19. This may be because of the sampling process of the Australian study. The sample was chosen randomly using the Yellow Pages business directory, and so women were more likely to be directly involved in the business: see Supriya Singh, *For Love Not Money: Women, Information and the Family Business* (Consumer Advocacy and Financial Counselling Association of Victoria Inc, 1995) at 19-20.

20. Belinda Fehlberg, “Women in ‘Family’ Companies” (1997) 15 *Companies and Securities Law Journal* 348 at 364.

21. See Kate Keating, “Relationship Debt” (2000) 2 *Butterworths Consumer Credit Bulletin* 3 at 4.

22. Research in the USA has revealed that personal and professional lives of women in family businesses are dominated by interactions with other family members, to the detriment of other participation in external networks such as friendships or support groups. While there is a suggestion that family businesses may be more “family friendly” for women, family businesses are extensions of a family's culture,

2.11 Fehlberg concludes from her analysis 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”.<sup>23</sup>

2.12 These studies suggest that great care should be taken of the way that women’s involvement in family companies is analysed and assessed by the courts when they consider women’s actual involvement in and benefit (if any) from the family business.<sup>24</sup> The suggestion that the provision of extra legal or financial advice to women about their roles and activities within a business will alleviate difficulties with guarantee transactions may well be misconceived. Lack of information does not appear to be the major problem – the underlying issue is the absence of power or opportunity that would enable effective and active decision-making.

## FAMILY SUPPORT FOR FAMILY COMPANIES

“Once again the Court has before it an appeal involving a claim by a female spouse for relief under the *Contracts Review Act 1980* (the Act). The claim relates to a legal transaction entered at the request of the male spouse.”<sup>25</sup>

2.13 In our research information about borrowers was obtained from guarantors, solicitors, barristers and judges, as well as from a review of recent litigated cases. Borrowers themselves were not directly surveyed.

2.14 We anticipated that there would be a high number of male borrowers and company borrowers, both supported mainly by female guarantors. This was confirmed by the data.

2.15 The review of litigated cases revealed that men were the principal or sole borrower in 42% of the pool of cases assessed. No cases in our pool revealed a female primary borrower. A third of the cases analysed involved a family company as the borrower. Ninety per cent of borrowers in the litigated cases were individuals, or companies owned and run by individuals, who were related to the guarantor. Our surveys revealed very

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dynamics and biases. This may mean that the role of some women in family businesses may be traditional and limiting. See, for example, Barbara Hollander and Wendi Bukowitz, “Women, Family Culture and Family Business” (1990) 3 *Family Business Review* 139.

23. Belinda Fehlberg, *Sexually Transmitted Debt: Surety Experience and English Law* (Clarendon Press, 1997) at 89.

24. Belinda Fehlberg, “Women in ‘Family’ Companies” (1997) 15 *Companies and Securities Law Journal* 348 at 364. See also Kristie Dunn, “Yakking Giants: Equality Discourse in the High Court” (2000) 24 *Melbourne University Law Review* 427, in particular at 447–454.

25. *Gough v Commonwealth Bank of Australia* (1994) ASC 56-270 per Kirby P.

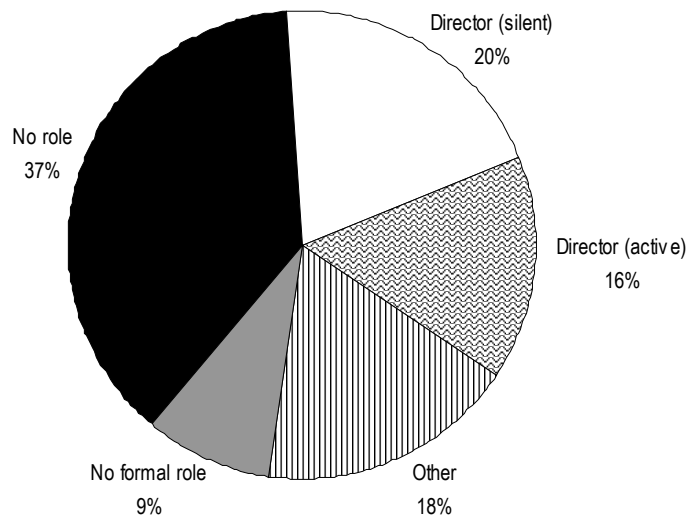
similar results with between 70% and 80% of guarantors in a familial relationship with the borrower. The relationship between the borrower and guarantor is discussed in more detail in Chapter 3: Who are guarantors and why do they sign?

2.16 When we examined business loans specifically, the findings from family business studies cited earlier were clearly borne out.

2.17 Thirty-seven 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. 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.<sup>26</sup>

2.18 A further 20% of our guarantor respondents were “silent” directors of the business. Only 16% were active directors of the business whose loan they had guaranteed.<sup>27</sup> 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.

**FIGURE 2.1: ROLE OF GUARANTORS IN THE BUSINESS**



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

27. Of the remaining 18%, most were partners in a partnership arrangement. *Guarantor Survey*, Question 31.

## HOW MUCH ARE THEY BORROWING AND WHY?

2.19 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% respectively of guarantees were for business loans 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.

2.20 Of the guarantors surveyed 48% were involved with loans of less than \$50,000, while 26% were involved with loans of between \$50,000 and \$200,000 and 24% were involved with loans of over \$200,000. Solicitors and barristers reported significantly larger amounts at stake in the transactions they last dealt with.<sup>28</sup> Our analysis of litigated cases also revealed far higher amounts than those reported by guarantors.<sup>29</sup> It is logical that the involvement of lawyers and the use of litigation correlated with high value transactions. The smaller value of loans in the guarantors survey also correlates with the proportion of guarantees that were for non-business purposes (such as loans to purchase cars for individual use).

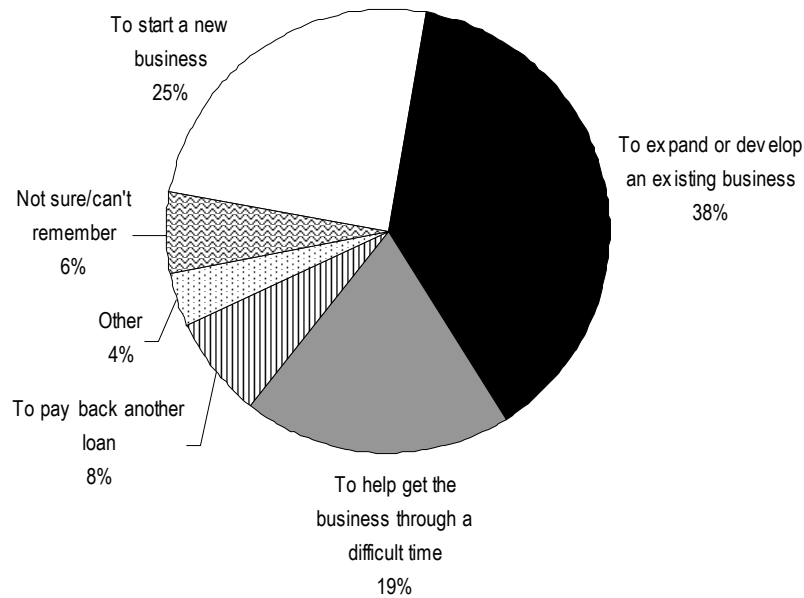
2.21 We were interested to discover whether guarantees were being sought to support finance for businesses that were starting up or expanding, or for a business that was in difficulty or had loans that were already problematic. From our survey it appears that expansion, rather than start-up or later 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. While a sizeable proportion of guarantees are therefore taking place to assist a business that it already ailing, it appears that the majority of guarantees in our pool were undertaken in a climate of optimism.

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28. 38 % of barristers and 31% of solicitors reported that in the last guarantee matter on which they acted, the loan was valued at between \$50,000 and \$250,000, while 18% of barristers and 25% of solicitors reported loans between \$250,000 and \$500,000 in their last matter, and 38% of barristers and 22% of solicitors reported loans over \$500,000: *Barrister Survey*, Question 10(b), *Solicitor Survey* Q11(b).

29. In the case review only 2% of matters involved a loan of less than \$50,000, 38% concerned a loan between \$50,000 and \$250,00, 25% were between \$250,000 and \$500,000 and 35% were over \$500,000.

FIGURE 2.2: PURPOSE OF BUSINESS LOANS



2.22 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.<sup>30</sup> However Fehlberg notes that whether a business was in trouble or was new or expanding, debtors were rarely in a position to present the risks inherent in the guarantee objectively. 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.<sup>31</sup>

## TYPES OF LOANS: THE BUSINESS/CONSUMER DISTINCTION

2.23 The Uniform Consumer Credit Code regulates the provision of credit where it is provided wholly or predominately for personal, domestic or household purposes.<sup>32</sup> The Consumer Credit Code is enacted in legislation in each Australian state.<sup>33</sup> Consumer loans benefit from provisions that require lenders to provide plain language documents, cooling off periods and the provision of warnings and information to prospective guarantors.

30. Belinda Fehlberg, *Sexually Transmitted Debt: Surety Experience and English Law* (Clarendon Press, 1997) at 163.

31. Belinda Fehlberg, *Sexually Transmitted Debt: Surety Experience and English Law* (Clarendon Press, 1997) at 164.

32. *Consumer Credit Code* s 6.

33. *Consumer Credit (New South Wales) Act 1995* and Regulations.

The safeguards provided by the Consumer Credit Code are not available for business or certain types of mixed purpose loans. The regulation of guarantees of business loans is therefore significantly more limited than the protections available where the guarantee is provided to support a loan which is essentially of a personal or domestic nature.

2.24 The Commission's *Issue Paper* noted the widening gulf between laws regulating business finance and consumer finance and the policy behind maintaining those distinctions.<sup>34</sup> Many submissions to the Commission advocated abandoning those divisions. Some were of the view that people entering guarantees for business loans are not necessarily more sophisticated than guarantors supporting consumer loans.<sup>35</sup> Another submission noted the ability to make things or provide a service does not mean that business people necessarily have any more financial understanding than consumers in general.<sup>36</sup> Furthermore, issues such as power imbalances and relative economic circumstances are just as relevant in many small business loans as they are in relation to consumer loans.<sup>37</sup> Small business guarantors do not have access to the same statutory legal protections prior to entering into a guarantee transaction and may have more limited access to assistance from community legal centres or legal aid to assist them with subsequent disputes.<sup>38</sup>

2.25 The Commission's *Issue Paper* identified the need to review the continuation of the distinction between business and consumer loans.<sup>39</sup> The categories are not two diametrically opposed categories, but in practice may operate along a continuum with mixed purpose loans that use a mortgage to support both a family business and some measure of personal spending, such as home expansion or repairs.

2.26 The presumption that people entering into guarantees for businesses are more sophisticated, more empowered or on a more equal bargaining footing than those guaranteeing personal loans was not borne out in our research.

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34. New South Wales Law Reform Commission, *Guaranteeing Someone Else's Debts* (Issues Paper 17, 2000) at 6-7.

35. NSW Legal Aid Commission, *Submission* at 2-3.

36. Ryde-Eastwood Financial Counselling Service, *Submission* at 3.

37. Women's Legal Resources Centre, *Submission* at 3.

38. Report of the Expert Group on Family Financial Vulnerability, *Good Relations, High Risks: Financial Transactions Within Families and Between Friends* (Report, 1996) at 38.

39. New South Wales Law Reform Commission, *Guaranteeing Someone Else's Debts* (Issues Paper 17, 2000) at 7 and 100.



## CONCLUSION

2.27 Small business represents a significant and fundamental part of the Australian economy. Utilising the equity in personal assets such as the family home is a convenient and common way to raise capital to start-up and/or to expand a business. Belinda Fehlberg argues that:

“While it is in everybody’s interests to ensure that small businesses have access to the capital they need, there is a need to undermine the link between suretyship by loved ones and business financing.”<sup>40</sup>

2.28 Most family businesses are owned and run by men, with little involvement from female partners. Our research confirmed that the majority of third party guarantees are undertaken to support small business, and followed a pattern of male borrowers and female guarantors. Women who guaranteed business loans in our study were generally uninvolved in the operation of the business.

2.29 Guarantees undertaken for business purposes, or mixed business and consumer purposes, are not covered by the provisions of the Consumer Credit Code. Our research indicates that the largest area of guaranteed loans is subject to the least legal regulation.

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40. Belinda Fehlberg, “Money and Marriage: Sexually Transmitted Debt in England” (1997) 11 *International Journal of Law, Policy and the Family* 320 at 340.

### 3. Who are guarantors and why do they sign?

- Guarantor characteristics
- Why did they sign?
- Conclusions

“The melancholy truth is that Mrs Correy mortgaged her home for a substantial sum to help a son ... Such is a mother’s love.”<sup>1</sup>

3.1 Although it has been noted that, “Trusting wives and elderly parents from non-English speaking backgrounds are familiar characters in Australian contract law”<sup>2</sup>, there is very little information about those who guarantee loans for others beyond the law reports. While research has identified that some guarantors, in particular those who have a close personal relationship with the primary borrower, and those from non-English speaking backgrounds appear to be at particular risk, most research has based its findings on anecdote or upon reported case law rather than upon empirical research.<sup>3</sup>

3.2 A major aim of this research was to investigate more fully the experiences of, and problems faced by, third party guarantors who do not appear in the litigated cases. We wanted to find out who the guarantors in the community are, how old they are, what their backgrounds are, what their relationships with borrowers are, why they sign guarantees, what kind of information they have, and what kind of information they need. 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 that a large proportion of guarantors are also from non-English speaking backgrounds – could be confirmed.

3.3 What we found was that the majority of guarantors are indeed women, that they mostly guarantee loans for borrowers who they are in a close personal relationship with, and many of them are elderly. A large proportion of guarantors are also from non-English speaking backgrounds. Details of the data collected are summarised below.

3.4 Some of these categories reflect those that have been considered by courts in Australia as relevant to a legal claim of unconscionability. To be entitled to claim relief from a transaction for unconscionability the claimant must show that they were under a “special disadvantage” which the other party was, or ought to have been, aware of and took advantage of. Factors such as old age, lack of formal education and inability to speak or read English have all been considered as “special disadvantages”.<sup>4</sup>

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1. *Pasternacki v Correy* [2001] ANZ ConvR 240; [2000] NSWCA 333 at para 34.
  2. Sue Mahalingham, “Deep and meaningful: Dealing with Emotionally Transmitted Debt” (1999) 3(6) *Consumer Rights Journal*.
  3. See, for example, the report of the Expert Group on Family Financial Vulnerability, *Good Relations, High Risks – Financial Transactions within Families and Between Friends* (Report, 1996); Australian Law Reform Commission, *Equality Before the Law: Women’s Equality* (Report 69, Part 2, 1994).
  4. For further detail see New South Wales Law Reform Commission, *Guaranteeing Someone Else’s Debts* (Issues Paper 17, 2000).

3.5 It should be noted that these categories are not self contained, and many guarantors would be placed in more than one: for instance if they were older women who were from a non-English speaking background. Likewise when the reasons why guarantors agreed to the transaction are explored later in this chapter, it should be recalled that there is a considerable overlap between categories, as respondents gave more than one reason for their actions. The headings in this chapter are therefore only a guideline, and are not intended to suggest that the many issues outlined below can be readily separated out.

## GUARANTOR CHARACTERISTICS

### Gender

3.6 The survey of guarantors revealed almost two-thirds of those who guaranteed loans were women.<sup>5</sup> 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). One financial counsellor advised that in his experience guarantees affect women three times more often than men.<sup>6</sup>

3.7 The gender breakdown of our guarantor respondents reflects similar findings in research conducted in Victoria in 1997. The study found that:

“... women are more willing than men to guarantee loans ... While women comprise roughly two-thirds of the sample, they represent more than three-quarters (77.8%) of those who have guaranteed loans. More than one-fifth (20.6%) of the 188 persons surveyed say they would guarantee a loan for their spouse. Women say it more often than men. More than one-fifth (21.4%) of the persons studied ... say they would do so for their child. This includes nearly the same proportion of men and women.”<sup>7</sup>

3.8 In Fehlberg’s UK study only 2 of the 22 guarantors were male. The higher proportion of men in our study arises due to our inclusion of all guarantors, rather than just spouse and partner guarantors which Fehlberg’s study was limited to. Our study was comparable to Fehlberg’s in that a very small number of men guaranteed a female partner’s debts. Male guarantors appeared in our study largely as parents of the primary borrower, while women were most likely to appear as the partner of the borrower. The marked gender disparity in the relationship of guarantor and borrower is discussed further in the section on relationships.

5. 64.6% of respondent guarantors were women.

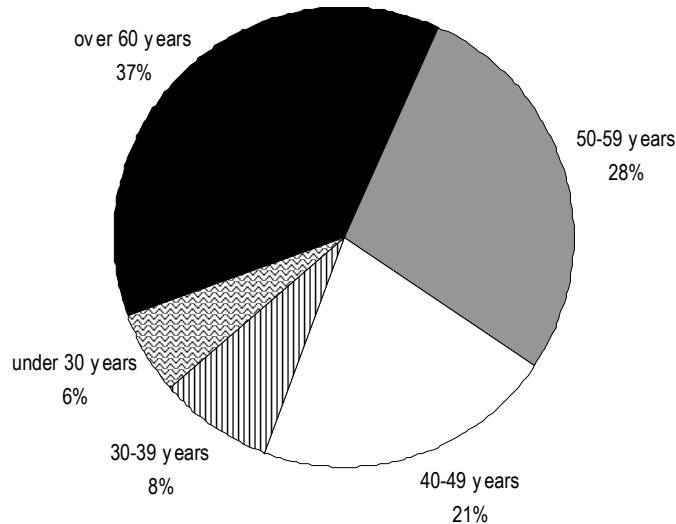
6. Richard Brading, Wesley Mission, *Consultation* 6 July 2001.

7. Supriya Singh, *Marriage Money: The Social Shaping of Money in Marriage and Banking* (Allen and Unwin, Sydney, 1997) at 50.

## Age

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

FIGURE 3.1: AGE OF RESPONDENTS



The highest proportion were 60 years or over (37%); followed by 28% aged between 50 and 59; 21% between 40 and 49 years; 8% between 30 and 39 years and 6% under 30 years old.

3.10 This is consistent with the statistics on the relationship between the borrower and guarantor from our review of litigated cases, which pointed to a high proportion of parents guaranteeing loans for their own children (29%); and a further small percentage of parents guaranteeing loans for sons-in-law.<sup>8</sup>

3.11 These statistics indicate that older people are disproportionately represented in problematic third party guarantee transactions.<sup>9</sup> Men appear particularly likely to be guarantors 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.<sup>10</sup>

8. Notably there were no borrowers who were daughters-in-law.

9. 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. See Fiona Burns, “Undue Influence and the Elderly” (2002) 26 *Melbourne University Law Review* 499 for a recent comprehensive review of literature and cases involving undue influence and elderly people.

10. 39% of the guarantors were women of fifty or over, while 24% were men of that age.

3.12 There is significant potential for pressure to be brought to bear on elderly parents, especially by someone they trust. The Aged Rights Advocacy Service has documented a high and rising incidence of financial abuse of elders – defined as “the illegal, improper use and/or mismanagement of a person’s money, property or resources”. In 2001 the service noted that 43% of their clients reported financial abuse.<sup>11</sup> 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.<sup>12</sup> It is also possible that older people may also be less likely to pursue legal action after problematic guarantees are enforced.<sup>13</sup>

### Country of birth and language background

3.13 The Australian Law Reform Commission has noted that credit contracts cause particular problems for people of non-English speaking backgrounds, and especially recently arrived migrants, as communication difficulties lead to information imbalance.<sup>14</sup>

3.14 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.<sup>15</sup> Of those born outside Australia, 85% were from non-English speaking countries – a figure more than double that in the population as a whole.<sup>16</sup>

3.15 Twenty per cent of respondents to the guarantor survey spoke a language other than English as their first language. Of those who indicated that English was their second language, the majority indicated that their

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11. Aged Rights Advocacy Service, “Abuse Prevention Program, Annual Summary July 2001 to June 2002”, <http://www.sa.agedrights.asn.au/> (accessed 3 June 2003).
  12. Juliet Lucy Cummins, “Relationship Debt and the Aged: Welfare and Commerce in the Law of Guarantees” (2002) 27 *Alternative Law Journal* 63.
  13. See Rosslyn Monro, “Elder Abuse and Legal Remedies: Practical Realities” (2002) 81 *Reform* 42 at 44.
  14. Australian Law Reform Commission, *Multiculturalism and the Law* (Report 57, 1992).
  15. *Guarantor Survey*, Question 1. The 2001 Census reports 22% of Australia’s population was born overseas: see *Census 2001* Cat. No. 2015.0 (ABS, 2002).
  16. As at June 2000, of Australia’s overseas born residents, 39% were from the main English-speaking countries such as the United Kingdom or New Zealand: see Australian Bureau of Statistics, *Australian Historical Population Statistics*, Cat. No. 3105.0.65.001, AusStats Time Series Spreadsheets 2001 (ABS, 2001), 6. Migration.

level of spoken English was weak or fair,<sup>17</sup> while half reported their understanding of written English was weak.<sup>18</sup>

3.16 The barrister survey data reveals that over one-fifth of their clients were from a non-English speaking background.<sup>19</sup> Most judges reported that many trials had a third party guarantor from a non-English speaking background.<sup>20</sup>

3.17 This very high over-representation of people from non-English speaking backgrounds is reflected in litigated cases. In our review of litigated cases we found that 42% of cases involved guarantors from a non-English speaking background. These figures indicate that there may be significant issues for many guarantors with language and their ability to understand written and spoken information about the guarantee transaction. Yet our review of litigated case found that very few guarantors from non-English speaking backgrounds successfully had a guarantee set aside on this basis.<sup>21</sup> This issue is discussed further in Chapter 7: Litigation.

3.18 The above statistics differ markedly from the solicitor survey. 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.

3.19 Clearly, people from non-English speaking backgrounds appear to be disproportionately affected by problematic third party guarantees. The issue of culture and ethnicity in third party guarantee transactions is discussed in further detail below.

## Literacy

3.20 Most guarantor survey respondents stated their ability to speak English was good or very good,<sup>22</sup> while 3% rated their ability as weak and 10% as fair. This degree of confidence declined somewhat with written

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17. 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.

18. 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.

19. 21% of barristers reported that the guarantor in the last guarantee matter that they acted on was from a non-English speaking background.

20. 47% reported that between 11-40% of trials they had sat on involved a guarantor from a non-English speaking background; 7% said the number was between 60-89%.

21. Only seven out of the 52 cases analysed in the *Case Law Review* were successful on these grounds, despite 42% of guarantors being from a non-English speaking background.

22. 21% and 66% respectively.

English. While a similar proportion described their ability as good or very good,<sup>23</sup> 11% reported their ability as weak and 5% as fair.<sup>24</sup>

3.21 Levels of confidence with the English language generally contrasted with the respondents' degree of comprehension of specifically legal documentation. Twenty-seven per cent of the respondents reported that they could not read, or understand the documents that they signed.

### Level of education

3.22 A guarantor's level of education is often referred to in the context of litigation, where in assessing claims of unconscionability the background of the guarantor is discussed.<sup>25</sup>

3.23 A quarter of our guarantor respondents had not completed high school education. While 12% reported that their highest level of education was primary school, a further 13% had undertaken only some secondary school.

3.24 Most guarantors had some secondary education and a technical or university qualification: 29% had completed high school, a further 20% had a technical or trade qualification and 26% had completed a university degree. When educational level was recorded by gender, we found that men were somewhat more likely than women to have been educated post-secondary school.<sup>26</sup> This level of higher education is roughly in accord with that found by Fehlberg in her UK study.<sup>27</sup>

### Financial position of the guarantors

3.25 The research team examined the financial position of the guarantors at the time they entered into the transaction to ascertain whether the guarantors had the capacity to undertake responsibility for the loan should they be called upon to do so.

3.26 Survey data revealed that guarantors were generally not in a strong financial position when they agreed to undertake the guarantee. Respondents were asked to describe their own financial situation at the time of signing the guarantee. While 60% said it was fairly strong or very strong;<sup>28</sup> it is significant that 40% described it as fairly weak or very

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23. 18% and 67% respectively.

24. 9% and 5%.

25. See, for example, *National Australia Bank v Petit-Breuilh* [1999] VSC 368; [2000] ANZ ConvR 520.

26. 55% of male guarantors, compared to 41% of female guarantors.

27. Belinda Fehlberg, *Sexually Transmitted Debt: Surety Experience and English Law* (Clarendon Press, 1997) at 104-105.

28. 48% and 12% respectively.



weak.<sup>29</sup> This finding is reinforced by the fact that 49% of respondents reported that at the time they gave the guarantee they did not believe they had the capacity to pay the loan if called on.

## Relationships

“Family situations are more difficult because you want to help them out and you trust them.”<sup>30</sup>

“It would be a sad state of affairs if courts interfered as of course with gifts and beneficial transactions effected in favour of children in circumstances where it could truly be said that they were entered into “in consideration of the natural love and affection” that parents have for their offspring. Every day of the week, indeed far more frequently, parents make gifts to children though they might be disadvantageous to themselves.”<sup>31</sup>

3.27 Many studies have reported that a close emotional relationship (usually, but not necessarily, a familial relationship) between a guarantor and borrower is pivotal to why people enter third party guarantees.<sup>32</sup> 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 female spouses, followed by parents of borrowers.

3.28 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.<sup>33</sup>

3.29 The review of litigated cases revealed similar results: 43% of the guarantors were the spouse or partner of the primary borrower. Thirty five per cent were parents guaranteeing loans for their children and 12% were other relatives.<sup>34</sup>

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29. 23% and 17% respectively.

30. *Guarantor Survey*, Respondent 4.

31. *Mitchell v 700 Young Street Pty Ltd* [2003] VSCA 42 per Ormiston JA at para 2.

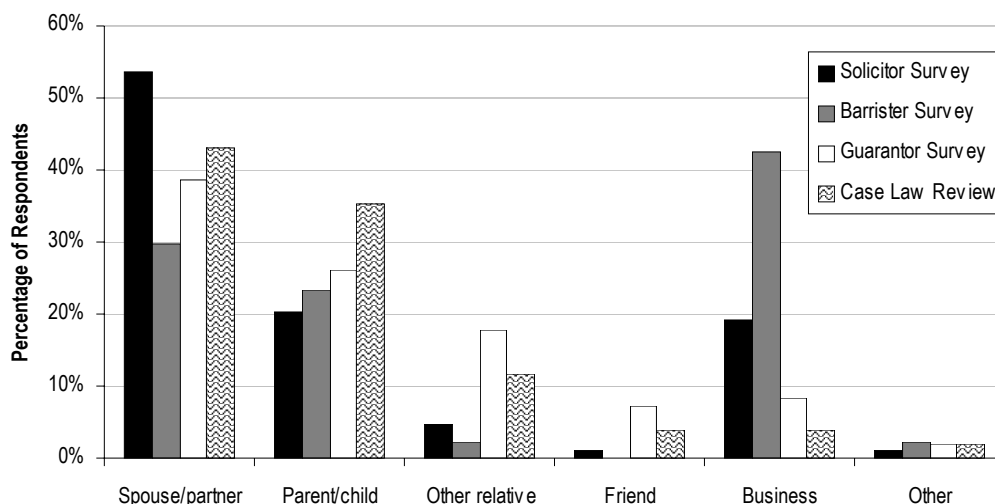
32. See, for example, Belinda Fehlberg, *Sexually Transmitted Debt: Surety Experience and English Law* (Clarendon Press, 1997); Supriya Singh, *For Love Not Money: Women, Information and the Family Business* (Consumer Advocacy and Financial Counselling Association of Victoria Inc, 1995); Australian Law Reform Commission, *Equality Before the Law: Women's Equality* (Report 69, Part 2, 1994); and Australia, Expert Group on Family Financial Vulnerability, *Good Relations, High Risks: Financial Transactions Within Families and Between Friends* (Report, 1996).

33. 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.

34. Four per cent guaranteed loans for friends; 4% signed for a business associate and the remaining 1% signed either for a business entity or their own company.

3.30 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.<sup>35</sup> The barrister survey statistics also revealed over half of guarantors were in close personal relationships with the borrower.<sup>36</sup> Judges confirmed this trend when they stated that the vast majority of litigated guarantor cases they see before the courts involve wives guaranteeing debts for their husbands and parents guaranteeing loans for their children.

FIGURE 3.2: RELATIONSHIPS BETWEEN GUARANTOR AND BORROWER



3.31 When we examined in more detail the relationships of those who responded to our guarantors survey, we found a distinctly gendered pattern. Men were most likely to appear as guarantors for the debts of their children (9), followed by a sibling or some other relative (5), business associate (4) or friend (2).<sup>37</sup> Only 2 men were the guarantors of a spouse or partner's debt. This was starkly contrasted with female guarantors, the great majority of whom were the spouse or partner of the borrower (32 of 52 discernible relationships).<sup>38</sup>

3.32 Responses from lenders were less consistent. We asked lenders what proportion of guarantees are provided by family or people in close personal

35. 54% spouses or de facto partners; 20% parents/children; 5% some other relative.

36. 30% were spouse or partner; 23% were parents of the borrower, and 2% were related to the borrower in some other way.

37. A further 2 men indicated "someone else" and 4 noted "some or all of the above".

38. A further 9 women were the parent of the borrower, 7 were a sibling or other relative, 4 were friends, 2 were business associates, 2 were "someone else" and 4 indicated "some or all of the above".

relationships with the primary borrower. One bank said it does not keep those statistics, another bank estimated that 80% of its guarantees of small business are given by directors of the borrower “in husband and wife combinations” and another 15% are given by wives in favour of businesses run by their husband. This bank said 5% of the guarantees that it takes are given by parents in favour of their children. The majority of smaller lenders said that guarantees from family members are only taken if they are involved in the business. The Australian Finance Conference submitted that, contrary to our findings, its members reported that guarantees are usually provided by a person who has a connection with the borrower but that it was rare to take a guarantee from any close family member unless it can be established that that person is closely associated with the benefits from that business.<sup>39</sup>

## WHY DID THEY SIGN?

Q. You knew your husband was asking you whether you would sign it?

A. He was asking me to sign it, not whether I would. “Darling, please sign this form” would be the way he would put it.<sup>40</sup>

3.33 Third party guarantors are not directly involved in the transaction for which they provide security and 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. The survey results indicate the reasons why people sign on as guarantors are complex, especially in situations where the transaction involves family members.

3.34 By contrast, when third party guarantee matters come before the courts litigants are forced to rely on known legal categories such as duress or unconscionability when seeking relief. The courts often struggle when considering these complex interpersonal relationships which challenge the framework of traditional legal categories.<sup>41</sup>

3.35 Courts often look to the actual moment of execution as crucial to determining whether the transaction was informed with some kind of invalidating factor such as duress, unconscionability or misrepresentation.<sup>42</sup> Our research indicates that the point of signing is often not as significant

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39. Australian Finance Conference *Submission*.

40. Cross-examination of Mrs Stavrianos from *Commonwealth Bank of Australia v Stavrianos* (Unreported, NSW Supreme Court, No 12224/94, Graham AJ, 17 October 1997) at 57.

41. 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.

42. For further information see New South Wales Law Reform Commission, *Guaranteeing Someone Else’s Debts* (Issues Paper 17, 2000).

as the circumstances surrounding the relationship and the pressures on a guarantor to sign well before the execution. To get a more complete picture of the reasons why people sign it is necessary to look at what is going on behind the scenes prior to entering the guarantee. That is, what forces are operating – commercial, social and emotional – to make someone enter a guarantee. We also tried to ascertain what was going on at a more immediate and prosaic level and consider, therefore, questions such as who was with the guarantor when they signed and where they signed.

3.36 The stories gathered in the course of interviewing guarantors paint a complex picture of the reasons why a guarantee is signed. While many guarantors had some insight into the risky nature of the transaction or had misgivings, they still went ahead with it.<sup>43</sup> This is consistent with Belinda Fehlberg’s findings in her UK study.<sup>44</sup> Our guarantor survey data revealed that many guarantors value their relationship over and above any concerns they may have about a transaction. Forty-one per cent reported that they agreed to the guarantee because they did not want to risk or damage their relationship with the borrower by failing to act as a guarantor. A significant proportion of guarantors reported that they did not understand what they were doing at the time of the transaction.<sup>45</sup>

3.37 Clearly, many of these reasons cannot be easily translated into discrete and identifiable legal claims or categories. These factors are explored below.

### Economic dependence

“A. I gave security over my third share of the home because my husband asked me to.

Q. And that is the only reason?

A. Yes.”<sup>46</sup>

3.38 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.<sup>47</sup>

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43. 42% respondents agreed with the statements that they “it was a silly thing to do but they did it anyway”, while 54% agreed that they were nervous or worried about the arrangement from the start. Respondents could indicate more than one response.

44. Belinda Fehlberg, *Sexually Transmitted Debt: Surety Experience and English Law* (Clarendon Press, 1997) at 165.

45. 33% of respondents said it was not true that they understood what they were doing at time, while 60% said it was true that they understood what they were doing. 8% were not sure or could not remember.

46. *Sialepis v Westpac Banking Corporation* [2001] NSWSC 101 at para 127.

47. Australian Law Reform Commission, *Equality Before the Law; Women’s Equality* (Report 69 Part 2, 1994) Chapter 10.

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 financial arrangements, and to feel more entitled to mobilize the available resources for their personal use.”<sup>48</sup> Fehlberg found in her UK study that non-income earning wives with children had the least power over family finances.<sup>49</sup>

3.39 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.<sup>50</sup>

3.40 In 14% of the litigated cases we reviewed the guarantor claimed financial or emotional dependence on the borrower as a factor influencing their decision to sign the documents. According to the wife in one of these cases:

“I felt totally dependent on [my husband] financially and emotionally. If I had been asked ... to sign the Guarantees by him, I would have done so without questioning his judgement because my health, my marriage and my children were vulnerable if any conflict were to arise between us.”<sup>51</sup>

In another litigated case a woman explained that she did not ask any questions about the documents because she was too embarrassed to ask questions in front of her husband, who was threatening to leave her and was present when she signed them.<sup>52</sup>

3.41 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.<sup>53</sup> Indeed, they inform many of

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48. Belinda Fehlberg, *Sexually Transmitted Debt: Surety Experience and English Law* (Clarendon Press, 1997) at 85.

49. Belinda Fehlberg, *Sexually Transmitted Debt: Surety Experience and English Law* (Clarendon Press, 1997) Chapter 4.

50. Three men and 12 women noted that this was a reason they signed.

51. *Brueckner v The Satellite Group (Ultimo) Pty Ltd* [2002] NSWSC 378 at para 158.

52. *Commonwealth Bank of Australia v Horkings* [2000] VSCA 244 at para 16.

53. 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

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. Other structural inequalities arising from economic imbalance and dependence many also be present in other relationships, for instance 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

“My role was a housewife. I had to trust my husband and I did.”<sup>54</sup>

“I trusted my husband and the bank officer to do the right thing.”<sup>55</sup>

3.42 An overwhelming majority of respondents said one of the reasons they signed the guarantee was because they trusted the borrower.<sup>56</sup> The issue of trust featured even more prominently where the guarantor was in a familial relationship with the borrower. Such trust may be qualified – some respondents indicated that they signed because they trusted the other person, but added their own comments such as “*to an extent*”, “*but pressured*.” 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.<sup>57</sup>

3.43 The data from our surveys and review of the litigated cases confirms the proposition that women place a high value on trust in their relationship: many believe that their relationship with the debtor obliges them to help him obtain credit.

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*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.

54. *Guarantor Survey*, Respondent 14.

55. *Guarantor Survey*, Respondent 6.

56. 76% said they signed because they trusted the borrower.

57. 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.

## Optimism

“You always hope that it will be alright...that it will be for the best.”<sup>58</sup>

3.44 Caseworkers, financial counsellors, lawyers, judges and policy workers generally agreed that people signing as guarantors (leaving aside those who are clearly misled, duped or the like) are generally optimistic: they think that, as guarantor, they will never be called on to repay the loan.

3.45 One barrister made the following observations:

“The real problem is that no-one signing a guarantee really believes they will be obliged to pay. Human nature is the problem, not banks or other lenders.”<sup>59</sup>

One lawyer commented:

“People will give guarantees unwisely because they have dreams and aspirations and can only achieve those by borrowing. Most guarantees are given by spouses and company directors/shareholders who share the dreams.”<sup>60</sup>

3.46 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. 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.<sup>61</sup> 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.”<sup>62</sup>

3.47 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.

