Sexually Transmitted Debt: Criticisms and Prospects for Reforms

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I: INTRODUCTION

Sexually Transmitted Debt ("STD") occurs when one party ("the surety") provides "security" (contracts for third party loan security) for another party's indebtedness ("the principal debtor") to a third party ("the financier"). The surety is involved in an intimate or otherwise close relationship with the principal debtor. Repeatedly it is the emotional pressure and economic dependence embodied within the relationship that motivates the provision of the security, as opposed to any potential commercial advantage or financial gain. Consequently, the securities are given in circumstances where the surety has no effective decision-making power.[1]

Although men may also be victims of STD, women seem particularly vulnerable to the problem.[2] STD is not a new legal issue. Recently, however, it has received considerable judicial attention and provoked much academic discussion. This is the result of an increase in the number of women litigating such cases in an attempt to avoid liability and the self-regulation of the banking industry in an attempt to establish procedures rendering such securities unimpeachable in the event of a challenge.

This essay considers the current legal responses of three jurisdictions to the contractual relationship between financier and surety, where the surety attempts to avoid his or her obligations under the surety transaction. It then identifies two fundamental criticisms of these responses, raised by commentators generally evaluating the issue of STD from a feminist perspective. Finally, prospects for law reform are identified whilst recognising that ultimately such suggested reforms may never adequately resolve the central problem faced by sureties in a STD situation: their constrained capacity for independent decision-making. STD may, therefore, be a larger social problem, not merely a legal one.[3]

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1 Australian Law Reform Commission, *Equality before the Law: Women's Equality; Report No. 69 Part II* (1994) 240.

2 Baron, "The Free Exercise of Her Will: Women and Emotionally Transmitted Debt" (1995) 13 Law in Context 23, 25.

3 Fehlberg, "Money and Marriage: STD in England" (1997) 11 International Journal of Law, Policy and the Family 320, 340.

II: SEXUALLY TRANSMITTED DEBT

1. Definition

The practice of financiers requiring one party to assume liability for the debts of their spouse or partner has been termed "sexually transmitted debt".[4] This has been defined as:[5]

> [T]he 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.

Generally the responsibility for the debt is transmitted in one of three ways:[6]

(i) Where the surety provides a mortgage over the family home (usually held jointly with his or her spouse or partner) as security for a guarantee of the partner's business debts; or
(ii) Where the surety enters into a loan contract as joint borrower with his or her partner where the loan will be used for the partner's business purposes. A mortgage is offered over their jointly owned home by way of security; or
(iii) Where the surety is a silent partner or director in a family business or company formed to run the partner's business in which case he or she may be primarily liable for the company's debts if the company becomes insolvent.

The crucial features of STD are the relationship of dependence, and the emotional ties that dominate the transaction and lead the surety to accept liability that they would not otherwise have accepted. The dependent party accepts responsibility for the debt primarily because of his or her relationship with the principal debtor and the emotional pressure and/or economic dependence involved in that relationship. If the principal debtor becomes unable or unwilling to meet the debt, through insolvency or other circumstances, the dependent party is liable for the debt. In that way the debt is "transmitted" to the dependent party.[7]

Such dependence and emotional ties are found in many relationships including husband/wife, parent/child and de facto relationships, both same-sex and heterosexual. As the transfer of responsibility for the debt is based on a wider range of relationships than simply that of sexual partners the phrase "STD" can be misleading. It has been

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4 Kaye, "Equity's Treatment of STD" (1997) 5(1) Feminist Legal Studies 35.
5 Supra note 1 at 241.
6 Supra note 4 at 36.
7 Supra note 1 at 240.

suggested the terms "emotionally transmitted debt"[8] or "[r]elationship [t]ransmitted [d]ebts"[9] are preferable, as they emphasise that it is the emotional bond that leads to the transmission of responsibility for the debt, as opposed to the sexual nature of the relationship between surety and principal debtor. Further, these terms recognise such assumption of debt is not confined to the debts of partners, as many sureties assume liability for the debts of their relatives and friends.[10] Nevertheless, and perhaps unsurprisingly, the phrase "STD" seems to have captured the imagination of legal and feminist circles and become the more widely used and understood.[11]

1. Victims of STD: A Gender Issue?

In recent years a proliferation of litigation has occurred involving sureties seeking to set aside STD contracts.[12] In the reported cases, the surety is generally a wife, the principal debtor her husband and the financier a bank.[13] Belinda Fehlberg, in conducting the first empirically based analysis of STD, found that although male sureties do exist they are clearly a minority.[14] Fehlberg also discovered that, as yet, there is no English case law involving a male surety. A similar position exists in Australia[15] and New Zealand.

