Till Debt Us Do Part: A Note on *National Australia Bank Ltd v Garcia*

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1. *Introduction*

National Australia Bank Ltd v Garcia[1] is one of three recent New South Wales Court of Appeal decisions concerned with the status of the so-called special equity deriving from *Yerkey v Jones*.[2] The other two cases *are Akins v National Australia Bank* [3] and *Teachers Health Investments Pty Ltd v Wynne*.[4]

The fact situation is a familiar one. B (A's husband) or B1 (a company A's husband controls) borrows money from F (a financier) for a business venture and offers the family home as security. The house is owned jointly by A and B, and they both sign the security documents. The business venture fails and F attempts to enforce the security. A resists F's claim arguing that her signature was procured by B's undue influence, misrepresentation or other unfair tactics and that therefore F should not be allowed to enforce the security against her.

Spousal guarantees have become a fertile source of litigation. In England, no fewer than 11 reported cases had been before the Court of Appeal in the eight years to the end of 1993,[5] and many more would have been dealt with in the lower courts. The pace has not slackened in the intervening years.[6] The trends have been similar in Australia, as Kirby P remarked in *Gough v Commonwealth Bank of Australia*,[7] and also in other common law jurisdictions.[8]

The *Yerkey v Jones* special equity represents one judicial response to the problem. *Barclays Bank Plc v O'Brien*[9] suggests an alternative approach. The New South Wales Court of Appeal cases reject both the *Yerkey v Jones* special equity and *Barclays Bank Plc v O'Brien* in favour of a third alternative based on the doctrine of unconscientious dealing as expounded in *Commercial Bank of Australia Ltd v Amadio*.[10] The purpose of this note is to assess the competing options.

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1 (1995) 39 NSWLR 577.

2 (1940) 63 CLR 649.

3 (1994) 34 NSWLR 155.

4 (1996) ASC s56-356.

5 *Barclays Bank Plc v O'Brien* [1994] 1 AC 180 at 185-6 Lord Browne-Wilkinson.

6 Hans Tjio, "*O'Brien* and Unconscionability" (1997) 113 *LQR* 10 at 13.

7 (1994) ASC s56-270 at 58, 834.

8 Michael J. Trebilcock and Steven B. Elliott, "The Scope and Limits of Legal Paternalism: Intra-Familial Financial Arrangements and Gatekeeper Responsibilities" (unpublished manuscript, dated in error 13 January 1996 instead of 13 January 1997) (copy on file with author).

9 Above n5.

10 (1982-1983) 151 CLR 447.

2. *The Policy Considerations*

In *Barclays Bank Plc v O'Brien and Another*, Lord Browne-Wilkinson identified the policy tension underlying spousal guarantee cases as follows:[11]

> Society's recognition of the equality of the sexes has led to a rejection of the concept that the wife is subservient to the husband in the management of the family's finances ... Yet ... although the concept of the ignorant wife leaving all financial decisions to the husband is outmoded, the practice does not yet coincide with the ideal. In a substantial proportion of marriages it is still the husband who has the business experience and the wife is willing to follow his advice without bringing a truly independent mind and will to bear on financial decisions. The number of recent cases in this field shows that in practice many wives are still subjected to, and yield to, undue influence by their husbands.

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> It is easy to allow sympathy for a wife who is threatened with the loss of her home at the suit of a rich bank to obscure an important public interest, viz., the need to ensure that the wealth currently tied up in the matrimonial home does not become economically sterile. If the rights secured to wives by the law renders vulnerable loans granted on the security of matrimonial homes, institutions will be unwilling to accept such security, thereby reducing the flow of loan capital to business enterprises.