3.48 Optimism may reflect ignorance about the extent of liability for a debt. One financial counselling service reported “[our] service finds that most people, whether highly educated or not, are not aware that they are

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58. *Guarantor Survey*, Respondent 14.

59. *Barrister Survey*, Respondent 27.

60. *Solicitor Survey*, Respondent 77.

61. See Expert Group on Family Financial Vulnerability, *Good Relations, High Risks: Financial Transactions Within Families and Between Friends* (Report, 1996) at 10.

62. Belinda Fehlberg, *Sexually Transmitted Debt: Surety Experience and English Law* (Clarendon Press, 1997) at 131. See also 185-188.

liable to repay the full loan, they believe that they are liable for 50%, or some other portion.”<sup>63</sup>

3.49 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 from a natural unwillingness on the part of the guarantor to believe that the worst will happen.”<sup>64</sup>

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.

### Lack of 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.”<sup>65</sup>

“Q: Why did you sign the document?

A: Because my husband sign and I sign.”<sup>66</sup>

3.50 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.

3.51 Over one-third of respondents said they did not feel that they had a choice about whether they signed the documents.<sup>67</sup> Of those who reported this as a reason they signed, the great majority were women.<sup>68</sup> 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”.<sup>69</sup>

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63. Kate Keating, *Telephone Consultation* 5 July 2000.

64. 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.

65. *Reisch v Commonwealth Bank of Australia* [1998] ANZ ConvR 628.

66. *Sayer v Turk* [2001] NSWSC 750, *Transcript*, Tuesday 21 August 2001.

67. 34% said they didn’t think they had a choice when they signed.

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

69. Belinda Fehlberg, *Sexually Transmitted Debt: Surety Experience and English Law* (Clarendon Press, 1997) at 181.



3.52 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.

3.53 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."<sup>70</sup> Likewise, our review of the litigated cases found that it was not 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*, 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."<sup>71</sup> (emphasis added)

3.54 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 in our survey:

"for the sake of domestic harmony there is usually irresistible pressure on the guaranteeing spouse to sign."<sup>72</sup>

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".<sup>73</sup>

3.55 Dependency, vulnerability and absence of real choice do not always fall into the neat legal category of "undue influence";<sup>74</sup> 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

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70. Belinda Fehlberg, *Sexually Transmitted Debt: Surety Experience and English Law* (Clarendon Press, 1997) at 181.

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

72. *Barrister Survey*, Respondent 41.

73. Belinda Fehlberg, *Sexually Transmitted Debt: Surety Experience and English Law* (Clarendon Press, 1997) at 181.

74. 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.

repay assistance from other family members. Below are some of the comments made by guarantors:

“the company directors stated that I had a moral obligation to assist them during a cash flow period as I had a safe government job and I would be putting eight people out of work in a high unemployment area [if I didn’t sign the guarantee].”<sup>75</sup>

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

“It was for my daughter and I would do anything for my children.”<sup>76</sup>

“a family situation – wanted to help son...family situations more difficult because you want to help them and you trust them.”<sup>77</sup>

“due to family relationship – he was my son.”<sup>78</sup>

“we are family. It is the right thing to do for your family.”<sup>79</sup>

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.

## Pressure

“I was too scared not to sign – he’d leave or kill me.”<sup>80</sup>

3.57 Fehlberg’s UK study found that pressure ranged from actual physical violence to more subtle forms of emotional pressure.<sup>81</sup> Our observations were consistent with these findings; many guarantors reported they signed because of a range of pressure of various kinds.

3.58 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.”<sup>82</sup>

“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 ...”<sup>83</sup>

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75. *Guarantor Survey*, Respondent 54.

76. *Guarantor Survey*, Respondent 3.

77. *Guarantor Survey*, Respondent 4.

78. *Guarantor Survey*, Respondent 5.

79. *Guarantor Survey*, Respondent 13.

80. *Guarantor Interview*, Respondent 1A.

81. See Belinda Fehlberg, *Sexually Transmitted Debt: Surety Experience and English Law* (Clarendon Press, 1997) at 267.

82. *Guarantor Survey*, Respondent 12.

83. *Guarantor Survey*, Respondent 21.

3.59 Solicitors also commented that family pressure is one of the main reasons why guarantors sign, despite being advised against doing it. Such emotional pressure is also reflected in the reported cases.<sup>84</sup>

3.60 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.”<sup>85</sup>

“I was really harassed. Fearful of physical threats, and I lost sight of perspective. He [the borrower] was aggro – out of control.”<sup>86</sup>

3.61 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.

3.62 Our review of the litigated cases confirmed the proposition that courts are often reluctant to consider the relevance and importance of a background of violence (particularly violence that is “domestic”) in cases that aren’t directly about “violence” – that is, outside the sphere of criminal law.<sup>87</sup> How evidence of violence in a relationship is treated by the courts is dealt with in further detail in Chapter 7: Litigation.

## Culture and Ethnicity

3.63 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 identified cultural attitudes as further complicating transactions involving family members.<sup>88</sup> 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.

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

85. *Guarantor Interview*, Respondent 1A.

86. *Guarantor Survey*, Respondent 11.

87. Reg Graycar, “Telling Tales: Legal stories about violence against women” (1996) 7 *Australian Feminist Law Journal* 79. See eg *Sialepis v Westpac Banking Corporation* [2001] NSWSC 101; *Elkofairi v Permanent Trustee Co Ltd* [2002] NSWCA 413.

88. Report of the Expert Group on Family Financial Vulnerability, *Good Relations, High Risks – Financial Transactions within families and between friends* (Report, 1996) at 10.

## CULTURAL FACTORS

Mr V is a 74 year old pensioner, with a University education in Vietnam. In 1995 he mortgaged his home to assist his son-in-law develop a shopping centre. In 1998 the bank commenced proceedings for possession of his home after the son-in-law didn't make his repayments. Mr V said he signed the guarantee because his son-in-law had sponsored him to Australia many years ago. Because of this he felt "indebted to him and felt obliged to help him." Mr V said he felt "an emotional obligation to repay this 'debt'" of sponsorship to his son-in-law. In the end son-in-law left his daughter and is now a successful businessman, and Mr V lost his home. Mr V says, however, that if someone else was in his shoes he would do the same "because of the family situation and especially the sponsoring".<sup>89</sup>

3.64 The Australian Law Reform Commission's Report, *Multiculturalism and the Law* notes that migrants and refugees often arrive in Australia with special needs which makes them more reliant on credit than other members of the community.<sup>90</sup> They may have no savings and few possessions. The report further states that the downgrading of government sponsored post-arrival accommodation and bond requirements for certain categories of migrants have made the need for credit even more immediate. Migrants are likely to require credit in order to establish themselves after arrival in Australia and many set up a small business in order to gain an income. Lack of credit history or savings means that recent migrants are more likely to require a guarantor or co-borrower in order to obtain credit.<sup>91</sup> The pressure on family members to provide a guarantee for a relative or community member is overwhelming in some cultural contexts.

3.65 One participant of non English speaking background in the guarantor survey, and his wife, agreed to provide security over their home to guarantee a loan for the benefit of some friends because they wanted to help out the friends who were new immigrants.<sup>92</sup> In another case, an Iranian man who had received temporary financial assistance from another Iranian man when his marriage broke down later felt a moral obligation to provide him a guarantee.<sup>93</sup>

3.66 The ALRC noted that its consultations indicated that people with bargaining disadvantages (including language problems) are particularly vulnerable to unfair practices including inadequate or misleading information about terms and conditions. These factors were borne out in our research.

89. *Guarantor Survey*, Respondent 72.

90. Australian Law Reform Commission, *Multiculturalism and the Law* (Report 57, 1992).

91. Australian Law Reform Commission, *Multiculturalism and the Law* (Report 57, 1992) at para 11.3.

92. *Guarantor Survey*, Respondent 51.

93. *Australia and New Zealand Banking Group Ltd v Alirezai* [2002] QSC 175.

3.67 Additionally, there appears to be considerable cultural confusion about what exactly a guarantee is, as such transactions are not universal. Third party guarantee liability is sometimes a completely foreign notion to people from different ethnic backgrounds. For example, in *Tong v Esanda Finance*, it was apparent there was no concept of the meaning of “mortgage” in Vietnamese, let alone third party mortgage liability.<sup>94</sup> One judge surveyed in this research noted:

“... I have come to doubt that people from different legal cultures even suspect that they could become liable for a loan in which they have no direct interest and from which they have derived no benefit. The idea that a moneylender can secure two debtors for the price of one is quite foreign! The particular case which I recall involved a request from a companion who had shared with the person he persuaded to act as guarantor the horrors of refugee camps and I am sure that the guarantor believed that he was presenting his title deeds to show that he was not a man of straw and as such could credibly recommend the borrower to the moneylender. The matter was complicated by a perfunctory signature before an ‘independent’ solicitor who did little beyond ensuring that signatures were affixed to the ‘right’ places. The solicitor was joined by cross claim ... I believe that the whole notion, inherited from English law, may be little understood by a significant proportion of Australians from non English backgrounds and I would commend investigation.”<sup>95</sup>

## Misunderstandings and misinformation

Mrs A, a sole parent with 8 children, with limited English, was approached by her brother-in-law to be a guarantor for loan of \$10,000 to purchase stock for his business. The brother-in-law defaulted and the lender pursued Mrs A, attending her home and threatening to evict her and her children unless she made payments. Upon obtaining legal advice, Mrs A discovered for the first time that:

1. She was in fact a co-borrower and not a guarantor
2. the loan was for \$30,000, and not \$10,000
3. the debt was secured over her home.<sup>96</sup>

3.68 Previous reports on third party guarantees and family relationships highlight the potential dangers for guarantors that arise out of misunderstanding the documents or the transaction.<sup>97</sup> Our research

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94. *Tong v Esanda Finance* (Unreported, NSW Supreme Court, No 20449/94, Grove J, 17 April 1996).

95. *Judge Survey*, Question 25, Respondent 17.

96. Case Study, Legal Aid Commission, *In Whose Interest?* <<http://www.lawlink.nsw.gov.au/lac/lac.nsf/pages/avcoapp>>.

97. Australian Law Reform Commission, *Multiculturalism and the Law* (Report 57, 1992) at para 11.4. See also the Report of the Expert Group on Family Financial Vulnerability, *Good Relations, High Risks – Financial Transactions Within Families and Between Friends* (Report, 1996) at 10.

confirms that many guarantors sign without an understanding of the nature of the transaction. 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.

3.69 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 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.<sup>98</sup> It appears there is also a general misunderstanding about the obligations for contribution of co-guarantors.

3.70 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 cover 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 (that is, were they are guarantor or a borrower) and whether the loan was secured over property.<sup>99</sup>

3.71 The reasons for the many varieties of misunderstanding are complex: it could be that deceit or fraud are involved, or a guarantor's 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.

3.72 The range of confusion or misunderstanding is 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.”<sup>100</sup>

“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.”<sup>101</sup>

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98. Jenny Lawton, Narelle Brown, Kate Keating, *Consultations*, July 2000.

99. See eg *Ribchenkov v Suncorp-Metway Ltd* (2000) 175 ALR 650.

100. *Guarantor Survey*, Respondent 71.

101. *Guarantor Survey*, Respondent 41.

“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.”<sup>102</sup>

“I didn’t understand any of it, no legal or business mind. All legal stuff that I didn’t understand.”<sup>103</sup>

3.73 Many guarantors were under the mistaken apprehension that they were only signing a guarantee for a limited period of time.<sup>104</sup> Others thought that signing was a mere formality and did not understand that this meant they were putting their homes at risk. Some thought they were merely signing a personal overdraft.<sup>105</sup> In our review of litigated cases we also found that guarantors commonly claimed they were misled by the borrower about the transaction.<sup>106</sup>

3.74 Lack of information about liability, or a misunderstanding about the nature of the transaction must be distinguished from cases where the signature was procured in fraudulent circumstances such as forgery.<sup>107</sup>

### Would the guarantor have signed regardless?

3.75 Legal responses to the problem of third party guarantee transactions have tended to focus upon the provision of information, usually in the form of legal advice prior to signing. Recommendations have also on occasion focused upon the provision of financial advice or information about the borrower’s financial position.

3.76 While we did not explicitly ask guarantors whether they would have signed regardless of information, warnings or advice, the following are some of the comments made by guarantors which indicate that for some the execution of the guarantee was, in effect, a forgone conclusion:

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102. *Guarantor Survey*, Respondent 34.

103. *Guarantor Survey*, Respondent 58.

104. See eg *Guarantor Survey*, Respondent 3. See also, *Janesland v Simon* [1999] ACTSC 35; *Sialepis v Westpac Banking Corporation* [2001] NSWSC 101.

105. See, for example, *Commonwealth Bank of Australia v Khouri* [1998] VSC 128.

106. See eg *Micarone v Perpetual Trustee* (1999) 75 SASR 1; *Fraser v Power* (2001) Aust Contract R 90-127; *National Australia Bank v Starbronze Pty Ltd* [2001] ANZ ConvR 247; *Lang v Licciardello* [1999] NSWSC 93; *Westpac Banking Corporation v Bagshaw* [2000] NSWSC 650; *State Bank of New South Wales v Hibbert* (2000) Aust Contract R 90-119; *State Bank of New South Wales v Sullivan* [1999] NSWSC 596; *Farrow Mortgage Services Pty Ltd (In Liq) v Torpey* (1998) NSW ConvR 55-857.

107. For example, *St George Bank v Trimarchi* [2003] SCNSW 151, where the guarantors’ son forged his parents’ signatures on the loan application and provided false information to the bank about their assets and liabilities. *Sialepis v Westpac Banking Corporation* [2001] NSWSC 101 and *Commonwealth Bank of Australia v Khouri* [1998] VSC 128 which concerned allegations of the husbands forging the signatures of their wives.

“being [guarantor] for my daughter, I was not worried one iota as I was helping her.”<sup>108</sup>

“... sick at the time, didn’t want to worry about things so I just signed.”<sup>109</sup>

“It was for my daughter and I would do anything for my children.”<sup>110</sup>

3.77 It appears that, for some guarantors at least, they would enter the transaction no matter what they knew about it in advance. In numerous Australian decisions judges have held that, although the guarantor was deceived or misinformed, if they would have signed under any circumstances, then relief should be refused because the misconduct was not the cause of the guarantor’s decision to enter into the transaction.<sup>111</sup> Other cases have similarly held that the absence or inadequacy of legal advice would not permit relief if the guarantor would have consented to the transaction regardless.<sup>112</sup> Such an approach has been doubted in decisions in the UK concerning situations where the guarantor was, in addition to such failures, misled.<sup>113</sup>

3.78 However, many respondents to our guarantor survey suggested that more information would have made a difference to their choice: had they been properly or better informed, they may not have proceeded with the transaction. The following are some of the comments from guarantors:

“I should have had independent legal advice. I should have had time to discuss the issue with financial/relationship counsellors.”<sup>114</sup>

“More information should be given to people like me ... the lender should make it a rule that someone like me has to go to the bank and be fully aware of their legal rights and what could happen to them.”<sup>115</sup>

“... should explain things more, especially if husband and wife ... should have been sat down, should have explained liability clearly.”<sup>116</sup>

3.79 The issue of what the guarantor knew when they signed and what advice or assistance they received is explored further in Chapter 5: The Guarantee Transaction.

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108. *Guarantor Survey*, Respondent 68.

109. *Guarantor Survey*, Respondent 7.

110. *Guarantor Survey*, Respondent 3.

111. See eg: *Commonwealth Bank of Australia v Stavrianos* (Unreported, NSW Supreme Court, No 12224/94, Graham AJ, 17 October 1997); *National Australia Bank v Mitolo* [2002] SASC 102.

112. See, for example, *Farrow Mortgage Services Pty Ltd (In Liq) v Torpey* [1998] NSWSC 114; *Sapuppo v Ribchenkov* [2001] FCA 1428.

113. See *UCB Corporate Services Ltd v Williams* [2002] All ER 28. See also Mark Pawlowski, “A post-*Etridge* World” (2002) *Property Law Journal* 5.

114. *Guarantor Survey*, Respondent 55.

115. *Guarantor Survey*, Respondent 33.

116. *Guarantor Survey*, Respondent 41.



## CONCLUSIONS

3.80 Most third party guarantors are in close personal relationships with the borrower. Many are women who are the spouse of the borrower, a large number are also the parents of the borrower. People from non-English speaking backgrounds are dramatically over-represented compared to the general population and appear to be under-advised prior to entering into the transaction compared with other guarantors.

3.81 The reasons why people enter such risky transactions are not clear cut and cover a range of often intermingled factors including: relationships of trust, feeling a lack of choice, pressure, misunderstanding or optimism. Many such factors are clearly heightened in situations in which the guarantor is economically dependent upon the borrower.

3.82 Both the demographic information gathered by this research, and the reasons given by guarantors as to why they signed suggest that third party guarantee transactions are being regularly undertaken in situations of power imbalance. These factors suggest that many guarantors could not be regarded as making a free choice to enter into the transaction.

3.83 The following chapter outlines the credit environment in Australia and examines the regulation of lenders' conduct in taking guarantees. In Chapter 5 we then examine in some detail guarantors' experiences of giving guarantees.

## 4. The lenders

- The regulatory environment
- Lender practice
- Better practice
- Conclusion

“it is not ordinarily incumbent upon a lender to evaluate the commercial merits of the underlying transaction, other than for evaluating the lender’s own credit risk.”<sup>1</sup>

4.1 To gain as full a picture as possible of industry practice, the research team sought to consult with lenders and their peak bodies. There is very little information available to indicate how often third party guarantees are enforced, or the grounds upon which guarantors rather than borrowers are pursued for guaranteed debts. Anecdotally, it seems that the incidents of bad debts being enforced by recourse to third party guarantees are relatively few. The research team considered solid statistical information of this kind very important in understanding the whole climate of guarantee transactions, and not just the “problem cases” which appear in the law reports and newspapers.

4.2 The research project asked lenders (banks, building societies, credit unions and other financiers) to provide us with aggregated data or estimates about loans secured by third party guarantees on a confidential basis. We asked for information on the number of third party guarantees that are given in a set period, the number or proportion of such guarantees that are supported by residential properties as security, the number or proportion of such guarantees that are called upon and the number or proportion of such guarantees that are disputed.

4.3 The term “bank lender” is used to differentiate the large banks from other lenders. We were particularly concerned to hear from banks, as they were the source of the overwhelming majority of loans guaranteed in Belinda Fehlberg’s UK study,<sup>2</sup> and likewise were the major lenders reported by our guarantors.<sup>3</sup>

4.4 Despite undertakings of confidentiality and assurances that the aim of this research is to provide greater certainty in the lending environment and ease burdens on those involved in financing small business enterprises, the response rate from bank lenders was very low. Smaller finance company lenders were comparatively more candid than banks in disclosing statistics, but as they appear far less involved in the granting of finance through guarantees, this information was of limited use.

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1. *Barrister Survey*, Question 29, Respondent 1.

2. Of the problematic securities given, Fehlberg notes 18 were to major banks, 2 to minor banks and 1 to an insurance company: *Sexually Transmitted Debt: Surety Experience and English Law* (Clarendon Press, 1997) at 156. Fehlberg’s interviews with lenders also revealed that banks were far more likely to be involved in guarantees than building societies: at 203.

3. 63% of guarantors reported that the loan was made by a bank, only 1% from a credit union and 23% from other finance institutions. In the “other” category, three guarantors reported that the loan was from their solicitor.

4.5 We also sought assistance with our research from various lenders' peak bodies. The Australian Bankers' Association failed to respond to our inquiries. Some assistance, however, was received from the Australian Finance Conference and Credit Union Services Corporation Limited.

4.6 In all, over one hundred lenders were approached for information. Disappointingly, only seven lenders responded to our request for information (while a further two replied that they were unable to assist as they did not use guarantees in their loan practice). It is, perhaps, indicative of a more defensive lending climate in Australia, or greater defensiveness in recent years, or both, that Fehlberg's small UK study in the early 1990s was supported by a larger number of lenders than our study, and received a dramatically higher response rate.<sup>4</sup>

4.7 Of the few lenders who participated in our research, most stated that they do not maintain the statistics we sought, nor could they provide estimates in answer to our queries. Given the detailed content of the lenders' reporting obligations to regulatory bodies such as the Australian Prudential Regulatory Authority, the Reserve Bank of Australia and the Australian Securities and Investments Commission, their inability to provide even estimates is somewhat surprising.

4.8 The following chapter explores the lending and credit environment including lending policy and practice and the regulatory framework in which it takes place. The chapter opens with a brief outline of factors relevant to business finances and debt, the operation of the Code of Banking Practice and industry self-regulation as it relates to guarantees. Once this context is established, we detail the data received in the course of the study which relates to lending practices and the extent of problems with third party guarantees. To augment this information we have also drawn upon non-confidential submissions to the Commission's Issues Paper *Guaranteeing Someone Else's Debts*.<sup>5</sup> This includes information received from lenders, and comments from other stakeholders about lenders in relation to the provision and enforcement of third party guarantees and guarantee-like transactions and about what lenders' obligations should be.

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4. Fehlberg contacted 20 lenders and was assisted by 9: see Belinda Fehlberg, *Sexually Transmitted Debt: Surety Experience and English Law* (Clarendon Press, 1997) at 94. Our initial attempts even to identify the appropriate contact person at the banks' offices was surprisingly difficult and went no way to dispel the impression of a culture of secrecy. When one major bank was approached and asked for contact details to send a survey, the researcher was told: "the bank policy is to not participate in research"; a receptionist at another major bank flatly refused even to connect the researcher's telephone call to the legal department.

5. New South Wales Law Reform Commission, *Guaranteeing Someone Else's Debts* (Issues Paper 17, 2000). Non-confidential submissions are identified by lender, while confidential submissions are referred to as "Bank A", "Lender H" etc.

## THE REGULATORY ENVIRONMENT

### Legislative controls

4.9 The scope of this report does not extend to enquire in detail into the legislative environment – this has been largely covered in the Commission’s Issues Paper, *Guaranteeing Someone Else’s Debts*.<sup>6</sup>

4.10 Unfair practices may be challenged under the common law of unconscionability, including the “special” rule for wives revived by the High Court in *Garcia* in 1998,<sup>7</sup> and under statutes such as the *Contracts Review Act 1980* (NSW), *Fair Trading Act 1987* (NSW) and *Trade Practices Act 1974* (Cth).

4.11 We sought information on the impact and effectiveness of these forms of regulation, particularly since changes in the late 1990s. Test cases being pursued by the Australian Competition and Consumer Commission have extended the scope of the unconscionability provisions in the *Trade Practices Act 1974* (Cth) (which were extended to cover small business in 1998).<sup>8</sup> Whether or not unconscionability has expanded to such a degree that it is inhibiting economic activity is contested. The few credit providers who participated in our survey were generally circumspect, or dismissive, about the impact of the 1998 decision *Garcia* upon their lending practices.

4.12 The Uniform Consumer Credit Code, in place since 1996, provides for plain language documents, cooling off periods, the provision of warnings and information to prospective guarantors.<sup>9</sup> The Consumer Credit Code also provides for disputes in NSW to be resolved through the Consumer, Trading and Tenancy Tribunal, a low cost and relatively accessible forum. However the Consumer Credit Code only regulates the provision of credit where it is provided wholly or predominately for personal, domestic or household purposes.<sup>10</sup> The Consumer Credit Code is therefore largely inapplicable to guarantor loans, as the majority of guarantees are given to support small business borrowing.

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6. See New South Wales Law Reform Commission, *Guaranteeing Someone Else’s Debts* (Issues Paper 17, 2000), Chapter 2.

7. *Garcia v National Australia Bank* (1998) 194 CLR 395 reviving *Yerkey v Jones* (1940) 63 CLR 649.

8. For application of statutory unconscionability, pursuant to the *Trade Practices Act 1974* (Cth) in the finance sector, see: *ACCC v CG Berbatis Holdings Pty Ltd* [2000] FCA 1376; *ACCC v CG Berbatis* [2003] HCA 18 and *ACCC v No-Knead (Franchising) Pty Ltd* [2000] FCA 1365; *ACCC v Leelee Pty Ltd* [1999] FCA 1121. 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* 73.

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

10. *Consumer Credit (New South Wales) Code and Regulations 1995* (NSW) s 6.

4.13 With the exception of the Consumer Credit Code, the conduct of the finance industry in taking guarantees is largely governed not by legislation or regulations but by self regulating, voluntary codes of conduct. This is also true of the management of disputes at a pre-litigation stage. So if a guarantee is for business purposes, it is usually only if enforcement is disputed in court that a non-voluntary legal framework is invoked to govern the conduct of the parties and the consequences of their transaction. The framework and limitations of such self regulation are explored below.

### Self regulation and codes of conduct

4.14 The policy framework informing consumer protection is clearly marked by a preference for industry or market-based self-regulation. The present Federal Government's "general presumption is that competitive market forces deliver greater choice and benefits to consumers";<sup>11</sup> and that "government regulation may be inefficient, and, even though it prevents harm to consumers, may create a greater harm, especially lack of profitability for the providers of goods and services."<sup>12</sup> This view assumes that codes and self-regulation will foster best practice, deliver more certainty, be more flexible, less costly and therefore increase consumer protection.<sup>13</sup>

4.15 A recent UK study has found that the effectiveness of self-regulation of consumer protection should be re-visited after finding that industry development of codes lead to variable standards between the codes, lack of consumer awareness of codes and a general lack of coverage.<sup>14</sup> This experience has led one commentator to argue that it would be irresponsible for Australia to abandon consumers and encourage the expansion of self-regulated codes at the expense of government intervention to assist a fair market place.<sup>15</sup>

4.16 Consumer protection laws and case-law on unfair dealing evidence a range of unfair practices that clearly do require regulation. Many commentators have argued that when industry or business is allowed to regulate itself, self-interest may be the driving force.<sup>16</sup>

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11. Minister for Consumer Affairs, "Foreword" in Department of Industry, Science and Tourism 1998, *Codes of Conduct – Policy Framework* at 3.

12. John Goldring, Laurence Maher, Jill McKeough and Gail Pearson, *Consumer Protection Law* (Federation Press, 1998) at 13.

13. Ministerial Council on Consumer Affairs, *Fair Trading Codes of Conduct – Why Have Them, How to Prepare Them* (AGPS, 1996) at 1.

14. See United Kingdom Office of Fair Trading, *Raising Standards of Consumer Care: Progressing Beyond Codes of Practice* (1998).

15. Chris Field, "The New Face of Consumer Protection" (1999) 24 *Alternative Law Journal* 157 at 159.

16. See Chris Field, "The New Face of Consumer Protection" (1999) 24 *Alternative Law Journal* 157 at 158; and John Goldring, Laurence Maher, Jill McKeough and Gail Pearson, *Consumer Protection Law* (Federation Press, 1998) at 13.

4.17 The finance industry and regulation in Australia, is characterized generally by a tendency towards increasing complexity.<sup>17</sup> As a general principle, self-regulation initiatives have the greatest influence in industries with a relatively small number of players who are homogenous in operation and whose interests converge. A recent report noted that these characteristics are inapplicable to the finance and mortgage broker industry.<sup>18</sup> Brokers are independent agents who are not directly employed by lenders and work for commissions on transactions. As such brokers are increasingly used, concerns about a heterogeneous and unregulated finance industry are likewise increasing.

### **Mortgage and loan brokers**

4.18 New market entrants are playing an increasingly important role in the rapidly changing and competitive business of credit provision. For example, the rise of broker-originated transactions means that there are not two, but three or more parties to a loan: the borrower, lender, broker and guarantor, each with competing interests. This is of concern for guarantors.

4.19 A recent report by the Consumer Credit Legal Centre has found that brokers are an expanding and largely unregulated aspect of the finance industry.<sup>19</sup> The report found that while consumers' use of brokers has expanded greatly, the mortgage broker industry has few entry barriers such as clear minimum competency or training standards. The report also found that national regulation and state-based laws governing the industry fell short of the regulatory oversight required to protect consumers adequately.

4.20 This report noted that there is particular concern about legal redress available to guarantors who enter into a transaction facilitated by a mortgage broker which is tainted by unconscionability or misrepresentation. Complex considerations of agency may mean that fault cannot be attributed to the credit provider, and unjust contract provisions under the Consumer Credit Code may not be available as the court would have to decide between the competing interests of two "innocent" parties, the third party guarantor and the credit provider.

4.21 The Australian Banking Industry Ombudsman ("ABIO") has also recently expressed concern about the increase in the use of brokers by banks, including the delegation to brokers by banks of the responsibility of matters such as security documents. The ABIO set out a revised approach

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17. Tyrone Carlin and Guy Ford, "Editorial" (2002) 1 *Journal of Law and Financial Management* 5.

18. Consumer Credit Legal Centre (NSW) Inc, *A Report to ASIC on the Finance and Mortgage Broker Industry* (2003) at 45.

19. See, Consumer Credit Legal Centre (NSW) Inc, *A Report to ASIC on the Finance and Mortgage Broker Industry* (2003).

to the question of when a bank will be liable as principal for misleading and deceptive conduct of a broker as the bank's agent. Based on the ABIO's observations of cases before it, the approach outlines the circumstances when the ABIO would be likely to conclude that the broker is an agent of a bank.<sup>20</sup>

## The Code of Banking Practice

4.22 A major self regulatory mechanism is the Code of Banking Practice ("the Banking Code"). The Banking Code was established in 1993 and exists to set standards of good banking practice.<sup>21</sup> The Banking Code is not legislation – only those banks that adopt the Banking Code are subject to its provisions.<sup>22</sup>

4.23 The Code seeks to regulate both the conduct of loan transactions and also provides dispute resolution mechanisms. In relation to guarantees the Code establishes minimum standards for disclosure and documentation.<sup>23</sup>

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20. Australian Banking Industry Ombudsman, *Bulletin No 36*, December 2002.

21. See also *Building Society Code of Practice* (1994) and *Credit Union Code of Practice* (1994). Both of these Codes are modelled upon the *Code of Banking Practice*. Copies are available on the Australian Securities and Investments Commission website: <http://www.asic.gov.au>.

22. Banks that have adopted the Code as at August 2002 are: 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.

23. *Code of Banking Practice* (1993). This code is available at <http://www.bankers.asn.au>. Clause 17 regulates the provision of guarantees:

“17.2 A Bank may only accept a guarantee if the amount of the guarantor's liability is limited to, or is in respect of, a specific amount plus other liabilities (such as interest and recovery costs) that are described in the guarantee.

17.3 Before accepting a guarantee a Bank shall inform a prospective guarantor that the documents specified in section 17.4(ii) and 17.6 will be provided to the prospective guarantor if the borrower consents. If the borrower does not consent, the Bank shall so inform the prospective guarantor and shall not accept the guarantee without the agreement of the prospective guarantor to proceed with the guarantee in the absence of such consent.

17.4 A Bank shall provide to a prospective guarantor:

- (i) a written warning about the possibility of the prospective guarantor becoming liable instead of, or as well as, the borrower; and
- (ii) subject to obtaining the consent of the affected borrower, a copy or summary of the contract evidencing the obligations to be guaranteed.”



The 1993 Code includes recommendations of legal advice to guarantors<sup>24</sup> and provides (with the important proviso of the borrower's consent) for the provision of information on the loan through its duration to the guarantor.<sup>25</sup> The Code also establishes a dispute resolution mechanism for disputed transactions.

4.24 Breaches of the Banking Code are internally investigated according to the offending bank's internal complaints handling system or by reference to the Australian Banking Industry Ombudsman provided it has jurisdiction to deal with such a complaint. Failure to adhere to the Banking Code will be relevant to the way a consumer's complaint is dealt with by the ABIO (see Chapter 6 for further discussion on the ABIO and dispute resolution).

4.25 Monitoring and compliance with the finance industry codes of practice including the Banking Code are undertaken by the Australian Securities and Investments Commission ("ASIC").<sup>26</sup> Monitoring is based on completion of an annual self-assessment compliance report and dispute statistics by the members of each of the finance system codes.<sup>27</sup> Where disputes are not resolved through a bank's internal dispute resolution process, a consumer can refer a dispute to the ABIO.

4.26 While there has been an overall decrease in the incidence of disputes, in the compliance reporting period from April 2001 to March 2002, disputes about breaches of the Banking Code that were referred to the ABIO increased by 31% since the previous year's reporting.<sup>28</sup> The report also noted that over half of the disputes referred to the ABIO were referred back to the bank by the ABIO for resolution at that level. The report noted some concern that this may suggest that banks' internal dispute resolution processes are not operating effectively.<sup>29</sup> The report also indicates that

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24. "17.5 A Bank shall recommend that a prospective guarantor obtain independent legal advice."

25. "17.6 Subject to obtaining the consent of the affected borrower, a Bank shall send to a guarantor:  
(i) a copy of any formal demand that is sent to the borrower; and  
(ii) on request by the guarantor, a copy of the latest relevant statements of account provided to the borrower, if any."

26. ASIC inherited responsibility for monitoring the codes from the Australian Payments System Council in July 1998.

27. According to ASIC, as a result of the recent review of the *Code of Banking Practice*, responsibility for monitoring that Code is likely to move to a new body once the revised code is in effect.

28. Australian Securities and Investments Commission, *Compliance with the Payments System Codes of Practice and the EFT Code of Conduct: April 2001 to March 2002* (2003) at 26.

29. Australian Securities and Investments Commission, *Compliance with the Payments System Codes of Practice and the EFT Code of Conduct: April 2001 to March 2002* (2003) at 26.

disputes about guarantees are over three times more likely to be resolved externally by the ABIO than internally by the bank.<sup>30</sup>

4.27 The Banking Code (1993) faced major limitations. The guarantor provisions did not apply to guarantees given to support the loans of companies or partnerships in which the guarantor had an interest<sup>31</sup> – and many if not most guarantee transactions supporting small business were therefore excluded. Given these limitations it is perhaps not surprising that our guarantor respondents reported many practices in the taking of guarantees (discussed in Chapter 5) that did not comply with the Banking Code’s requirements.

4.28 In May 2000, the Australian Bankers’ Association asked Dick Viney, an independent consultant, to conduct a review of the Code of Banking Practice. After widespread industry, consumer and government consultations, an issues paper and final report were released.<sup>32</sup> The review received a high number of submissions, many of which commented on the Banking Code’s narrow application, and the poor protections afforded to guarantors. The final report made recommendations to improve consumer protection under the Banking Code and broaden its coverage.

4.29 An amended Banking Code, reflecting many of these concerns, came into force in August 2003. The 2003 Banking Code applies to all guarantees given by an individual to secure loans to another individual, or small business, considerably broadening the scope of coverage of

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30. Australian Securities and Investments Commission, *Compliance with the Payments System Codes of Practice and the EFT Code of Conduct: April 2001 to March 2002* (2003) at 25, 27.

31. “17.1 This section shall apply to each guarantee and each indemnity (whether or not contained in a security) (called “guarantee” in this section 17) obtained from a third party who is an individual (called “the guarantor” in this section 17) for the purpose of securing any financial accommodation or facility provided by a Bank to any person (called “the borrower” in this section 17) other than:

- (i) a public corporation or any of its Related Entities;
- (ii) a corporation of which the guarantor is a director, secretary or member or any of its Related Entities;
- (iii) a trustee of a trust (including a discretionary trust) of which the guarantor or a corporation or a Related Entity that is referred to in paragraph (ii) is a beneficiary or one of a class of beneficiaries under the trust; and
- (iv) a partner, co-owner, agent, consultant or associate of any of the guarantor, a corporation or Related Entity referred to in paragraph (ii) or a trustee referred to in paragraph (iii);

at the time the guarantee is obtained. The term “public corporation” has the meaning set out in section 9 of the Corporations Law.”