Therefore, although in theory both men and women may be the victims of STD and execute improvident, emotionally motivated securities, in reality, the cases almost always involve either legal or de facto female spouses.[16]

Whilst the legal distinctions between married and non-married couples remain in other areas of the law,[17] recent case law indicates that the courts are prepared to apply the same rules governing STD to surety spouses and partners, including same-sex[18] and non-cohabiting couples.[19] Ultimately, however, the case law predominately reflects the experiences of married couples, particularly that of married women.[20]

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8 Supra note 2 at 24.

9 Howell, "STD: A Feminist Analysis of Laws Regulating Guarantors and Co-Borrowers" (1995) 4 The Australian Feminist Law Journal 93, 96.

10 Supra note 2 at 24.

11 Supra note 4 at 35.

12 *Barclays Bank plc v O'Brien* [1994] 1 AC 180, 185 (HL). Lord Browne-Wilkinson commented that it was a "problem which has given rise to reported decisions of the [English] Court of Appeal on no less than 11 occasions in the last eight years".

13 Fehlberg, *STD: Surety Experience and English Law* (1997) 3.

14 Ibid 4. Results based on 49 in-depth personal interviews with sureties, financiers and lawyers. Of the 22 sureties interviewed, two were men.

15 Ibid 3.

16 Pascoe, "Wives, Business Debts and Guarantees" (1997) 9 Bond LR 58, 60.

17 For example, in relation to property distribution on the dissolution of a relationship, see *Gillies v Keogh* (1989) 5 FRNZ 490.

18 *Barclays Bank plc v O'Brien,* supra note 12 at 198.

19 *Massey v Midland Bank plc* [1995] 1 All ER 929 (CA).

20 Fehlberg, "The Husband, the Bank, the Wife and Her Signature– the Sequel" (1996) 59 Modern Law Review 675.

3. The Issue: A Public/Private Dichotomy

"The 'public' and the 'private' rarely confront each other so starkly as in [STD cases]."[21] This dichotomy refers to the division of the world into a strictly limited "public" sphere a sphere appropriate for regulation either by the state or the market, and a "private" sphere, which is unregulated and in which the law has been traditionally loath to intervene.[22] The interaction between sureties and principal debtors occurs predominantly in the "private" (family) sphere whereas the interaction between financiers and sureties occurs predominantly in the "public" sphere, within the realm of formal contract law.[23]

The issue of STD involves a complicated and controversial application of this dichotomy. This is because the provision of the security extends beyond the purely domestic sphere of the relationship, as an outsider, the financier, uses the private relationship to protect its own interests. The involvement of the financier is significant as it means that instead of viewing the financial dealings between intimate partners as part of the "private" and unregulated incidences of domestic life, it has been assumed the law of contract is wholly appropriate and applicable.

The crucial issue arising in cases of STD is the extent to which private, emotional pressures and economic dependence, constraining the independent will of the surety, operate to render invalid the transaction as against the financier. Admittedly, the courts have been prepared to acknowledge they are faced with a social problem and not merely a legal issue.[24] Their approach to resolving the issue of STD, however, generally involves little more than flagging the existence of the social problem before applying the standard legal framework of identifying the contractual issue and deciding the worthy winner.[25]

Consequently, judicial responses to STD cases represent the uneasy interaction and boundaries between the "private" world of family and intimate, spousal relationships and the "public" world of third party security contracts.[26] In recent times commentators have criticised the application of a standard legal framework to STD cases.[27] This raises the issue that I wish to pursue further: the inadequacy of the current judicial responses to STD surety transactions and the fundamental problems inherent in such responses, which are the result of the application of a "public" contract perspective.

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21 Oldham, "'Neither a Borrower nor a Lender Be'– The Life of *O'Brien*" (1995) 7 Child and Family Law Quarterly 104.

22 Olsen, "The Family and the Market: A Study of Ideology and Legal Reform" (1983) 96 Harvard LR 1497.

23 Supra note 13 at 15.

24 For example, see *Barclays Bank plc v O'Brien,* supra note 12.

25 Supra note 3 at 322.

26 Supra note 13 at 2.

27 For example Howell, supra note 9; Baron, supra note 2.

III: CURRENT LEGAL RESPONSES TO STD

1. England

Barclays Bank plc v O'Brien[28] and *CIBC Mortgages plc v Pitt*[29] are two leading decisions of the House of Lords handed down the same day in 1993. These two cases represent the current English judicial interpretation of STD cases and have influenced the responses of other jurisdictions.