Trebilcock and Elliott elaborate on Lord Browne-Wilkinson's first concern as follows:[12]

> It is enough to state the communal ideal of family life to recognise that it is rarely achieved. Particularly where families are characterised by a sharp division of labour and a high degree of dependency between members, intra-familial contracting can be rife with abuse. The law reports are replete with cases in which a vulnerable spouse, parent or child claims that they have been taken advantage of financially by another family member concerned primarily with personal gain ... It may seem rational for a family member to delegate financial decision making to a family leader as an efficient division of labour. Unfortunately, having placed their financial affairs in the hands of that family leader, their interests may be ignored to their detriment.
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> The difficulties of intra-familial contract regulation arise out of the fact that no family is a perfect unity. The communality of family life is never absolute — even in the most harmonious households, family members have several as well as mutual ends. These differences of interest are accentuated by the possibility of family breakdown. The high incidence of divorce in most western societies and the prevalence of elder abandonment mean that the prospect of breakdown should usually weigh in the making of intra-familial financial arrangements. Prudent family members will want to protect their personal position in light of this contingency. The trust and informality that result from family communality can easily be abused by a member seeking to favour their own severable interests at the expense of their family. The purpose of regulating intra-familial arrangements is to put safeguards in place to prevent this from happening.

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11 Above n5.
12 Above n8.

Statistics indicate that the average standard of living for women following divorce declines, whereas for men it rises. The reason has in part to do with women's lack of earning power due to the time they have spent at home and out of the work-force. The risk of divorce therefore makes the conservation of family assets a relatively more important issue for women than for men. In many cases the probability is that A will take insufficient account of this consideration in agreeing to mortgage the family home as security for B's debts.[13] In other cases, B may use the threat of divorce as a weapon to secure A's agreement.[14] This is in fact what happened in *Teachers Health Investments Pty Ltd v Wynne*.[15]

The justification for invalidating F's security in spousal guarantee cases is not that F itself is guilty of exploiting A's dependency. Rather, it has to do with what Trebilcock and Elliott describe as a "gatekeeper" function.[16] F is in a position to prevent A's exploitation at B's hands by refusing B co-operation or support. As between A and F, F is the party best placed to avoid A's loss. If B has exercised undue influence over A, A's capacity for self-help will be limited. She is unlikely even to be aware of the need for action. On the other hand, F is relatively well placed, by virtue of its relationship with both A and B, to check for signs of B's misconduct and take remedial steps. By invalidating F's security in the event of B's misconduct, the courts give lending institutions the incentive to take such steps in future. The challenge for the courts is to set F's gatekeeping obligations at a level that minimises the sum of compliance costs and the costs of contract failure. Excessively stringent gatekeeping obligations may deliver a high level of protection to A, but at the cost of discouraging legitimate lending activity (the second of Lord Browne-Wilkinson's concerns in *Barclays Bank Plc v O'Brien*[17]). Conversely, excessively lenient obligations may involve low transactions costs, but deliver less than the optimal level of protection to A.

3. *The Judicial Responses*

A. *Yerkey v Jones*

The *Yerkey v Jones*[18] special equity is attracted where F relies on B to obtain A's consent to the security agreement. It is not limited to the case where F gives B the documents for A to sign; it is enough if F leaves it to B to persuade A to sign, even if the documents are executed later under F's supervision.[19] Where the loan is made to B1 the special equity will not be attracted if A has a substantial interest in B1.[20]

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13 Id at 13-14.
14 Id at 18-19.
15 Above n4.
16 Above n8 at 31-32.
17 Above n5.
18 Above n2.
19 *Peters v Commonwealth Bank of Australia* (1992) ASC s56-135 (Supreme Court of New South Wales).
20 *Warburton v Whiteley* (1989) NSW Conv R s55-453 (New South Wales Court of Appeal).

There are two limbs to the special equity. The first limb applies where A's consent is procured by B's undue influence. In that event, A will be entitled as against F to have the security set aside unless F can show that A received independent advice. To succeed on the first limb, A must either lead evidence of B's undue influence or point to features of the relationship which make the exercise of undue influence likely. Undue influence will not be presumed simply on the basis that A and B are married. On the other hand, there is no need for A to prove that F knew about the special facts. In effect, F is fixed with constructive notice of B's actual or presumed undue influence by virtue of knowing that A and B are married.