32. Dick Viney, *Review of the Code of Banking Practice, Issues Paper* (2001); Dick Viney, *Review of the Code of Banking Practice, Final Report* (2001).

guarantees.<sup>33</sup> The amended Banking Code is also more far-reaching in its disclosure provisions. It requires lender's to give advice that the guarantor can refuse to enter into the guarantee, warnings that there are financial risks involved, advice that the guarantor can request information about the loan during its operation, and a commitment to inform the guarantor of any notice of demand or debt dishonour on the part of the borrower in the past two years.<sup>34</sup> Importantly the revised Banking Code also requires that the bank make available to the guarantor a range of information about the borrower's loan and the financial information upon which the bank made its decision to extend credit. This information must be made available prior to signing, and in the absence of independent legal advice, the bank must allow the guarantor a day to consider the information.<sup>35</sup> The provision of this information is no longer subject to the borrower's consent. The revised Banking Code, if complied with, represents a very significant advance in lender practice. The Banking Code remains voluntary.

4.30 In light of the degree of self-regulation in the finance industry, the remainder of this Chapter focuses upon lender's internal processes for making and calling upon loans, and goes on to address the question of what lenders believe their responsibilities to guarantors ought to be.

### Financier's lending policies and guidelines

4.31 One of the more contentious areas of lending is the assessment of credit risk for a lender. Credit risk is the potential for loss arising from a debtor failing to meet their repayments.

4.32 Credit risk is generally managed by controls upon individual lending divisions and business managers who are responsible for lending. Lending is carried out within the boundaries of the financier's lending policies (which cover the approval, documentation and management processes), often set out in manuals. The manuals set out information, guidance and directions to bank staff for the conduct of a bank's business.

4.33 In the event of litigation, courts may refer to a bank's manuals and internal lending instructions to address whether a bank has been negligent in a particular case.<sup>36</sup> Failure to observe instructions in a manual does not

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33. *Code of Banking Practice* (2003). A "small business" under the amended Code means a business employing less than 100 full time (or equivalent) employees if the business is or includes the manufacture or goods; or in any other case, less than 20 full time (or equivalent) employees: cl 40.

34. *Code of Banking Practice* (2003) Cl 28.4.

35. *Code of Banking Practice* (2003) Cl 28.5.

36. See Wickrema Weerasooria, "25 years of banking litigation (1972-1997) and emerging issues in retail banking in Australia" (1998) 13 *Australian Banking Law Bulletin* 2 at 15 (Supplement).

necessarily give rise to legal liability, although it may point to negligence. Much of the case law in this area derives from England.<sup>37</sup> The status of bank manuals does not appear to have been looked at in any detail in Australia. Where courts have considered such procedures, the fact that lenders have not adhered to their own guidelines or policies does not appear to have significant influence on the results of litigation.<sup>38</sup>

4.34 According to the ABIO's Policies and Procedures, when investigating alleged maladministration in a decision to lend, the ABIO will review, among other things, the decision to lend by reference or adherence to the lenders' own guidelines. Adherence to these guidelines is an important criterion by which to assess a lender's actions.

4.35 As part of the research, we sought to access lenders' manuals, to examine the criteria for seeking third party guarantees, and the process of signing up guarantors. Lenders were mostly unwilling to assist in this regard.<sup>39</sup> Two of the lenders provided the research team with guidelines and excerpts of lending manuals in relation to the signing up of guarantors.<sup>40</sup> One lender declined to provide extracts from its documented policies and procedures, but assured us that it does provide guarantors all information required by statute or relevant industry codes.

4.36 In the limited material we received we found that the procedures set out were generally concise and clear. Particular emphasis was placed on strictly following these procedures to avoid having transactions reopened by the courts. Emphasis was also placed on making appropriate file

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37. See Wickrema Weerasooria, *Banking Law and the Financial System in Australia* (5th ed, Butterworths, 2000) at 343–348.

38. See eg *State Bank of NSW v Watt* [2002] ACTSC 74. The lender's own procedures for informing mortgagors/guarantors were not followed as the documents were not signed in the presence of a bank officer or solicitor as the bank's internal procedures required. The son obtained his parents' signature on refinancing documents while they were holidaying in Sweden. Gray J held that "nothing adverse" could be drawn from this, at para 50. In *Mitchell v 700 Young St Pty Ltd* [2003] VSCA 42, the Victorian Court of Appeal noted that the lender failed to follow its own guidelines in that it never dealt directly with the elderly guarantor but communicated with her son and allowed him to deliver to her the security documents for execution, but nothing turned on that point. However, in the recent case of *St George Bank v Trimarchi* [2003] NSWSC 151, Dunford J found it significant, when granting relief for an unjust contract under the *Contracts Review Act 1980* (NSW), that the bank had failed to follow its own policies, at para 95.

39. One confidential submission from a former bank manager of a large bank confirmed that banks are extremely reticent to pass on information from their bank manuals. He suggested that the only way banks will disclose such documents is through the coercive discovery process in litigation: *Confidential Submission*, September 2000.

40. Bank A, *Submission* 17 September 2001.

annotations.<sup>41</sup> These documents confirm the ABIO's comments that "considerable skill and care has gone into the development of lending guidelines so that staff can properly analyse the risks associated with lending."<sup>42</sup> Belinda Fehlberg noted in her UK study that lender representatives she interviewed, "often emphasized the difficulties in ensuring that practice followed procedure."<sup>43</sup>

### A guarantee by any other name

"company to be formed as borrower with all four persons as directors so negates any dramas with 3rd parties etc".<sup>44</sup>

4.37 A guarantee-like transaction includes one where one of the parties to the loan may receive little or no benefit from the loan and is, in substance if not in form, a guarantor. There appears to be an increasing trend to avoid rules protecting guarantors by restructuring a transaction so that the guarantor becomes the borrower.<sup>45</sup> The rise in problematic "guarantee-like" transactions, and fall in traditional third party guarantee transactions was raised by a number of advocates in the course of our initial consultations.<sup>46</sup>

4.38 This concern was borne out in the research. A number of the litigated cases we reviewed included instances where people were technically the principal debtor in the transaction but were in reality a guarantor for funds advanced to another person.<sup>47</sup> This proposition was confirmed by a majority of judges.<sup>48</sup> Guarantors also reported that they had jointly borrowed funds – with 8% acting as joint borrowers for business loans and 11% as joint borrowers for personal loans. Two female guarantors reported that they had borrowed funds for the benefit of their bankrupt spouse.

4.39 The distinction between a guarantee and joint loan is important for a number of reasons. First, some of the legislative protections for guarantors

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41. Bank B, *Submission* 6 August 2002.

42. Australian Banking Industry Ombudsman, *Policies and Procedures Manual* at 25.

43. Belinda Fehlberg, *Sexually Transmitted Debt: Surety Experience and English Law* (Clarendon Press, 1997) at 202.

44. Fax from finance broker to lender concerning two elderly mothers who were to put up their homes as security for a loan made to a company owned and controlled by their respective children: *Challenger Management Investment Ltd v Davey* [2002] NSWSC 430, exhibits 3 and 7 in the trial.

45. Report of the Expert Group on Family Financial Vulnerability, *Good Relations, High Risks – Financial Transactions within Families and Between Friends* (Report, 1996) at 7.

46. Narelle Brown, Financial Counselling Association of New South Wales, *Consultation* July 2000.

47. *Pasternacki v Correy* [2001] ANZ ConvR 240; *McAuley v Panagiotis* (No 2) (1998) 200 LSJS 205; *Ribchenkov v Suncorp Metway* (2000) 175 ALR 650; *Sapuppo v Ribchenkov* [2002] ANZ ConvR 164.

48. Judge Survey, Question 6(a).

are not available to joint debtors.<sup>49</sup> Secondly, there is nothing on the face of an advance to joint debtors to put a lender on inquiry that one of the borrowers may be in a position of disadvantage or undue influence in relation to the other. Thirdly, the remedies available to guarantors by application of the principles in *Yerkey v Jones* and *Garcia* have not been extended to transactions other than guarantees.<sup>50</sup>

4.40 The Code of Banking Practice has been amended to reflect the recommendation of the Review of the Code of Banking Practice that a bank ought not accept a person as co-debtor under a credit facility where it is clear on the facts known to the lender, that the person will not receive any direct benefit under the facility.<sup>51</sup>

## LENDER PRACTICE

### Small business debt, residential security, and loan defaults

4.41 As part of the research, we sought to investigate how small business was financed. There is surprisingly little data available on how small business is financed in Australia. We sought information directly from lenders to determine how many business loans are guaranteed by mortgages over residential properties, what proportion of guarantees are called upon, and how many of those are disputed.

4.42 However, lenders were not able or were unwilling to provide us with statistics that would enable us to understand fully issues with sourcing small business finance and the extent of third party guarantees to it.<sup>52</sup> Some lenders have been conducting their own empirical research on how they are affected by delinquent business loans. For example, analysis undertaken by Westpac in 1998 looked into the severity of loss to the bank in the event of loan default.<sup>53</sup> If other lenders had undertaken similar analysis, they were unwilling to disclose it.

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49. In its submission to the New South Wales Law Reform Commission's Issue Paper, one financial counselling service raised concerns that joint borrowing may be used as an alternative to more strictly regulated guarantees: Ryde-Eastwood Financial Counselling, *Submission* at 8-9.

50. *Elkofairi v Permanent Trustee Co Ltd* (2003) Aust Contract R 90-157; [2002] NSWCA 413.

51. See Dick Viney, *Review of the Code of Banking Practice, Final Report* (2001) at 63-64; *Code of Banking Practice* (2003) cl 26.1.

52. One bank lender who named themselves as "the worst offender" stated that they "were not inclined to respond" to our request for statistics: Bank X, *Telephone Consultation* 3 May 2002.

53. Robert Eales and Edmund Bosworth, "Severity of Loss in the Event of Default in Small Business and Larger Consumer Loans" (1998) 80 *Journal of Lending and Credit Risk Management* 58.

4.43 The research team also tried to obtain aggregated data on what proportion of loans are supported by third party guarantees, and of those, what proportion of guarantors were family or friends. Again, the lenders were largely unable or unwilling to provide us with data.

4.44 As an alternative source of information on business finance and debt, we sought assistance from the Australian Prudential Regulation Authority (“APRA”) and the Reserve Bank of Australia (“the RBA”) who are collectively responsible for monitoring Australia’s fiscal stability and setting standards on risk management and reporting within the finance sector.

4.45 As part of its supervisory role, APRA requires lenders to report on their asset quality including reporting on banks’ impaired assets. The test of “impairment” is whether there is a reasonable doubt as to the collectibility of principal and/or interest.<sup>54</sup> This information gives at least a general sense on how many loans are being defaulted upon. In its 2001 Annual Report, APRA noted that banks’, building societies’ and credit unions’ impaired assets had begun to rise.<sup>55</sup> Unfortunately, APRA has stated that they do not collect data which differentiates business and consumer lending in the process of assessing and collecting reports on prudential standards and impaired assets.

4.46 Reserve Bank of Australia figures note that the weighted average interest paid by small businesses across all types of variable-rate loans has declined recently.<sup>56</sup> The Reserve Bank states that this fall is due in part to a shift in small business borrowing to lower-cost products – such as loans secured by housing.<sup>57</sup> Our consultations with financial advisors and advocates revealed that many guarantors and co-borrowers are unaware of

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54. A bank’s impaired assets represent the aggregate of its restructured and non-accrual exposure, plus any assets acquired through enforcement of security. Building societies and credit unions report their impaired assets as loans in arrears or overdrawn accounts. See Australian Prudential Regulation Authority, Guidance Note AGN 220.1, *Impaired Asset Definitions*, November 2002.

55. Australian Prudential Regulation Authority, *Annual Report 2002*, “Supervision” at 8-9. The 2002 Annual Report did not report on impaired assets, but it did refer to lenders who significantly increased their exposure to commercial lending. Some lenders were requested to curtail their lending activity until adequate credit policies and assessment criteria were put into place: Australian Prudential Regulation Authority, *Annual Report 2002* at 22.

56. See *Reserve Bank of Australia Bulletin*, February 2002 at 60.

57. See *Reserve Bank of Australia Bulletin*, February 2002 at 60; refer also Reserve Bank Statistics, Statistical Tables D7: Bank Lending to Business (as at 7/4/03) <http://www.rba.gov.au/Statistics/Bulletin/index.html>. The RBA defines small business loans by reference to the size of the loan (that is, a loan of \$500,000 or less). On the basis of loans of this size which are loaned at particular interest rates, the RBA infers that these loans are residentially secured loans. According to the RBA, the trend to residentially secured products is also evident from changes in the weighted average interest rate paid on variable rate loans by small businesses.

different options on loans. Guarantors thought that the loan would not be made without a guarantee, and did not understand that in many cases a loan (with a higher interest rate) could be taken out that did not require a guarantee or a joint borrower to support the loan. Taken together, these two sources suggest the possibility that some guarantees are being entered into in order to gain access to cheaper interest rates, rather than as a last resort.

4.47 Data from the ABIO and finance industry code compliance reports from ASIC suggest that the incidents of bad debts being enforced by recourse to a third party guarantee are relatively small. However, statistics from lenders would be useful to confirm this, and get some idea of the breadth of practice and to work out what triggers the requirement for a guarantee. The research team sought to consult directly with banks, building societies and credit unions to confirm that proposition.

### **What proportion of small business loans require guarantees?**

4.48 We were unable to obtain any clear information on the number or proportion of loans that are supported by guarantees.<sup>58</sup> Bank lenders said that they could not provide such statistics, though some gave very rough estimates. Smaller lenders, presumably with far fewer resources than the bank lenders were generally able to provide more detailed information than bank lenders. However small lenders were both less likely to undertake commercial lending, and less likely to take guarantees on small business loans.<sup>59</sup>

4.49 One bank lender said that they do not keep statistics on the proportion of guarantees obtained to support small business loans.<sup>60</sup> However, the lender noted that guarantees are “far more common” for business borrowings. The lender suggested that businesses are often undercapitalised and do not have sufficient assets to provide security in their own right, thus guarantees and third party securities are “frequently” obtained. One of the reasons that directors or operators of small businesses provide real property as security is that the costs of finance are considerably lower than finance secured solely over business assets. Another bank lender estimated that 75% of its small business loans are

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58. Fehlberg likewise notes the absence of even basic statistics on the incidence of third party guarantees in the UK: Belinda Fehlberg, *Sexually Transmitted Debt: Surety Experience and English Law* (Clarendon Press, 1997) at 91.

59. Taking of guarantees is not a large part of credit union practice as they are not generally involved in commercial lending. In the past it was estimated that guarantees were required for less than 10% of all loans, and it is suspected that it is even less now. Credit Union Services Corporation Limited, *Telephone Consultation* 21 July 2001.

60. Bank A, *Submission* 17 September 2001.



supported by a guarantee,<sup>61</sup> but by contrast a smaller bank lender estimated that it requires a guarantee in only approximately 5% of small business loans.<sup>62</sup>

4.50 Of the smaller lenders who do undertake business finance, most required directors' guarantees.<sup>63</sup> One lender stated that 39% of its small business loans require a guarantee.<sup>64</sup>

4.51 It has been suggested that the frequency of guarantees in the business context rather than in the consumer context may be due, at least in part, to the fact that the Consumer Credit Code regulates guarantees of consumer loans.<sup>65</sup> Likewise, it has been suggested that guarantees are common for business loans because of the prevalence of corporations as the preferred structure for conducting business.<sup>66</sup> One lenders' peak body estimated that in the commercial credit environment, the percentage of required guarantees is in the high 70s.<sup>67</sup>

### **What proportion of those guarantees are called upon and disputed?**

4.52 We could not obtain sufficient statistics to enable any clear analysis of this issue. A large bank lender said that it does not keep those statistics,<sup>68</sup> nor did it provide estimates. Another bank lender estimated 30% of guaranteed small business loans are referred to its problem loan section in any one year. This does not always result in enforcement action. Typically, as many as 50% of those referred loans were refinanced, and a further quarter were discharged following voluntary liquidation of the secured property and 7.5% of secured loans result in the sale of the security. This bank said a "nominal" number of guarantees were disputed – it estimated less than 10 disputed guarantees over a recent twelve month period.<sup>69</sup>

4.53 Data from the smaller lenders indicate the proportion of their guarantees being called up is very small – in the vicinity of less than 1%,

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61. Bank B, *Submission* 6 August 2002.

62. Bank C, *Submission* 30 May 2002.

63. Lender D, *Submission* 7 September 2001, Lender G, *Submission* 28 September 2001.

64. Lender F, *Submission* 8 October 2001.

65. Australian Finance Conference, *Submission* at 2.

66. Australian Finance Conference, *Submission* at 2.

67. Australian Credit Forum, *Submission* at 2.

68. Bank A, *Submission* 17 September 2001.

69. Bank B, *Submission* 6 August 2002. Similarly, Bank C estimated less than 5% of loans are called upon; and that although statistics of disputed guarantees are not maintained, they were able to say "very few" are disputed: Bank C, *Submission* 30 May 2002.

although a higher number become “bad debts” or are issued with letters of demand.<sup>70</sup>

### Risk assessment, business finance and criteria for the use of guarantees

4.54 The Australian Banking Industry Ombudsman writes:

“What appears to be missing is the information that if a person has been asked to give a guarantee it is usually because the bank has concerns about making the loan without security ... In other words, the fact that the guarantee is being asked for is usually an indication of insecurity on the part of the bank about the loan.”<sup>71</sup>

In the course of the research team’s initial consultations it was suggested that guarantors ought to have the right to know what “triggers” the requirement for a guarantee.<sup>72</sup> Banks don’t explain why they require a guarantee, which they determine usually after carrying out a credit rating. It was suggested that banks should be explaining the risk of the loan, and why they consider a particular loan so risky as to require a guarantee. One solicitor stated that lenders need to take more responsibility for their lending practices: if they intend to lend to “high risk” clients, then they should accept the fact they will lose out sometimes.<sup>73</sup> This criteria could be particularly useful for guarantors to assist them in their decision to become a guarantor.<sup>74</sup> One judge who responded to our survey thought that commercial lenders often seek guarantees where it is not necessary.<sup>75</sup>

4.55 Most of the information provided to us by lenders about risk assessment and lending criteria was of a general nature. One major bank lender refused to “provide precise details of its lending criteria” and did not provide *any* details of its lending criteria.<sup>76</sup> Another major bank stated that it only considers what security the borrower can provide after first

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70. Lender D stated that “very few, less than 1%” of its business loan guarantees are called up: *Submission 7* September 2001 at 1. Lender E does not provide business finance: Lender E, *Submission 24* August 2001 at 1; Lender F approximates 3% of its business loans with guarantees become bad debts, but was unable to state the percentage of guarantees that were called up, but that it would be “very small”: Lender F, *Submission 8* October 2001 at 1. Lender G reported that in less than 1% of cases a guarantee is called upon: Lender G, *Submission 28* September 2001 at 1. Lender H estimates it issues letters of demand against a guarantor in 5% of cases, but issues proceedings against a guarantor in less than 0.5% of all contracts: Lender H, *Submission 5* October 2001.

71. Colin Neave, Australian Banking Industry Ombudsman, paper presented at the Australian Finance Conference (2000) at 14.

72. Conrad Grey, Legal Aid Commission, *Consultation* July 2000.

73. *Solicitor Survey*, Comments, Respondent 71.

74. Conrad Grey, Legal Aid Commission; Ben Slade, Solicitor, *Consultations* July 2000.

75. *Judge Survey*, Respondent 1.

76. Bank B, *Submission 6* August 2002.

considering the borrower's ability to service the debt.<sup>77</sup> In general, where the borrower is a company, directors' guarantees are required. In these cases a fixed and floating charge may be taken over all the assets of the company,<sup>78</sup> or third party security may be taken where "offered".<sup>79</sup> One lender's general rule is that if they are not prepared to lend to the borrower, then they should not lend based on security offered by a guarantor unless in an "unusual situation" such as a parent assisting their child to buy a car.<sup>80</sup>

4.56 In the Issues Paper *Guaranteeing Someone Else's Debts*, the Commission asked whether the use of third party guarantees moves the emphasis away from effective risk assessment by lenders. A number of lenders submitted that lenders were generally effective in assessing risk, and the availability of third party guarantees does not affect that. St George Bank submitted that they only lend to borrowers able to service their loan themselves, not on the basis of a guarantor's income, but "on the occasions when we lend to a borrower whose capacity to service the debt relies partially on the cash flow of a personal guarantor, we require the guarantor to obtain independent financial as well as legal advice".<sup>81</sup> The Commonwealth Bank submitted that the borrower's ability to repay the loan is the "prime criterion, which is not relaxed merely because a guarantee is available".<sup>82</sup> The Australian Finance Conference submitted that assessment of risk "is not a definite science", but that its members are very effective in assessing risk and any transaction must stand on its merits, regardless of a guarantee.<sup>83</sup>

4.57 In contrast, the Legal Aid Commission submitted that "the existence of any form of security ... can lead lenders to be less rigorous in assessing the capacity of the borrower to repay".<sup>84</sup> The Financial Counsellors' Association of NSW submitted that "lenders will reduce their lending criteria with the provision of a guarantor"<sup>85</sup> which "shifts the onus of responsibility".<sup>86</sup> The Women's Legal Resource Centre submitted that if, at the time the guarantee is signed, a guarantor is not in a position to meet the debt, "then the risk has been improperly shifted to the guarantor".<sup>87</sup> The Department for Fair Trading submitted that "there is a danger that

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77. Bank A, *Submission* 17 September 2001.

78. Bank A, *Submission* 17 September 2001.

79. Bank C, *Submission* 30 May 2002.

80. Lender D, *Submission* 7 September 2001 at 2.

81. St George Bank, *Submission* at 2.

82. Commonwealth Bank, *Submission* at 4.

83. Australian Finance Conference, *Submission* at 7-8.

84. Legal Aid Commission, *Submission* at 8.

85. Financial Counsellors' Association of NSW, *Submission* at 1.

86. Financial Counsellors' Association of NSW, *Submission* at 1.

87. Women's Legal Resource Centre, *Submission* at 2.

the use of a guarantee moves the emphasis away from proper assessment of the creditworthiness of a borrower”.<sup>88</sup> And the Country Women’s Association suggested that if a lender had some doubt about the viability of the borrower, then the availability of a guarantee may mean the lender “takes a more liberal approach” to the assessment of risk than they would otherwise.<sup>89</sup>

4.58 Asset based lending, where the borrower and guarantor appear unable on the face of the transaction to be able to repay the loan, is a feature of improvident transactions. Data collected by the project, set out in Chapter 3, indicates that many guarantors are in a vulnerable financial position at the time they provide the guarantee and do not have sufficient income to service the guarantee should they be called upon to do so.

### ASSET BASED LENDING

The following are some of the stories collected in the course of the research which clearly indicate asset based lending:

- Mrs F has been on an invalid pension since 1990 with no other income. Her husband is her carer. Mrs F thought she was signing a character reference for her son. In fact, Mrs F was a co-borrower on her son’s mortgage. When her son didn’t make payments the bank sold the son’s property and sought recovery of the difference on the loan from Mrs F. Her son is trying to get a personal loan to make up the difference, as Mrs F is clearly unable to repay the loan.<sup>90</sup>
- Ms M guaranteed a business loan from NAB to her husband and his partner who ran a small engine repair business. She owned her home in her own name and the guarantee was secured by a mortgage over the home. Although Ms M received legal advice before signing the guarantee, she says the advice was cursory, the solicitor was also her husband’s solicitor, and she did not know that she stood to lose her home. Documents obtained from NAB included a letter from NAB to the business indicating that the business accounts had been in arrears in the past and the loan was necessary to refinance an unsecured overdraft that was in default. Further, NAB’s records revealed that the loan was approved even though the account had regularly been in arrears and the NAB manager had formed the view that the partners were not good business people and did not have the income to finance all commitments. Ms M was told nothing of the financial state of the business. Ms M’s husband was made bankrupt and [the bank] sought possession of the property in the Supreme Court.<sup>91</sup>

88. Department for Fair Trading, *Submission* at 3.

89. Country Women’s Association, *Submission* at 2.

90. *Guarantor Survey*, Respondent 71.

91. Legal Aid Commission, *Submission*.

4.59 In our research we asked the guarantors of business loans whether the lender made enquires about whether or not they would be able to repay the loan if necessary. While 8 responded that the lender did enquire and 5 could not recall, some 28 guarantors responded that such enquiry was not made. Over 70% of respondents to the guarantor survey who supported a business loan gave security in the form of a mortgage over their home.<sup>92</sup> Of those who guaranteed business loans for someone else, around a third had to sell the secured family home to pay the debt. In these cases, while the loan may be improvident from the perspective of the guarantor, it is not so improvident for the credit provider who can rely on a mortgaged property in the case of default by the borrower.

4.60 The ABIO has quoted with approval the statement that “No banker should rely on realisation of assets held as security as the primary source of repayment and the banker must be satisfied that there is a clear repayment source”.<sup>93</sup> If a loan is approved and the borrower clearly had little or no hope of repaying the loan, then a dispute may raise issues of maladministration.

### **What kind of security is generally required?**

4.61 Lenders stated very generally that the type of security is dependent on the type of loan facility and what security the borrower can provide,<sup>94</sup> or that this would depend on the level of security support for the transaction.<sup>95</sup>

4.62 However, as noted above, data from our guarantor survey indicates a high frequency of guarantor homes and other personal property used as security for business borrowing. Our review of the litigated cases revealed that 88% of the guarantors mortgaged their home to facilitate the loan for someone else; and 94% of the disputed guarantees supported business loans.<sup>96</sup>

4.63 The use of residential homes as security for business loans is justified by some as an efficient, indeed necessary, use of economic resources.<sup>97</sup> For guarantors, however, this entails an enormous loss if the security is

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92. 51% of guarantors to a business loan gave a mortgage over their home, 18% stated that they gave a personal guarantee while 20% stated that they gave both, 11% gave other security or took out the loan in their own name.

93. ABIO, “Maladministration in the Decision to Lend” *Policies and Procedures Manual* at 24.

94. Bank A, *Submission* 17 September 2001.

95. Bank C, *Submission* 30 May 2002.

96. *Case Law Review*, Issues 12 and 10.

97. See eg Robin Baxendale, “*Garcia v National Australia Bank Limited* – Ensuring Equity in Surety Transactions: A Legal Debt End?” (1999) 21 *Sydney Law Review* 313.

called upon. Belinda Fehlberg noted in her interviews with lenders that the mixture of emotional and financial investment in a family home was a factor that they were well aware of and prepared to use to advantage. Fehlberg states that lenders:

“emphasized the importance to them in commercial terms of the surety’s emotional investment in both the relationship with the debtor and the home ... In essence private commitments enhanced public enforceability ... the family home was described as an important ‘motivational asset’ ... particularly to debtors: if a debtor’s home was on the line, he or she would do their best to meet their liabilities to the lender.”<sup>98</sup>

## BETTER PRACTICE

### What obligations, if any, should a lender owe a guarantor in a close relationship with the borrower?

4.64 Some of the submissions to the Commission’s Issues Paper indicated that a threshold difficulty for lenders is the identification of those in a close personal relationship with the borrower.<sup>99</sup> One lender suggested that depending on the complexity and amount of the loan, a lender may make independent legal advice a precondition of providing finance.<sup>100</sup> The Australian Finance Conference states that a guarantor in a close personal relationship with a borrower “needs to have time to consider or reflect on their position as guarantor and to make an assessment ... away from the pressures of the relationship”.<sup>101</sup> The Legal Aid Commission suggested that rather than imposing a burden on a lender to question the nature of the relationship between the borrower and guarantor, the better approach would be to recognise that guarantees, as a class of contract, are peculiarly susceptible to being entered into in unjust circumstances, and that lenders should approach all guarantees on this basis.<sup>102</sup>

4.65 None of the lenders who sent submissions to the Commission referred to any policy or guidelines in relation to obligations owed to guarantors in close personal relationships with borrowers. It has been suggested, given the changes in the common law over the past few years, that some banks

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98. Belinda Fehlberg, *Sexually Transmitted Debt: Surety Experience and English Law* (Clarendon Press, 1997) at 204.

99. The NSW Minister for Fair Trading submitted that requiring a lender to inquire into the relationship between the borrower and guarantor would be “onerous and clumsy”, *Submission* at 5; see also Australian Finance Conference, *Submission* at 20; Commonwealth Bank, *Submission* at 13.

100. Commonwealth Bank, *Submission* at 13.

101. Australian Finance Conference, *Submission* at 21.

102. Legal Aid Commission, *Submission* at 3.

may need to consider their current procedures and how they classify and handle “high risk” and “low risk” transactions at a policy level.<sup>103</sup>

4.66 St George Bank said a lender’s obligations should be limited to taking reasonable steps to ensure the guarantor understands the effect of the guarantee which may include a recommendation the guarantor obtain independent legal advice, plain English and legible documentation and allowing the guarantor reasonable time to read the documents. It did not think there should be any special rule for guarantors in close personal relationships with the borrower: but did concede that it is more difficult for a lender to satisfy it has discharged its duty in explaining documents to certain guarantors, such as a non-English speaking guarantor.<sup>104</sup>

4.67 The Commonwealth Bank’s general approach was to refer a guarantor in a close personal relationship with the borrower to independent legal advice and, if appropriate, financial advice. It did, however, caution that a lender may not be aware of any close personal relationship, and there may be situations where making such an inquiry would perturb the borrower. A lender, it said, may make it a precondition of providing finance that a guarantor obtain legal advice, depending on the complexity and amount of the loan.<sup>105</sup> The role of independent legal advice is discussed further in Chapter 5.

### **What should a reasonable lender do?**

4.68 The New South Wales Law Reform Commission asked for submissions about what information a lender should be required to disclose to a prospective guarantor in relation to the primary borrower before they sign the guarantee.<sup>106</sup>

4.69 Submissions opposing change to lenders’ currently limited common law duty to guarantors were received from lenders or lenders’ associations and included the following reasons:<sup>107</sup>

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103. 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* 73 at 91. Horrigan also suggests that the extension of unconscionability criteria under the *Trade Practices Act 1974* (Cth) opens the way for more judicial review of banking conduct in both consumer and business transactions.

104. St George Bank, *Submission* at 5.

105. Commonwealth Bank, *Submission* at 13.

106. New South Wales Law Reform Commission, *Guaranteeing Someone Else’s Debts* (Issues Paper 17, 2000) at 102.

107. St George Bank, *Submission*; Australian Finance Conference, *Submission*; Commonwealth Bank, *Submission*.

- it would increase in the cost of transactions – the borrower’s costs will increase because the lender’s costs will increase;
- most guarantees are entered by directors of the borrower company and these directors are already in a position to understand the financial position of the borrower;
- such a requirement would be of dubious benefit to the majority of guarantors and administratively onerous for lenders;
- for some simpler transactions lenders might be required to explain credit scoring systems, which may not be easily understood by prospective guarantors;
- there will be an increased risk that guarantors will avoid the contract on the grounds that the lender failed to disclose all relevant information (unless the disclosure requirements are tightly limited);
- lending approvals will reduce because of the increased risk that guarantors may avoid the contract;
- guarantors may rely too much on the information provided by the lender, rather than making their own assessment of such matters as the borrower’s honesty;
- lenders might become liable for financial loss suffered by a prospective borrower as the result of mistaken advice provided to a prospective guarantor.

4.70 The general flavour of lenders’ submissions was that more information would only cost more, would be otiose for some company transactions and could expose the lender to more risk where the information is either insufficient, incorrect, misunderstood or poorly interpreted.

4.71 Most non-lender submissions supported providing guarantors with all the information necessary to assist making the decision whether to guarantee the loan.<sup>108</sup> Similar issues were discussed in the review of the Code of Banking Practice.<sup>109</sup>

4.72 While the most recent High Court decision on guarantees, *Garcia*, provided confirmation of the legal principles concerning guarantees entered into by wives, it did not offer much practical guidance on what lenders, and

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108. NSW Legal Aid Commission, *Submission* at 13; Women Lawyers’ Association of NSW, *Submission* at 3; Women’s Legal Resources Centre, *Submission* at 6; NSW Young Lawyers, *Submission* at 3; Financial Counsellors’ Association of NSW, *Submission* at 3; University of Western Sydney, Centre for Elder Law, *Submission* at 17; Ryde-Eastwood Financial Counselling Service, *Submission* at 4.

109. Dick Viney, *Review of the Code of Banking Practice, Issues Paper* (2001) at 88-98; Dick Viney, *Review of the Code of Banking Practice, Final Report* (2001) at 56-61.



solicitors, should do to ensure that a guarantee is enforceable.<sup>110</sup> By contrast, the House of Lords decision in the 2001 case of *Etridge* contains clear instructions on practical procedural matters in relation to advising and signing up a guarantor, specifically when a wife guarantees a loan for her husband or his business.<sup>111</sup> This duty is balanced between lenders and lawyers, but nonetheless is presented as a directive. First, the lender must communicate directly with the wife; and secondly, the lender must disclose relevant financial information. There is also a third procedure to be adopted in the exceptional event where the lender believes or suspects that the wife has been misled or her signature was obtained by undue influence. The result of *Etridge* means those in the business of lending must revise their procedures for obtaining security from a debtor's family or friends.

4.73 A significant issue for guarantors was the availability (or lack thereof) of information about the loan they have guaranteed. In *Etridge*, the House of Lords directed that lenders should be obliged, as routine practice, to disclose certain documents to the solicitor advising the wife about signing the guarantee. In *Etridge*, these documents include: information on the purpose for which the new facility is requested; the current amount of the husband's indebtedness; the amount of the husband's current overdraft facility and a copy of the written application for which the current guarantee is required. In order to disclose this information to the guarantor, the husband's consent is required. If the consent is not given, then the transaction cannot proceed. This procedure requires operational changes to lenders' practice.<sup>112</sup>

4.74 The Final Report on the Review of the Code of Banking Practice adopted a similar approach to *Etridge*. The recommendations advocate full lender disclosure of all information to the guarantor, including any relevant financial details about the debtor and the transaction being guaranteed. This disclosure is required if such facts are in the possession of the bank and a reasonable prospective guarantor would reasonably require them in order to decide whether or not to enter the guarantee.<sup>113</sup>

4.75 The Australian Banker's Association accepted most of the recommendations made in the Final Report concerning guarantees. Disclosure provisions under the amended Banking Code have been significantly expanded.<sup>114</sup> The ABIO has expressed the view that as a result

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110. 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 123.

111. *Royal Bank of Scotland v Etridge (No 2)* [2002] 2 AC 773, per Lord Nicholls at para 79.

112. *Royal Bank of Scotland plc v Etridge (No 2)* [2002] 2 AC 773 at para 50 and 80.

113. See *Code of Banking Practice* (2003) at cl 28.4.

114. *Code of Banking Practice* (2003) at cl 28.4.

of the broader disclosure obligations there will be a decline in complaints it receives in relation to disputed guarantees.<sup>115</sup> The new Banking Code is effective from August 2003. At least one bank expressed concern that the new disclosure rules represent a problem for banks in that they may find it difficult to obtain all the material the far-reaching provisions require. Even prior to the amended Banking Code coming into effect, there was talk of a transitional period allowing banks to remain compliant despite not disclosing material.<sup>116</sup>

4.76 It is important to keep in mind that while “informational disparity”<sup>117</sup> between a guarantor and the borrower or lender is often a significant issue, lack of information about the true financial position of the borrower is not necessarily determinative of the reason why a guarantor would enter into an improvident guarantee transaction. The empirical research in Chapters 2 and 3 including analysis of the reasons why guarantors enter into these kinds of transactions, demonstrates that more or better information will not necessarily solve problematic guarantee transactions.

## CONCLUSION

4.77 While there is a wide range of common law and legislative avenues available to challenge unjust transactions after the event, there is relatively little external regulation of the conduct of the finance industry in taking guarantees. The Consumer Credit Code provides a range of protections for borrowers, but it is limited in its application to “consumer” transactions. Most guarantees are given to support small business borrowing and so are not currently covered by the Consumer Credit Code.

4.78 The finance industry’s conduct in taking guarantees is therefore largely self-regulated. The Code of Banking Practice is the main self-regulation mechanism. However, this Code only applies to banks that adopt it. While the Code was originally limited to consumer guarantees, following a comprehensive review, guarantees of small business loans are included in the scheme from August 2003. The revised Code of Banking Practice contains far more wide-reaching constraints on the taking of guarantees than have existed to date.

4.79 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

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115. Australian Banking Industry Ombudsman, *Telephone Consultation* 11 March 2003.

116. Francis Wilkins, “Cracking the Code” *Lawyers Weekly* (7 March 2003) at 18.

117. 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.

proportion of debts which are disputed by guarantors. More data from lenders would have greatly assisted our quantitative assessment of problematic third party guarantees. It would also have been useful if lenders could have better participated in the debate which will inevitably inform reform initiatives in the area.