(a) Previous Responses

Prior to these cases, divergent approaches had been utilised by the English courts in deciding cases involving wives, husbands and financiers, originating from the judgment of Lord Lindley in *Turnbull & Co v Duval.*[30] Although this case provides the foundations for the modern English law relating to cases of STD, the basis on which it was decided is somewhat obscure.[31] From subsequent cases seeking to apply the ratio in *Turnbull*, two general judicial approaches have evolved: "agency theory" and "special equity theory".[32]

(i) "Agency theory"

The first approach applied was the "agency theory". This involves the husband's wrongdoing (undue influence, misrepresentation or other legal or equitable wrong) being imputed to the financier, where the husband can be regarded as the financier's agent in procuring the wife's consent to the security, thereby allowing the transaction to be set aside. This "agency theory" was applied with varying degrees of stringency and artificiality in several cases,[33] and eventually resulted in the wholesale application of the common law agency principles of actual and ostensible authority in subsequent cases.[34]

Logically, this approach presented acute difficulties and, finally, in *Bank of Credit and Commerce International SA v Aboody,*[35] it was held that a true agency "in accordance with the general law of principal and agent" had to be established before the financier would be liable for the husband's conduct.[36]

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28 Supra note 12 at 191.
29 [1994] 1 AC 200.
30 [1902] AC 429 (PC).
31 Supra note 12 at 191.
32 For example *Chaplin & Co Ltd v Brammall* [1908] 1 KB 233; *Avon Finance Co Ltd v Bridger* [1985] 2 All ER 281.
33 Beginning with *Kings North Trust Ltd v Bell* [1986] 1 WLR 119 (CA).
34 Including *Midland Bank plc v Perry* (1988) 56 P & CR 202 (CA); *Coldunell Ltd v Gallon* [1986] QB 1184 (CA); *Bank of Baroda v Shah* [1988] 3 All ER 24 (CA).
35 [1990] 1 QB 923 (CA).
36 Ibid 972.

(ii) "Special equity theory"

The second approach applied subsequent to *Turnbull & Co v Duval*[37] was that of a "special equity theory" for wives. The modern formulation of this rule emerged from the judgment of Dixon J in *Yerkey v Jones*:[38]

> [I]f a married woman's consent to become a surety for her husband's debt is procured by the husband and without understanding its effect in essential respects she executes an instrument of suretyship which the creditor accepts without dealing directly with her personally, she has a prima facie right to have it set aside.

This general principle enunciated by Dixon J has been widely expressed as a "special equity" favouring married women.[39] Lord Justice Scott and the majority of the Court of Appeal purported to reintroduce and apply the special equity theory to the facts in *O'Brien*.[40]

There are two limbs to this special equity theory.[41] To succeed on the first limb the surety may have been aware of the nature and effect of the obligation undertaken, but must establish she was induced to enter into the security by her husband through his undue influence.[42] The legal propriety of this limb is not in doubt.[43]

More controversial is the second limb of the rule in *Yerkey*. Under this limb of the rule a wife has a *prima facie* right to set aside any security provided for her husband's debt if:[44]

(i) The security was procured by her husband;
(ii) the security was accepted by the financier without any contact with her; and
(iii) she failed to understand the effect of the document in "essential respects".

The most significant aspect of this limb is that a lack of understanding of the transaction itself provides a basis for relief for a wife.

Thus the rule in *Yerkey* offers married women special treatment by the courts. If a married woman enters into a surety transaction and either is the subject of undue influence or does not understand the nature and effect of the security, then by virtue of her status as a married woman she is entitled to the benefit of a presumption. The presumption is that the financier knew of these circumstances and the security will be set aside unless the presumption is rebutted.

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37 Supra note 30.
38 (1940) 63 CLR 649, 683 (HCA) ("*Yerkey*").
39 For example in *O'Brien*, supra note 12; *Pitt*, supra note 29.
40 *Barclays Bank plc v O'Brien* [1993] QB 109 (CA).
41 Bogan, "*Garcia v National Australia Bank Ltd*: Resurrecting the Corpus of *Yerkey v Jones*" (1998) 21(3) UNSW Law Journal 845.
42 Rickett & McLauchlan, "Undue Influence, Financiers and Third Parties: A Doctrine in Transition or the Emergence of a New Doctrine?" [1995] NZ Law Review 328, 337.
43 Supra note 41.
44 Fehlberg, "Surety Wives and Australian Law: *Akins v National Australia Bank*" (1995) 11 BFLR 423, 423.

Given the controversial nature of the second limb, the distinction between the two situations where a wife has a special equity to set aside a surety transaction is frequently overlooked. Accordingly, in the majority of cases and articles discussing "the rule" from *Yerkey*, it is the second limb that is commonly referred to as the "special equity theory".[45]

(b) Current Response: Barclays Bank v O'Brien[46] *and CIBC Mortgages v Pitt*[47]

Where a surety attempted to avoid his or her obligations under a security contract by pleading that the financier should be responsible for any private pressure or misunderstanding suffered, the application of either theory created uncertainty regarding the enforcement of such contracts. Consequently, in delivering the unanimous decision of the House of Lords in *O'Brien,*[48] Lord Browne-Wilkinson sought to restate the law in a form which was principled, reflected the current requirements of society and provided as much certainty as possible.[49]

