

ALERT

18 JULY 2012

Lenders beware

Lenders beware. The court's tightening of the law regarding the enforceability of guarantees may render this type of security ineffective in certain circumstances. The recent case of ***Bank of Western Australia Ltd v Abdul [2012] VSC 222*** involved a claim for equitable relief from the enforcement of personal guarantees in accordance with the principles enunciated in the High Court decisions of *Garcia v National Australia Bank* (1998) 194 CLR 395 (**Garcia**) and *Commercial Bank of Australia Ltd v Amadio* (1983) 151 CLR 447 (**Amadio**).

The first defendant, Mr Abdul, was a director and shareholder of four related companies that were in the business of providing residential aged care services (**Abdul Companies**). The second defendant, Mrs Abdul, was a director of one company and a shareholder of a further two of the companies within the corporate group. On 1 June 2007, the Bank of Western Australia (**Bankwest**) entered into a series of loan facilities under which monies were advanced to each of the Abdul companies. The defendants jointly and severally guaranteed repayment of the loan facilities. Bankwest extended a further advance to the defendants in their personal capacity. The

facilities subsequently entered into default, causing the plaintiff to issue a notice of demand on the Abduls seeking immediate repayment of monies owed totalling \$18,897,136.45 plus interest on 10 June 2009. The second defendant argued that she did not understand the 'purport and effect' of the guarantee or alternatively, she was subject to undue influence which would make it unconscionable in the circumstances to allow Bankwest to enforce the personal guarantee she had provided.

The High Court in *Garcia* at [408]-[409] held that a guarantee may be unenforceable in the following circumstances:

- the surety is a volunteer in the sense that he or she is not in receipt of any immediately apparent benefit from the transaction;
- the surety did not in fact understand the 'purport and effect' of the transaction, which requires an appreciation of the concept of liability, the extent of that liability and potential consequences of default;
- the lender has notice that the co-guarantors are married and that one of the parties reposes trust and confidence in the



ALERT

other, which gives rise to an apprehension that the stronger party may not have adequately explained the document to the other party; and

- the lender fails to explain the document or take reasonable steps to satisfy itself that the volunteer guarantor fully understands the nature and effect of the transaction.

With regard to the facilities advanced to the Abdul Companies, Justice Croft was satisfied that Mrs Abdul did not adequately understand the nature and effect of the transaction. His Honour found that she was not meaningfully involved in the management of the Abdul businesses and did not understand the terms of the loan agreements, the amount borrowed or the cross-collateralisation of the loan facilities. His Honour also accepted that she did not appreciate that default could lead to bankruptcy proceedings or loss of the family home.

Justice Croft then considered whether the bank had taken sufficient steps to negate any unconscionability which would otherwise arise from enforcement of the guarantee. His Honour found that the evidence in favour of Bankwest, at its highest, was only capable of establishing that the transaction had been explained to the second defendant in broad terms. His Honour preferred the evidence of Mrs Abdul, who reported she was presented with a 'pile of documents' requiring her signature, and she was not invited to read the documents nor was she told what document she was signing as she applied her signature. Finally, Bankwest sought to rely on statutory declarations signed by Mrs Abdul which stated that she had received independent legal and financial advice. In addition to a number of procedural irregularities regarding the documents, Justice Croft held that an 'exhortation' to the effect that the second defendant had received adequate advice did not establish what was truly in issue – which was whether the second defendant had a *'real understanding as to the nature of the documents which were being signed'*.¹ His Honour stated at [80]:

'Bankwest should not be able to defeat the equity in favour of the second defendant by adding an additional document to the pile to sign, that effectively purports to waive her rights. It was submitted that the equity could be routinely defeated, without offering any protection to the people it is designed to protect, if banks were able to escape it by simply adding a waiver to be signed.'

On the issue of undue influence, Justice Croft held that Mrs Abdul was in a relationship of 'trust and confidence' with her husband and that Bankwest knew that the co-guarantors were married but failed to take steps to nullify the presumption that Mrs Abdul was subject to undue influence at the time she executed the guarantees. Further evidence supporting a claim for undue influence was the large borrowing, knowledge of volunteer status and a lack of disclosure as to any substantial source of income from the second defendant.

The second defendant also sought to avoid liability arising under the loan facility that was advanced to the defendants in their personal capacity. The facility was to be used for the express purpose of acquiring an 'age care leasehold business'.² Bankwest resisted the application on the basis that the loan agreement was not in the form of an instrument of suretyship and therefore did not fall squarely within the High Court authority decision in *Garcia* which, in its opinion, only applied to guarantees. Nevertheless, Justice Croft held that the principles enunciated in *Garcia* could be extended to include transactions that amounted to 'constructive suretyship'. His Honour held that extending credit to Mrs Abdul, which was secured by her personal liability, with knowledge that it would be applied towards the business operations of the Abdul companies, amounted to constructive suretyship and fell within the scope of *Garcia*. Mrs Abdul's signature was procured in the same manner as the guarantees and thus she was absolved of liability to Bankwest.

¹ *Bank of Western Australia Ltd v Abdul* [2012] VSC 222, [75].

² *Ibid* [84].



ALERT

Does this case mean that courts are requiring lenders to look behind the declarations and certificates signed by guarantors, and require lenders to independently verify the accurateness of these documents? Surely not...

Authored by: **Lesley Naik**, Cornwall Stodart

Want to republish any of this article?

If you would like to republish any part of this article in your staff newsletter or elsewhere please contact our Marketing team on **+61 3 9608 2168**

Disclaimer

This Alert is intended to provide general information on legal issues and should not be relied upon as a substitute for specific legal or other professional advice.



For further information please contact:

Elpis Korosidis, Partner
Phone (direct) **+61 3 9608 2115**
Mobile **+61 400 598 926**
Email **e.korosidis@cornwalls.com.au**

Sonali Stella, Lawyer
Phone (direct) **+61 3 9608 2225**
Mobile **+61 432 445 002**
Email **s.stella@cornwalls.com.au**