4.80 The criteria which trigger the need for a third party guarantee are unclear, and do not appear to be transparent. If a guarantee is required, it seems that it is usually because the lender has doubts about the viability of the enterprise or the capacity of the borrower to repay. Yet these criteria are not made apparent to the guarantor. There was some evidence suggestive of the fact that some lenders had engaged in asset based lending, where they assess the risk of the loan by reference of the value of the security rather than on the ability of either the borrower or the guarantor to repay the loan.

4.81 Lenders were generally opposed to any extension of responsibility in providing greater information or explanation of transactions to guarantors, including providing information on the reason for requiring a guarantee.

4.82 The experiences of guarantors at the point of executing the guarantee contract are explored in the next chapter.

## 5. The guarantee transaction

- The documents
- Circumstances of the transaction
- Independent legal advice
- Conclusion

“a guarantee is not a piece of cheese. A guarantee is a complex of obligations.”<sup>1</sup>

“a guarantee is the worst legal relationship you can enter into.”<sup>2</sup>

5.1 Most third party guarantee transactions proceed and are discharged without incident. Unavoidably, the bulk of guarantee transactions that came to our attention in the course of this research were the “bad stories”. A comparison of guarantee transactions that were discharged without incident with those which went awry would be useful to assist understanding what is “best practice” in this area. However, the research project was not provided access to such material by lenders.

5.2 This chapter first explores some of the complexity of the guarantee documentation itself drawing upon some of the documentation publicly available through law reports of litigated cases. It then examines responses from our surveys where guarantors reported on the situations in which they agreed to provide security. This information includes factors such as: what information the guarantor had, whose idea it was for the guarantee to be executed, where and when the transaction took place, who was present and what occurred.

5.3 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.<sup>3</sup> We do not focus upon the application of these legal principles but instead explore the transaction from the guarantor’s point of view. We then consider the role of legal advice prior to the execution of guarantee transactions.

5.4 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.<sup>4</sup> Over half of the guarantors who participated in our survey had entered the transaction between the years

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1. *Gattellaro v Westpac Banking Corporation* (High Court of Australia, No S92/2001, transcripts, 14 February 2003), per Gummow J.

2. *Solicitor Survey*, Respondent 26.

3. New South Wales Law Reform Commission, *Guaranteeing Someone Else’s Debts* (Issues Paper 17, 2000) at 73.

4. See Belinda Fehlberg, *Sexually Transmitted Debt: Surety Experience and English Law* (Clarendon Press, 1997) Chapter 7.

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).<sup>5</sup>

## THE DOCUMENTS

### Intelligibility

5.5 The New South Wales Law Reform Commission's Issues Paper *Guaranteeing Someone Else's Debt* identified problems with legibility of security documents and the use of complex legalistic language in the documents.<sup>6</sup> While plain language documentation may be more common than it was in the past, evidence suggests that guarantors may still not read the documents and instead rely on general comments made by the lender or the borrower about the nature of the obligation they are assuming.<sup>7</sup> It is important to note, also, that the plain language reforms to documentation, including the warnings to guarantors under the Uniform Consumer Credit Code do not apply to those who guarantee business debts.

5.6 Some lawyers still feel that the documentation remains complex. Loan and mortgage documents have increased dramatically in size. One solicitor commented:

“Over 18 years in practice, I have seen loan and mortgage documents increase dramatically in size, various forms of independent advice certificates come and go and the occasional case where a guarantor successfully escaped liability. By and large, financiers seem to respond to successful defences of guarantee cases by focusing on closing ‘loopholes’ in their loan documents or pushing more responsibility on to solicitors to provide a back-stop, through use of certificates. We now have very complicated ‘plain English’ documents often (including) ‘all moneys’ securities and Consumer Credit Code disclosures which run for many pages but which average borrowers cannot understand. At the end of the day I think lenders need to accept more responsibility

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

6. New South Wales Law Reform Commission, *Guaranteeing Someone Else's Debts* (Issues Paper 17, 2000) at 85-87.

7. Report of the Expert Group on Family Financial Vulnerability, *Good Relations, High Risks – Financial Transactions within Families and Between Friends* (Report, 1996) at 32.

for their lending practices and, if they lend to 'high risk' clients, they should accept the fact that they will lose out sometimes.”<sup>8</sup>

5.7 Our research confirmed that guarantee documentation remains very poorly understood by guarantors. In our review of litigated cases, we found that in 73% of the cases the guarantor had not read the security documents. 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. Twenty-seven per cent of respondents to this question stated that they could not read or understand the documents they signed. 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:

“Didn’t understand any of it, no legal or business mind. All legal stuff that I didn’t understand, just did it for my daughter and hoped for the best.”<sup>9</sup>

“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.”<sup>10</sup>

“At time of signing they made me sign so many papers and kept turning the pages and saying sign here. No time to read anything.”<sup>11</sup>

5.8 A recent case heard in New South Wales illustrates this issue well. The case concerned a loan and guarantee executed in 2000 in which the documentation consisted of a 58 page memorandum of mortgage, a six page deed of guarantee/indemnity and a 25 page deed of loan. The elderly guarantors, who were the mothers of the people operating the business receiving the benefit of the loan, were confronted with a total of 89 pages of documents.<sup>12</sup>

5.9 In guarantee cases the documents may not even be intelligible to lawyers. In a 2001 case concerning “all moneys” guarantees executed some years earlier, the judge stated

“The obscurity in the terms of the mortgage relied on by the Bank was evidenced by the difficulties experienced by Counsel for the Bank in dialogue with the bench in the present case. Experienced Counsel

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8. *Solicitor Survey*, Respondent 71.

9. *Guarantor Survey*, Respondent 58.

10. *Guarantor Survey*, Respondent 23.

11. *Guarantor Survey*, Respondent 25.

12. *Challenger Management Investment Ltd v Davey* [2002] NSWSC 430, Exhibit A in the trial.

initially had difficulty even identifying the relevant clauses, let alone their exegesis or proper explanation. How could lay people, the more so if only educated to the degree that the Karams were, be expected to understand its complex obscurities without proper legal advice?”<sup>13</sup>

5.10 In another recent case the Court commented on the illegibility of security documents relied on by the bank in the course of an application by the bank for summary judgment and possession. The documents had been executed in 1994.

“I might add that the guarantee is in tiny print, and for example, the wording of paragraphs (1) is unintelligible. The document is illegible.”<sup>14</sup>

5.11 The following is a clause of a guarantee contract the subject of litigation. In this case, one of the guarantors, Mrs Torpey, received no real independent advice on this guarantee document, which allowed the lender to pursue her without first seeking repayment or pursuing enforcement against the debtors.

“Although, as between [the debtors] of the one part and the Guarantor of the other, the Guarantor is a surety, it is agreed that, as between the Guarantor and [the creditor], the within guarantee shall constitute a principal obligation and shall not be treated as ancillary or accessory to the Mortgage or any other obligation howsoever created, and may be enforced against the Guarantor notwithstanding any laches, compounding or compromise or any forbearance, extension of time or indulgence granted to [the debtors] or any other acts or omissions whatsoever on the part of [the creditor], AND the liability of the Guarantor hereunder shall not be affected by reason of the Mortgage, or any other security or agreement held, taken or entered into by [the creditor], at any time being or becoming, in whole or in part, invalid, illegal, unenforceable, void, voidable, defective or informal by reason of any act, omission, rule of law or equity or otherwise.”<sup>15</sup>

5.12 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”<sup>16</sup> 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

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13. *Karam v ANZ Banking Group Ltd* [2001] NSWSC 709 at para 215.

14. *ANZ Banking Group v Capper* [2001] NSWSC 946 at 31.

15. *Elkhoury v Farrow Mortgage Services Pty Limited (In Liquidation)* (1993) 114 ALR 541 at 549.

16. *Solicitor Survey*, Respondent 80.



and spoken information would have assisted them at the time they signed up to be a guarantor.<sup>17</sup>

### “All moneys” clauses

“I did not know it was an all moneys mortgage and what that meant.”<sup>18</sup>

5.13 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.<sup>19</sup> 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.<sup>20</sup> 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.

5.14 The complexity and potential ambit of “All Moneys” clauses (or “dragnet clauses” as they are sometimes known) is illustrated by the case of *Johncorp Industries v Sussman*.<sup>21</sup> In that case a wife and husband executed a mortgage and also executed personal guarantees to secure certain debts. The mortgage contained an “All Moneys” clause. One loan was advanced to the husband only, and although the “All Moneys” clause in the mortgage did not cover that loan, the inter-relation of all of the documents was held to extend liability to the wife through a chain-reaction.<sup>22</sup>

5.15 Many guarantors are often unaware that their liability for a debt is caught by an “All Moneys” clause in a mortgage they signed many years earlier. In a case currently under litigation, Westpac is suing Mr and Mrs Gattellaro in reliance on a 1985 guarantee which was in turn secured

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17. 61% stated that more written information would have helped them and 55% reported that a simple, spoken explanation of their obligations would have helped.

18. *Guarantor Survey*, Respondent 39.

19. 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.

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

21. *Johncorp Industries v Sussman* [2001] NSWSC 519.

22. The court held that the personal guarantee given by the wife secured loans made solely to the husband, and as the mortgage contained a reference to money owed by the mortgagor pursuant to any guarantee, so the wife was thereby liable to an unlimited amount for subsequent loans to the husband.

by a 1977 “All Moneys” mortgage – despite the fact that even Westpac itself no longer had a copy of the 1977 document.<sup>23</sup>

5.16 The following is an extract from the Standard Mortgage Provisions of a major bank.<sup>24</sup> According to the Land Titles Office, this document is still current:

**“Principal money**

At any time all money (unless otherwise agreed in writing by [the bank]) which:

- (a) I owe to [the bank] at that time for any reason;
- (b) Any other person owes to [the bank] at that time because of something that [the bank] does or does not do at my express or implied request;
- (c) When [the bank] makes a demand under this mortgage or the question of payment arises, it is reasonably foreseeable that I or another person will owe to [the bank] arising out of some earlier transaction: with me; or with that other person at my express or implied request, whether or not the transaction is also with anyone else;
- (d) Is money that [the bank] has received for crediting to any of my accounts but that: [the bank] has to pay to someone else because of a legal requirement ; or [the bank] has in its discretion paid to someone else upon a claim being made by a liquidator, trustee in bankruptcy or other person; or
- (e) [the bank] pays, whether voluntarily or not, because some payment of, or transaction or arrangement relating to, money previously paid to it is or is claimed to be void, voidable or a preference.

Money which is described in each of the above paragraphs will be principal money:

- (a) whether or not the money is due for payment at that time;
- (b) even if the money is owing only on a contingency;
- (c) whether I or the other person owes the money alone or jointly, or jointly or severally or in common with any other person and whether as principal surety;
- (d) whether the relevant transactions took place before or after I executed this mortgage; and
- (e) whether or not the relevant transactions took place in the course of [the bank’s] banking business.

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23. *Gattellaro v Westpac Banking Corporation* [2001] NSWCA 76. Special leave to appeal to the High Court was granted on 14 February 2003.

24. Legal Aid Commission, NSW, *Submission*.

For example, principal money includes money which I owe or may owe [the bank];

- (a) because [the bank] issues a letter of credit, or gives a guarantee or other undertaking, for me or at my request;
- (b) because [the bank] draws, issues, accepts, endorses, purchases, discounts or pays any bill of exchange or promissory note for me or at my request;
- (c) under any bill of exchange or promissory note which I issue, accept or endorse (including for example one issued, accepted or endorsed by a partnership of which I am a member) and which [the bank] holds in any capacity;
- (d) under any leasing arrangement; and
- (e) under any arrangement that [the bank] enters into for me or at my request to manage movements in foreign currency exchange or interest rates or other costs of obtaining financial accommodation.”

5.17 In order to gain a proper understanding of the section of the mortgage document extracted above it is necessary to read it with two other separate clauses. One of those clauses defines the secured money under the mortgage as “principal money” while the other states that where there are two mortgagors the obligations in relation to the secured money applies to each of them individually and together, that any one of the mortgagors can exercise rights in relation to the secured money on behalf of all, and that when the bank deals with one mortgagor it is taken to have dealt with all of them.

5.18 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. It appears that guarantors who receive legal advice may in fact be more, rather than less, likely to be entering into such transactions. Forty-six per cent of respondents in the solicitor survey said that on the last occasion they gave advice to a guarantor the security documents contained an “All Moneys” clause.

5.19 Our research also found that “All Moneys” clauses are very common in litigation over third party guarantees. In our review of litigated cases, we found that over half of them involved security documents that contained an “All Moneys” mortgage. Further 83 % of barristers who responded to our survey stated that on the last occasion they acted in a third party guarantee matter the loan included an “All Moneys” clause. These results indicate that the clauses are still common in security documents and that guarantors are often unaware of the existence of the provision.

5.20 “All Moneys” provisions are often justified on the basis of convenience for both the lender and the borrower.<sup>25</sup> It is increasingly accepted, however, that such provisions present a stark likelihood of unjust transactions. The Uniform Consumer Credit Code provides some regulation of all money clauses by requiring notice to be given to the guarantor of extensions of credit.<sup>26</sup> Under the Consumer Credit Code a mortgage may include an all money or all accounts clause but it is unenforceable unless the credit provider has provided the guarantor with a copy of the loan or guarantee contract and obtains a written acceptance from the guarantor for the extension of further credit.

5.21 The Australian Bankers Association has attempted to regulate the use of “All Moneys” and all accounts mortgages by banks since 1993. The Code of Banking Practice expressly prohibits the use of unlimited guarantees (although guarantees of company loans were not included in these provisions).<sup>27</sup> Our research shows that such provisions have had little effect in terms of the number of such provisions reported to us. The revised Code of Banking Practice in effect since August 2003 will hopefully be somewhat more effective as it covers a far greater range of guarantee transactions, including those supporting loans to small business.<sup>28</sup> The amended Banking Code also regulates the use of third party mortgages so that the written consent of the mortgagor is required for any extension of the mortgage.<sup>29</sup> The Banking Code is discussed in further detail above in Chapter 4.

### Information about the borrower’s loan

5.22 Guarantors who secure a business loan often have little or no knowledge of the financial situation of the business or the person borrowing the money.<sup>30</sup> One commentator has argued that:

“There is hardly a more unequal position than the usual large bank as against the average person, as the guarantor. The bank knows everything about the account; the guarantor does not. The bank takes at best an assessed risk (if it is making future advances) and none

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25. Justification for “all moneys” mortgages were made by a number of submissions to New South Wales Law Reform Commission, *Guaranteeing Someone Else’s Debts* (Issues Paper 17, 2000).

26. *Consumer Credit (New South Wales) Code* 1995, s 43.

27. See *Code of Banking Practice* (1993) cl 17.

28. See *Code of Banking Practice* (2003) cl 28.2.

29. See *Code of Banking Practice* (2003) cl 28.12.

30. See New South Wales Law Reform Commission, *Guaranteeing Someone Else’s Debts* (Issues Paper 17, 2000) 69-73 for information on the current law and regulation on the lender’s duty to provide information to the guarantor.

(if there are past advances). The guarantor takes a large risk, and they've probably not been able to assess it.”<sup>31</sup>

5.23 Data collected by the project indicates that few people ever receive adequate information from the lender. Our research shows that few people obtain a copy of the documents they sign, or a copy of the borrowers contract.<sup>32</sup> It is as if the borrower takes the money and “disappears”.<sup>33</sup>

5.24 Third party guarantors are rarely in the position of a business partner who has an understanding of the business' prospects and risks. Many solicitors who advised against signing a guarantee cited insufficient information on the borrower's finances as a reason for this advice. Guarantors rarely play an active role in the business conducted by the borrower. Only 16% of the guarantors surveyed played an active role in the business.<sup>34</sup> 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.<sup>35</sup>

5.25 This information supports the assumption that many guarantors are not entering into guarantee transactions within the traditional arms-length contractual context, they are taking on financial responsibility for a transaction in which they have little understanding of the risks in circumstances where they are usually unable to pay should they be called on.

5.26 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 guarantors. 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.<sup>36</sup>

5.27 Industry codes of practice require banks, building societies and credit unions to provide prospective guarantors with written information about

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31. Susan Kiefel, “Avoidance of Guarantees on Equitable Grounds” (1989) 19 *Queensland Law Society Journal* 293 at 295.

32. 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.

33. *Guarantor Survey*, Respondent 25.

34. 20% reported they were a silent director, 9% had no formal role and 38% had no role.

35. Belinda Fehlberg, *Sexually Transmitted Debt: Surety Experience and English Law* (Clarendon Press, 1997) at 142.

36. See Recommendation 1, Report of the Expert Group on Family Financial Vulnerability, *Good Relations, High Risks – Financial Transactions Within Families and Between Friends* (Report, 1996) at 1.

the liabilities of a guarantor, but these are of limited effect.<sup>37</sup> The revised Code of Banking Practice in effect since August 2003, requires banks 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.<sup>38</sup>

## CIRCUMSTANCES OF THE TRANSACTION

### Whose idea to be guarantor?

5.28 Third party guarantors appear unlikely to enter the transaction unless requested to do so by the borrower or the lender.

5.29 Data collected by the project confirms that many people agree to act as a guarantor at the request of the person borrowing the money.<sup>39</sup> 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.<sup>40</sup>

5.30 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."<sup>41</sup> 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?

5.31 Our research indicates that it is fairly common for mortgage and guarantee documents to be signed in relatively informal surroundings such as the family home. This contrasts with Fehlberg's study, where most

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37. See New South Wales Law Reform Commission, *Guaranteeing Someone Else's Debts* (Issues Paper 17, 2000) at 71.

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

39. *Guarantor Survey*, Question 12: 53% of respondents reported that it was the idea of the person borrowing the money/receiving the benefit of the loan.

40. *Guarantor Survey*, Question 12: 21% of respondents reported that it was the lender's idea, 8% that it was the idea of both the guarantor and the borrower, only 4% said it was their own idea.

41. Belinda Fehlberg, *Sexually Transmitted Debt: Surety Experience and English Law* (Clarendon Press, 1997) at 159.

guarantors signed at the lender's premises or a solicitor's office.<sup>42</sup> A minority of our respondents signed in a solicitor's office reflecting the fact that very few received legal advice (discussed below).

5.32 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.

5.33 Twenty-two per cent of respondents to the guarantor survey signed the security documents at home.<sup>43</sup> 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.<sup>44</sup> In one instance, a guarantee was signed in hospital,<sup>45</sup> and in another "at the greengrocer's down the road from the bank".<sup>46</sup>

5.34 In our review of litigated cases, 13% involved allegations that the documents were signed at the guarantor's home.<sup>47</sup> In several instances the guarantor, often a wife, signed the guarantee documents on the kitchen or dining table.<sup>48</sup> In one case the guarantors' signatures were procured by the borrower (their son-in-law) while they were on holiday in Sweden.<sup>49</sup>

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42. Belinda Fehlberg, *Sexually Transmitted Debt: Surety Experience and English Law* (Clarendon Press, 1997) at 167.

43. Thirty-eight per cent of respondents to the guarantor survey reported they signed the documents in the lender's office.

44. *Guarantor Interview*, Respondent 1A.

45. *Guarantor Survey*, Respondent 77.

46. *Guarantor Survey*, Respondent 51.

47. In 33% of the cases in the case law review the documents were signed at the lender's office; in 28% of cases the documents were signed in a solicitor's office.

48. See *Commonwealth Bank of Australia v Horkings* [2000] VSCA 244; *Commonwealth Bank of Australia v Khouri* [1998] VSC 128; *Liptak v Commonwealth Bank of Australia* (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).

49. *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.

## Who was with the guarantor when they signed?

5.35 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.<sup>50</sup> Judicial decisions have also indicated that it is not appropriate for a lender to entrust the execution of guarantee documents to the borrower.<sup>51</sup>

5.36 Despite the inherent risks associated with the presence of the borrower at the 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 said the borrower was present when they signed the guarantee documents. Twenty-three per cent of guarantors said that *both* the borrower and the lender were present.

5.37 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 other 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.”<sup>52</sup>

5.38 Data collected by the project indicates that many people enter guarantor transactions in a hurry and with little or poor preparation:

“There was always urgency in my signing and (my husband) had always told me that if I didn’t sign the “deal would not go through” ... I was, I think without one exception, given only a few hours notice; no regard was given to the fact I had two young children or the fact that I didn’t live or work in the City. I was never asked what times would be suitable or convenient for me. I was simply told when and where.”<sup>53</sup>

5.39 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

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50. See Recommendation 2, Report of the Expert Group on Family Financial Vulnerability, *Good Relations, High Risks – Financial Transactions Within Families and Between Friends* (Report, 1996) at 1.

51. New South Wales Law Reform Commission, *Guaranteeing Someone Else’s Debts* (Issues Paper 17, 2000) at 76.

52. *Guarantor Survey*, Respondent 20.

53. Extract from the guarantor wife’s evidence in *Brueckner v The Satellite Group (Ultimo) Pty Ltd* [2002] NSWSC 378 at para 176.



she did not have her glasses with her so she was not able to read the documents. The next day she returned to the bank to ask it to “ignore” the documents she had signed. The bank officer reassured her, but took no subsequent action.<sup>54</sup>

5.40 In one case in our review of the litigated cases, the wife claimed that she received a telephone call from her husband who asked her to go to the bank to sign some documents. Prior to the telephone call the wife knew nothing about the proposal to use the family home to secure the debts of her husband’s business. She went to the bank with her 2 year old child and signed a mortgage in front of a bank officer who, she claimed, gave no explanation of the mortgage. The Court ultimately held that the mortgage should be set aside.<sup>55</sup>

5.41 Our research found strong support from guarantors for the introduction of a 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.<sup>56</sup>

5.42 The following comments come from our guarantor survey:

“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.”<sup>57</sup>

“Would like to see a cooling off period, not so much pressure to sign on the day so they can take the car home.”<sup>58</sup>

“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.”<sup>59</sup>

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54. *Guarantor Survey*, Respondent 6: the borrower subsequently defaulted on the loan and the guarantor paid the debt.

55. *Westpac Banking Corporation v Mitros* [2000] VSC 465. Similarly in *Robinson v Watts* the wife found out that she was to sign documents giving security over her home for her husband’s business debts when in the car with her husband driving to the solicitor’s office. In this case the solicitor was the lender’s solicitor who advised the wife and provided a certificate that the wife understood the documents. In addition, the husband was present at the time: *Robinson v Watts* [2000] NSWSC 584. The wife was unsuccessful in defending the bank’s enforcement of the security.

56. *Guarantor Survey*, Question 15(e): 31% of respondents stated that a cooling off period would not have helped them.

57. *Guarantor Survey*, Respondent 9.

58. *Guarantor Survey*, Respondent 79.

59. *Guarantor Survey*, Respondent 10.

5.43 The strong support for a cooling off period is consistent with provisions in the Consumer Credit Code. Under the Consumer Credit Code a guarantor can withdraw from the transaction any time before the credit is provided under the credit contract.<sup>60</sup> The limited application of the Consumer Credit Code to many third party transactions due to the distinction between consumer and business loans was discussed earlier in this chapter.

### Opportunity to negotiate terms of the contract

5.44 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*”.<sup>61</sup>

5.45 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. Our consultations with financial advisors and advocates found that many borrowers are unaware they are able to negotiate contracts, and the terms thereof, and many settle on contracts which are plainly disadvantageous to them. Many guarantors and co-borrowers seem to be unaware that the primary borrower could have negotiated a different contract (albeit a loan with a higher interest rate), but one which did not require a guarantee or a joint borrower to support the loan. For some, the ease and availability of an “on the spot” deal overrides consideration of terms and financial implications of the transaction.<sup>62</sup>

5.46 In rare cases where a guarantor was informed about some or all of these matters, we found that they still had only a very limited capacity to negotiate the terms of the transaction. One guarantor’s experience illustrates the inequality in bargaining power between a prospective guarantor and a lender in such a situation:

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60. *Consumer Credit Code* s 53(1)(a). Section 53(1)(b) provides that the guarantor can also withdraw after credit has been provided if the credit contract is materially different from the proposed contract given to the guarantor before it is signed.

61. Belinda Fehlberg, *Sexually Transmitted Debt: Surety Experience and English Law* (Clarendon Press, 1997) at 176. Emphasis in original.

62. See comments by Kate Keating, *Relationship Debt and Comparison Rates: A Caseworker’s Perspective*, paper delivered at Australian Finance Conference, February 2000.

“In May this year my husband applied for a loan ... In the initial documentation and application form I was asked to sign as a guarantor of a \$100 000 loan to buy a share in my husband’s office space. There was no mention at that point that I would be guaranteeing anything more than the \$100 000. ...It was only when I was asked to sign the contract that we realised I was signing an unlimited guarantee as it included the following paragraph:

‘I acknowledge that I have received advice and understand that this guarantee and indemnity is not limited to the Specified Credit Contract.’

At this point it was too late to organise alternative finance so we consulted a solicitor in an attempt to have the contract altered. After a lot of negotiation all we were able to obtain was a ‘Letter of Comfort’ from [the lender’s solicitors], stating it was their practice to consult guarantors in relation to any variation in its loan transactions but they were not prepared to have the guarantee documents amended in any way. Of course this letter has no legal standing ...

Although I was extremely unhappy with the arrangement I really had no choice but to sign. [The lender] can now do what they like and they have covered themselves against any legal action.”<sup>63</sup>

## INDEPENDENT LEGAL ADVICE

“The requirement for a guarantor to obtain “independent” legal advice has merely become a device to join legal advisers to the litigation process – failing to advise etc – I do not support the notion of independent advice – it should always be – do not sign the guarantee unless given by fully informed and participating shareholders/directors.”<sup>64</sup>

5.47 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 a factor that may relieve a lender of responsibility for unfairness under the High Court decision in *Garcia*. It is commonly thought that many lenders now insist that guarantors obtain independent legal advice.<sup>65</sup>

5.48 The provision of such advice has received considerable attention from professional bodies regulating the legal profession. The Banking Finance and Consumer Credit Committee of the Law Council of Australia believes that a consistent national approach to the provision of legal advice is in the

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63. *Guarantor Survey*, Respondent 67.

64. *Solicitor Survey*, Respondent 26.

65. 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.

interests of credit providers, guarantors and lawyers,<sup>66</sup> but as yet there is no uniform national approach to the use of solicitors' certificates in guarantee transactions.

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

5.50 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.”<sup>67</sup>

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**

5.51 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.<sup>68</sup>

5.52 Our data suggests that in actuality many guarantors do not obtain independent 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.

5.53 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.

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66. 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.

67. Mark Sneddon, “Unfair Conduct in Taking Guarantees and the Role of Independent Advice” (1990) 13 *University of New South Wales Law Journal* 302 at 345.

68. *Guarantor Survey*, Question 17: only 14% of respondents obtained legal advice before signing; *Case Law Review*, Issue 22: in 29% of the cases the guarantor had legal advice.

5.54 These findings contrast to Fehlberg’s UK study where half of the guarantors had signed the document before a solicitor. However it is noteworthy that none of Fehlberg’s respondents believed that the purpose of the appointment was to receive legal advice, and most continued to believe that the role of the solicitor was simply to witness their signature, even after they had been “advised”.<sup>69</sup> This finding was consistent with experiences reported by guarantors in our research, that the meeting was a brisk formality, closely followed by signing.

### Guarantors’ perceptions of legal advice

5.55 Of the 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 afterwards they signed the contract, five reported that they signed the same day, while another two signed within two days.

5.56 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 telling them 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 also acting for the borrower.

5.57 Some guarantors indicated that the advice was perfunctory, with one guarantor noting that it took less than fifteen minutes. Another 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.<sup>70</sup>

5.58 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.*”

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69. Belinda Fehlberg, *Sexually Transmitted Debt: Surety Experience and English Law* (Clarendon Press, 1997) at 170-171.

70. Belinda Fehlberg, *Sexually Transmitted Debt: Surety Experience and English Law* (Clarendon Press, 1997) at 171.

5.59 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.<sup>71</sup>

### Solicitors’ perceptions of their role

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

5.61 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.<sup>72</sup>

5.62 The majority judgment in *Micarone v Perpetual Trustees* identified three policy reasons to exclude the provision of financial or practical advice from the scope of legal advice: solicitors are not always qualified to give such advice, the solicitor may not be able to ascertain all the relevant information and solicitors will refuse to advise if the duty and risks attached are too onerous.<sup>73</sup> The Court estimated that such advice would take “several hours, if not a day or two”, and involve considerable cost to the client, if advice was to include the financial and practical circumstances of the transaction.<sup>74</sup>

5.63 Numerous commentators have argued that legal advice on the effect of a guarantee is of very little assistance in the absence of financial

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71. Belinda Fehlberg, *Sexually Transmitted Debt: Surety Experience and English Law* (Clarendon Press, 1997) at 227-8.

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

73. *Micarone v Perpetual Trustees Ltd* (1999) 75 SASR 1.

74. *Micarone v Perpetual Trustees Ltd* (1999) 75 SASR 1 at para 698 and 699 per Debelle and Wicks JJ.

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.<sup>75</sup> Despite this, most solicitors who participated in our survey reported they had sufficient information to enable them to give the guarantor useful advice.<sup>76</sup> Interestingly, however, almost half of all the solicitors reported advising guarantors to seek further information or advice before signing the guarantee documents.<sup>77</sup>

5.64 Many of the solicitors and barristers who responded to our surveys expressed the view that the lender should take greater responsibility for the provision of information, both legal and financial, to guarantors.<sup>78</sup> In one sense lenders are well placed to advise on the financial consequences of the transaction, as they are the only party to have the relevant information on hand. One solicitor commented:

“The lender obtains the benefit and has the resources to do so. It also has the financial details of the borrower. It should make a commercial lending decision and accept the risks. Private practitioners should not be made ‘co-guarantors’ by being exposed to proceedings this way.”<sup>79</sup>

However there is clearly also an inherent conflict of interest in lenders providing advice on a transaction that financially benefits them.

### **The “independence” of independent legal advice**

5.65 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.

5.66 While Courts talk about the “scope of the solicitors 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 lawyer's duty is and to whom it is owed.

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75. *Solicitor 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.

76. 95% of respondents stated that they had sufficient information to give useful advice.

77. 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.

78. *Solicitor Survey*, Question 50: 58% supported the proposition. *Barrister Survey*, Question 29: 59% supported it.

79. *Solicitor Survey*, Respondent 45.

5.67 In a number of the litigated cases we reviewed, the solicitor who advised the guarantor was organised by either the borrower or the lender.<sup>80</sup> 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.<sup>81</sup>

5.68 The potential for conflict of interest is also apparent when the lawyer is retained by a party other than the guarantor.<sup>82</sup> In an extreme example, *Tong v Esanda Finance*, the certificate of independent advice given by the “independent” solicitor testified an absence of professional interest in the transaction on behalf of the lenders or on behalf of the borrowers. However, in evidence the solicitor made it clear that he believed he was acting as solicitor for the borrowers rather than in the interests of the guarantors.<sup>83</sup> A repeat of such a scenario appears alarmingly possible. 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.

5.69 The current NSW Law Society Practice Rule regarding the provision of advice to guarantors includes clear guidelines about conflict. The Rule also provides that the solicitor who advises a borrower or guarantor must not also act for the lender and that in cases where there is potential conflict between parties to the transaction (that is, the borrower and guarantor) the

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80. See *Micarone v Perpetual Trustees Ltd* (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, 17 April 1996); *Esanda Finance v Tong* (1997) 41 NSWLR 482; *Janesland Holdings Pty Ltd v Simon* [2000] ANZ ConvR 11.

81. Belinda Fehlberg, *Sexually Transmitted Debt: Surety Experience and English Law* (Clarendon Press, 1997) at 175-176.

82. 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.

83. *Tong v Esanda Finance* (Unreported, NSW Supreme Court, No 20449/94, Grove J, 17 April 1996); *Esanda Finance v Tong* (1997) 41 NSWLR 482.



solicitor cannot provide advice to more than one of those parties without the written consent of each party.<sup>84</sup>

5.70 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.<sup>85</sup> Fehlberg found that while solicitors considered that it was not "good practice" to see guarantors in the 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.<sup>86</sup> While the majority of solicitors we surveyed reported to us that on the last occasion they gave advice, only the guarantor was present,<sup>87</sup> 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.

5.71 There were also several reported cases in our pool of litigated cases where legal advice was clearly provided in the presence of the borrower.<sup>88</sup> While there has been some adverse judicial comment about the propriety of the borrower being present while the guarantors received legal advice,<sup>89</sup> 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

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84. Law Society of New South Wales, *Professional Conduct and Practice Rules* (1995, amended 2000) Rule 45.9 and 45.4.

85. Belinda Fehlberg, *Sexually Transmitted Debt: Surety Experience and English Law* (Clarendon Press, 1997) at 175.

86. Belinda Fehlberg, *Sexually Transmitted Debt: Surety Experience and English Law* (Clarendon Press, 1997) at 224.

87. *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.

88. See eg *St George Bank v Trimarchi* [2003] NSWSC 151; *Tong v Esanda Finance* (Unreported, NSW Supreme Court, No 20449/94, Grove J, 17 April 1996); *Esanda Finance v Tong* (1997) 41 NSWLR 482.

89. *Micarone v Perpetual Trustees Ltd* (1999) 75 SASR 1 at para 702.

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.”<sup>90</sup>

5.72 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.<sup>91</sup> 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.<sup>92</sup>

5.73 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.<sup>93</sup> Rule 45 of the Solicitors Practice Rules was subsequently amended in 2000 in a climate of great concern about 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%.<sup>94</sup>

5.74 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

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90. *Solicitor Survey*, Respondent 73.

91. See eg Jim O’Donovan, “Guarantees: Vitiating Factors and Independent Advice” (1992) 66 *Law Society Journal* 57 at 60.

92. 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).

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

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

none of those cases was the solicitor found liable for the guarantor's or lender's loss.<sup>95</sup>

5.75 Nonetheless, just less than half of the solicitors who participated in our survey reported that they had concerns about their professional liability in giving advice to a third party guarantor.<sup>96</sup> 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".<sup>97</sup>

### The impact of Rule 45 on legal practice

5.76 Prior to amendments to the Solicitor's Practice Rules in 2000, solicitors in NSW signed a statutory declaration that they had provided independent advice to a guarantor. The amendments to Rule 45 now provide that it is the guarantor who signs a statutory declaration that they signed the guarantee documents after they received independent legal advice. The Rule gives guidelines for the content of the advice to be given by solicitors to third party guarantors and makes it clear that the advice to be provided by the solicitor is limited to legal advice and does not extend to financial advice.<sup>98</sup>

5.77 Many solicitors who responded to our survey gave positive feedback on Rule 45 of the Solicitors Practice Rules adopted by the New South Wales Law Society. Some solicitors said that the new procedure simplified matters or provided clearer documentation. One said that Rule 45 has probably lifted the quality and consistency of advice. Some felt it eased their disquiet about their own liability.<sup>99</sup>

5.78 By contrast some solicitors were negative about the requirements of the rule, particularly the documentation. A few commented on the increased cost or time involved in complying with the rule, for which they

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

96. *Solicitor Survey*, Question 15(b): 48% of respondents stated that they had concerns.

97. *Solicitor Survey*, Respondent 45.

98. See Law Society of New South Wales, *Professional Conduct and Practice Rules* (1995, amended 2000) Rule 45 and also the discussion in New South Wales Law Reform Commission, *Guaranteeing Someone Else's Debts* (Issues Paper 17, 2000) at para 3.41.

99. See, for example, Respondent 82 who said: "A great help. It makes it clear we are simply "explaining" legal issues".

receive little reward, and which increased the cost of the guarantee transaction. Some solicitors expressed the view that the decision in *Garcia*, and the requirements of Rule 45 (despite its protections for lawyers) has led to clients avoiding advice on guarantees prior to entering the transaction.

#### LEGAL ADVICE IN AUSTRALIA IN COMPARISON WITH THE UK: ETRIDGE

The position taken in Australia with respect to the circumstances and content of independent legal advice for third party guarantors contrasts with benchmarks proposed in the United Kingdom.