Lord Browne-Wilkinson proceeded to do this by expressly rejecting the special equity theory.[50] He ruled that there is no legal basis for the special treatment of surety wives as they can be adequately protected by the application of general equitable principles. Further, financiers should not be required to prove that a wife understood the transaction.[51] Lord Browne-Wilkinson was of the view that if the doctrine of notice is properly applied there is no need for the introduction of a special equity in STD cases.[52] He then purported to preserve the agency theory, but narrowly restricted it to cases where the principal debtor can realistically be viewed as the agent of the financier. This will be a very rare occasion and in the English cases since *O'Brien* the agency theory has virtually disappeared.[53]

(i) Facts and decision

In rejecting the special equity theory and restricting the agency theory to render it all but irrelevant, *O'Brien* then established legal principles to govern future cases of surety transactions involving close relationships, emotional pressure and economic dependence. *CIBC Mortgages v Pitt* is an illustration by Lord Browne-Wilkinson of a practical application of the principles so established.[54]

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45 Supra note 42 at 337.
46 Supra note 12.
47 Supra note 30.
48 Supra note 12.
49 Ibid 195.
50 As set out in *Yerkey*, supra note 38 at 683.
51 Supra note 12, at 195.
52 Ibid.
53 Supra note 42 at 338.
54 Supra note 30.

Both cases involved wives who, induced by the wrongful conduct of their husbands, misrepresentation and undue influence respectively, charged the matrimonial home as security for their husbands' financial interests. The cases differed in one crucial aspect: Mrs O'Brien charged the matrimonial home for overdraft facilities that extended to a business in which her husband, but not Mrs O'Brien had an interest. In contrast, Mrs Pitt charged her interest in the matrimonial home to secure a joint borrowing for the stated purpose of discharging a first mortgage over their home and purchasing a holiday home (in fact the funds were used mainly for Mr Pitt's unsuccessful, pre-crash share market speculation). Consequently, the *O'Brien* transaction was not "on its face" to the financial advantage of Mrs O'Brien whereas the *Pitt* transaction was said to be "on its face" to the financial advantage of Mrs Pitt.

Thus, the House of Lords held Mrs O'Brien should succeed while Mrs Pitt should fail.[55] This even though Mrs Pitt was in an equally, if not more, invidious position than Mrs O'Brien: Mrs Pitt had no control over how the transaction was structured, and the capacity in which she was involved.

(ii) Reasoning of O'Brien

Lord Browne-Wilkinson began by expressly recognising that such cases involve balancing competing policy considerations: the need to protect the vulnerable, coupled with the need to avoid rendering the family home unacceptable security to financiers:[56]

> [A] high proportion of privately owned wealth is invested in the matrimonial home. Because of the recognition by society of equality of the sexes, the majority of matrimonial homes are now in the joint names of both spouses. Therefore, in order to raise finance for the business enterprises of one or other of the spouses, the jointly owned home has become a main source of security. The provision of such security requires the consent of both spouses.
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> ....[A]lthough 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. Such wives can reasonably look to the law for some protection when their husbands have abused the trust and confidence reposed in them.

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[55] Mr O'Brien's misrepresentations included statements as to the length of the security as well as the amount. Consequently the security was set aside *in toto*. However, in later cases where the surety has been successful and where the misrepresentations were as to quantum of the surety's potential liability, the securities have also been set aside *in toto*. In *TSB Bank plc v Camfield* [1995] 1 WLR 430 a wife believed she was standing surety to the Bank for a limited debt when in fact the debt was unlimited. She sought to avoid liability on the basis of her husband's misrepresentation and the Bank's constructive notice of her prior equity. The Court of Appeal (applying *O'Brien*) accepted her claim on the basis that, as in any case where a financier had constructive notice of the earlier right of the complainant, the financier's right was to be subordinated *in toto* to that earlier right.

But, in addition to the need to protect the vulnerable, Lord Browne-Wilkinson stated there are also compelling policy reasons why such surety transactions should not be discouraged. Thus, this need to protect wives must be counterbalanced against the need of her financiers to have resort to security when extending finance, to ensure the wealth invested in the matrimonial home is not rendered economically sterile: [57]

> 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. It is therefore essential that a law designed to protect the vulnerable does not render the matrimonial home unacceptable as security to financial institutions.

Their Lordships considered a fair balance between the competing interests of vulnerable sureties and secured financiers and an adequate resolution of such cases could be achieved by applying the equitable doctrine of notice.[58] When a wife agrees to stand surety for her husband's debts, as a result of his undue influence or misrepresentation, a financier will take subject to the "wife's prior equity to set that transaction aside", but only if the circumstances are such as to put the financier on inquiry as to the circumstances in which she agreed to stand surety.[59]

A financier will be put on inquiry when a wife offers to stand surety for her husband's debts and there is a combination of two factors: [60]

(i) The transaction is on its face not to the financial advantage of the wife; and
(ii) there is substantial risk in transactions of that kind that, in procuring the wife to stand surety, the husband has committed a legal or equitable wrong that entitles the wife to set aside the transaction.