The second limb of the special equity applies where B does not use undue influence, but A fails to understand the effect of the document and the significance of giving a guarantee. In that event, A may be entitled as against F to have the guarantee set aside unless F took steps to inform A about the transaction and reasonably supposed that she understood. For this purpose, it may not be necessary for F to show that A was independently advised.

B. Barclays Bank Plc v O'Brien

In *Barclays Bank Plc v O'Brien*,[21] the House of Lords refused to follow *Yerkey v Jones*,[22] preferring instead an approach which can be summarised as follows:

- there is no special equity favouring wives, and the fact situation in question is subject to the same general principles governing undue influence as apply in other cases;
- nevertheless the general principles governing undue influence should be applied generously in A's favour in recognition of the facts that the transaction is on its face not to A's financial advantage, and there is a substantial risk of undue influence on B's part;
- if A establishes misrepresentation or undue influence against B, F will be fixed with constructive notice and will be unable to enforce the security upon proof that A and B were married;
- F can avoid being fixed with constructive notice by taking reasonable steps to satisfy itself that A entered into the transaction freely and with knowledge of the true facts;
- unless there are exceptional circumstances, F will have taken such reasonable steps if it first, warns A (at a meeting not attended by B) of the amount of her potential liability and of the risks involved and second, recommends that A take independent advice;
- if there are exceptional circumstances, it may be necessary for F to insist that A take independent advice; and

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21 Above n5.
22 Above n2.

- relationships analogous to husband and wife, including de facto relationships and homosexual relationships between cohabiting partners, are to be treated on the same basis.

This approach is different from the *Yerkey v Jones* special equity in the following respects:

- A must establish actual or presumed undue influence by B, and she will not be entitled to relief against F simply on the basis that she failed to understand the transaction;
- in the normal case, F will avoid liability for B's undue influence by adopting the two-step procedure just referred to, whereas under the *Yerkey v Jones* special equity nothing short of independent advice will do; and
- the special protection of the *Barclays Bank v O'Brien* rule extends beyond married couples to analogous relationships.

C. *The New South Wales cases*

In *Warburton v Whiteley*, Kirby P strongly criticised the *Yerkey v Jones* special equity, describing it as "anachronistic" and an affront to "respect for the equality of women".[23] Clarke JA was also critical of the principle, suggesting that though "there are still to be found women in the community who are overborne by their husbands", there may no longer be any need for a separate doctrine extending special protection to wives who give guarantees.[24] These comments echoed observations earlier made by Rogers J in *European Asian of Australia Ltd v Kurland*:[25]

> I feel compelled to say that in the year 1985 it seems anachronistic to be told that being a female and a wife is, by itself, a sufficient qualification to enrol in the class of persons suffering a special disadvantage.

Nevertheless, despite these conclusions, the court in *Warburton v Whiteley*[26] followed *Yerkey v Jones*[27] on the basis that it considered itself bound to do so.

In *Akins v National Australia Bank*,[28] which was decided after *Barclays Bank Plc v O'Brien*,[29] a differently constituted Court of Appeal concluded that it was not bound to apply the *Yerkey v Jones* special equity after all and that the special equity should no longer be recognised in New South Wales. There were two reasons. First, the *Yerkey v Jones* special equity derived solely from Dixon J's judgment, and since it was not supported by the other judgments in the case, it was not strictly binding. Secondly, Dixon J's judgment had relied substantially on the Privy Council decision in *Turnbull and Co v Duval*[30] and the Victorian Supreme Court case of *Bank of Victoria Ltd v*

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23 Above n20 at 58,286-7.
24 Id at 58, 293.
25 (1985) 8 NSWLR 192 at 200.
26 Above n20.
27 Above n2.
28 Above n3.
29 Above n5.
30 [1902] AC 429.

Mueller.[31] In *Barclays Bank Plc v O'Brien*[32] it was held that both cases had been wrongly decided and it therefore followed that Dixon J was wrong as well.