In *Etridge*, the content of the legal advice is set out in detail by Lord Nicholls of Birkenhead.<sup>100</sup> A solicitor should:

- discuss with a prospective guarantor the practical consequences of the contract, the present financial situation of the guarantor and the borrower and whether there are other assets or income that might be used to satisfy the debt in the event of failure of the business
- obtain information from the lender in order to do this and if the lender fails to provide information the solicitor should cease to act
- ultimately only give confirmation to the bank of the provision of legal advice on the guarantor's specific instructions.

The benchmarks prescribed by Lord Nicholls focus on substantive fairness to the guarantor rather than simply upon procedural steps.<sup>101</sup>

### Who benefits from independent legal advice?

5.79 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

100. *Royal Bank of Scotland plc v Etridge (No 2)* [2002] 2 AC 773.

101. *Royal Bank of Scotland plc v Etridge (No 2)* [2002] 2 AC 773 at para 65 and 67. However, the regime in relation to obligations by lenders imposed by *Etridge* is expressly prospective, and past transactions will continue to be governed by the procedures set out in earlier cases. For discussion see: John Phillips, “Setting aside Guarantees: Another Approach” (2002) *Oxford University Commonwealth Law Journal* 47; K Scott, “Evolving Equity and the Presumption of Undue Influence” (2002) 18 *Journal of Contract Law* 236. Some have argued that this approach passes the burden of these risky transactions on to lawyers: see Paula Giliker, “Barclays Bank v O’Brien Revisited: What a Difference Five Years Can Make” (1999) 62 *Modern Law Review* 609 (discussing the Court of Appeal decision).

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.”<sup>102</sup>

5.80 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 even by thorough and impartial legal advice.<sup>103</sup>

5.81 Our research indicates that in the course of providing advice to prospective guarantors many solicitors consistently give a strong warning to prospective guarantors that they should not sign up to the transaction.<sup>104</sup> However the solicitors also reported that despite providing strong advice about the risks of the transaction, most guarantors proceed with the transaction.<sup>105</sup> 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 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.

5.82 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 of solicitors as the reason guarantors proceeded with the transaction. Another solicitor identified “moral obligation” while another said: “family will always guarantee family”.

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102. Sue Mahalingham, “Deep and meaningful: Dealing with emotionally transmitted debt” (1999) 3(6) *Consumer Rights Journal*.

103. Belinda Fehlberg, *Sexually Transmitted Debt: Surety Experience and English Law* (Clarendon Press, 1997) at 172.

104. *Solicitors Survey*, Question 21(a): 73% of solicitors who responded said that they had advised a client not to sign a contract in the last 10 years; Question 21(b): 43% said they gave such advice on 2-5 occasions.

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

5.83 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.”<sup>106</sup>

5.84 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.”<sup>107</sup>

5.85 The provision of legal advice may be of little significance in terms of providing guarantor protection. While our research indicates that independent legal advice, as it is currently given (if it is given at all) is insufficient to assist the guarantor to make an informed decision where the guarantor is signing out of a feeling of obligation, pressure or trust, this does not mean that there is no role for advice. Our research indicates that there is some potential for solicitors to provide meaningful assistance. For example one solicitor reported advising a parent that she could usefully, and safely, assist her child by providing her with a small loan so that the daughter had sufficient funds for a deposit to purchase a block of land as an alternative to proceeding with a guarantee for the daughter. Independent financial advice could also assist the guarantor in that they could be informed about alternative financing arrangements which would not require a third party guarantee, for example a limited guarantee, a loan with a higher interest rate, or a loan directly to the borrower, rather than providing a guarantee.

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

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106. *Solicitor Survey*, Respondent 78.

107. Debbie Georgopoulos, Department of Fair Trading, *Consultation* 11 July 2000. See also Paula Barron, “The Exercise of Her Free Will: Women and Emotionally Transmitted Debt” (1995) 13 *Law in Context* 23 at 47.

## CONCLUSION

5.87 Guarantee transactions are frequently very complex commercial arrangements, often involving voluminous and impenetrable legal documents. Such documents are often signed in rushed or informal circumstances that are far from conducive to informed decision-making. Guarantors frequently lacked basic information about the borrower's financial position and entered into the transaction with minimal explanation, usually in the absence of any legal advice.

5.88 Our research found evidence of practices such as asset based lending, the continued use of "all moneys" clauses, and an increased use of "joint loan" documentation to disguise what were genuinely third party guarantees: all of these practices are significantly disadvantageous to guarantors and conducive to unfair dealing.

5.89 The role of legal advice in guarantee transactions, while it has received considerable attention, does not necessarily offer a solution to problems of informed consent.

5.90 As we will see from the next chapter, it is usually not until the loan goes wrong – the borrower defaults and the lender calls on the guarantor – that the reality of the risk is bought home to the guarantor.

## 6. When the loan went wrong

- How long before the loan went wrong?
- Communication failures
- Resolution
- The personal cost
- Conclusion



“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.”<sup>1</sup>

6.1 After the execution of the guarantee, the next time the guarantor hears about the loan is often when enforcement action is taken following the borrower’s default on the loan. Our research indicates that few guarantors received information about the loan during the period of the loan. Most guarantors were surprised when the lender advised the loan was in default and the guarantee would be enforced, and were further shocked to discover the extent of their liability.

6.2 This chapter looks at what happened when the transaction went wrong: how the guarantors found out there was a problem, how long after execution problems arose, how the guarantor addressed the problem and who (if anyone) they sought assistance from and what happened to the debt subsequently. We also examine enforcement issues, and the dispute resolution mechanisms that are available prior to, or instead of, litigation. Litigation is an expensive, complex and time consuming process. Many of our respondents were of the view that litigation was best avoided if at all possible. However, we found that the range of alternatives to litigation was very limited. Litigation itself is explored in Chapter 7.

## HOW LONG BEFORE THE LOAN WENT WRONG?

6.3 The guarantor survey revealed that problems with the loan transaction emerged within a range of “straight away” to four years, with the majority becoming problematic within two years. This data is similar to that from our review of the litigated cases. Three-quarters of barristers who responded to our survey reported that recovery against the security occurred between one to five years after the guarantee was executed.

## COMMUNICATION FAILURES

“Financial institutions often employ inadequate systems to administer loans and ensure fairness so guarantor is not exposed. There should be an onus on financial institutions to put [such systems] in place when

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1. *Guarantor Survey*, Respondent 2.

each loan is assessed and defaults are handled on a personal basis, ie, no form letter. Problems arise because the standard and nature of communications is inadequate, including during the course of the loan.”<sup>2</sup>

6.4 The following section outlines some of the problems guarantors experienced once the loan fell into arrears. 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.

6.5 Poor communication from the lenders about the guarantee and its enforcement is clear from the survey of solicitors who reported, among other things, the refusal of lenders to communicate adequately with the guarantor, an aggressive or confrontational stance taken by lenders and the guarantor’s lack of bargaining power in the enforcement process.

### Information about the loan

6.6 Consistent with other studies, guarantors generally only become aware of problems when their legal responsibilities were tested in times of trouble.<sup>3</sup> 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.<sup>4</sup>

6.7 Our guarantor survey revealed a similarly high level of ignorance among guarantors about their liability and its extent. Over 80% of our respondents were shocked to discover their liability as a result of signing the transaction<sup>5</sup> and 65% of the respondents were surprised to find the debt was for a lot more than they had thought. Twenty seven per cent reported that they unaware that they had signed an all-moneys mortgage until the lender pursued them.

6.8 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 no information about any increase in the amount guaranteed.<sup>6</sup>

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2. *Barrister Survey*, Respondent 31.

3. See, for example, 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, *For Love Not Money: Women, Information and the Family Business* (Consumer Advocacy and Financial Counselling Association of Victoria Inc, 1995) at 18-19.

4. Belinda Fehlberg, *Sexually Transmitted Debt: Surety Experience and English Law* (Clarendon Press, 1997) at 236.

5. *Guarantor Survey*, Question 26(b): 82% said the problem came as a big shock for them.

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

6.9 It seems many guarantors experienced problems getting information from the lender about the level of debt. One guarantor went to the bank to request information on the level of debt and was told that they could not have access to that information. It was only after they approached the bank after seeking advice from Legal Aid that they were given the information they were entitled to.<sup>7</sup> Another guarantor was prevented from getting any information by his son (the primary borrower): his son vainly hoped the business would recover and he would be able to resume making payments.<sup>8</sup>

#### LACK OF INFORMATION: A CASE STUDY

Mr and Mrs D, 77 and 66 years old respectively, are age pensioners who own their home in Sydney's western suburbs. In 1992 Mr and Mrs D's daughter borrowed \$26,000 to start up an optometrist practice. Mr and Mrs D agreed to grant a mortgage over their home to secure this loan. Mr and Mrs D understood that if their daughter did not repay her loan their house could be sold. It was not, however, explained to Mr and Mrs D that the mortgage that they signed included an all moneys clause to the effect that the mortgage secured all future advances made by the bank to the daughter.

In 1996 Mr and Mrs D agreed to sign a contract of guarantee limited to \$20,000 for their son-in-law's business. At this time their daughter's loan was almost repaid. No security was referred to in the guarantee contract, and Mr and Mrs D believed that it had nothing to do with their house. Although their son-in-law ran the business, the paperwork for the business was jointly in the daughter's name.

In 1996 the daughter also obtained a personal overdraft on her cheque account with the bank. Mr and Mrs D had no knowledge of this account. In May 1997, the daughter took out a personal loan to pay a taxation bill. Again, Mr and Mrs D had no knowledge of this loan. In 1997 the daughter paid out her original business loan. Mr D wrote on a number of occasions to the bank asking for their title deeds to be returned. He never received a reply.

In 1998 both the daughter's and her husband's business collapsed, and both were eventually declared bankrupts. Aware of their \$20,000 guarantee, Mr and Mrs D sold a block of land and paid off \$15,000, and entered into an arrangement to pay the remaining \$5,000. However the bank asserted, relying on the all moneys clause in the mortgage, that they were responsible for all of the business debts, the daughter's personal loan and the daughter's cheque account overdraft. The bank threatened proceedings to sell their home.

With the assistance of the ABIO and the Legal Aid Commission of NSW the debt was settled by payment of \$5000 only.<sup>9</sup>

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7. *Guarantor Survey*, Respondent 3.

8. *Guarantor Survey*, Respondent 77.

9. Case study from Legal Aid Commission of NSW, *Submission*.

## How guarantors found out there was a problem with the loan

“I was given no information whatsoever. You are the last to know if your borrower does not tell you.”<sup>10</sup>

6.10 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.<sup>11</sup> Such requirements are, however, subject to the consent of the borrower.<sup>12</sup> 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.<sup>13</sup>

6.11 Information from the guarantor survey points to a marked lack of communication from the lender about whether the borrower was keeping up with their repayments. This corroborated with comments from the barrister survey, some of whom said that financial institutions’ systems of communication with guarantors were inadequate.<sup>14</sup>

6.12 In some instances, guarantors found out that there was a problem with the debt quite incidentally. One guarantor reported going to make a purchase on credit and being informed that they were “blacklisted”. Other situations in which guarantors became aware that the loan had been defaulted on include receiving a notice that possession proceedings had been commenced in the Supreme Court. In one case, a woman put up her house as security for a loan for a friend’s company. The bank made no communication whatsoever with the guarantor until they attempted to take possession of her house. While the directors of the company had given personal guarantees, the bank made no attempt to recover the debt from them. It was only with the assistance of expensive private legal assistance that the guarantor eventually discovered that the directors had considerable assets.<sup>15</sup> In *Charles v Parkinson* Mrs Parkinson only became aware of her husband’s business debts when a writ of execution was issued

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10. *Guarantor Survey*, Respondent 30.

11. *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* now includes small business transactions in its jurisdiction. These amendments are effective from August 2003.

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

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

14. *Barrister Survey*, Respondent 31. It is unclear from the reports of litigated cases how the guarantor found out there were problems with the loan, as legal proceedings tend to focus on pre-transaction conduct. Data from our case law review is therefore limited.

15. *Guarantor Survey*, Respondent 54.

and a sheriff seized goods from the family home, following a default judgment from court proceedings about which she knew nothing.<sup>16</sup>

6.13 Many guarantors were unaware that the mortgage documents they signed involved an all moneys clause. In one case, the contract had been varied many times, with more money extended to the borrower without the guarantor's knowledge. In this case, the guarantor only found out when she was called in to the bank to sign some more documents and she discovered that her fiancé had on previous occasions forged her signature.<sup>17</sup>

#### **BELATED DISCOVERY: A CASE STUDY**

Ms A signed, at the request of her husband, what she thought was a simple refinancing contract for work on the family home. The home had been bought by the family company: she and her husband were directors, the children were shareholders. The husband was the majority shareholder. The signing took place in the presence of her husband and took less than two minutes. She did not find out that the document was an all moneys mortgage until divorce proceedings at the Family Court, by which time she discovered there was \$1.2million dollars owing under the contract. She then discovered, after demanding access to the family company's files, that the bank had been lending her husband amounts of \$100,000 at time under the all moneys clause. No company resolution was noted on the bank's loan documentation. Ms A threatened to sue the bank on behalf of the minority shareholders (ie, herself and the children). The bank removed the penalty rates and the husband was left with a \$200,000 debt, but the family home had already been sold when the mortgage was called in.<sup>18</sup>

6.14 One solicitor reported that many guarantors have no idea of the seriousness of arrears of the borrower until the matter reaches a critical point at a possession application.<sup>19</sup> From our observations of the Possession List at the NSW Supreme Court through 2001 and 2002, it seems clear that once the matter has reached this stage, many guarantors turn up to Court with no legal representation and little idea of how to resolve the matter. It appears that much time is spent adjourning matters to enable unrepresented litigants seek legal advice.

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16. *Charles v Parkinson* [2000] FCA 1467.

17. *Guarantor Survey*, Respondent 55. The bank settled the matter for a much smaller figure than the debt.

18. Confidential, *Submission* 15 June 2000.

19. Stella Sykiotis, Legal Aid Commission of NSW, *Telephone Consultation* July 2000.

## RESOLUTION

6.15 It appears that many guarantors simply pay the debts of others rather than dispute a transaction. Given the high cost and low success rate of disputing debts, this is perhaps unsurprising. Furthermore, as most of the guarantors undertook obligations for a close family member, the added complication of further straining relationships appears to act as a strong disincentive for disputing the debt and prolonging the process.

6.16 Almost a third of respondents to the guarantor survey reported that they had paid the loan back in part or full.<sup>20</sup> 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.

## Enforcement

6.17 We asked guarantors if they sought assistance with the debt once they became aware of their liability. Around 40% of respondents sought help from private solicitors; a quarter sought help from the community sector,<sup>21</sup> 7% from the Legal Aid Commission; and 6% from another government body. The Australian Banking Industry Ombudsman (“ABIO”) was only used by 7% of respondents. This could be either a result of the respondents not being aware of its existence, or its jurisdiction had been ousted and was therefore not available to them. The role of the ABIO is discussed in further detail below.

6.18 We asked solicitors and barristers whether they thought the enforcement processes used by lenders to enforce guarantees was satisfactory. Most solicitors thought the process was not satisfactory, and the views of barristers were roughly evenly split. Many responses were clearly coloured by who they represent: whether their clients are lenders or guarantors.

6.19 Comments from those representing lenders included:

“Process of enforcement is slowed down by a barrage of generally unmeritorious and cumbersome defences and technical arguments.”

“... it should not be too hard and expensive to enforce guarantees. Too often straightforward claims to enforce just debts are turned into drawn out, expensive battles over bullshit defences.”

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20. *Guarantor Survey*, Question 24(a): 18% paid the money in full; 13% paid part of the money.

21. Financial Counselling Service 15%; Community Legal Centre 11%.

“No, usually the guarantor’s case is very weak and the lender’s legal advisors make no effort to negotiate a compromise until the “usual defences” are mounted.”

6.20 Responses from lawyers representing guarantors included:

“as to the legal process – yes, as to the lender’s process, no.”

“Banks are unreasoning, uncompassionate bureaucrats who take no responsibility for what are (usually) bad lending decisions. If credit were more difficult to obtain in marginal cases there would be less litigation.”

“It was unfair, the process was such that ... the client had little or no idea of the ramifications of the transaction.”

“Sometimes not. Sometimes it seems guarantor cases do not explore all of the defences that might be available to them.”

Most of those who thought the process was satisfactory did not explain why they thought so; others qualified their affirmation with comments that costs become too high.

6.21 Although the reasons given varied, there was a high level of dissatisfaction with legal processes. Over three-quarters of judges said that in their experience, these kinds of disputes are suitable to be dealt with by mediation or other dispute resolution mechanism.<sup>22</sup> It was therefore surprising to find that more accessible alternative dispute resolution (“ADR”) regimes such as mediation, industry resolution and tribunal processes were not well utilised. While most matters settled, this often happened at a late stage.

6.22 Many guarantee transactions provide that it is the guarantor who is liable for the costs of enforcement – such costs can quickly escalate into tens of thousands of dollars. The costs of enforcement are often unclear on the face of the guarantee documents. One judge commented that consideration should be given to a statutory provision that requires each guarantee given by an individual specify the maximum sum of money which can be recovered on the guarantee, including interest, and preventing a lender from recovering any amount greater than that sum. This would obviate the practice of lenders using guarantees which render the guarantor liable for much greater sums of money than is initially apparent.

## Settlement

“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.”<sup>23</sup>

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22. 23% said it was not suitable for mediation.

23. *Solicitor Survey*, Respondent 6.

6.23 Solicitors, barristers and judges were asked how often third party guarantee matters settle. Almost 60% of solicitor respondents reported that their matters settled, with almost 70% of those matters settling during litigation, and 30% settling before litigation.

6.24 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.

6.25 Some lawyers commented that the heavy-handed methods adopted by lenders in enforcing securities mean that chances of settlement are diminished. The following are some of the comments:

“the financial institution used the litigation process in a heavy-handed way. It failed to ensure the guarantor knew what the process was and what his rights were. This led to mistrust on both sides and made it impossible to settle in a timely and cost effective way.”<sup>24</sup>

“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.”<sup>25</sup>

However, other lawyers felt that obfuscation and delay caused by guarantors makes settlement difficult.

6.26 Data from our survey of judges was not definitive. Half of the judges who responded said that less than 40% of matters settle before judgment, around 20% said that many trials settle.<sup>26</sup> One judge commented that matters are less likely to settle if family relationships or the survival of a small business is involved, rather than a commercial transaction with commercial parties. There does seem to be an impression that guarantors become desperate litigants: they have everything to lose by not defending a claim. One judge’s impression was that “many guarantors would rather spend their last dollars before financial ruin on lawyers no matter what their chances of success,”<sup>27</sup> another commented that some cases are pursued in vain “only to delay the evil day”.<sup>28</sup>

6.27 While not asked what encourages settlement, some judges made the following comments. One judge said “early trial date is the only key to settlement”.<sup>29</sup> Another judge commented that a bank may settle if it feels that the damage caused by publicity about the proceedings will outweigh the benefits of successful litigation.

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24. *Barrister Survey*, Respondent 22.

25. *Barrister Survey*, Respondent 26.

26. 7% reported that about half the matters settle, another 7% said almost all trials settle before judgment.

27. *Judge Survey*, Respondent 34.

28. *Judge Survey*, Respondent 45.

29. *Judge Survey*, Respondent 6.



## Alternative Dispute Resolution

6.28 In recent years there has been a substantial growth in codes of practice and alternative dispute resolution (“ADR”) schemes, especially industry-funded ADR and Ombudsman schemes. This follows a commitment to self-regulatory policies by Governments. Codes of practice now represent a significant part of the consumer protection regulatory framework, and ADR schemes are set up as a way of securing accessible justice for consumers.

6.29 Under the Code of Banking Practice (“the Banking Code”), bank members are obliged to provide external dispute resolution processes to their customers.<sup>30</sup> All Banking Code members reported that they used the Australian Banking Industry Ombudsman scheme to meet their obligations to provide an external dispute resolution process to their customers.<sup>31</sup> This process is explained in Chapter 5.

6.30 In contrast, credit unions have established a number of different schemes or arrangements for external dispute resolution. The vast majority of credit unions are members of the Credit Union Dispute Resolution Centre, however, a significant number are members of the Credit Union Ombudsman schemes. Other external dispute resolution arrangements are used only by a small number of credit unions.<sup>32</sup>

6.31 Members of the Building Society Code have not established an industry-wide external dispute resolution scheme. Instead, they use a combination of small claims and consumer claims tribunals, expert determination and/or a mediation process based on a model developed by the Australian Association of Permanent Building Societies (“the AAPBS”). The AAPBS has supported the development of the Financial Co-operative Dispute Resolution Scheme<sup>33</sup> (which will replace the Credit Union Ombudsman) as the external dispute resolution scheme for its members.

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30. See of the *Code of Banking Practice* (1993) cl 20.4; see *Code of Banking Practice* (2003) Part E.

31. See Australian Securities and Investments Commission, *Compliance with the Payments System Codes of Practice and the EFT Code of Conduct: April 2001 to March 2002* (2003) at 21.

32. For details on the schemes or arrangements used by credit unions to meet their dispute resolution obligations under cl 20.4 of the *Credit Union Code of Practice* (1994) see Australian Securities and Investments Commission, *Compliance with the Payments System Codes of Practice and the EFT Code of Conduct: April 2001 to March 2002* (2003) at 42.

33. This scheme was approved by the Australian Securities and Investments Commission on 28 January 2003.

## The Australian Banking Industry Ombudsman

6.32 The Australian Banking Industry Ombudsman (“ABIO”) resolves complaints between banks and their customers. The ABIO’s Terms of Reference set out its jurisdiction to consider disputes. Around 50% of disputes received by the ABIO are outside its Terms of Reference. The main reasons that a matter will be outside the Terms of Reference are:

- The dispute was made out of time;<sup>34</sup>
- The amount claimed exceeded \$150,000;
- The subject matter of the dispute was being or had been addressed in another jurisdiction.

6.33 Despite there being support for the use of the ABIO, only 7% of our guarantor survey respondents reported using the ABIO to assist them with their problems with a guarantee.

6.34 Consumer advocates generally agree that using the ABIO is a good option. However, creditors are often quick to seek possession by instituting court proceedings: this immediately ousts the jurisdiction of the ABIO to mediate a matter.<sup>35</sup>

6.35 The fundamental problem with the ABIO in relation to third party guarantees is the low financial 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.

6.36 In September 1999, the ABIO published a report on relationship debt.<sup>36</sup> The report aimed, among other things, to provide information on resolving relationship debt complaints under the ABIO scheme, and to identify the legal issues which may arise in such cases. The number of

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34. The event to which the dispute relates must have occurred not more than six years before the disputant notified the financial services provider in writing of the dispute (para 5.5 Terms of Reference); the Ombudsman must only consider a dispute in relation to events which first occurred on or after the lender became a member of the ABIO scheme, on or after 6 July 1998 if the disputant is incorporated and on or after 6 July 1998 if the dispute relates to a guarantee or charge in favour of a financial services provider to secure an amount owed by an incorporated entity (para 5.6 Terms of Reference).

35. Stella Sykiotis, Legal Aid Commission of NSW, *Telephone Consultation* August 2000.

36. Australian Banking Industry Ombudsman, *Report on Relationship Debt*, Bulletin No 22, September 1999. The ABIO defined relationship debt as “the transfer of responsibility for a debt incurred by a party to his/her partner in circumstances in which the fact of the relationship, as distinct from an appreciation of the reality of the responsibility for the debt, is the predominant factor in the partner accepting liability”.

complaints received concerning guarantees is relatively small and the proportion of guarantee complaints has decreased relative to the overall number of complaints. In 1991 guarantee complaints represented 5% of all closed complaints, while in the year ending June 1998 they represented 0.4%.<sup>37</sup> We asked the ABIO to provide more recent figures on the cases received relating to guarantees by gender. The updated figures indicate that the numbers of cases relating to guarantees handled by the ABIO are generally decreasing. However, a much higher proportion of these cases are coming from women rather than men or couples. In fact, the proportion of cases relating to guarantors as women are higher than they have ever been.<sup>38</sup> The ABIO suggested that this increase may be due to the recent expansion of the ABIO's jurisdiction to consider disputes over the debts of guarantors of companies.<sup>39</sup>

6.37 The ABIO suggested that they expected to see a decline in disputes relating to guarantees after the amended Code of Banking Practice became effective in August 2003 because the Code more thoroughly regulates guarantor transactions prior to execution.<sup>40</sup> The Ombudsman has also noted that the new Banking Code will provide greater clarity to the ABIO's dispute resolution work and will assist the ABIO in deciding whether a bank has observed good banking practice.<sup>41</sup>

### Problems with using ADR in guarantee matters

6.38 One community legal centre stated that alternative dispute resolution was "the way of the future" and they always refer disputed guarantees to dispute resolution by the ABIO.<sup>42</sup> According to this centre, alternative dispute resolution is an excellent way to get a fair hearing and encourage settlement. Another benefit is that the process is cheaper and the hearing is by a specialist industry focused body.

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37. Australian Banking Industry Ombudsman, *Report on Relationship Debt*, Bulletin No 22, September 1999 at 3; note there was a small increase to 0.5% in the year ending June 1999. The ABIO speculates this is due to its then new jurisdiction to consider complaints about guarantees given to support loans to companies. This new jurisdiction is not, however, retrospective: the ABIO can only consider these complaints if the relevant act or omission of the bank took place on or after 6 July 1998.

38. Australian Banking Industry Ombudsman, *Report on Relationship Debt*, Bulletin No 22, September 1999 at 21 and statistical report provided to NSW Law Reform Commission July 2001: July 1998 to June 1999 – 27%; July 1999 to June 2000 – 38%; July 2000 to December 2000 (6 months) – 46%.

39. Australian Banking Industry Ombudsman, *Telephone Consultation* 11 March 2003, referring to the 1998 amendments to the ABIO's terms of reference.

40. Australian Banking Industry Ombudsman, *Telephone Consultation* 11 March 2003.

41. Australian Bankers' Association, *Media Release*, 12 August 2002.

42. Katherine Lane, Consumer Credit Legal Centre, *Consultation* June 2002.

6.39 Australian banking mediation differs from current American and British practices in that by the time a matter comes on for mediation in Australia the debt has already been classified as problematic and been moved from local branch management to an asset management group (or recovery section) within the bank's head office.<sup>43</sup> By this time, meaningful negotiation may be impossible, as often the only option proffered by a lender is foreclosure and realisation of any property secured by a loan.<sup>44</sup> One guarantor described his role in the mediation as being "largely a spectator."<sup>45</sup> It has been suggested that early dispute intervention by negotiation would increase chances of debt recovery.

6.40 A review of the mandated mediation scheme under the *Farm Debt Mediation Act 1994* (NSW) has not been promising. Participants in the review of the scheme described the mediation as "an orderly exit" via foreclosure, rather than a process for exploring options.<sup>46</sup> Garwood concludes from this review that if mediation such as that under the Act is to be mandated, it is vital that mediation be conducted at a stage where more than one option is possible to give the process a meaningful purpose. It appears from that review that early mediation intervention by short sessions spread over a longer period is more successful than single mediation sessions.<sup>47</sup>

6.41 It is also worth noting the issue of gender and power in the resolution of disputes between lenders and guarantors. Certainly, an "information differential"<sup>48</sup> exists between parties to this kind of dispute. The differences in resources and concomitant bargaining power between a guarantor and a lender are exacerbated where the site of the dispute is partially located within a domestic relationship.

6.42 In its submission to the Commission, the Women's Legal Resource Centre ("WLRC") cautioned against reliance on industry dispute resolution schemes.<sup>49</sup> WLRC noted concerns that some of these types of dispute resolution process amount to a "privatisation of justice". This means that there is no precedent and no public resolution to guide similar cases.

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43. Maureen Garwood, "A Time for Review and Change in Dispute Resolution Practices for Banks and Insolvent Borrowers" (2002) 13 *Australasian Dispute Resolution Journal* 211 at 212.

44. Ruth Charlton, *Dispute Resolution Guidebook* (LBC, 2000) at 223.

45. Confidential, *Submission* 13 December 2002.

46. Maureen Garwood, "A Time for Review and Change in Dispute Resolution Practices for Banks and Insolvent Borrowers" (2002) 13 *Australasian Dispute Resolution Journal* 211 at 220.

47. Maureen Garwood, "A Time for Review and Change in Dispute Resolution Practices for Banks and Insolvent Borrowers" (2002) 13 *Australasian Dispute Resolution Journal* 211 at 221.

48. Hilary Astor and Christine Chinkin, *Dispute Resolution in Australia* (Butterworths, 2002) at 345.

49. Women's Legal Resource Centre, *Submission* at 10.

The WLRC argues that mediation may thereby militate against the development of conscientious lending practices.<sup>50</sup>

### Consumer, Trader and Tenancy Tribunal

6.43 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.<sup>51</sup> 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. The CTTT was unable to provide comprehensive information from their records concerning cases heard in the tribunal involving third party guarantees, but they indicated that disputes involving third party guarantees are not common in the CTTT.<sup>52</sup>

6.44 This lack of usage is likely to be caused by the consumer/business distinction drawn in the Consumer Credit Code, noted in Chapter 3. 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.<sup>53</sup>

6.45 A recent decision of the New South Wales Supreme Court significantly restricted the possible operation of the Consumer Credit Code in this area.<sup>54</sup> In *Park Avenue Nominees v Boon*, credit was provided to the plaintiff to refinance an earlier loan made to the plaintiff and his son to finance the son’s cattle stud. The plaintiff was not involved in the cattle stud and the credit was secured by mortgages over property owned by the plaintiff. The NSW Fair Trading Tribunal (predecessor of the CTTT), held that the predominant purpose of the plaintiff in obtaining the loan was to assist his son and therefore obtained for a personal purpose, making the loan subject to the provisions of the Credit Code. The Supreme Court of NSW overturned this decision.<sup>55</sup> The court found that the creditor

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50. Women’s Legal Resource Centre, *Submission* at 10.

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

52. The CTTT advised that their information system could not identify relevant cases. Few decisions of the CTTT are written.

53. Communication from Graeme Durie, Senior Member of the CTTT, 22 August 2002.

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

55. The Supreme Court held the Credit Code did not apply because the purpose of the loan did not come within s 6(1)(b). Both the Court and the Tribunal referred to the Victorian Supreme Court decision in *Linkenholt Pty Ltd v Quirk* (2000) ASC 155-040. However while the Tribunal distinguished that case, the Supreme Court relied upon it.

established that the loan was not provided wholly or predominantly for personal, domestic or household purposes.

6.46 This decision effectively narrows the operation of the Consumer Credit Code in the area of third party guarantees. Data collected by the research project indicates that the primary motivation for many third party guarantors is the provision of assistance to family members and that most borrowers apply these funds to small business enterprises. The implication of the decision in *Park Avenue* is that where a relative is motivated to assist a borrower with a business loan, because of factors arising out of their relationship, access to dispute resolution mechanisms under the Consumer Credit Code are not available.

6.47 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,<sup>56</sup> but this is clearly not possible under the current jurisdictional restrictions of the Tribunal.

## THE PERSONAL COST

6.48 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.<sup>57</sup>

6.49 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.

6.50 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.

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56. See eg Legal Aid Commission of NSW, *Submission*; Women’s Legal Resource Centre, *Submission*.

57. Belinda Fehlberg, *Sexually Transmitted Debt: Surety Experience and English Law* (Clarendon Press, 1997) 253-258.

## CONCLUSION

6.51 Our research found significant problems with communication once the loan became problematic. Many guarantors were not advised of difficulties with the loan and had problems gaining access to information during the course of the loan. Many guarantors were shocked when enforcement proceedings were begun against them as this was the first they had heard of any difficulties with the transaction. While privacy laws are an obstacle to open provision of much borrower information by lenders to guarantors there is clearly much room for improved communication on problematic loans.

6.52 Many participants 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. While the majority of disputed guarantees in our research settled, we found that it was quite common for settlement to occur once litigation was already underway. Litigation is still clearly central to the dispute resolution process in this area.

6.53 The following chapter explores the particular complexities of litigation of third party guarantee matters.

## 7. Litigation

- The litigation process
- Legal principles and their effect on outcomes
- Evidential issues
- Do the banks always finish last?
- Conclusion



“It is not easy to suppress an uncomfortable feeling that had the defendant been able to engage competent legal representation, he might have been able to present a more focussed case. Further, though it is not here intended to criticise the plaintiff bank for conduct which there is no sufficient basis to criticise, the defendant might, with competent legal representation, by utilising the processes of discovery and subpoenas, the facility of better evidence in chief, and the tool of cross-examination, have elicited material favourable to his case. The court room contest revealed a gross disparity in power between the plaintiff bank and the defendant. The plaintiff bank was legally represented, was very experienced in this type of litigation, and was prepared to make full use of the opportunities which the rules of evidence and procedure afford a party not bearing the burden of proof in an adversary system. The defendant was not represented, was wholly inexperienced and was evidently almost wholly unable to do his cause any justice. The disparity in forensic power was akin to their disparity in economic power.”<sup>1</sup>

7.1 While a range of common law and statutory remedies may be available to guarantors who seek to challenge the enforcement of a guarantee,<sup>2</sup> 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.<sup>3</sup> Our research confirms that there is a lack of uniformity in the decided cases and that litigation in this area is expensive and complex.

7.2 The research project could not establish the number or proportion of transactions involving third party guarantees that are disputed or that result in litigation compared to those that are executed and conclude without difficulty (see Chapter 4: The Lenders). This chapter relies upon data drawn from our review of the cases that did proceed to litigation and data drawn from our surveys, particularly of barristers and judges. While these cases are almost certainly not representative of guarantees generally, they are quite likely to be representative of recent *litigated* guarantee cases.

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1. *Conley v Commonwealth Bank of Australia* [2000] NSWCA 101 per Heydon JA at para 102.
  2. See generally, New South Wales Law Reform Commission, *Guaranteeing Someone Else's Debts* (Issues Paper 17, 2000); 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).
  3. Report of the Expert Group on Family Financial Vulnerability, *Good Relations, High Risks: Financial Transactions Within Families and Between Friends* (Report, 1996) at 36-37.

7.3 This Chapter examines the process of litigation, how it commences and what defences and doctrines are most commonly employed. We examine the impact of the *Contracts Review Act 1980* (NSW) and the High Court decision in *Garcia*, both of which are perceived to have considerably broadened the availability of relief to guarantors at the expense of lenders.<sup>4</sup> We also explore some themes and issues that were prominent in the litigated cases: the role of lenders’ “usual practice” in determining facts, the reluctance of courts to examine issues of domestic violence, the issue of guarantor credibility, and the question of cultural and gender stereotyping.

## THE LITIGATION PROCESS

### How litigation commences

7.4 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.<sup>5</sup> 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.<sup>6</sup> 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 evidenced in the research.