Unless a financier who is put on inquiry takes "reasonable steps" to ensure the wife's agreement has been properly obtained, the financier will have constructive notice of the wife's rights. To avoid being fixed with constructive notice, the "reasonable steps" a financier should take include the steps necessary to "bring home to the wife the risk she is running by standing as surety and to advise her to take independent advice". This includes: [61]

(i) Insisting the wife attend a private meeting, in the absence of the husband, with a representative of the financier at which she is told of the extent of her potential liability; and
(ii) ensuring the wife is warned of the risk she is running and urged to take independent legal advice.

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56 Supra note 12 at 188.
57 Ibid.
58 Ibid 195.
59 Ibid 196.
60 Ibid.
61 Ibid.

Further, Lord Browne-Wilkinson stated that the law should recognise that as unmarried cohabitation (both heterosexual and homosexual) is widespread in modern society, and that legal wives are not the only class of partners now exposed to the emotional pressure of cohabitation. If the financier is aware the surety is cohabiting with the principal debtor, or the surety reposes trust and confidence in the principal debtor in relation to financial affairs, the same rules are to apply. Consequently, the financier is put on inquiry in relation to securities given by virtue of a de facto or parent/child relationship, in the same manner as it is in relation to husband and wife.[62]

(c) Summary

The result of *O'Brien* is that a wife or other surety cohabiting with, or otherwise party to an intimate or otherwise relationship with the principal debtor, must win at four distinct stages in order to avoid liability under a security.[63] Firstly, a surety must establish a prima facie case for relief against her husband (such as undue influence or misrepresentation). Secondly, it must be established that the financier should be fixed with liability for this wrong, either on the basis of agency (which will be rare), or constructive notice on the basis that the financier was put on inquiry. Thirdly, a financier may avoid being fixed with constructive notice if it has taken "reasonable steps" to satisfy itself that the agreement to stand as surety has been properly obtained. Independent advice is the ultimate limit for financier responsibility. If a financier insists a surety should receive independent legal advice, there is no scope for a surety to avoid liability however pressured they may have been. Unlike the approach in *Yerkey*, a mere lack of understanding of implications of the transaction is insufficient to avoid liability. The fourth and final stage involves determining the extent and form of relief.

(d) Post-O'Brien Case Law

In post-*O'Brien* case law, although Lord Browne-Wilkinson purported to establish rules balancing the interests of both sureties and financiers, their subsequent application has tended to ensure financiers are more likely to succeed. Consequently legal protection available to sureties is limited, as current social policy views that suretyship as a social good dictates financiers must win more often than they lose.[64] In subsequent cases the courts have tended to be financier-sympathetic, focussing on how matters looked to the financier, as opposed to the surety.

(i) Constructive notice of invalidating circumstances

Problems have arisen for sureties in the context of whether a financier was put

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62 Ibid 198.
63 Supra note 20 at 676.
64 Supra note 13 at 20.

on inquiry as to the circumstances in which the surety agreed to provide security. Constructive notice has emerged as the more usual basis for financier liability in post-*O'Brien* cases, as opposed to the alternative bases of agency theory or actual notice. To be fixed with constructive notice a financier will be put on inquiry by a combination of two factors.

The "substantial risk" aspect of this test has been interpreted flexibly in post-*O'Brien* cases, to the advantage of sureties. The fundamental requirement is the existence of an emotional relationship which is personal as opposed to commercial.[65]

However, the "face of the transaction" requirement is problematic for sureties. In *CIBC Mortgages v Pitt*,[66] Mrs Pitt was unsuccessful with her case as there was held to be nothing on the face of the transaction to indicate the joint borrowing was to her disadvantage.

This requirement creates two problems for sureties. Firstly, it is a test revolving around financial advantage accruing to a surety. Such a test ignores the practical reality that sureties often enjoy only an indirect financial advantage (if any) from a security transaction.[67] Although *Goode Durant Administration v Biddulph*[68] suggests that indirect benefit may be insufficient to constitute financial advantage, the Court of Appeal decision in *Equity and Law Life Assurance Society plc v McGrath* suggests a different view. [69]

Secondly, the requirement ignores the irony that it may operate to form the basis for denying relief when a surety who provides security as a result of pressure by her husband or partner is unlikely to have practical control over how she appears "on the face of the transaction". Hence, in *Pitt* Mrs Pitt entered into the transaction as a result of her husband's undue influence and appeared as a joint borrower for a holiday home on the face of the transaction. Yet in reality she had no control over family expenditure or her husband's business investments and no control over how she appeared in the transaction documentation.[70]

(ii) Interpretation of the "reasonable steps" requirement

Even if a financier is put on inquiry, it will avoid being fixed with constructive notice of the principal debtor's misconduct if it takes "reasonable steps" as set out in *O'Brien*. The "reasonable steps" criteria involve a private meeting between surety and financier, in the absence of the principal debtor, where the surety is informed of the extent of potential liability and advised to seek independent legal advice.[71]

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65 See *Massey v Midland Bank plc*, supra note 19, where the rules in *O'Brien* were held to apply in to a non-cohabiting couple involved in a 14-year relationship.