In *National Australia Bank Ltd v Garcia*,[33] Sheller JA, who delivered the leading judgment, disputed the analysis in *Barclays Bank Plc v O'Brien*[34] of the authorities on which Dixon J had relied. Nevertheless, he agreed for the first of the reasons mentioned above that the court was not bound to follow *Yerkey v Jones*. The same position was taken *in Teachers Health Investments Pty Ltd v Wynne*.[35] The court in *Garcia* rejected the need for any special rule favouring A at all. Mahoney P said:[36]

> In my opinion it is wrong to approach the position of a party to transactions of the kind here in question upon the basis that there is a principle or a presumption that either party has been less than fully capable of dealing with his or her affairs. It is wrong to treat the position of a party — in the present case it is the position of a married woman — as being in principle one of disadvantage. Each case must, for such purposes, be considered according to its own facts.

It was further held that "the High Court's decision in *Commercial Bank of Australia v Amadio* describes the jurisdiction in equity to relieve against unconscionable dealing" in cases of this kind.[37] *In Teachers Health Investments Pty Ltd v Wynne*,[38] the statement just quoted was taken to mean that in Australia the *Amadio* doctrine applies to the exclusion of *Barclays Bank Plc v O'Brien*.[39]

4. *Comment*

A. *Yerkey v Jones and equality of the sexes*

The three New South Wales Court of Appeal cases each held that women who guarantee their husbands' business debts no longer need special protection and each case must be judged on its facts by reference to the ordinary doctrines. This conclusion amounts to an implicit denial of the first policy concern Lord Browne-Wilkinson identified *in Barclays Bank Plc v O'Brien*.[40] The conclusion is motivated by concern for the equality of women. However, this misses the point. As mentioned above, the case for special protection rests not on the proposition that women are inherently less competent than men, but on the proposition that women are disadvantaged by the dynamics of the family relationship when it comes to the disposal of family assets. It is a hollow kind of liberalism that insists on formal equality between the sexes when in

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31 [1925] VLR 642.
32 Above n5.
33 Above n1.
34 Above n5.
35 Above n4.
36 Above n1 at 578.
37 Id at 597, footnotes omitted.
38 Above n4 at 56, 988.
39 Above n5.
40 Id at 188.

fact differences between them are routinely observable in terms of endowments, opportunities, bargaining power and the like. Dixon J's judgment may or may not have been technically correct,[41] but as a matter of policy it comes pretty close to the mark. Dixon J's judgment focuses exclusively on the position of married women, without taking account of analogous intra-familial relationships. In this respect, it may be anachronistic, but not otherwise.

As mentioned earlier, in *Teachers Health Investments Pty Ltd v Wynne*,[42] B used the threat of divorce as a weapon to secure A's agreement to the security transaction. A was successful in having the transaction set aside against F. The court held that she was in a highly vulnerable state and her will had been overborne. Beazley JA noted that "education or experience may not be sufficient to overcome such vulnerability".[43] This remark stands in sharp contrast to the position taken in *Garcia*. There the court accepted the trial judge's view that A was "an intelligent, articulate lady with a professional position" and there was therefore nothing to put F on notice of B's undue influence[44]. The outcome of *Wynne's* case is more sensitive to the relevant concerns. The trouble is that the decision assumes the fact situation to have been an isolated one. If the court had recognised its recurrent nature, it would hardly have rejected the case for a special rule.

B. Impact on lending institution practice

In terms of the likely impact on lending institution practice, there is little to choose between the *Yerkey v Jones*[45] special equity, *Barclays Bank Plc v O'Brien*[46] and the case by case approach preferred by the New South Wales Court of Appeal.

Given the first limb of the *Yerkey v Jones* special equity, F should insist that A receives independent advice. Otherwise, F will be at risk if A is later able to establish actual or presumed undue influence on B's part. The problem for F, of course, is that at the time of transacting it will usually have no way of knowing whether there has been undue influence or not. Therefore, it is better to take the precaution. Where the second limb applies, it may not be necessary for F to show that A was independently advised. In other words, the burden on F in this kind of case, ostensibly at any rate, is not as heavy as in the case where undue influence is involved. In practice, however, this concession is unlikely to make much difference to F. Again, the reason is that, at the time of transacting, F will usually have no way of knowing whether B has been guilty of undue influence. Therefore, in order to be safe, F should assume the worst and ensure that A is independently advised.