### Settlement once litigation has commenced

7.5 As noted in Chapter 6, few disputed cases settle prior to litigation or during any alternative dispute resolution process.<sup>7</sup> Where cases did not settle, most proceeded to litigation and very few went on from a failed settlement process to any form of alternative dispute resolution.<sup>8</sup>

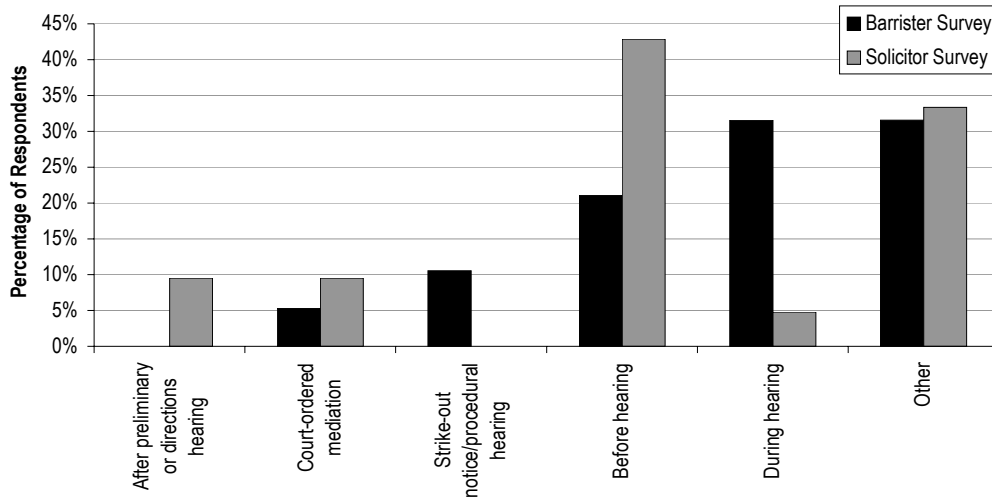
7.6 Our research indicates that many cases settle in the course of litigation. Fifty-nine per cent of solicitors reported that their last guarantor

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4. See Robin Baxendale, “*Garcia v National Australia Bank Limited* – Ensuring Equity in Surety Transactions: A Legal Debt End?” (1999) 21 *Sydney Law Review* 313. For a comparative analysis see: Misty Bailey, “Sexually Transmitted Debt: Criticism and Perspectives” (1999) 8 *Auckland University Law Review* 1001.
  5. *Case Law Review*, Issue 26: 22% of cases were commenced by the guarantor.
  6. *Case Law Review*, Issue 12: in 88% of litigated cases the family home was mortgaged as security for the guarantee.
  7. *Solicitor Survey*, Question 34: 33% of solicitors reported that their last guarantor case settled prior to litigation, 67% said it settled during litigation.
  8. *Solicitor Survey*, Question 39: 91% of respondents stated that when their last case did not settle it went to litigation, 5% reported it went to ADR and 5% stated that it went to both ADR and litigation.

case settled. Barristers, who are far more likely to be engaged in litigation, reported that just less than half of their cases settled.<sup>9</sup>

7.7 Cases are a little more likely to settle just before or during the hearing rather than in the earlier stages of litigation or at court ordered mediation.<sup>10</sup>

FIGURE 7.1: SETTLEMENT ONCE LITIGATION COMMENCED



## Defences and cross claims

“the usual raft of unsustainable defences.”<sup>11</sup>

7.8 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.<sup>12</sup> The most prominent of these are

9. 46% reported that the last case they acted on settled, while 54% said it did not.

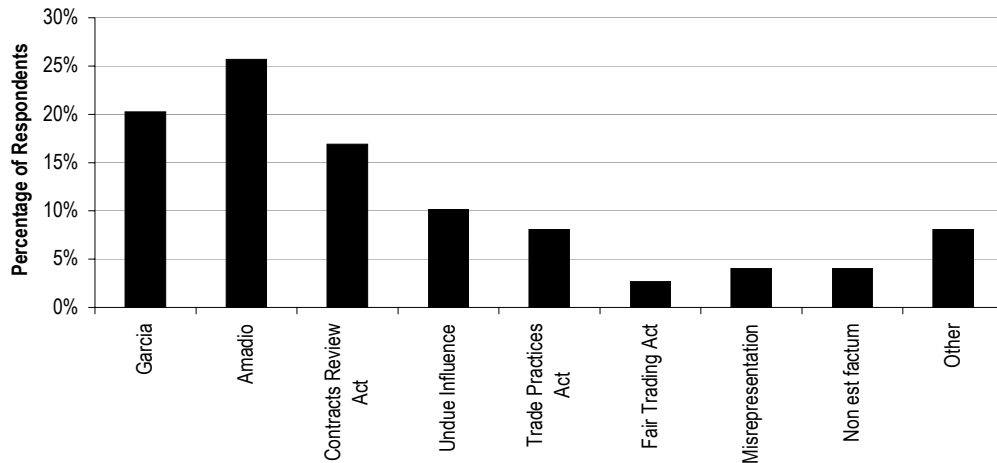
10. *Solicitor Survey*, Question 35: 43% of solicitors reported that their last case settled before the hearing, 5% said at the hearing, 10% said after the preliminary or directions hearing, 10% said at mediation and 33% said at another stage in the proceedings which included after default judgment, after the service of the statement of claim and after judgment but before the hearing of an appeal. *Barrister Survey*, Question 16: 21% of barristers said their last case settled before the hearing, 32% said during the hearing, 11% said it settled at a strike out/procedural hearing, 5% said at court ordered mediation and 32% said it settled at another stage which included after judgment but before an appeal was heard.

11. *Barrister Survey*, Respondent 36.

12. For an overview of the requirements of common law and statutory claims of unfairness, see New South Wales Law Reform Commission, *Guaranteeing Someone Else’s Debts* (Issues Paper 17, 2000), Chapter 2.

unjustness under the *Contracts Review Act 1980* (NSW),<sup>13</sup> and unconscionability,<sup>14</sup> including the “special wives equity” affirmed in *Garcia*.<sup>15</sup> 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*.<sup>16</sup>

FIGURE 7.2: PLEADINGS IN CASE LAW REVIEW



7.9 It is clear that litigation is often a complex maze of claims and cross claims. For example, in *Ribchenkov v Suncorp-Metway Ltd*, Mrs Ribchenkov, an 81 year old retiree was made a joint borrower with her son-in-law after the bank refused to allow her to be a third party mortgagor as she clearly received no benefit from the loan. After her son-in-law went bankrupt and the bank sought to enforce the mortgage against her, Mrs Ribchenkov sought to have the mortgage set aside on the grounds of undue influence, unconscionable conduct, fraudulent misrepresentation or misleading conduct in contravention of s 52 of the *Trade Practices Act 1974* (Cth). She also sued the solicitor who advised her on the transaction for negligence. The bank cross-claimed against the solicitor and the solicitor, in turn, claimed

13. See Ben Zipser, “Unjust Contracts and the Contracts Review Act 1980 (NSW)” (2001) 17 *Journal of Contract Law* 76. In our review, we found that the *Contracts Review Act* was relied on in 17% of cases.

14. *Commercial Bank of Australia v Amadio* (1983) 151 CLR 447. *Amadio*-type (special disability) principles were raised in 26% of cases.

15. *Garcia v National Australia Bank* (1998) 194 CLR 395. *Garcia* principles were relied on in 20% of the cases.

16. Undue influence was raised in 10% of the surveyed cases, the *Trade Practices Act* in 8%, the *Fair Trading Act* in 3%, misrepresentation in 4% and *non est factum* in 4%. Other types of claims were raised in 8% of the cases.

against his professional indemnity insurer who declined to provide indemnity because it is alleged the claim arose out of, inter alia, fraud and therefore was within an exclusion clause in the contract of insurance.<sup>17</sup>

7.10 We found that guarantors are very likely to rely on more than one defence and cross claim. Our review of litigated cases found that guarantors were commonly pleading from three to six different claims or defences.<sup>18</sup> The responses of barristers and solicitors to our surveys confirmed that guarantors tend to rely on more than one ground or category of defence or cross claim.

### Conduct of litigation

7.11 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.<sup>19</sup> 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.

7.12 Our research reveals that those involved in litigation involving third party guarantees have a range of strong views concerning the effectiveness and conduct of litigation. Some were of the view that the current law went too far in giving guarantors avenues to challenge enforcement of guarantees, while others considered that the financial power of lenders meant they could unfairly use the litigation process. Overall comments were coloured by the practice and experience of the lawyer and in particular, whether they work predominately for lenders or guarantors.

7.13 There is some evidence that lenders are quick to get default judgment and then commence bankruptcy proceedings. For example, in litigation between Mr and Mrs Hubner and the ANZ Bank in Queensland, the bank quickly got default judgment in the possession list in the Supreme Court, despite some evidence that the bank was aware that the Hubners were preparing a defence. When the Hubners unsuccessfully applied to have the default judgment set aside, they had costs orders entered against them. On the basis of these orders (and other costs orders on other unsuccessful

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17. *Ribchenkov v Suncorp-Metway Ltd* (2000) 175 ALR 650.

18. Of the 52 surveyed cases, 19 raised three separate defences or causes of action, while 13 raised four or more. Only 9 cases relied on one type of claim or defence and 11 cases pleaded two claims or defences.

19. 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.

applications) the bank commenced bankruptcy proceedings against them. Without yet having effectively ventilated their substantive case, including a *Garcia* claim from Mrs Hubner, the Hubners have been involved in at least six matters in the Queensland Supreme Court and two in the Court of Appeal, in addition to six Federal Court interlocutory applications and a High Court special leave application.<sup>20</sup>

7.14 Several judges suggested that where a number of claims or defences are raised it affects the efficiency of the trial. The data from the survey of judges tends to confirm that at least in some cases parties raise claims or defences that are, in the opinion of the presiding judge, without merit.<sup>21</sup> Some judges commented that the wide range of claims or defences lead to “unnecessary additional claims” or submissions that are “often hopeless or barely arguable”. A few judges commented that this can mean a less focussed trial: sometimes one defence becomes the focus of the trial, and the evidence and law relating to the other defences is overlooked or inadequate. This often necessitates adjournments and clearly adds to the costs of litigation. One judge noted that:

“It depends very much on who the counsel are who are running the case. There are clear differences between the ways of attacking guarantees, both as to the elements that need to be established and how onus of proof operates (eg if a presumption of undue influence can be made out). Provided counsel know what they are doing, a trial which raises several defences may take longer than a trial which raised only one defence, but it could hardly be said to be for that reason, less efficient.”

7.15 In at least half of the litigated cases in our review late amendments - either just before or during trial - were made to the pleadings.<sup>22</sup> According to the data collected from the judges late amendments are a marked feature of third party guarantee cases. The research project examined the

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20. See eg: *Hubner v Australia and New Zealand Banking Group* (Unreported, Federal Court of Australia, Dowsett J, 7 December 1998); *Australia and New Zealand Banking Group v Hubner* (Unreported, Qld Supreme Court, Byrne J, 15 October 1997); *Australia and New Zealand Banking Group v Hubner* (Unreported, Qld Supreme Court, Jones J, 6 November 1997); *Hubner v Australia and New Zealand Banking Group* (Unreported, Federal Court, Beaumont J, 21 November 1997); *Hubner v Australia and New Zealand Banking Group* (Unreported, Qld Supreme Court, Jones J, 28 May 1998); *Hubner v Australia and New Zealand Banking Group* (1999) 88 FCR 445; *Australia and New Zealand Banking Group Ltd v Hubner* [1999] FCA 1346; *Hubner v Australia and New Zealand Banking Group Ltd* (2000) 21(12) Leg Rep SL5a.

21. *Judge Survey*, Question 15: out of the 15 judges who responded to this question, 7 reported that this occurred in some trials, 3 said in about half of the trials while 2 said in many trials.

22. In 54% of cases late amendments were made, in 8% there were no late amendments while in 38% it was unclear from the judgment.

pleadings in a small number of cases. In one matter the plaintiff/guarantor filed six different summonses/statements of claim during the course of the proceedings. During the actual trial the plaintiff sought leave to file a further amended summons as a result of evidence of violence against the guarantor which had emerged during her cross examination.<sup>23</sup>

7.16 One barrister interviewed for the project expressed the view that many guarantors are very disorganised due to their inability to separate out their emotion and make a commercial decision about their case, or because they don't want to confront the inevitable loss, but also noted the inability of guarantors to marshal legal resources because of the high cost.<sup>24</sup>

### Legal representation in litigation

7.17 One barrister advised the research project that, in his experience, guarantors are often poorly prepared in litigation.<sup>25</sup> Many guarantors do not have the same resources as banks to retain solicitors and barristers and conduct litigation effectively. A common scenario in litigated cases concerning third party guarantees is that the guarantors are generally fighting over their last remaining asset, the family home, therefore they have little or no funds to spend on solicitors and barristers but are determined to proceed with the litigation.

7.18 Lack of legal representation always disadvantages litigants, especially where one side is disproportionately well resourced. Clearly, lenders will always be represented in these kinds of matters.<sup>26</sup> We were unable to get a definitive picture of how often third party guarantors went to trial without legal representation, but it was apparent from our survey of judges and court observations that a reasonable proportion of these matters proceed without the guarantor having legal representation.<sup>27</sup>

7.19 Efficient conduct of litigation is clearly affected by what kind of legal representation the parties have. In one recent New South Wales case, the guarantors were represented by three different solicitors with a change of solicitor just before the trial.<sup>28</sup> At the commencement of the trial no pleading had been filed on behalf of the wife even though leave had been

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23. *Sialepis v Westpac Banking Corporation* [2001] NSWSC 101. This case is discussed in further detail in relation to domestic violence issues later in this chapter.

24. Barrister, *Confidential Interview* 19 August 2002.

25. *Confidential Submission*, 18 September 2002.

26. In cases where the lender retains counsel (or senior counsel) there are serious costs implications for the unsuccessful self-represented litigant.

27. While most judges reported that in all their trials, the third party guarantor had legal representation, 25% of judges stated that in 11-40% of trials the third party guarantor had no legal representation.

28. *Sayer v Turk* [2001] NSWSC 750.

granted prior to the trial. Two applications for adjournment of the trial were made, just prior to the trial and on the first day of the trial, however these were refused. A defence and cross claim on behalf of the wife was filed on the last day of the trial however it did not clearly plead *Garcia* and/or any claim under the *Contracts Review Act 1980* which were both arguably available to the wife. The guarantors' representative abandoned a claim under the *Contracts Review Act 1980* during the trial.

7.20 During a day of court observations in 2002, we viewed an unrepresented husband and wife of non-English speaking background appear before the Supreme Court defending a possession application by a major bank lender. The bank was agitating for the possession application to be expedited and finalised that day; and it seemed that the couple were on the verge of consenting to those orders. From the facts, it appeared that the matter disclosed that the wife may have had a separate *Garcia* type defence of which she was completely unaware. This kind of ignorance about legal rights and entitlements and lack of preparedness was far from uncommon in our observations. In the course of interviewing respondents about their experiences with guarantees, there were many occasions where it appeared a woman would have had a *Garcia* defence, but this was never pleaded. When asked whether she had ever sought separate advice, it was not uncommon for women to express dismay at the thought of getting advice which may put her claim differently from her husband's: "we're in this together", was a typical response. There was also a sense that a separate approach would be perceived as causing further disquiet in their relationships; this was all the more common where women left the dispute entirely in the hands of their husbands.

7.21 It was not uncommon to hear that some guarantors who *had* sought legal advice away from their partners or spouses did not appear to be advised of the availability of *Garcia* or *Contracts Review Act* claims or defences. This appeared to be more common from guarantors from rural areas. One judge said that sometimes the most common causes of action/defences are overlooked because of the inexperience or lack of ability of the legal advisors.<sup>29</sup>

## Cost and delay

7.22 Delay and the high costs of litigation and enforcement of guarantees emerged from the research as issues of concern.

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29. *Judge Survey*, Respondent 43.



7.23 Many guarantee contracts contain a specific provision allowing the lender to claim all reasonable costs of recovery from the guarantor.<sup>30</sup> Most solicitors and barristers commented on the burden of costs in the enforcement and litigation process:

“Extraordinary costs add to guarantor’s debt before guarantor given opportunity to respond.”

“From a creditor’s perspective they (court proceedings) are time consuming and expensive, with a risk of no return. From the guarantor’s perspective they are costly and difficult to defend and guarantors have little bargaining power.”

7.24 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 costs may have ballooned out to \$30,000.<sup>31</sup>

7.25 While not a third party guarantee matter, the case of *Ristic v Greater Building Society Ltd* gives a good indication of how costs in mortgage cases can quickly accrue. In 1998 Mr Ristic had a \$20,000 loan. In 2001 the balance of the loan account had reached \$92,937. Of this, the solicitor’s costs and costs of the enforcement proceedings totalled \$72,294.<sup>32</sup>

7.26 Some respondents to the research project surveys expressed the view that delay by litigation is unreasonably caused by guarantors who raise defences with little or no merit.<sup>33</sup> The following comments are from solicitors and barristers surveyed for the project:

“In the cases where I acted for the lender, while the lender succeeded (as it should have), the guarantor caused a great deal of delay and inconvenience.”

“Funds are wasted and expectations unnecessarily raised by false hopes in the usual raft of unsustainable defences.”

“The process presently provides debtors and guarantors with an extremely broad basis to obfuscate and delay. Unfortunately, however, substantial amendment would likely result in injustice to those who do have genuine grounds for complaint.”

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30. 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. 91% of solicitors reported 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.

31. Stella Sykiotis, Legal Aid Commission, *Telephone Consultation* July 2000.

32. See *Ristic v Greater Building Society Ltd* [2002] NSWCA 266.

33. *Barrister Survey*, Respondents 32 and 29.

7.27 To manage delay in the litigation process, one judge said he adopts:

“a procedure where I try to flush out those defendants who are simply delaying the inevitable. I order most defendants ...to file an affidavit at the beginning setting out all facts and circumstances relied on to establish a defence/cross claim. This often brings an early resolution to claims, especially where there is less than \$100,000 involved.”

7.28 While both lenders and guarantors are prejudiced by the delays in litigation, lenders generally have an advantage due to their greater financial power:

“Proceedings too expensive for client and Legal Aid insufficient for time and expense in proceedings.”

“the lender used its superior financial position to make the guarantee enforceable.”

“Impossible for impecunious guarantor to fund.”

7.29 However while the litigation process may be expensive it does allow for issues to be explored, particularly where mediation is not possible.

“Yes, the litigation process (although expensive) allowed the parties to raise all issues involved.”

7.30 Most solicitors stated that litigation is expensive for both sides, and that the enforcement process used by the lender resulted in higher costs. One solicitor commented that Legal Aid is insufficient for the time and expense of litigation, clearly a impediment to those without the resources to litigate otherwise.<sup>34</sup> One barrister interviewed for the project pointed to the increase in indemnity costs as a significant hurdle for guarantors who litigate, and a strong disincentive for *pro bono* legal assistance.<sup>35</sup>

## LEGAL PRINCIPLES AND THEIR EFFECT ON OUTCOMES

### Contracts Review Act 1980 (NSW)

7.31 The NSW Law Reform Commission’s Issues Paper on third party guarantees notes there has been little research into the operation of the *Contracts Review Act*.<sup>36</sup> Since the publication of the Issues Paper some research has been published by Tyrone Carlin. That research examined a selection of cases including many cases concerning mortgage contracts and guarantees. It concluded that the legislation provides for an individual, case by case approach to establishing “unjust contracts” which more readily

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34. *Solicitor Survey*, Respondent 31.

35. Barrister, *Confidential Interview* 19 August 2002.

36. New South Wales Law Reform Commission, *Guaranteeing Someone Else’s Debts* (Issues Paper 17, 2000) at 6.

gives a remedy than traditional common law doctrines.<sup>37</sup> It concludes that the legislation offers some benefits over equitable remedies but also notes it has produced some inconsistency in the decided case law.<sup>38</sup> Carlin also noted a trend towards the granting of partial relief as opposed to complete relief.<sup>39</sup>

7.32 The findings of our review of litigated cases are consistent with Carlin's research. We found that the *Contracts Review Act* does provide relief where other remedies, such as the rules of unconscionability, do not provide a remedy for a guarantor seeking to impugn a guarantee or mortgage. Remedies under the Act have been available to guarantors of loans to businesses despite the provisions in section 6 of the Act.<sup>40</sup> It is also useful for situations where a guarantee transaction is disputed, and *Garcia* is not applicable.<sup>41</sup> The provisions of the Act have been interpreted broadly, consistent with its characterisation as remedial legislation. In particular it appears that courts may be prepared to grant a remedy under the Act where the lender has knowledge about the risky nature of the business enterprise that is not disclosed to the guarantor,<sup>42</sup> or in circumstances of

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37. Tyrone Carlin, "The *Contracts Review Act 1980* (NSW) – 20 Years On" (2001) 23 *Sydney Law Review* 125 at 136-137.

38. Tyrone Carlin, "The *Contracts Review Act 1980* (NSW) – 20 Years On" (2001) 23 *Sydney Law Review* 125 at 144.

39. Out of the 21 cases studied that concerned mortgages and guarantees, complete relief was granted in 11 of those cases while partial relief was granted in 10. Tyrone Carlin, "The *Contracts Review Act 1980* (NSW) – 20 Years On" (2001) 23 *Sydney Law Review* 125 at 135.

40. Section 6(2) of the *Contracts Review Act* provides that relief is not available in respect of contracts entered into "in the course of or for the purpose of trade, business or profession carried on or proposed to be carried on by the person seeking relief" other than a "farming undertaking." Remedies under the *Contracts Review Act* were granted in *State Bank of New South Wales v Hibbert* (2000) 9 BPR 17,543; *Fraser v Power* (2001) Aust Contract R 90-127; *Karam v Australia and New Zealand Banking Group* [2001] NSWSC 709; *Reisch v Commonwealth Bank of Australia* [1998] ANZ ConvR 628; *Farrow Mortgage Services Pty Ltd (In Liq) v Torpey* (1998) NSW ConvR 55-857 where the guarantee was provided for a business undertaking. However in *Westpac Banking Corporation v Bagshaw* [2000] NSWSC 650 the wife's claim for relief under the Act was rejected because the contract was made for a business partnership conducted primarily by the husband.

41. See, for example, *Elkofairi v Permanent Trustee Co Ltd* [2003] Aust Contract R 90-157.

42. For example, in *Reisch v Commonwealth Bank of Australia* [1998] ANZ ConvR 628 the Court specifically found that the bank did not act unconscionably but granted relief under the Act. The mother who provided security for her son's business enterprise was found to have understood the nature and consequences of the transaction, but the bank was aware of past problems with one of the company's directors and that the business enterprise did not have any assets of significance. The Court held it was unfair of the bank not to divulge this information or satisfy itself that the guarantor had obtained independent advice about the transaction. The Court declared that the contract (mortgage) was unjust in the circumstances

asset based lending (where it is apparent that the guarantor or borrower do not have the capacity to service the loan).<sup>43</sup> However there are also cases demonstrating a narrower interpretation of the Act.<sup>44</sup>

7.33 Our research also confirms that those practising in the area consider it a useful tool for guarantors, in particular, because of the broad discretionary considerations available to the Court. For example, the *Contracts Review Act* may provide a remedy even where the guarantor has obtained independent legal advice but nevertheless proceeds with the arrangement where the contract itself is unfair or the loan improvident.<sup>45</sup> One barrister who participated in the survey commented that the defences available under the *Contracts Review Act* are more “user friendly” and that the other mechanisms available are more unwieldy or cumbersome in terms of pleading and proof. A number of barristers also commented on the wide discretion the Act provides for the Court to consider the loan contract, although one felt that the Act was “too vague”.

### The influence and application of *Garcia*

7.34 The 1998 decision of the High Court in *Garcia*<sup>46</sup> confirmed that the “special wives’ equity” in *Yerkey v Jones*<sup>47</sup> 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 the guarantor seek advice.

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and ordered that the mortgage be amended to limit the guarantor’s liability to \$60,000, plus simple interest, and not be enforced until after the death of the plaintiff. See also *Melverton v Commonwealth Development Bank of Australia* (1989) ASC 55-921 where the bank was ordered to not enforce its security during the guarantor’s life.

43. See eg *State Bank of New South Wales v Hibbert* (2000) 9 BPR 17,543. It was evident that neither the borrower nor the guarantor could realistically service the loan from their incomes. The guarantor, who provided security with a mortgage over her home for the business in which her de facto partner had an active interest, was also a director of the company that received the benefit of the loan. The Court held that the bank did not act unconscionably but the contract was unjust in all the circumstances and that the guarantor should be relieved of all her liability pursuant to the mortgage and guarantee. See also *Pasternacki v Correy* [2000] NSWCA 333 and *Elkofairi v Permanent Trustee Co Ltd* [2003] Aust Contract R 90-157.
44. *IMB Society Ltd v White* [2000] NSWSC 1085; *Zorbas v Avco Financial Services Ltd* [1999] NSWSC 54.
45. See *Farrow Mortgage Services Pty Ltd (In Liq) v Torpey* (1998) NSW ConvR 55-857.
46. *Garcia v National Australia Bank* (1998) 194 CLR 395.
47. *Yerkey v Jones* (1939) 63 CLR 649.

7.35 At the time of the decision, there were fears that *Garcia* would unleash a floodgate of claims against lenders.<sup>48</sup> However such fears appear to have been unfounded. In 58% of litigated cases in the pool we surveyed, the guarantor sought to rely on the principle confirmed in *Garcia*.<sup>49</sup> Guarantors were successful on the basis of this equity in only 27% of cases where it was claimed.

7.36 We asked lawyers whether the decision in *Garcia* had made any difference to their practice. Most responses indicated that it had not made much difference as it merely supplements existing law. A few barristers commented that *Garcia* had given wives unwarranted protection; and some stated that it made settlement easier, although others felt that the judge allocated to hear the case was a more important determinant of outcomes than the legal principles. Only two barristers suggested *Garcia* had clarified the principles in this area of law<sup>50</sup> and our review of cases suggests a significant degree of uncertainty about the scope and application of the principle.

7.37 In her discussion of UK cases, Belinda Fehlberg has argued that in adjudication:

“judges tend to take an ultimately creditor’s-eye view of suretyship, with the underlying judicial assumption usually being that the surety’s prospect of material benefit (assumed to be shared between spouses), which is measured against financial risk, often with little or no analysis of, or weight attached to, the surety’s point of view. The interests of wives have tended to be ‘lumped in’ with their husbands ... This situation is made more complicated by the tendency of surety wives themselves to see their own interests as being closely entwined (although significantly **not** identical to) those of their debtor husband.”<sup>51</sup>

7.38 Major issues that have emerged in the litigated cases where the *Garcia* principle is raised include the scope of relationships that are covered by the principle and what is required to be a “volunteer” under the doctrine. These issues are discussed below.

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48. 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.

49. The *Case Law Review* only considered cases decided post-*Garcia*.

50. *Barrister Survey*, Respondents 22, 47.

51. Belinda Fehlberg, *Sexually Transmitted Debt: Surety Experience and English Law* (Clarendon Press, 1997) at 20.

***Does Garcia only cover wives?***

7.39 While the High Court decision in *Garcia* was based upon the claim of a married woman, there were suggestions in decisions that the principle could apply to a broader range of relationships of trust and confidence beyond marriage.<sup>52</sup> The majority judgment in *Garcia* suggested that the principles which justified equitable intervention could apply also to “long term and publicly declared relationships short of marriage between members of the same or opposite sex”.<sup>53</sup> It appears that other courts have been hesitant to apply the principle to relationships other than marriage.

7.40 While de facto relationships would appear to be the most closely analogous to formal marriages, there is considerable uncertainty over even this extension of principle: some cases have applied the principle to heterosexual de facto partners,<sup>54</sup> other decisions have denied that *Garcia* could extend to cover them.<sup>55</sup> It is also unclear whether ex-spouses can be covered by the principle.<sup>56</sup>

7.41 The claims of elderly parents based on *Garcia* principles were accepted by the NSW Supreme Court<sup>57</sup> but more recently rejected by the ACT Court of Appeal.<sup>58</sup> The Court of Appeal held that the “real vulnerability” of parents in relation to guaranteeing loans of children usually stems not from a failure to comprehend the transaction or insufficient information, but “from the love of their children ... the principles in *Yerkey v Jones* and *Garcia* offer no protection for people lured into improvident transactions by feelings of this kind”.<sup>59</sup>

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52. See *Garcia v National Australia Bank* (1998) 194 CLR 395 at para 22 per Gaudron, McHugh, Gummow and Hayne JJ and at para 109 per Callinan J.

53. *Garcia v National Australia Bank* (1998) 194 CLR 395 at para 22 per Gaudron, McHugh, Gummow and Hayne JJ.

54. *Liu v Adamson* [2003] NSWSC 74.

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

56. In *Westpac Banking Corporation v Paterson*, O'Connor J of the Federal Court found that *Garcia* principles could apply where a woman guaranteed her ex-husband's debts. This decision was reversed on appeal, although the Full Court did not decide whether the principles in *Garcia* apply to former spouses, as they found against Mrs Paterson on other points: *Westpac Banking Corporation v Paterson* (2001) 187 ALR 168.

57. *State Bank of New South Wales Limited v Layoun* [2001] ANZ ConvR 487; [2001] NSWSC 113 at para 72-75.

58. *Watt v State Bank of New South Wales* [2003] ACTCA 7.

59. *Watt v State Bank of New South Wales* [2003] ACTCA 7, per Higgins CJ and Crispin P at para 22.

7.42 The claims of in-laws,<sup>60</sup> clients who guaranteed the loans of solicitors,<sup>61</sup> and those of close friends<sup>62</sup> have also been denied coverage under the *Garcia* principle.

7.43 It is notable that the dilemma over what relationships may be afforded protection in third party guarantee transactions has been simplified in the United Kingdom by the House of Lords decision in *Royal Bank of Scotland plc v Etridge*. In that case Lord Nicholls of Birkenhead held there is “no rational cut-off point” as to the kinds of relationships which may be susceptible to undue influence in surety transactions. In the absence of banks evaluating the extent to which a debtor may have influence over a guarantor “the only practical way forward is to regard banks as ‘put on inquiry’ in every case where the relationship between the surety and the debtor is non-commercial”.<sup>63</sup>

#### ***Who is a volunteer?***

7.44 In *Garcia* the Court held that the *Yerkey v Jones* principle applied where the wife is a “volunteer”.<sup>64</sup> Although Mrs Garcia was a director and shareholder of the company operated by her husband, the Court adopted the trial judge’s findings which characterised Mrs Garcia as a volunteer to the transaction. Even though the family would have received some benefit from the business controlled by her husband, the court found that she obtained “no real benefit from her entering the transaction”.<sup>65</sup> 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.

7.45 Two issues arise in considering whether a guarantor is a volunteer when guaranteeing the debts of a family business. One is the issue of “ownership” or control of the company if the guarantor is a director or shareholder of the company; while the second, and related, issue is whether the guarantor will receive any direct or indirect “benefit” from the loan to the company.

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60. *National Australia Bank v Starbronze Pty Ltd* (2001) V ConvR 54-640; [2000] VSC 325.

61. *Australia and New Zealand Banking Group v Alirezai* [2002] ANZ ConvR 597; [2002] QSC 175.

62. *Equitiloan Securities v Mulrine* [2000] ACTSC 48.

63. *Royal Bank of Scotland plc v Etridge (No 2)* [2002] 2 AC 773 at para 87. On the UK law prior to this decision, see Belinda Fehlberg, “The Husband, the Bank, the Wife and Her Signature” (1994) 57 *Modern Law Review* 467 and “The Husband, the Bank, the Wife and Her Signature – the Sequel” (1996) 59 *Modern Law Review* 675.

64. *Garcia v National Australia Bank* (1998) 194 CLR 395 at 409.

65. *Garcia v National Australia Bank* (1998) 194 CLR 395 at 412. Anne Finlay argues that the High Court should have examined this issue more critically: “Australian Wives are Special: *Yerkey v Jones* Lives On” (1999) *Journal of Banking Law* 361.

7.46 In *State Bank of NSW v Chia*, Einstein J sets out a summary of the case law on whether a given transaction is voluntary when discussing the elements of equity as identified in the majority judgment in *Garcia*:

“The second requirement is that the wife is a volunteer. It is not sufficient that the wife has received consideration as would be recognised in the law of contract. The consideration for the guarantee must be of ‘real benefit’ to the wife. Incidental benefit which accrues generally to the family of which the wife is a member is not sufficient benefit to render a transaction which does not otherwise contain a ‘real benefit’, non-voluntary. Where the wife expects to reap direct profit from the transaction, the transaction cannot be said to be voluntary. Neither can it be said to be voluntary where the moneys secured by the guarantee are used to purchase an asset in which the wife is equally interested with her husband. However, where the interest of the wife is a shareholding in the company through which her husband conducted his business and in which she has no real involvement, then a guarantee given by the wife over that company’s debts will be voluntary. But where the wife has an active and substantial interest in the conduct of, and the fortunes of, the business run by her husband, she will not be a volunteer in relation to any guarantee over the debts of that business. Where the transaction is not ex facie for the benefit of the wife, then the onus will lie on the party seeking to enforce the security to show that the wife was not, relevantly, a volunteer.”<sup>66</sup>

These guidelines have, however, not produced consistent results.

### ***Ownership of the business***

7.47 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.<sup>67</sup> 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 controlled by the husband and any benefit comes to her as a result of his “discretion” rather than as a right.<sup>68</sup>

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66. *State Bank of New South Wales v Chia* (2000) 50 NSWLR 587 at 601. Case citations within the quote are omitted here.

67. *State Bank of New South Wales v Watt* [2002] ACTSC 74; *Commonwealth Bank of Australia v Ridout Nominees Pty Ltd* [2000] WASC 37.

68. 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.



7.48 When the business is structured as a partnership it may be very difficult for a guarantor wife to prove that she was not in control of the enterprise. In *Westpac v Bagshaw* the wife was held not to be a volunteer because she was in a partnership with her husband, even though her role was secondary to that of her husband. There was no partnership deed in evidence although other documents such as partnership taxation returns, bank accounts and business registration indicated the involvement of the wife at a formal level. She signed an “all moneys” mortgage over the family home to secure debt to the business. While the Court held that she probably was not aware of the all moneys provision, and that there was no evidence that anyone explained this provision to her, the principles in *Garcia* were not applied. The Court’s decision was influenced by the fact that Mrs Bagshaw received half of the proceeds of the sale of plant and business on her husband’s bankruptcy.<sup>69</sup>

7.49 In many cases the approach taken is whether the wife’s “interest” in her husband’s business undertaking was an active or passive one or whether she received a “real” benefit as opposed to an incidental one.<sup>70</sup>

### **Benefit**

7.50 If a guarantor has received benefit from the loan transaction then they are 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 the 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<sup>71</sup> although it has been held to in several cases.<sup>72</sup>

7.51 Another difficulty that arises in construing benefit is where the guarantee, however onerous, is used to replace an earlier security. In a number of cases guarantors were held to have received a benefit because

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69. *Westpac Banking Corporation v Bagshaw* [2000] NSWSC 650.

70. For example see the discussion in *Brueckner v The Satellite Group (Ultimo) Ltd* [2002] NSWSC 378 para 190-195.

71. *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.

72. *Commonwealth Bank of Australia 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.

earlier security obligations were discharged by the transaction under challenge.<sup>73</sup> For instance in *Micarone*, the South Australian Court of Appeal held that the plaintiffs (who had mortgaged their home in favour of their son's business) did obtain a benefit as a result of the refinancing because their monthly repayments were reduced in comparison to their earlier mortgage.<sup>74</sup> Likewise a refinancing that secured additional funds was held to provide a benefit to a guarantor wife.<sup>75</sup>

7.52 Similarly, the issue of “partial” benefit from a guarantee, where some funds loaned on the basis of a guarantee flow to a business and some are freed for personal purposes, has been considered. As no firm principle has evolved, the decisions vary greatly. In the case of *State Bank of NSW v Chia*, the wife was not considered a volunteer when she guaranteed funds even though, of the \$5 million that were advanced to the husband, some portion assisted her to carry out renovations at her home.<sup>76</sup>

7.53 Furthermore, many commentators have contested judicial analysis of the issue of voluntariness. Belinda Fehlberg argues that the:

“approach of measuring the strength of a surety's case by the extent to which she was involved in or benefited from the business is too simplistic, as it ignores a fundamental aspect of the position of sureties: their lack of power over the way the business was conducted and therefore of access to that benefit. Moreover, this approach ignores the fact that the often self-sacrificing acts of sureties for the furtherance of often non-profitable businesses were apparently motivated by non-financial rather than financial factors, particularly commitment to the debtor, and fundamental economic realities (the debtor having usually been the main breadwinner throughout the relationship).”<sup>77</sup>

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73. *State Bank of New South Wales v Watt* [2002] ACTSC 74; *Westpac Banking Corporation v Paterson* (2001) 187 ALR 168; *Burrawong Investments Pty Ltd v Lindsay* [2002] QSC 82.

74. *Micarone v Perpetual Trustees Ltd* [1997] SASC 6438; *Micarone v Perpetual Trustees Ltd* [2000] ANZ ConvR 597. See also *Westpac Banking Corporation v Paterson* [2001] FCA 556; (2001) 187 ALR 168.

75. *Permanent Trustee Company Limited v Elkofairi* [2003] Aust Contract R 90-148. The New South Wales Court of Appeal affirmed that the principle in *Garcia* was not available for Mrs Elkofairi because the bank did not have notice that she was a partial volunteer. However that Court did find for her under general principles of unconscionability and the Contracts Review Act. Interestingly in his judgment Santow JA considers the issues that arise where the wife is a constructive guarantor (a guarantor in substance rather than form) and where the wife is a partial volunteer.

76. *State Bank of New South Wales v Chia* (2000) NSWLR 587. However, partial relief was granted under the wider doctrine of unconscionability and pursuant to the *Contracts Review Act 1980* (NSW).