66 Supra note 29.

67 Supra note 20 at 682.

68 [1995] 2 FLR 827.

69 *Equity and Law Life Assurance Society plc v McGrath* (CA, 9 May 1995, Stuart, Smith and Morritt LJJ) (Lexis transcript). Cited in Fehlberg, supra note 13 at 45.

70 Supra note 13 at 47. A point well documented by Peter Gibson LJ in *CIBC Mortgages v Pitt* (1993) 66 P & CR 179, 181 (CA).

71 Supra note 12.

It is on this "reasonable steps" requirement that the courts' financier-sympathetic approach is particularly evident, as this requirement has proved very easy for financiers to satisfy. This is because the courts have taken the view that the issue is not whether the surety actually received adequate independent advice, but whether the financier has fulfilled the "reasonable steps" requirement by making the surety aware of the risk they are running and advising the surety to take independent advice.[72] Consequently, what has generally been referred to in post-*O'Brien* cases as "independent advice" has not involved any "advice" to the surety as to whether or not it is in their best interests to sign, and has invariably been given by solicitors who are not truly independent.

Illustrative of this is *Massey v Midland Bank plc*[73] where it was held the Bank had taken "reasonable steps" by insisting Miss Massey take "independent advice", notwithstanding that the so-called independent advice was given by solicitors who acted for Miss Massey's long-term partner, the principal debtor. Lord Justice Steyn held that a financier could avoid a private meeting with the surety and a finding of constructive notice if the financier urged the proposed surety to take independent advice from a solicitor. The advice provided would then be a matter between the solicitor and surety, not the financier. The bank, by merely insisting on independent advice, was released from any further obligation under the "reasonable steps" requirement.

A similar approach, with similar facts to *Massey* was evident in *Banco Exterior Internacional v Mann*[74] and *Bank of Baroda v Rayarel.*[75] In *Rayarel*, although the Bank knew the same solicitor was advising the surety wife, her husband, her son and the debtor company, the Bank was entitled to assume the solicitor had properly advised the wife.[76]

In *Midland Bank plc v Serter*[77] the solicitor acted on behalf of all the parties: surety, principal debtor and financier. Mrs Serter (the surety) was in Holland and the solicitor advised her over the phone. The circumstances of the signing, according to Mrs Serter, were that her marriage was in difficulties and she was under psychological stress. Mr Serter flew to Holland and took her out to lunch where an amount of alcohol was consumed. At the end of the meal and without any explanation, her husband produced some documents and requested she sign them. She did so and the head waiter witnessed her signature to the security documentation, which included a certification stating she had received independent advice.[78] The Court held that the fact the solicitor may not have been truly independent would not alter the situation. There is no obligation on the financier to ensure the surety receives entirely independent advice before executing the security.

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72 Ibid 196.
73 Supra note 19.
74 [1995] 1 All ER 936 (CA).
75 [1995] 2 FLR 376.
76 Ibid 384.
77 [1995] 1 FLR 1034.
78 Supra note 4 at 52.

(iii) "Reasonable steps": a preference for form over substance

Thus, in relation to the "reasonable steps" criteria, the current judicial approach reflects a strong preference for form (the existence of a meeting) over legal substance (content of meeting) by supporting the view that financiers can safely leave it to external advisers to fulfil the "reasonable steps" requirement for them.[79] This is regardless of whether the instructions given to the advising solicitor reflect the "reasonable steps" requirement and notwithstanding that the financier is aware the solicitor acts for other parties to the transaction. The existence of a meeting between the surety and a solicitor appears sufficient to fulfil the "reasonable steps" requirement, regardless of the content of the meeting and whether the surety is then placed in a position to protect their own interests.

The post-O'Brien cases indicate the current judicial view towards the "reasonable steps" requirement is that the purpose of both the private interview and independent advice is neither to ensure the surety understands the document, nor to ensure that he or she is not acting under undue influence. The purpose is to insulate the financier from liability:[80]

> She was to a degree the tool of her husband. However, despite the fact she was under his influence to a degree she cannot escape, if the Bank took all reasonable steps to ensure that she had appreciated and understood what she was signing. It may be that Mrs Wright-Bailey did not have an adequate comprehension of the nature of the charge ... even if she did not, the Bank did take all reasonable steps...