Compare *Barclays Bank Plc v O'Brien*.[47] There it was held that unless there are exceptional circumstances, it will be sufficient if F, having first ex-

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41 See text at nn 30-34, above.
42 Above n4.
43 Id at 56, 985.
44 Above n1 at 598.
45 Above n2.
46 Above n5.
47 Ibid.

plained the transaction to A, suggests that she obtain independent advice. The decision appears to contemplate that, in the usual case, F need not concern itself about whether A did in the end obtain independent advice or, if she did, whether the advice was adequate. However, the difference between *Barclays Bank Plc v O'Brien* and the *Yerkey v Jones* special equity in this respect may be more apparent than real. The reason is that, at the time of contracting, F will often have trouble spotting the exceptional case. Therefore, to be on the safe side, it will be wise for F in all cases to insist (not just suggest) that A take independent advice.[48]

For the reasons suggested above, the New South Wales Court of Appeal's case by case approach amounts to an implicit denial of the first policy concern identified by Lord Browne-Wilkinson in *Barclays Bank Plc v O'Brien*.[49] It also represents an implicit denial of the second policy concern. The reason is that a case by case approach to the issue increases uncertainty at the point of contracting and threatens security of transactions. At the point of contracting, F will often have no way of knowing what facts a court retrospectively may regard as material. As in *Teachers Health Investments Pty Ltd v Wynne*,[50] the court may take a position that is sensitive to the concerns Trebilcock and Elliott identify or, as in *National Australia Bank Ltd v Garcia*[51] it may not. From F's perspective at the time of contracting, trying to predict the outcome of this kind of litigation is like a lottery. Accordingly, the safest course will be for F always to assume the worst and in every transaction adopt precautions that will protect A's interests. The precaution least susceptible to challenge is to insist that A take independent advice. Consequently, the likely effect on lending institutions' behaviour of the case by case approach the New South Wales Court of Appeal favours is that an independent advice strategy will routinely be adopted.

C. *Knowledge, notice and unconscientious dealing*

In *National Australia Bank Ltd v Garcia*,[52] it was held that in Australia the *Amadio* doctrine displaces *Barclays Bank Plc v O'Brien*.[53] The application of the *Amadio* doctrine to the case of spousal guarantees was discussed in *Akins v National Australia Bank*.[54] It was held there that A's susceptibility to B's undue influence may be a special disadvantage for the purposes of the doctrine. Clarke JA said:[55]

> Where ... a creditor leaves it to the debtor husband to procure the execution of the guarantee and takes no steps to ensure that the wife understands the responsibility and liability that she is undertaking, or that she is independently advised, the view may well be open, depending on the particular facts of the

48 Above n6 at 13.
49 Above n5.
50 Above n4.
51 Above n1.
52 Ibid.
53 Above n5.
54 Above n3.
55 Id at 171-172.

> case, that the creditor should be held to be aware of the possibility that the wife was in a position of special disadvantage.

This passage assumes that "knowledge" in the *Amadio* sense is the same as constructive notice. The assumption may not be correct. The leading judgments *in Commercial Bank of Australia Ltd v Amadio*[56] were delivered by Mason J and Deane J. Both quoted with approval Lord Cranworth's statement in *Owen and Gutch v Homan*[57] that "wilful ignorance is not to be distinguished in its equitable consequences from knowledge". Mason J said that if instead of having actual knowledge of a situation F:[58]

> is aware of the possibility that that situation may exist or is aware of facts that would raise that possibility in the mind of any reasonable person, the result will be the same.

This is the language of constructive notice. On the other hand, Deane J said that the doctrine will apply if:[59]

> [the weaker party's] disability was sufficiently evident to the stronger party to make it prima facie unfair or 'unconscientious' that he procure, or accept, the weaker party's consent to the impugned transaction.