77. Belinda Fehlberg, *Sexually Transmitted Debt: Surety Experience and English Law* (Clarendon Press, 1997) at 147. See also 143.

7.54 The difficulty presented for lenders is if the appearance of involvement or benefit is abandoned for more substantive questions of power, how exactly is a lender to be put on notice? The mixed response of the courts to these questions to date illustrate that considerable unpredictability and confusion attend the application of *Garcia*. This presents difficulty for both lenders and guarantors.

## EVIDENTIAL ISSUES

### Violence and litigation

7.55 Our research found that many guarantors entered the transaction because they were too scared to refuse or believed they had no choice. (See Chapter 3). Despite this finding, violence, intimidation and threats were rarely raised or discussed in the litigated cases we surveyed. Violence was raised as an issue by the guarantor in only 8% of the cases in our pool. A close examination of these cases reveals some disturbing aspects about the way the issue of violence arose in the litigation process and was subsequently treated by the Court.

7.56 In all of these cases details of the violence emerged in the course of the trial and was not therefore detailed in the pleadings of the guarantor. Once the issue emerged the Court then tended to disregard or discount the evidence because of the way in which it emerged or because of its lack of proximity to the transaction in question.

7.57 In *Sialepis v Westpac*<sup>78</sup> the issue of violence arose during the cross examination of the wife on the second day of the hearing. The wife had earlier deposed to violence in the marriage in an affidavit filed in Family Court proceedings. Despite this, her case in the Supreme Court was not framed around any allegations of violence. The wife's evidence was that there had been violence in 1992 and earlier and in 1993 that she had obtained a domestic violence order against her husband after he had threatened her "it will only cost \$800 to get rid of you. You could be sunk to the bottom of Sydney Harbour with a slab of concrete".<sup>79</sup> Some ten days after the issue arose in the trial the wife's counsel made an "informal application" to amend the wife's pleadings to include a claim of undue influence and duress. The Court rejected the application to amend the pleading partly on the basis that if there were any substance in the case of duress it would have received consideration by the wife's solicitors.<sup>80</sup>

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78. *Sialepis v Westpac Banking Corporation* [2001] NSWSC 101.

79. *Sialepis v Sialepis* (Unreported, NSW Supreme Court, Hunter J, 1 September 2000) at para 20.

80. By the time of the trial Mrs Sialepis had been represented by 3 different solicitors in the proceedings in the Family Court and the Supreme Court.

The Court concluded, if the mortgage transaction was signed by the wife as a result of duress or undue influence, it was difficult to see why these instructions were not “forthcoming in a timely way.”<sup>81</sup> The Court also rejected the claim of duress and undue influence because the evidence disclosed that there was no act of violence – only threats of violence – committed by the husband towards his wife for several years prior to the execution of the mortgage.<sup>82</sup>

7.58 In *Permanent Trustee Company Limited v Elkofairi*,<sup>83</sup> Mrs Elkofairi who with her husband gave a mortgage over the family home to secure funds advanced to the husband, gave evidence that her husband continually abused and yelled at her, that she had attempted to leave her husband on 3 or 4 occasions and attempted suicide because of the way her husband treated her. She feared violence if she did not do as he said and in April 1996 she obtained an apprehended violence order against her husband.<sup>84</sup> The evidence of threats and violence given by the wife during the trial was largely disregarded and barely discussed in the trial judgment. In the subsequent appeal the Court of Appeal was critical of this aspect of the case: “[o]n the unchallenged facts it would have been hard to resist an argument that this was a clear case of imbalance of power. However, undue influence was neither pleaded or argued...”<sup>85</sup>

7.59 The problem with violence or threats in the context of a domestic relationship is that they will generally be hidden and remain unreported. Both victim and perpetrator are unlikely to disclose these matters to a bank or even a solicitor consulted for the purpose of obtaining independent legal advice for a transaction. The lender is therefore highly unlikely to have any notice concerning circumstances of violence or intimidation in the context of a third party guarantee. Further a guarantor who consults a solicitor once problems arise with the guarantee may also be reluctant to reveal that violence to a solicitor she is consulting about a business or commercial matter. An insistence in the law that acts of violence be

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81. *Sialepis v Sialepis* (Unreported, NSW Supreme Court, Hunter J, 1 September 2000) at para 29 – 30. Similarly, see *Radin v Commonwealth Bank of Australia* [1998] FCA 1361.

82. *Sialepis v Westpac Banking Corporation* [2001] NSWSC 101 at para 133. See also *Challenger Management v Davey* [2002] NSWSC 430 where one of the two guarantors, both elderly women who gave guarantees for a business operated by their children, sought to reopen her case after she advised her solicitor, during the trial, that she had signed the documents because of fear of her son. Cripps AJ refused the application because he believed that if this had been a “real issue” in the case it would have been raised at an earlier point in the proceedings.

83. *Permanent Trustee Company Limited v Elkofairi* [2003] Aust Contract R 90-148.

84. *Permanent Trustee Company Limited v Elkofairi*, submissions from NSWCA Court File CA 41071/01.

85. *Elkofairi v Permanent Trustee Company Limited* [2003] Aust Contract R 90-157; [2002] NSWCA 413 at para 40.

proximate to the act of signing the relevant documents ignores the possibility that threats of violence towards a guarantor, or previous experience of violence perpetrated against the guarantor, are just as likely to influence a guarantor to concur with any demands by the perpetrator to sign documents, as a demand accompanied by violence. The distinction made in the cases between documents signed as a result of a specific threat or act of violence and documents signed in the context of a violent relationship is a highly artificial one from the perspective of a person subjected to violence within a relationship.

### Usual practice versus recollection of the guarantors

“It is not uncommon in this kind of case, [that] bank officers are relying not upon independent recollection of particular events or instances of document signing, but rather [on] ‘general practice.’”<sup>86</sup>

7.60 When the enforcement of a guarantee reaches the court, the debate is often reduced to a contest of evidence between the lender and the guarantor about the circumstances attending the signing of the guarantee. Guarantors often claim they had little or no information or advice at the time they entered the transaction, while the lender will seek to establish that they were informed about the nature of the transaction. By the time the case is before the Court the transaction may have occurred many years before. As the third party guarantor is unlikely to have made any contemporaneous records of the circumstances of the transaction, the probative value of diary entries and notes made by the lender is often very significant.<sup>87</sup> However, in the absence of such records, many lenders, rely on evidence of bank officers and solicitors concerning their “usual practice”. Most judges recorded a high incidence of lenders and legal advisors relying on their “usual or standard practice” at trial.<sup>88</sup> We were concerned at the frequency with which the “usual practice” of a lender or solicitor was accepted in order to determine the circumstances in which a transaction was executed.

7.61 With litigation focusing so closely on the actual point of execution, it is a difficult hurdle for a guarantor to convince the court of the veracity of their recollection when compared to the evidence of the lender or advisor that they followed a constant and unerring practice. For example, in *Westpac v Bagshaw* the Court accepted evidence that bank documents were executed in the presence of the witnessing bank officer rather than the evidence of the wife that she signed the documents at home in the

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86. *State Bank of New South Wales v Layoun* [2001] ANZ ConvR 487 at para 30.

87. See, for example, *Commonwealth Bank of Australia v Liptak* [1998] SASC 6632.

88. *Judge Survey*, Question 19(b): 35% of judges reported that this occurred in about half of the trials they sat on, 30% said many trials, 15% said most trials.

presence of her husband only.<sup>89</sup> In *Australia and New Zealand Banking Group Ltd v Alizerai*, the solicitor instructed by the bank to give independent legal advice to Mr Alizerai was admitted as a solicitor in October 1991, and gave the independent legal advice in December 1991. Despite the solicitor giving evidence that he could not recall any of the details of the advice he gave to Mr Alizerai, the court nonetheless accepted the solicitor’s “practice” in advising guarantors.<sup>90</sup>

7.62 From time to time some Courts have conceded that there may be dangers in accepting evidence of usual practice as conclusive of what actually occurred on a particular occasion. One obvious question in relation to accepting evidence of usual practice, particularly where a guarantor is asserting a contradictory account of what occurred, is the extent to which usual practice develops over time or is susceptible to departure due to the actual circumstances of the case.<sup>91</sup> In some decisions, courts have noted that the guarantor is more likely to recall the circumstances of the execution of documents because it is an unusual event for them whereas for the bank officer it is a routine transaction and therefore indistinguishable from many other transactions.<sup>92</sup> For example, in *National Australia Bank v Petit-Breuilh*, Balmford J referred to the execution of mortgage and guarantee documents as “a matter of common routine for [the bank officer], but a very unusual event for the defendants, and accordingly it may well be that it was more readily remembered by them than by [the bank officer]”.<sup>93</sup>

7.63 In such cases, much will hinge upon the Court’s determination on the credibility of witnesses. These kinds of cases where credibility is critical are known as “credit cases”: if one side’s oral testimony is believed they are entitled to relief, if they are disbelieved they are not.<sup>94</sup>

### Credibility as a determining issue

7.64 It appears that a critical issue in most cases that go to trial is the credibility of the various parties: the lender, the guarantor and sometimes

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89. *Westpac Banking Corporation v Bagshaw* [2000] NSWSC 650. See also *Permanent Trustee v Elkofairi* [2003] Aust Contract R 90-157; [2001] NSWSC 1113.

90. *Australia and New Zealand Banking Group v Alirezai* [2002] QSC 172 at para 42.

91. See *Westpac Banking Corporation v Bagshaw* [2000] NSWSC 650; *Commonwealth Bank of Australia v Ridout* [2000] WASC 37 and *Burrawong Investments Pty Ltd v Lindsay* [2002] QSC 082. In all of these cases the Court acknowledged or commented on the risk of accepting such evidence but ultimately accepted the evidence of usual practice in preference to the account given by the guarantor.

92. See eg *Westpac Banking Corporation v Mitros* [2000] VSC 465; *State Bank of New South Wales v Vecchio* [1998] NSWSC 546; *Reisch v Commonwealth Bank of Australia* [1998] ANZ ConvR 628.

93. *National Australia Bank v Petit-Breuilh* [1999] VSC 395 at para 90.

94. See *Anjou v Westpac Banking Corporation* [2000] NSWCA 355.

the independent advisor. Therefore cases are often determined on the basis of whom the Court finds most credible. Almost all of the judges who had experience of these trial, and responded to our survey, confirmed that the critical issue in cases is the contest between the guarantor's evidence and the evidence of the lender or advisor concerning the guarantor's understanding of the transaction at the relevant time.<sup>95</sup> Rulings substantially based on credibility are even more important when it is noted that there are tight restrictions on appealing findings of credibility.<sup>96</sup>

7.65 The following section examines the credibility of the guarantor in the litigation process, with particular reference to the courts' interpretation of the credibility of guarantor wives and those who are from a non-English speaking background. A close reading of the litigated cases reveals that many decisions are based on adverse findings on credibility, and this is particularly apparent in matters where guarantors are from non-English speaking backgrounds. This is not to say that in all cases adverse findings by a trial judge are unfounded.

7.66 In third party guarantee cases where one of the guarantors is from a non-English speaking background credibility arises in a number of situations. In many cases the court has made adverse findings on credibility based upon the guarantor appearing evasive and/or unresponsive in cross-examination. In some instances the guarantors limited ability to speak or understand English is not given serious consideration by the court.<sup>97</sup>

7.67 In cases where the guarantor is a wife of the primary borrower, credibility arose in different ways. Because of the importance of being characterised as a volunteer under *Garcia*, many cases brought by wives involve a detailed cross-examination on her role in the business enterprise and her knowledge of the transaction (or other similar transactions).

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95. Of 15 judges who responded to this question 14 agreed that the critical issue is the guarantor's understanding of the guarantee at the time of signing and that this leads to a contest between the credibility of the guarantor's evidence and the evidence of the lender or advisor.

96. Note the "general rule" that if a trial judge's findings on credibility form a substantial part of the judge's reasons for a finding of fact, then an appellate court will not interfere with that finding unless it can be shown that the judge failed to use or misused that advantage (*Pham v ANZ Banking Group* [2002] VSCA 206) or has acted on evidence inconsistent with facts incontrovertibly established elsewhere or which are glaringly improbable (see *Walsh v Law Society of New South Wales* (1999) 198 CLR 472 at 479 per McHugh, Kirby and Callinan JJ).

97. For example, in the one case the researchers observed in the Supreme Court in 2002, when the elderly Italian-born parents of the borrower were being cross examined the barrister and at one point the judge were keen not to use the interpreter even though it was quite clear that while they could speak some English complex questions were causing them considerable difficulty.

In cases where the borrower and guarantor have separated, the court has made adverse findings on credibility based on the wife's alleged antipathy towards the borrower due to relationship break down.<sup>98</sup>

## Stereotyping

“It might represent a convenient division of labour. Maybe the wife defers to her husband in relation to certain matters of business and maybe he defers to her in relation to decisions as to where the children will go to school”.<sup>99</sup>

“I always believed, during the course of the marriage, that I always had an implied permission, or implied consent, from my wife to sign her name when she was not able to, because of the fact that I was taking care of the business and I was the provider. That was my role. My wife's role was to be the housewife and to be the mother of my children. So, in the business sense, that is what I believed and I always believed that I had that implied permission.”<sup>100</sup>

7.68 Legal categories variously require the guarantor to display a number of characteristics including “special disability”, “trust and confidence” in her partner, or that the guarantor is under the “undue influence” of the borrower. This can sometimes lead to gender and other stereotyping.

7.69 One of the concerns about the doctrines relied in *Yerkey v Jones* and *Garcia* is that they rely on an outdated presumption that women are, generally, defenceless, uninformed about financial matters, and in need of protection from unscrupulous husbands.<sup>101</sup> Numerous commentators have noted a tendency for guarantor wives to be placed at either end of an extreme dichotomy.<sup>102</sup> Either they are capable agents in which case they are seen as knowledgeable and involved in the family business and are not relieved of liability (regardless of whether they had any real decision-making role or power within the business<sup>103</sup>) or they are seen as subservient with no knowledge at all about the business, in which case they

98. See eg, *Equuscorp v Wright* [2002] VSC 109.

99. *Micarone v Perpetual Trustees Ltd* (2000) 21(10) Leg Rep SL3c per Gleeson CJ.

100. *Sialepis v Westpac Banking Corporation* [2001] NSWSC 101at para 47.

101. Richard Haigh and Samantha Hepburn, “The Bank Manager Always Rings Twice: Stereotyping in Equity After *Garcia*” (2000) 26 *Monash University Law Review* 275.

102. See eg Paula Barron, “The Exercise of Her Free Will: Women and Emotionally Transmitted Debt” (1995) 13 *Law in Context* 23; Kristie Dunn, “Yacking 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” (1994) 4 *Australian Feminist Law Journal* 93; Nicola Howell, “Sexually Transmitted Debt: Where Emotion Meets the Law” (1998) 2(3) *Consumer Rights Journal*.

103. See, for example *State Bank of New South Wales v Chia* [2000] NSWSC 552; *Sialepis v Westpac Banking Corporation* [2001] NSWSC 101.



are more likely to have guarantees set-aside.<sup>104</sup> In one extreme example, in *Gough v Commonwealth Bank of Australia*, Mrs Gough was described by a judge who would have set aside the transaction as “a housewife ... with extremely modest intellectual pursuits generally confined to simple magazines”<sup>105</sup> while another (in majority) denied relief, stating that while Mrs Gough “may not be extremely sophisticated or well lettered ... she is no gaping rustic.”<sup>106</sup>

7.70 Disturbingly, if a woman who was otherwise characterised as “subservient” gave evidence that she would not have entered into the transaction had she been better informed of the risks, this assertion of agency was taken to undermine either her status as subservient at the time of the transaction or her credibility at the time of trial. So, for example in *McCauley v Panagiotidis*, the court commented: “While it was claimed that [Mrs Panagiotidis] was subservient to her husband in financial matters she did assert that she would not have signed the mortgages if she had known what they were. That suggests that she was not necessarily totally subservient, and could exercise some independence.”<sup>107</sup> This suggests that women, in particular, must fit within stereotyped confines of “weakness” in order to be able to gain relief:

“Q: Why did you sign the document?

A: Because my husband sign and I sign.

Q: Why did you sign because you’re your husband signed? Why was that reason for you to sign?

A: Because he is my husband and you know we follow our husbands.

Q: When you say ‘we follow’ what do you mean ‘we’?

A: Like in our custom.

Q: When you say ‘our custom’ – personal, the custom of yourself and your husband?

A: This is how we learn to be, we go along with our husband, what he say, what he wants.

Q: Who do you mean by ‘we’?

A: We Arab people.”<sup>108</sup>

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104. See, for example, *Commonwealth Bank of Australia v Horkings* [2000] VSCA 244; *Karam v Australia and New Zealand Banking Group* [2001] NSWSC 709; *Brueckner v The Satellite Group (Ultimo) Pty Ltd* [2002] NSWSC 378.

105. *Gough v Commonwealth Bank of Australia* (1994) ASC 56-270; (1994) Aust Contract R 90-044 per Kirby P.

106. *Gough v Commonwealth Bank of Australia* (1994) ASC 56-270; (1994) Aust Contract R 90-044 per Meagher JA.

107. *McCauley v Panagiotidis (No 2)* [1998] SADC 3916; (1998) LSJS 205, at para 52.

108. *Sayer v Turk* [2001] NSWSC 750, *Transcript*, Tuesday 21 August 2001.

7.71 Culture and background can be the basis of a claim of special disadvantage in both direct and indirect ways. If the guarantor has incomplete English skills and so has difficulty in reading or understanding the transaction then this may be a direct claim. However culture and ethnicity may be raised less directly, for instance when guarantors assert that their compliance with a request to execute a guarantee arise because of expected cultural roles. For example, in one case the court accepted that the wife guarantor “is of Italian descent, was brought up to honour her husband and, in matters of business, to follow his instructions” and that the husband “handled their business affairs, that she did not understand the papers which the bank asked her to sign and that no explanation was offered.”<sup>109</sup> In *Pasternacki v Correy*, Mrs Correy, who was elderly and recently widowed, gave evidence that she was reluctant to provide her house as security for her son’s loan. The son threatened to go to a “stranger” for money. The court held that “the threat to go to ‘a stranger’ was obviously culturally significant. She saw it as affecting her reputation and that of her family”.<sup>110</sup>

7.72 It is very difficult for the courts to take factors such as culture, language and ethnicity into account in a framework of “special disability” without falling into stereotypes. This may also reflect the arguments put before the court. In *State Bank v Layoun* the court considered an argument by the lender that the borrower, an eldest son, had not explained the transaction to his guarantor parents because of a culture of trust, that should be distinguished from the trust and confidence referred to in *Garcia*:

“It was submitted [by the bank] that this is a special kind of trust and confidence which is part of the Syrian culture – the eldest son in the family ‘looks after’ everyone else and is treated like a second father. ‘Whatever he says goes’. That level of trust is so high that no-one thinks to ask for, or needs an explanation from him. The trust and confidence reposed in him is, if you like, ‘blind faith’. In those circumstances, it is to be questioned whether anyone would have been concerned to hear the bank’s explanation of the transaction, given that Joseph had requested the parties to give the security. So far as they were concerned, they needed to hear nothing more.”<sup>111</sup>

7.73 That there is a “Syrian” or “cultural” exception to the principles in *Garcia* prompted the following response from the parents’ counsel:

“To suggest that the trust and confidence reposed as part of Syrian culture (arguably rendering the ‘truster’ in as great a need of the equitable protection afforded by *Garcia* as any other party falling within its principles) is not subject to scrutiny and protection in equity

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109. *Hubner v ANZ Banking Group Ltd* [1998] FCA 1779.

110. *Pasternacki v Correy* [2000] NSWCA 333 at para 33.

111. *State Bank of New South Wales v Layoun* [2001] ANZ ConvR 487; [2001] NSWSC 113 at para 47.

because it is ‘special’ and ‘Syrian’ is an inappropriate and inexcusable exception to the equitable protection offered by the Courts of this country. To hold otherwise could render a creditor’s ability to rely upon a security partly dependent upon the nationality and culture of its customers. That is not the law; to the contrary, in this regard, justice is impartial and ‘culture-blind.’”<sup>112</sup>

This submission was ultimately accepted by the Court.

7.74 In some cases courts will hold that a culture of deference by wives to their husbands may give rise to a special disadvantage on the part of the wife. For instance in *McAuley v Panagiotidis*, the court held that some of the mortgages should not be enforced against Mrs Panagiotidis. Mrs Panagiotidis was born in Greece, had less than 1 year of schooling and was illiterate in English and Greek. She was principally a housewife and carer of her five children. The court found that Mrs Panagiotidis “was part of the generation of immigrants in whose culture wives were expected to be subservient to their husbands in financial matters”.<sup>113</sup>

7.75 However findings of deference or subservience were equally held to deny relief on the basis that such wives would have agreed to the transaction no matter how well informed or advised they were. In *Micarone v Perpetual Trustees Olsson J* found that the deference of both Mrs Bechara, and Mrs Micarone to their husbands did not assist them:

“where the evidence shows that a wife has deferred to the wishes of her husband, the wife must accept the consequences of relying on her husband in that way. In such cases, the wife cannot shield behind the fact that she relied on her husband and so escape the consequences of her husband’s knowledge. Thus, although the female plaintiffs deferred to their husbands in these financial transactions, they must be treated as having the same degree of understanding as their husbands.”<sup>114</sup>

7.76 Likewise in another case, despite the court finding Mrs Mitolo’s understanding of English was poor, and accepting that she would have had a limited understanding of the legal advice given to her as it was conducted in English, the Court found

“that in business and financial matters she defers to her husband by and large” and so she “was not concerned about any advice that [the solicitor] might give. She was prepared to act on the decision of

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112. *State Bank of New South Wales v Layoun* [2001] ANZ ConvR 487; [2001] NSWSC 113 para 48 quoting the written submissions for the defendant guarantors in Reply page 8 para 19.

113. *McAuley v Panagiotidis (No 2)* [1998] SADC 3916; (1998) LSJS 205 at para 52.

114. *Micarone v Perpetual Trustees Ltd* [1999] SASC 265 at para 591.

her husband, and to a lesser extent her son, after they had listened to [the solicitor]. Accordingly, she stands or falls with them.”<sup>115</sup>

7.77 Overall we found that in only 7 of 52 litigated cases a non-English speaking guarantor was successful in having the transaction wholly or partly set aside.

## DO THE BANKS ALWAYS FINISH LAST?

“The publicity given to decisions such as *Amadio* has no doubt influenced some guarantors to concoct defences based on the cases where the guarantors have successfully avoided liability.”<sup>116</sup>

7.78 High profile cases where guarantors gain relief from the enforcement of guarantees, or statutory reform that provides increased protection for guarantors or consumers, are often followed by rising anxiety concerning the uncertainty of commercial law, expanding remedies available to consumers and an “explosion” in litigation.<sup>117</sup>

7.79 It has been argued that remedies available under the *Trade Practices Act 1974* (Cth), such as that provided by s 51AC on unconscionability, give too much protection to small business and encourage the Courts to “intrude” into commercial activity,<sup>118</sup> or that the new rules make it easy for a borrower or guarantor to avoid their legal obligations.<sup>119</sup> It has been suggested that, to the contrary, the intensely competitive lending industry is driven by a need to gain new business, and that the comparatively small number of losses in the courts are outweighed by the value of business obtained.<sup>120</sup>

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115. *National Australia Bank v Mitolo* [2002] SASC 102. See also *Cranfield Pty Ltd v Commonwealth Bank of Australia* [1998] VSC 140.

116. David Purcell, “Guarantees: their facts and validity” (2002) New South Wales Young Lawyers Continuing Legal Education Seminar Papers.

117. 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) New South Wales Young Lawyers Continuing Legal Education Seminar Papers.

118. Anne Finlay, “Unconscionable Conduct and the Business Plaintiff: Has Australia Gone Too Far?” (1999) 28 *Anglo-American Law Review* 470 at 500. On the contrary see Janine Pascoe, “The Effect of the Federal Government’s Small Business Package on Guarantees of Business Debts” (1998) *Commercial Law Quarterly* 17.

119. 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 ...”: Steven Mackay, “Banks Don’t Always Finish Last” (2002) 16 *Property Law Bulletin* 41 at 41.

120. Lynden Griggs, “Financial Institutions and Unconscionability – the banks are in the wars again” (2001) 9 *Competition and Consumer Law Journal* 88 at 92.

7.80 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. 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.<sup>121</sup>

## CONCLUSION

7.81 The data from this research clearly shows that the litigation process is a less than satisfactory way to seek redress. The research confirms that the litigation process is fraught. Excessive costs, delays and polarisation are hallmarks of litigation in guarantee transactions. Litigation is marked by a complex maze of claims and cross claims on a variety of common law and statutory bases. We found that it was common for three or more grounds of defence to be relied upon in any single matter and late amendments to pleadings were a regular event.

7.82 Legal costs are obviously high. The high cost of legal services impacts disproportionately on guarantors as they have both fewer financial resources and less experience compared to lenders. We were unable to determine clearly how many guarantors were proceeding to litigation without legal representation, although several judges stated that they saw a significant portion of unrepresented litigants.

7.83 The scope of the *Garcia* principle remains uncertain 5 years after it was handed down by the High Court, with considerable confusion about the breadth of relationships that are covered by it and what is required to be characterised as a volunteer. With this and other principles, we also found a wide variance of application in the decided cases, with some disturbing evidence of stereotyping on the grounds of gender and ethnicity.

7.84 There is a perception among some commentators that there has been an explosion in successful litigation by guarantors and the law has gone “too far” such that commercial certainty in this area has been undermined. This concern was not borne out by our research.

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121. *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.

## 8. Implications of this report

- A. Signing
- B. Later disputes

8.1 This report has collected empirical evidence on the practice of third party guarantees. This chapter outlines some of the implications of this research in two areas: first, pre-transaction conduct, and secondly, dispute resolution after a guarantee has been called upon and is disputed.

8.2 The objectives of law and policy reform in this area involve a tension between the need to protect guarantors, secure finance for small business, and provide some measure of certainty in procedure, practice and outcome for all parties concerned. This report does not suggest particular reform measures. Rather, it highlights key findings of our research and suggests how these findings need to be considered by, and may impact upon, future developments in law and policy.

## **A. SIGNING**

### **1. Guarantors in positions of vulnerability**

8.3 The evidence from this report clearly shows that women, elderly people and those from non-English speaking backgrounds are disproportionately affected by third party guarantees.

8.4 These findings highlight the need to consider these groups as the prime demographic of guarantors and to target them specifically in any reform or education measures.

8.5 This research found that many guarantors were in positions of vulnerability, either because of their emotional connection with the borrower or because of structural factors such as age, economic dependence or language skills. 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. These findings suggest that the guarantor relationship is one that is infused with inequity, and that third party guarantees may therefore be regarded as inherently suspect transactions.

### **2. Guarantor relationships and gender**

8.6 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.

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

### 3. Informational disparity

8.8 It appears common for guarantors to sign in situations where they have little information or are misinformed 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.

8.9 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.

8.10 The inclusion of “All Moneys” clauses is still apparently occurring in guarantee transactions despite moves from the Australian Banker’s Association in 1993 to prohibit them in at least some circumstances through the *Code of Banking Practice*. These clauses are very widely regarded as problematic, as they extend liability to future as well as past and present loans. A significant proportion of guarantors in our study did not discover that they had even signed an “all moneys” guarantee until it was called upon. 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.

### 4. The circumstances of signing

8.11 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 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.

8.12 These findings openly 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 lenders’ premises in formal circumstances, in the absence of the borrower and following the receipt of independent legal advice.



8.13 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.

## 5. Legal advice

8.14 In addition to a generally low number of guarantors receiving legal advice, guarantors of non-English speaking background appear particularly likely to enter guarantee transactions unadvised. These findings suggest that greater efforts need to be taken to make guarantors, especially those of non-English speaking background, aware of the need for such advice. Measures may also need to address the accessibility of legal advice avenues that are unrelated to the borrower or lender.

8.15 The research found that, of those guarantors who did receive advice prior to entering into the transaction, there was often a short time between such advice and signing. This means that there was no real chance to consider any advice and act upon it. This finding, in addition to those above in paragraphs 5.28-5.46 above, suggest that a “cooling off” period may assist in giving guarantors the opportunity to consider what information they do have in relation to the transaction. Such a “cooling off” period could relate to the period between being advised and signing, or between signing and the commencement of the legal effect of the guarantee, or both.

8.16 There were also very serious concerns about the content of legal advice. Our guarantors reported advice that was scant, hurried and in two instances, partisan for another party and plainly not independent. Lawyers saw their role as very limited. There appears to be 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 and does not extend to advising on the wisdom of entering into the transaction, the likely results or risks faced, or any alternative forms of transaction.

8.17 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.

## 6. Lack of regulation

8.18 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), 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.

8.19 Some of the problematic areas relating to guarantee practice *may* be assisted by the new provisions of the Code of Banking Practice. From August 2003 the Code of Banking Practice has greater coverage and enhanced guarantor protections. It 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. However the Code of Banking Practice 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. Further, the fact that if the Code of Banking Practice is breached by a bank and a complaint is made under it, the jurisdiction of the dispute resolution body is limited and easily ousted, may limit its effectiveness in acting as a deterrent (dispute resolution is discussed further below). Further, the proliferation of non-bank lenders and mortgage and loan brokers means that there are increasing numbers of lenders who fall outside of the Code.

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

## B. LATER DISPUTES

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

### 1. Litigation is inadequate

8.22 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 prior to judgment.

8.23 The comparative resources available to some parties to a litigated dispute about a guarantee are overwhelmingly disproportionate and it appears that many guarantors are proceeding with inadequate preparation, sometimes on a self-represented basis.

8.24 It appears that the complex and multiple factors that lead guarantors to enter into disadvantageous transactions are not readily translatable into existing legal categories of wrong. Courts have struggled to recognise experiences of disadvantage without resort to categories which stereotype the participants. Likewise existing law tends to assume forms of simplified power in which one party is empowered/advantaged and the other victimised, such that any degree of choice or empowerment by a claimant disentitles them to relief. In this respect the more flexible application of the *Contracts Review Act 1980* (NSW) has offered more scope to weigh the competing conduct of all parties to determine a fair result.

8.25 Yet the application of flexible and discretionary legal principles in decided cases – particularly the *Contracts Review Act* and the “special equity” for wives in *Garcia* – has been inconsistent and contributed to uncertainty. It appears that there are too many legal principles that are too uncertain in their application for any degree of predictability in this area.

## **2. Need for certainty**

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

8.27 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.

8.28 Enhanced regulation of pre-transaction conduct in taking guarantees, and greater uniformity in the regulation of the entire finance industry would also contribute to greater certainty.

## **3. The costs of dispute resolution**

8.29 Dispute resolution is costly and such costs appear to be increasing with time. This expense is in part due to a high reliance upon litigation to resolve disputes. There are issues with both the overall cost of dispute resolution and where the burden of those costs falls.

8.30 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.

8.31 While costs usually follow the result in litigation, the fact that most cases settle prior to or during litigation means that even guarantors who have strong claims or are only partially successful in their claims typically bear the costs of the dispute.

8.32 Considering that it is lenders who profit from the interest from the loan, that guarantors are volunteers who do not gain by the loan, and that lenders have already transferred the risk of lending to the guarantor, this seems an unfair additional burden. 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.

8.33 These findings suggest the need to consider both how to lower or control the costs of dispute resolution in this area and the impact of costs clauses in dispute resolution processes and outcomes.

#### **4. The need for accessible dispute resolution**

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

8.35 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. Jurisdictional limits such as low monetary limits on the value of the dispute (\$150,000 for the Australian Banking Industry Ombudsman) almost entirely excludes guarantees secured by residential properties. Jurisdictional limits on “consumer” rather than “business” transactions (such as the Consumer, Tenancy and Trading Tribunal) exclude guarantees that were given for the purposes of supporting business borrowing.

8.36 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 unusable as dispute resolution mechanisms for third party guarantee matters.

8.37 In addition, the voluntary nature of bank participation in the Australian Banking Industry Ombudsman scheme and the fact that any

dispute before it can be ousted by commencing litigation means that even a higher monetary limit would not necessarily enhance its coverage of the field if lenders were unwilling to use it.

8.38 The utility of informal dispute resolution processes may be limited if they are seen as merely a prelude to litigation, or if they do not offer parties a real opportunity to air their case. There is also the risk that informal mechanisms can exacerbate rather than reduce existing power and information imbalances between parties.

8.39 There is a clear need for a relatively even playing field in which disputed transactions can be heard and adjudicated in a structured yet accessible forum. Such forums are in addition to other avenues such as formally or informally mediated or negotiated settlements.

# A. The research methodology

- Approach and methodology
- Survey development, design and distribution
- Acknowledgements and confidentiality

A.1 The purpose of this research project was to examine the incidents of third party guarantee transactions, with particular reference to guarantees relating to business loans. The overall aim was to get a picture of the impact of third party guarantees on guarantors, as well as information from key stakeholders involved in guarantee transactions including lenders, lawyers and financial advisors and consumer advocates.

A.2 The project directed particular attention to the experience of guarantors in situations of particular vulnerability, such as guarantors who are women in relationships with borrowers, elderly relatives, guarantors from a non-English speaking background, or a combination of the above.<sup>1</sup> This is because it appeared that a high proportion of the reported cases involve guarantors who are drawn from these groups and thus we identify them as “high risk”.

A.3 The scope of the research was informed by a review of background material and consultations with key stakeholders, organisations and consumer advocates. Background materials used to inform our research included:

- Case law: reported and unreported;
- Research papers;<sup>2</sup>
- Industry reports and annual reports (including government policy documents relating to consumer and business credit and debt);
- Academic and professional literature on issues arising in the law on guarantees and the law of unconscionability more generally;
- secondary information on industry practice; and
- New South Wales Law Reform Commission’s Issues Paper 17: *Guaranteeing Someone Else’s Debts*.

## APPROACH AND METHODOLOGY

A.4 This research is breaking new ground as there is little available data in this area, for instance basic statistics such as how often third party guarantees are taken, what the criteria is for their use and what proportion of business loans are supported by guarantees from friends or relatives.

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1. See Expert Group on Family Financial Vulnerability, *Good Relations, High Risks: Financial Transactions Within Families and Between Friends* (Report, 1996) at 10.
  2. In particular, the Expert Group on Family Financial Vulnerability, *Good Relations, High Risks: Financial Transactions Within Families and Between Friends* (Report, 1996); Belinda Fehlberg, *Sexually Transmitted Debt: Surety Experience and English Law* (Clarendon Press, 1997); Radmila Jukic, *Till Debt Do Us Part* (Consumer Credit Legal Service, 1994); *For Love Not Money: Women, Information and the Family Business* (Consumer Advocacy and Financial Counselling Association of Victoria Inc, 1995).

Most of the available analysis of third party guarantees focuses almost exclusively on the outcomes of litigation. While an analysis of the case law is an element of our approach, we also wanted to examine the process of taking third party guarantees at the other end of the process, that is, at the early stages of the transaction.

A.5 Given the absence of any defined sampling frame, this research was exploratory in nature. One of the aims of this research was to investigate the circumstances in which guarantors considered to be in situations of financial vulnerability, such as women in relationships with borrowers, elderly relatives, guarantors from a non-English speaking background, or a combination of the above, enter into guarantee or guarantee-like transactions.

A.6 The project collected data from a number of sources using a multi-method, multi-data approach, also known as triangulation.<sup>3</sup> This diversity allowed the researchers to compare and contrast data from different perspectives. This approach has the benefit of addressing issues of validity and one-sided accounts. The sample included guarantors, legal practitioners (solicitors, barristers and judges) and lenders. The project also undertook a comparative review of litigated cases in the area of third party guarantees. Most data was obtained from survey instruments. However, material from other stakeholders with interest or expertise in the area of third party guarantees was obtained by semi-structured interviews or consultations. The diversity of methodologies permitted the inclusion of both qualitative and quantitative information in this research.

A.7 Given the exploratory and sometimes sensitive nature of the research, we considered it essential to be flexible to include other sources of information. The emphasis on the qualitative approach, and triangulation in sourcing the data, allowed us to obtain a useful snapshot of the complexities operating during the course of the life of guarantee transactions.