(iv) Summary

Hence, while the rules set out by Lord Browne-Wilkinson in *O'Brien* create the impression of balancing the interests of sureties and financiers, their manner of application has tended to ensure financiers are more likely to succeed. This is particularly so given the subsequent interpretation of the "reasonable steps" requirement and what has been held to constitute "independent legal advice". The courts' insistence on viewing the transactions from the point of view of the financier has resulted in reducing the requirement to no more than a mere formality, the only function of which is to protect the financier from liability.[81]

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79 Supra note 13 at 64.

80 *Lloyds Bank plc v Wright-Bailey*, (CA, 3 May 1995, Russell, Hirst and Rose LJJ). Cited in Kaye, supra note 4 at 51.

81 Supra note 4 at 54.

2. Australia

The leading STD case in Australia is the recent decision of the High Court in *Garcia v National Australia Bank Ltd.*[82]

(a) Previous Responses

Before *Garcia* the Australian courts had also diverged in their approach to such cases, which generated uncertainty around the enforceability of security contracts. The two approaches previously utilised were the "special equity theory" and more recently the equitable doctrine of unconscionability.

(i) "Special equity theory"

As previously discussed this theory originated from the decision of Dixon J in the High Court decision of *Yerkey v Jones.*[83] Although the binding force of this rule has been recognised and applied subsequently,[84] in recent years the trend has been to narrowly interpret the ratio and distinguish the case to avoid its application.[85] Consistently, the rule has been rejected on the basis that it fails to pay regard to the advances in status and education of women, the increasing role of women in business and commercial affairs and the variety of personal relationships that exist in the modern world.[86]

(ii) The doctrine of unconscionability

The recent trend of the Australian courts has been to resolve STD cases by applying the equitable doctrine of unconscionability. *Commercial Bank of Australia Ltd v Amadio*[87] is the leading Australia decision on the doctrine. The doctrine of unconscionability allows a contract to be set aside if it is made in circumstances where unequal bargaining power exists between the parties and the stronger party has known of a special weakness or disability in the weaker party's position and taken advantage of it.[88]

While there is no definitive list of what constitutes a "special disability", it is unlikely that gender in and of itself will be ranked with other judicially accepted special disabilities such as poverty, sickness, infirmity of body or mind, drunkenness,

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82 (1998) 155 ALR 614.

83 Supra note 38.

84 For example, *Bawn v Trade Credit* (1986) NSW Conv R 55-290.

85 For example, *European Asian of Australia Ltd v Kurland* (1987) 8 NSWLR 192. See also *Akins v National Australia Bank* (1994) 34 NSWLR 155 (CA) where the rule was expressly rejected.

86 *Akins v National Australia Bank,* ibid 168.

87 (1983) 151 CLR 447.

88 Supra note 1 at 245.

illiteracy or lack of education. An economically dependent surety wife is not seen as acting under a "special disadvantage".[89]

Furthermore, for a surety transaction to be set aside on the grounds of unconscionability, the financier must have known or ought to have known of the other party's special disability. This has proved a difficult requirement for a surety to prove.[90]

As a surety in a STD situation cannot usually establish a recognised disability and is unable prove the financier knew (or ought to have known) of this special disability, the doctrine of unconscionability has seldom led to STD securities being set aside.[91] The only successful cases have involved a supervening disability such as a medically certified condition,[92] or blatant misconduct by a financier (which will be rare).[93]

(b) Current Response: Garcia v National Australia Bank Ltd [94]

As the recent trend of the Australian courts was to decide STD cases based on the doctrine of unconscionability, it appeared the special equity theory had been relegated to a position as non-starter as a method for deciding STD cases.[95] The rule from *Yerkey*, although the leading authority on STD, was frequently criticised and met with harsh resistance. Thus, it was somewhat surprising in *Garcia* that five of the six High Court judges resurrected and approved of the special equity theory in *Yerkey*, explaining it in terms of unconscionability.

(i) Facts and decision

In 1979 Mrs Garcia and her then husband executed a mortgage over their home. The mortgage secured all moneys which might become owed under the mortgage, including moneys owing under future guarantees given by either of them to the mortgagee. In 1987 Mrs Garcia then signed a guarantee in favour of the Bank, to secure the debts of a company run by her husband. Her husband pressured her to sign the guarantee. He constantly reiterated what a fool she was in financial matters and assured her that there was no real risk associated with the interests she was

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89 For example see comments made by Rogers in *European Asian of Australia Ltd* supra note 85 at 200:

> [I]t 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.... That being a female spouse should place a person shoulder to shoulder with the sick, the ignorant and the impaired is not to be tolerated.

90 Supra note 1 at 246.

91 Ibid 247.

92 *Borg-Warner v Diprose* (1987) 4 BPR 97-279. Cited by the ALRC supra note 1 at 247.

93 *Nolan v Westpac Banking Corporation* (1989) 51 SASR 496. Cited by the ALRC supra note 1 at 247.