This statement is open to the reading that knowledge extends to wilful ignorance, but no further.

To treat constructive notice as a sufficient basis for unconscientious dealing is to mistake the purpose of the doctrine. In *Hart v O'Connor*,[60] the Privy Council held that the purpose of the doctrine is to provide relief against victimisation, and this necessarily implies actual knowledge, or at least wilful ignorance, on the stronger party's part of the weaker party's disadvantage. How can the stronger party be said to have victimised the weaker party if the stronger party is unaware of the relevant facts? Constructive notice is not enough to support a claim of victimisation. By contrast, the references in *Barclays Bank Plc v O'Brien*[61] to "notice" are clearly intended to include constructive notice. In that case, F had knowledge of B's wrongdoing only in this sense but it was still held liable. F was held liable not because it had itself victimised A. Instead, the reason was that F had acquired rights against A under the security agreement with notice of A's countervailing equity against B. This gave rise to a priority dispute. By analogy with property cases, the bona fide purchaser rule applied. F was defeated because it had constructive notice of A's prior equitable entitlement to set the transaction aside against B.[62]

The suggestion that spousal guarantee cases can be accommodated by the *Amadio* doctrine confuses the relevant policy considerations. The *Amadio* doctrine (unconscientious dealing) is about victimisation but in the typical spousal guarantee case it is artificial to say that F has victimised A because at the time of contracting F will usually have no actual knowledge of A's disadvantage. The

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56 Above n10.
57 (1853) 4 HLC 997 at 1034-5.
58 Above n10.
59 Id at 474-5.
60 [1985] AC 1000.
61 Above n5.
62 Graham Battersby, "Equitable fraud committed by third parties" (1995) 15 *Legal Studies* 35.

real justification for holding F liable lies in the gatekeeper strategy outlined above. The New South Wales Court of Appeal approach obscures the justification for intervention. Furthermore, because the approach requires knowledge to be read as including constructive notice, it threatens the policy underpinnings of the unconscientious dealing doctrine, not just in spousal guarantee cases but across the board. Attenuation of the knowledge requirement shifts the basis for intervention from prevention of the stronger party's wrongdoing ("procedural unconscionability") to relief of the weaker party's misfortune ("substantive unconscionability").[63] In this respect as well, the approach taken in *Barclays Bank Plc v O'Brien*[64] is superior. The virtues of the *O'Brien* approach are that it unambiguously treats B, not F, as the real wrongdoer vis-a-vis A, and correctly points to the gatekeeper strategy, not prevention of victimisation, as the reason for intervention against F.[65]

5. *Conclusions*

The conclusions can be summarised as follows:

(a) there is a case for giving special protection to married women who guarantee their husbands' debts;

(b) the same case can be made where the relationship between the borrower and guarantor is one that is analogous to husband and wife, and possibly also where the relationship is any kind of close intra-familial one;

(c) the optimal form of protection is for F to insist that A obtain independent advice before signing the guarantee or security documents;

(d) the three judicial responses to the spousal guarantee problem discussed above, though outwardly different, in practice each already encourages F to adopt the precaution suggested in (c), above;

(e) the *Amadio* doctrine is not appropriate for spousal guarantee cases, other than in the exceptional case where F independently of B is guilty of wrongdoing towards A; and

(f) *Barclays Bank Plc v O'Brien*[66] represents the correct approach, subject to the modification suggested in (c), above.

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63 Anthony Duggan, "Unconscientious Dealing" in Parkinson, P (ed), *Principles of Equity* (LBC Information Services Sydney, 1996), para [513].

64 Above n5.

65 Contrast Tjio, above n6 at 14: "Unconscionability, whether as substantive doctrine or an element of liability, could in fact provide the basis for imposing obligations in all non-priority third party or quasi-third party situations ...[Unconscionability is] to be preferred to constructive notice, which creates difficulties even for equity lawyers ... and 'leads to loose thinking' ". The burden of the present note has been to demonstrate that precisely the opposite is true.

66 Above n5.