A.8 A mixture of qualitative and quantitative data collection approaches were used, including:

- Consultations with lawyers, financial counsellors and consumer advocates with direct expertise in third party guarantee matters;
- Consultations with representatives from peak organisations whose constituents may have experience with third party guarantee or related financial issues;

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3. Robert Burgess, “Multiple Strategies in Field Research” in Robert Burgess (ed), *Field Research: A Sourcebook and Field Manual* (Routledge, 1991) at 163.



- Surveys of:
  - guarantors about their experiences with third party guarantees;
  - lenders about the criteria for taking third party guarantees, and policies and procedures which cover the use and enforcement of guarantees;
  - solicitors and barristers about their experiences advising and dealing with clients (guarantors, borrowers or lenders) with third party guarantees;
  - judges about their experiences with the litigation of third party guarantee cases;
- Case studies from consumer advocacy organisations such as community legal centres, financial counselling services, the Australian Banking Industry Ombudsman and the Legal Aid Commission of NSW;
- Analysis of statistical data from financial organisations and peak bodies;
- Comparative analysis of decisions made by courts; and
- Observations of the conduct of cases in courts and tribunals and analysis of cases currently being pursued through the courts (including examination of a sample of files involving disputed guarantees at the New South Wales Supreme Court).

A.9 The research was designed to develop a clear understanding of the law and practice relating to third party guarantees as understood by the courts, lawyers and consumer advocates, credit providers and guarantors themselves. Where information was otherwise not forthcoming, we also included information from other sources such as reports, reviews by other policy or compliance bodies and submissions to the New South Wales Law Reform Commission’s inquiry into third party guarantees.

A.10 This research was undertaken through both questionnaire and direct interviews. The approach to the surveys is outlined in detail below.

## **SURVEY DEVELOPMENT, DESIGN AND DISTRIBUTION**

A.11 Consultations were undertaken with academics and representatives from a wide range of organisations who have experience dealing with third party guarantees. The consultants, some of whom formed an informal “Reference Group” included representatives from financial counselling services,<sup>4</sup> solicitors and barristers in private practice, community legal centres,<sup>5</sup> the Legal Aid Commission of New South Wales and government

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4. In particular, the Financial Counselling Service of NSW.

5. In particular, the Consumer Credit Legal Centre NSW and the Women’s Legal Resource Centre.

consumer protection policy officers<sup>6</sup> as well as representatives from the finance industry sector.<sup>7</sup> These consultations helped to crystallise the issues for further research and assisted us to identify the best means to obtain further information from parties involved in such transactions. Most consultations were conducted in the early stages of the project, as their purpose was not only to elicit perceptions and opinions on issues of relevance to the study, but also to inform the design and development of the research strategies to be pursued.

A.12 Much of the data collected for this research was by way of survey. There were five separate survey documents (for guarantors, lenders, solicitors, barristers and judges). Surveys were either self-completed, or conducted over the telephone as a semi-structured interview.

A.13 The development and design of each survey is discussed in further detail below.

### **Guarantor Survey**

A.14 Urbis Keys Young, a consultancy firm, was engaged to assist in the design of the survey instrument. A draft of the survey instrument incorporated comments and feedback from the Reference Group. As the first survey instrument developed for this project, the guarantor survey informed the development of subsequent surveys.

A.15 In its final form the guarantor survey consisted of four parts:

- Part 1 asked for background information on the guarantor;
- Part 2 sought information about the transaction that caused them problems;
- Part 3 sought information about what happened once they found out there was a problem with the loan, and provided opportunity to make any other comments;
- Part 4 asked for responses from guarantors of business loans.

A.16 All interviews were conducted on a confidential basis using a semi-structured interview format. This format allowed for consistency between interviews, but gave the opportunity to raise other issues important with the participants. To an extent, the data collection process with the guarantors was exploratory and self-reflexive.

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6. In particular, the NSW Department for Women and the NSW Department of Fair Trading.

7. In particular, assistance was obtained from the Australian Finance Conference and the Credit Union Services Corporation Limited (CUSCAL).

A.17 The method of selecting interviewees commenced with a call for volunteers, with some initial assistance from consumer advocacy and financial counselling organisations.<sup>8</sup> This subsequently fostered a “snow-ball” process, with initial volunteers and organisations suggesting other prospective respondents. A large media campaign targeted regional and rural areas, as well as emphasis on the ethnic media.

A.18 A copy of the survey is reproduced at Appendix D.

***A note on our approach to the guarantor survey***

A.19 This project sought to investigate the instances and prevalence of people becoming liable for other people’s debts. While there was anecdotal evidence that the situation affected more women than men, the researchers did not approach the task of finding respondents with partiality or presumptions. The researchers were mindful, in this respect, that the validity of our inquiry depends on the recognition of a plurality of interests within the community.<sup>9</sup> We sought to be surprised by our data rather than having pre-existing assumptions confirmed.

***Distribution of surveys***

A.20 The guarantor survey was widely publicised throughout the community sector via consultations, conferences and mail-out from late 2001 through to 2002. Leaflets and surveys were posted directly to community legal centres and financial counselling services in New South Wales, many of whom publicised the survey through their networks, newsletters and other publications. A media campaign targeted metropolitan, suburban, regional and rural newspapers, magazines and radio stations. Radio interviews with the project worker greatly assisted in generating interest in the surveys.<sup>10</sup> We also publicised the project via consumer advocacy networks and electronic bulletin boards.<sup>11</sup>

A.21 One previous study focusing on women and the family business identified an under-representation of people from non-English speaking background in their research.<sup>12</sup> To ensure that views of people from non-

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8. Including Community Legal Centres, the Legal Aid Commission of NSW, Financial Counselling Service of NSW.

9. John Barnes, *Who Should Know What? Social Science, Privacy and Ethics* (Penguin, 1979).

10. The research was publicised by radio interviews on local ABC radio stations, the Alan Jones Show on Radio 2UE and SBS Radio.

11. Such as the Australian Consumers’ Association and the National Association of Community Legal Centres; we also sent information to the NSW Farmers’ Association, the Country Women’s Association and various electronic bulletin board services including the Rural Women’s Network.

12. Supriya Singh, *For Love Not Money: Women, Information and the Family Business* (Consumer Advocacy and Financial Counselling Association of Victoria Inc, 1995) at 20.

English speaking backgrounds were reflected in our research, we publicised the guarantor surveys in non-English language newspapers, and in adult migrant education and resources centre agencies. Editorials and advertisements were placed on SBS radio in three languages other than English (Vietnamese, Spanish and Arabic).<sup>13</sup> Telephone interpreters were used for interviewing guarantors who had difficulty communicating in English.

A.22 The survey was also publicised by stories published in regional and rural newspapers and magazines throughout late 2001 and early 2002, as well as stories and interviews on regional and rural radio.

### ***Response***

A.23 We actively sought to interview guarantors who had “good experiences”, as well as those who had experienced problems with the loan they guaranteed. Some respondents were found through contacts within the financial counselling services and community legal centre sector whose clients were by definition, those who had problems. Not surprisingly, most of the stories we heard were the “bad news” stories. While these responses cannot be taken to represent comprehensively the gravity or prevalence of problems with third party guarantees, the survey provides invaluable insight into the range of problems experienced by guarantors.

A.24 Eighty six per cent of our respondents were from New South Wales. Of those who were not, 4 respondents were from the ACT, 5 from Victoria and 1 each from Queensland, Western Australia and South Australia. Of the NSW respondents, a significant proportion from regional NSW. While 49% of respondents were from metropolitan NSW, 30% live in regional NSW reflecting a significant range of coverage.

A.25 We were aware that a low level of literacy was a problem for a significant number of guarantors: this was often a reason that they unwittingly became a guarantor or co-borrower in the first place. To overcome this as a barrier to filling in the survey, we encouraged people to telephone us so we could take them through the survey. We also made telephone interpreting services available at no cost to the respondents.

A.26 Consistent with research into other relationships which involve some kind of family conflict or breakdown, and confirmed by many advocates in our initial consultations, it is difficult for people to speak out about problems with a difficult personal (and in particular, familial) element. While our data reflects only a limited sample, it is very likely that there are large numbers of people who are unwilling or unable to talk about these kinds of problems. Many of those who did participate in our survey were at

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13. We chose these languages after we consulted credit and debt caseworkers to find the three community groups whose constituents were, in their opinion, most likely to have problems with third party guarantees.

pains to stress they wished to remain anonymous. Many respondents were ashamed at the situation they now found themselves in, or were embarrassed and didn't want to cause undue harm to anyone else in their family. Some had never spoken to anyone at all about their situation, and had just taken on the responsibility for paying someone else's debt quietly, but with extreme hardship. Many said that they only spoke up because they felt it important that other people don't get into the same situation they found themselves in. Nonetheless, there was a high level of co-operation during interviews from those who contacted us to participate in the survey.

A.27 Given the barriers to participation, we consider that the response to the guarantor survey was very good. In the end, the research project processed 87 surveys from guarantors. In addition, we received numerous informal submissions through telephone inquiries and letters. There were also several in-depth interviews before the survey document was finalised; these were treated as qualitative interviews. These interviews are not included in the statistical data. Where these informal submissions are used, they are referred to as interviews or confidential submissions.

A.28 Over half of the guarantors who participated in our survey had entered the transaction between the years 1993 and 2002 (51 of 87 respondents). Therefore a reasonable proportion of the data collected by the project reflects the way transactions are conducted since significant changes to law and practice as a result of the Australian Banker's Association Code of Practice 1993, the *Contracts Review Act 1980* (NSW) and the decisions in *Garcia* (1998) and *Amadio* (1983).

## **Solicitor Survey**

### ***Development***

A.29 The questionnaire for solicitors was developed by project staff who had worked with the consultants from Urbis Keys Young Pty Ltd during development of the guarantor survey.

A.30 The draft solicitor survey was piloted by a number of solicitors with experience in the area of third party guarantees. Valuable comments were incorporated into the final version of the survey. The survey of solicitors sought information about pre-contractual advice and post transaction disputes.

A.31 In its final form the solicitor survey consisted of four parts:

- Part 1 asked for background information on the solicitor and their practice;
- Part 2 sought information about legal advice given to guarantors (in the last 10 years) prior to the guarantor signing a contract to secure a loan. Many questions in this part focused on the last time such advice was given;

- Part 3 sought information about the enforcement of guarantees and guarantee-like situations (in the last 10 years). Many questions focused on the last time such advice was given. These questions were addressed to solicitors who had acted for both guarantors and lenders.
- Part 4 asked for responses to general questions and provided an opportunity for solicitors to make additional comments.

### ***Distribution and follow up***

A.32 An article seeking input from solicitors was published in the *Law Society Journal* in May 2002.<sup>14</sup> The solicitor survey was mailed to community legal centres in New South Wales, relevant law firms listed in *Legal Profiles*<sup>15</sup> and to accredited specialists listed in the NSW Law Society's Directory of New South Wales Accredited Specialists in relevant areas of law.<sup>16</sup>

A.33 In addition, surveys were sent to solicitors who had represented parties in recent third party guarantee litigation. Solicitors were contacted by phone or email 2-3 weeks after the survey was sent to them to encourage completion if they had not already done so. In September 2002 the project team stopped actively seeking further responses to the Solicitor Survey.

### ***Response***

A.34 The research project received and processed responses from 89 solicitors. The data provides a useful picture of the current practices in relation to legal advice to guarantors and perceptions of solicitors about their role in providing legal advice to third party guarantors.

A.35 Respondents consisted of solicitors who had acted for guarantors, borrowers and lenders. There was a roughly equal number of responses from solicitors for guarantors and lenders. Responses were often coloured by what "side" of the transaction the solicitor's client was from. The involvement of solicitors who acted for lenders helped to make the study more representative, as the bulk of lenders, by their own choice, did not participate.

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14. Kirsten Anker, "Getting to the bottom of third party guarantees" (2002) 40 *Law Society Journal* 34.

15. Surveys were sent to law firms practicing in the areas of Retail Banking & Consumer Credit, Corporate Advisory, Competition Law and Consumer Protection, Debt Recovery, Project & Structured Finance. See *Legal Profiles* 2001-2002 edition, at <http://www.legalprofiles.com.au>.

16. This included specialists in Advocacy (commercial law and common law); Business law (business disputes, business structures, commercial real estate, corporations law, insolvency, business/companies sale and purchase); Commercial litigation (corporations law, insolvency law, banking law) and Property law (Mortgages and securities law).

## **Barrister Survey**

### ***Development***

A.36 The research team decided to undertake a survey of barristers to better understand the conduct of litigation of third party guarantee matters. Barristers have specialised knowledge about the conduct of litigation, whereas solicitors are usually more heavily involved at the earlier stages of disputes. The barrister survey was developed in a similar fashion to the solicitor survey.

A.37 In its final form the barrister survey consisted of three parts:

- Part 1 asked for background information on the barrister and their practice;
- Part 2 sought information about barristers acting in a matter involving a guarantee or guarantee-like transaction (in the last 10 years). Many questions in this part focused on the last time the barrister acted for such a person. These questions were addressed to barristers who had acted for both guarantors and lenders.
- Part 3 asked for responses to general questions and provided an opportunity for barristers to make additional comments.

### ***Distribution and follow up***

A.38 The barrister survey was sent to all practitioners who listed contracts, banking and equity as areas of practice on the NSW Bar Association website. Barristers listed as counsel in recent litigation in the area of interest were also sent a copy of the survey. In addition, several clerks from chambers in Sydney and other regional chambers were contacted and asked to bring the survey to barristers' attention. Follow up was by way of phone call or email to the barristers' clerks 2-3 weeks after the surveys were first sent. The survey was also advertised in the *Bar Brief*.<sup>17</sup>

### ***Response***

A.39 A total of 47 surveys from barristers were processed. This consisted of barristers who had acted for guarantors, borrowers and lenders.

## **Judge Survey**

### ***Development***

A.40 After identifying areas of further interest from responses to the solicitor and barrister surveys the research team formulated a brief survey for completion by judges. In particular, we were interested in the settlement prospects and rates of litigation in third party guarantee

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17. A newsletter of the NSW Bar Association. See (2002) 94 (June) *Bar Brief* at 20.

matters. The survey was piloted on 3 judges, whose valuable comments were incorporated into the final survey instrument.

***Distribution and follow up***

A.41 The judge survey was sent to all judges of the Supreme Court of NSW, District Court of NSW, and Federal Court of Australia.

***Response***

A.42 A total of 46 surveys from judges were processed. A number of judges responded that they had little or no experience adjudicating matters relating to third party guarantees, but very detailed comments were received from those who did have experience.

**Lender Survey**

***Development***

A.43 The Reference Group assisted with development of an instrument to survey lenders about their experiences with third party guarantees and guarantee-like transactions. It was hoped that the participation of the finance sector in this research would help us to identify both lenders' current practices in seeking guarantees, and how they believe the law might regulate this area while protecting their legal and business interests. This information was sought by means of a survey of credit providers, to be supplemented, where appropriate, with interviews conducted with in-house legal counsel in a number of key financial institutions.

A.44 The final survey comprised questions seeking statistical information on the incidence and prevalence of third party guarantees, information on guidelines as they relate to third party guarantees, and information on enforcement of third party guarantees.

***Distribution, follow up and response rate***

A.45 Survey documents were sent to 112 lenders including banks, building societies, credit unions and finance companies.<sup>18</sup> Assistance was sought from lenders' peak bodies, including the Australian Bankers' Association ("ABA"), the Australian Finance Conference ("AFC") and Credit Union Services Corporation Limited ("CUSCAL") requesting that they encourage their members to participate in the research. The ABA did not respond to our survey, however the AFC and CUSCAL did give valuable assistance.

A.46 Lenders were sent follow up correspondence after one month, and major lenders were telephoned several times over the months that followed.

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18. The confidential nature of the research means the project can not publish the names of the lenders.



A.47 The response from the finance industry was, largely, very disappointing. Only two major banks, 2 smaller bank lenders and 3 finance companies responded to the survey and provided the project with information of varying substance.<sup>19</sup>

A.48 To analyse lender practice, the project made use of data from submissions the Law Reform Commission received in response to *Issues Paper 17: Guaranteeing Someone Else's Debts*.

## Case Law Review

A.49 It was hypothesised that an analysis and comparison of decisions of higher and lower courts and tribunals would reveal significant variations in their understandings or applications of the law in this area. However, at an early stage in the project it was apparent that lower courts and tribunals either do not hear many third party guarantee cases, or have insufficient resources to track the matters. The Consumer Trader & Tenancy Tribunal ("the CTTT") and its predecessors have a limited jurisdiction to hear third party guarantee matters.<sup>20</sup> While there are some decisions coming from the District Court, it has no process for identifying when third party guarantee cases are heard. Our consultations and research confirmed that the vast majority of third party guarantee matters that proceed to litigation in New South Wales are heard in the Supreme Court. However, some third party guarantee matters appear in the Federal Court as part of a bankruptcy matter, or under the unconscionability provisions of the *Trade Practices Act 1974* (Cth).

A.50 To enable a comparative analysis of the courts' decisions, the research team undertook a review of reported and unreported cases involving third party guarantees decided since the High Court's decision in *Garcia* in 1998. 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, mostly mirroring the issues raised in the guarantor and lawyer surveys.<sup>21</sup> The cases analysed for the case law review are indicated with an asterix in the case index in Appendix C. A number

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19. We also had letters from 2 building societies and 2 minor banks stating that they either do not keep the kind of information we were seeking or do not provide loans which require guarantees.

20. Claims at the CTTT are limited to matters under the Consumer Credit Code. As such there is no jurisdiction to hear matters involving commercial loans; nor is there jurisdiction to hear *Contracts Review Act 1980* (NSW) claims.

21. It was not always possible to identify each of the issues from the judgments. Wherever possible, court files were examined to get the information not referred to in a judgment. Nonetheless, the review of litigated cases represented a significant analysis of the current common law.

of significant decisions were handed down in late 2002 and early 2003. These are not part of the case law review, but are discussed in detail in the report.

## **ACKNOWLEDGEMENTS AND CONFIDENTIALITY**

A.51 An important issue in the conduct of this research project was the issue of confidentiality. We wished to encourage respondents to speak freely about their experiences and attitudes. All survey respondents were informed of the confidential nature of the research and assured that no identifying information would be included in our published findings. The research team adhered to relevant protocols relating to confidentiality as required by the University of Sydney Human Ethics Committee. Survey respondents and interview participants took part voluntarily after being approached by members of the project team, or being contacted and invited to participate by their financial or legal advisers.

A.52 We are extremely grateful to those who took the time to respond to the surveys. In particular, the researchers are indebted to consumer advocate groups for encouraging their clients to respond, and to the guarantors themselves for their willingness to contribute their stories.

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## **D.** Guarantor survey



## Guaranteeing Someone Else's Debts

GUARANTOR SURVEY

This questionnaire is designed to get an idea of **what happened to you when you guaranteed someone else's debt** (as a guarantor), or became fully responsible for a debt that you shared with someone else (for example, as a co-borrower or joint credit card holder).

This information is for research and statistical purposes only.  
**All your answers will remain strictly confidential.**



NSW Law Reform  
Commission

**AUGUST 2001**



University of  
Sydney

## UNDERSTANDING THIS SURVEY

**All moneys mortgage** refers to a guarantee or mortgage agreement which applies to an original amount and to all future debts between the borrower and the lender.

**Co-borrower** or **joint borrower** is a person who has borrowed money with another person and is legally responsible to pay the whole debt.

**Cooling off period** refers to a short period of time after an agreement has been made during which one or both parties can decide to not go ahead with the agreement.

**Independent advice** is advice received from someone who is not involved or has no interest in the matter for which they are providing advice.

### What does guaranteeing someone else's debts mean?

If you have guaranteed someone else's debt it means you have agreed to repay the whole of the other person's debt if that person does not pay.

### What is the difference between a business loan and a personal loan?

A personal loan is generally for an item like a car, boat, housing mortgage or furniture. It is not connected to any business or commercial activity. A business loan is a loan connected to a business, eg equipment for a business or extra money to help run or setup a business.

## HOW TO CONTACT US

**If you need assistance answering this survey, please contact us.**

### NSW LAW REFORM COMMISSION

STREET ADDRESS Level 17, 8-12 Chifley Square, Sydney

POSTAL ADDRESSES GPO Box 5199, Sydney NSW 1044 or DX 1227, Sydney

TELEPHONES VOICE (02) 9228 8230 or TTY (02) 9228 7676 or FAX (02) 9228 8225

EMAIL [nsw\\_lrc@agd.nsw.gov.au](mailto:nsw_lrc@agd.nsw.gov.au)

INTERNET [www.lawlink.nsw.gov.au/lrc](http://www.lawlink.nsw.gov.au/lrc)

## WOULD YOU LIKE TO PARTICIPATE AGAIN?

If you would be willing to take part in a more detailed, strictly CONFIDENTIAL discussion about your experience, please write down your contact details here:

FIRST NAME \_\_\_\_\_

ADDRESS \_\_\_\_\_

EMAIL ADDRESS \_\_\_\_\_

AND/OR TELEPHONE NUMBER \_\_\_\_\_

## A. INTRODUCTION

**1. Which country were you born in?**

1  Australia

2  Other PLEASE SPECIFY \_\_\_\_\_

**2. (a) Is English your first language?**

1  Yes

2  No

**(b) Would you say your ability to speak English is:**

1  Weak

2  Fair

3  Good

4  Very good

**(c) Would you say your ability to read English is:**

1  Weak

2  Fair

3  Good

4  Very good

**3. Which one of these age groups are you in?**

1  Under 30 years

2  30-39 years

3  40-49 years

4  50-59 years

5  60 years or over

**4. Which one of these best describes your highest level of education?**

1  No schooling

2  Primary school

3  Some secondary school

4  Completed secondary school

5  Technical or trade qualification

6  University

7  Other PLEASE SPECIFY \_\_\_\_\_

**5. Your gender?**

1  Male

2  Female

**6. Your postcode?**

PLEASE SPECIFY \_\_\_\_\_

**B. THE TRANSACTION THAT CAUSED YOU PROBLEMS**

**7. Thinking of the loan that you guaranteed for another person, or the debt that you became responsible for, which ONE of the following best describes what that situation was?**

- 1  You guaranteed a business loan for somebody else  
(eg equipment for the business or money to help run the business)
- 2  You guaranteed a personal loan for somebody else  
(eg to help them buy a car or furniture etc)
- 3  You jointly took out a business loan with another person (ie as a co-borrower)
- 4  You jointly took out a personal loan with another person
- 5  You got a joint credit card with another person
- 6  Not sure/can't remember
- 7  Some other situation PLEASE SPECIFY \_\_\_\_\_
- \_\_\_\_\_
- \_\_\_\_\_

**8. (a) Was that loan for a set amount, or an indefinite or unlimited amount?**

- 1  Set amount
- 2  Indefinite or unlimited GO TO QUESTION 9
- 3  Not sure/can't remember GO TO QUESTION 9

**(b) If set amount, roughly how much was the loan for?**

- 1  Less than \$10,000
- 2  Between \$10,001 and \$20,000
- 3  Between \$20,001 and \$50,000
- 4  Between \$50,001 and \$100,000
- 5  Between \$100,001 and \$200,000
- 6  Over \$200,000
- 7  Not sure/can't remember

**9. What year was that loan or credit card taken out? PLEASE SPECIFY \_\_\_\_\_**

**10. (a) Who was the other person whose loan you guaranteed (or the other person with whom you took out the loan or credit card)?**

- 1  Your husband/wife or partner
- 2  Your son
- 3  Your daughter
- 4  Your parent(s) or grandparent(s)
- 5  Your brother/sister
- 6  Some other relative
- 7  A friend
- 8  A business associate
- 9  Someone else PLEASE SPECIFY \_\_\_\_\_

**10. (b) At that time, about how long had you known that person?**

PLEASE SPECIFY \_\_\_\_\_ YEARS

**11. Who made that loan or issued that credit card?**

- 1  A bank
- 2  A credit union
- 3  Some other finance institution
- 4  A shop or other sales outlet
- 5  An individual person
- 6  Other PLEASE SPECIFY \_\_\_\_\_
- 7  Not sure/can't remember

**12. Whose idea was it to enter into this arrangement?**

- 1  My idea
- 2  The other person's idea
- 3  Both of us
- 4  The lender
- 5  Somebody else PLEASE SPECIFY \_\_\_\_\_
- 6  Not sure/can't remember

**13. How would you describe your own financial situation at that time, was it:**

- 1  Very weak
- 2  Fairly weak
- 3  Fairly strong
- 4  Very strong

**14. At that time, were the following statements true or not true for you?  
(tick one number on each line)**

- (a) The other person pressured me into making that arrangement  
(eg the guarantee, joint loan or credit card)  
1  TRUE                      2  NOT TRUE                      3  NOT SURE/CAN'T REMEMBER
- (b) I felt that I understood pretty well what I was doing  
1  TRUE                      2  NOT TRUE                      3  NOT SURE/CAN'T REMEMBER
- (c) I was nervous or worried about this arrangement from the start  
1  TRUE                      2  NOT TRUE                      3  NOT SURE/CAN'T REMEMBER
- (d) I had previously made other arrangements or commitments similar to this one  
1  TRUE                      2  NOT TRUE                      3  NOT SURE/CAN'T REMEMBER
- (e) I thought that at the worst I would have to help the other person pay  
back their debts  
1  TRUE                      2  NOT TRUE                      3  NOT SURE/CAN'T REMEMBER

THIS QUESTION CONTINUES OVER THE PAGE

- (f) I felt I had a good understanding of the other person's financial situation (eg that person's business or assets)  
 1  TRUE                      2  NOT TRUE                      3  NOT SURE/CAN'T REMEMBER
- (g) I thought it was maybe a silly thing to do but I did it anyway  
 1  TRUE                      2  NOT TRUE                      3  NOT SURE/CAN'T REMEMBER
- (h) I could not read, or could not understand, the documents that I signed  
 1  TRUE                      2  NOT TRUE                      3  NOT SURE/CAN'T REMEMBER

**15. And looking back from the present time, are the following statements true or not true for you? (tick one number on each line)**

- (a) More written information about the loan/guarantee/credit arrangement would have helped me a lot  
 1  TRUE   2  NOT TRUE   3  NOT SURE/CAN'T REMEMBER   4  NOT RELEVANT IN MY CASE
- (b) More written information about the other person's financial situation would have helped me a lot  
 1  TRUE   2  NOT TRUE   3  NOT SURE/CAN'T REMEMBER   4  NOT RELEVANT IN MY CASE
- (c) A 'cooling off' period before I signed up would have helped me  
 1  TRUE   2  NOT TRUE   3  NOT SURE/CAN'T REMEMBER   4  NOT RELEVANT IN MY CASE
- (d) I may not have signed if the lender had explained why my signature was required  
 1  TRUE   2  NOT TRUE   3  NOT SURE/CAN'T REMEMBER   4  NOT RELEVANT IN MY CASE
- (e) No matter how much information I had then, I would still have gone ahead with the arrangement  
 1  TRUE   2  NOT TRUE   3  NOT SURE/CAN'T REMEMBER   4  NOT RELEVANT IN MY CASE
- (f) A simple spoken explanation of what my obligations were would have helped me  
 1  TRUE   2  NOT TRUE   3  NOT SURE/CAN'T REMEMBER   4  NOT RELEVANT IN MY CASE
- (g) What happened was just bad luck that could have happened to anybody  
 1  TRUE   2  NOT TRUE   3  NOT SURE/CAN'T REMEMBER   4  NOT RELEVANT IN MY CASE
- (h) It turned out that the other person's financial situation was very different from what I thought then  
 1  TRUE   2  NOT TRUE   3  NOT SURE/CAN'T REMEMBER   4  NOT RELEVANT IN MY CASE

**16. Did anyone suggest that you should get independent advice about this loan or credit card arrangement before you signed the documents (that is, advice from the lender or a friend)?**

- 1  Yes   PLEASE SPECIFY \_\_\_\_\_
- 2  No
- 3  Not sure/can't remember

**17. Did you in fact get any independent advice before you signed?**

- 1  Yes
- 2  No GO TO QUESTION 19
- 3  Not sure/can't remember GO TO QUESTION 19

**18. If you did receive independent advice please answer the following:**

**(a) Who did you get independent advice from? (tick each number that applies)**

- 1  The other person's lawyer
- 2  A lawyer not connected with the other person or with the lender
- 3  A financial counsellor not connected with the other person or the lender
- 4  Somebody else PLEASE SPECIFY \_\_\_\_\_

**(b) Was that independent advice in writing?**

- 1  Yes
- 2  No
- 3  Not sure/can't remember

**(c) About how long did you have to consider that advice before you signed?**

- 1  Very little time, I had to sign the same day
- 2  One or two days
- 3  Between 2 days and a week
- 4  More than a week
- 5  Not sure/can't remember

**(d) Was that independent advice clear and easy to understand?**

- 1  Yes
- 2  No
- 3  Not sure/can't remember

**(e) Did that advice encourage you to go ahead?**

- 1  Yes
- 2  No
- 3  Not sure/can't remember

**(f) Did that advice make you worried or concerned?**

- 1  Yes
- 2  No
- 3  Not sure/can't remember

**(g) Can you remember any particular information or advice that you received in this way? PLEASE SPECIFY \_\_\_\_\_**

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**19. Here is a list of possible reasons why you might have signed up for this guarantee or loan. Please tick the number for each reason that was true for you (you may tick more than one answer):**

- 1  (a) I was embarrassed to say "no" or to ask too many questions
- 2  (b) I thought it was a good business proposition
- 3  (c) I thought it would be for the family's financial benefit
- 4  (d) I trusted the other person
- 5  (e) I thought I was just witnessing the other person's signature
- 6  (f) I didn't know it was a guarantee, I thought it was something else
- 7  (g) I didn't think I had any choice
- 8  (h) I did not want to risk or damage my relationship with the other person
- 9  (i) We were partners and it seemed right to share everything
- 10  (j) I didn't know I was taking any serious risk
- 11  (k) The other person made all the financial decisions, I just did what I was told
- 12  (l) I was putting my home at risk and I didn't know it
- 13  (m) I was scared not to sign
- 14  (n) I knew it was a risk but I did it anyway
- 15  (o) Apart from the reasons you have ticked above, was there some other reason you decided to sign? PLEASE SPECIFY \_\_\_\_\_

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**20. (a) Where did you sign the documents?**

- 1  At home
- 2  At the lender's offices (eg the bank)
- 3  At the seller's premises (eg shop, car-yard etc)
- 4  Other PLEASE SPECIFY \_\_\_\_\_
- 5  Not sure/can't remember

**(b) Who were you with when you signed?**

- 1  The other person?
- 2  Another friend or relative?
- 3  The lender or people representing the lender
- 4  Somebody else PLEASE SPECIFY \_\_\_\_\_
- 5  Not sure/can't remember



**21. Around the time that you signed, did the lender give you any of the following? (tick each number that applies)**

- 1  A copy of your contract
- 2  A copy of the other person's loan contract
- 3  A written explanation of your rights and obligations
- 4  A spoken explanation of your rights and obligations
- 5  Information about the other person's financial situation
- 6  An indication (in dollars) of the maximum amount you might have to pay
- 7  Not sure/can't remember

**22. At the time you signed how many children, if any, did you have who were aged 18 or under? PLEASE SPECIFY \_\_\_\_\_**

**C. WHAT HAPPENED LATER**

**23. About what year or how long after, did you first find out that there was a problem with repayment of the loan or the credit card debt?**

PLEASE SPECIFY \_\_\_\_\_

**24. (a) What has happened about the debt since then? (tick each number that applies)**

- 1  I paid the money back in full
- 2  By agreement with the lender, I paid back part of the money
- 3  I went bankrupt
- 4  I still owe money to the lender
- 5  I am still disputing the debt
- 6  Other PLEASE SPECIFY \_\_\_\_\_

\_\_\_\_\_  
\_\_\_\_\_

**(b) Was your family home sold to pay the debt?**

- 1  Yes
- 2  No

**25. During the period of the loan, did the lender give you any of the following: (please tick one number on each line)**

- (a) Information about whether the other person was keeping up with repayments
- 1  YES
  - 2  NO
  - 3  NOT SURE/CAN'T REMEMBER

- (b) Information about any increase in the amount guaranteed
- 1  YES
  - 2  NO
  - 3  NOT SURE/CAN'T REMEMBER

- (c) Other information PLEASE SPECIFY \_\_\_\_\_

\_\_\_\_\_

**26. When you found out about the problem with the debt, were any of the following things true or not true for you? (please tick one number on each line)**

- (a) The debt was for a lot more than I thought  
 1  TRUE                      2  NOT TRUE                      3  NOT SURE/CAN'T REMEMBER
- (b) It all came as a big shock to me  
 1  TRUE                      2  NOT TRUE                      3  NOT SURE/CAN'T REMEMBER
- (c) There was an all-moneys mortgage on my home that I did not know about  
 1  TRUE                      2  NOT TRUE                      3  NOT SURE/CAN'T REMEMBER

**27. Did you get help or advice regarding the debt from any of the following? (tick each number that applies)**

- 1  A Community Legal Centre  
 2  A financial counselling organisation  
 3  A private lawyer  
 4  Legal Aid Commission  
 5  The Australian Banking Industry Ombudsman  
 6  Government body (eg Fair Trading Department)  
 7  Other PLEASE SPECIFY \_\_\_\_\_

**28. Has your relationship with the other person changed much as a result of the debt or problems relating to it?**

- 1  Yes IN WHAT WAY? \_\_\_\_\_  
 2  No  
 3  Not sure

**29. Are there any other comments you would like to make about these matters, how they happened or how they could have been avoided?**

\_\_\_\_\_  
 \_\_\_\_\_  
 \_\_\_\_\_  
 \_\_\_\_\_  
 \_\_\_\_\_

If this was a **business loan**, please answer Questions 30-40.  
 If it was not a business loan, that is the end of the questionnaire.

**Many thanks for your help.**

If you would be willing to take part in a more detailed, strictly CONFIDENTIAL discussion about your experience, please fill in your contact details on page 2.

## D. GUARANTORS OF BUSINESS LOANS

**30. Why did the other person want to borrow this money?**

- 1  To start a new business
- 2  To expand or develop an existing business
- 3  To help get the business through a difficult time
- 4  To pay back another loan or loans
- 5  Other PLEASE SPECIFY \_\_\_\_\_
- 6  Not sure/can't remember

**31. What role did you have in the business?**

- 1  Director (active)
- 2  Director (silent)
- 3  I'd help out with the business, but no formal role
- 4  No role
- 5  Other PLEASE SPECIFY \_\_\_\_\_

**32. What did you put up as security for the loan?**

- 1  A house or home unit etc
- 2  A car
- 3  Personal guarantee
- 4  Other PLEASE SPECIFY \_\_\_\_\_

**33. Did anybody else guarantee the loan, or only you?**

- 1  Only me
- 2  One other person
- 3  More than one other person
- 4  Not sure/can't remember

**34. At the time this money was borrowed, how much knowledge did you have about the financial situation of the relevant business?**

- 1  Quite a lot of knowledge
- 2  Some knowledge
- 3  Little or no knowledge
- 4  Not sure/can't remember

**35. And at that time, how much knowledge did you have about the financial situation of the person who borrowed the money?**

- 1  Quite a lot of knowledge
- 2  Some knowledge
- 3  Little or no knowledge
- 4  Not sure/can't remember

- 36. Had you ever signed as a guarantor before?**
- 1  Yes
  - 2  No
  - 3  Not sure/can't remember
- 37. Did you know at the time how much you might have to pay if the borrower could not make all the repayments?**
- 1  Yes
  - 2  No
  - 3  Not sure/can't remember
- 38. Did you feel at the time that you had enough money to pay if you had to?**
- 1  Yes
  - 2  No
  - 3  Not sure/can't remember
- 39. At that time, how likely did you think it was that you would have to pay out money because of the guarantee you gave?**
- 1  Quite likely
  - 2  Possible, but not very likely
  - 3  Very unlikely, not likely at all
  - 4  Not sure/can't remember
- 40. Did the lender make enquiries about whether you would be able to repay the loan if necessary?**
- 1  Yes
  - 2  No
  - 3  Not sure/can't remember

**That is the end of the questionnaire.  
Many thanks for your help.**

If you would be willing to take part in a more detailed, strictly CONFIDENTIAL discussion about your experience, please fill in your contact details on page 2.



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