94 Supra note 82.

95 Supra note 41 at 847.

guaranteeing. The Bank took no steps to explain the extent of the obligations under the guarantee nor to recommend or insist she obtain independent advice regarding the new obligations she was assuming. Consequently, she failed to understand the guarantee to the Bank was secured by an "all moneys" mortgage which put the matrimonial home in danger.

The trial judge granted relief to Mrs Garcia on the basis of the principles set out in *Yerkey*. The Bank appealed to the NSW Court of Appeal, challenging the status of *Yerkey* as law. The Court held that it was not bound to follow the case, determining that Amadio and the doctrine of unconscionability properly described the jurisdiction of equity to relieve a guarantor against an unfair guarantee[96] and, on this basis, Mrs Garcia was not entitled to any relief. She appealed to the High Court.

Five out of the six members of the High Court[97] reaffirmed Justice Dixon's principle in *Yerkey* and allowed Mrs Garcia's appeal, holding the guarantees unenforceable. A majority of four reinterpreted the foundations of the principle,[98] creating the opportunity to extend the classes of those who may claim relief under *Yerkey*.

(ii) Reasoning

The majority, in their joint judgment, distinguished between the two limbs of the rule in *Yerkey*, *Garcia* being a case falling within the second limb. The majority explained that the rule in *Yerkey* enables a wife to have a security set aside as against a financier in two situations: actual undue influence (the first limb) or where there has been a failure to explain the nature and effect of the transaction (the second limb).[99] The majority held the rationale of *Yerkey* was not to be found in notions based on the subservience or inferior economic position of women, but was rather based on notions of trust and confidence in the marriage partnership.[100] Thus, the special equity protection of *Yerkey* exists because it would be unconscionable if it did not. It would be unconscionable on the basis that financiers would be able to take advantage of a relationship of trust and confidence, by virtue of which the security is given.

If the relationship between surety and principal debtor is one of trust and confidence, "in the ordinary sense of those words",[101] this creates the prima facie indicator that protection of the surety is necessary, as it would be unconscionable not to protect the relationship from the financier.

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96 *National Australia Bank Ltd v Garcia* (1996) 39 NSWLR 577, 597.

97 The majority of Gaudron, McHugh, Gummow and Hayne JJ, in addition to Callinan J, held that the principles stated by Dixon J in *Yerkey* must be accepted as law of longstanding in Australia. Justice Kirby dissented, rejecting the applicability of *Yerkey* and espousing a re-formulation of the principle expressed by Lord Browne-Wilkinson in *O'Brien*.

98 Justices Gaudron, McHugh, Gummow and Hayne.

99 Supra note 82 at 620.

100 Ibid 619.

101 Ibid, majority judgment.

Arguably, as this protection is based on a relationship of trust and confidence, it may extend beyond wives and husbands to other relationships in the modern context. This would naturally include de facto (homosexual or heterosexual) and intergenerational relationships, although the point did not need to be decided as *Garcia* involved the typical scenario of husband and wife.[102]

Hence, *Garcia* creates a special equity allowing a surety transaction to be set aside for those in a relationship of "trust and confidence" with the principal debtor. To invoke this special equity, a surety needs to establish the following:[103]

(i) They are within the class of protected persons (there exists a relationship of trust and confidence between the surety and principal debtor);
(ii) the financier knew or ought to have known of that relationship;
(iii) either they were subject to actual undue influence or simply did not understand the nature and effect of the transaction.

If such circumstances are established it would be unconscionable for the financier to rely on the security unless it had taken steps to explain the document and had advised the surety to obtain independent legal advice.[104]

To avoid the invalidity of the transaction the onus is on the financier to ascertain the nature of the relationship between the proposed surety and principal debtor. If the relationship is one of "trust and confidence" and there is no apparent financial benefit to the proposed surety, the financier will be required to demonstrate that it has taken "adequate steps" sufficient to alleviate these presumptions. Such steps require the financier to ensure the surety is fully informed as to the nature and effect of the security and advised to take independent legal advice.[105]

In practical terms these "adequate steps" will entail similar procedures to the "reasonable steps" requirement in *O'Brien*. To ensure the validity of the security, the financier needs to establish either that there was a financial benefit or advantage to the surety in the transaction, or that it explained the purport and effect of the proposed security contract and advised the surety to obtain legal advice. If, however, the financier did not explain the implications of the proposed transaction, it will be sufficient if the proposed surety received independent legal advice.

(c) Summary

The High Court has clearly established that the principles in *Yerkey* have not been abandoned. In reinterpreting the special equity theory, it is arguable that a new category of unconscionability has been invented,[106] rendering the Australian approach wider than that of the English courts.

[102] Ibid 620.
[103] Cockburn, "*Yerkey v Jones*: The Phoenix's New Clothes" (1998) 9 Journal of Banking and Finance Law and Practice 308, 317.
[104] Ibid.
[105] Supra note 82 at 621; Cockburn, supra note 104 at 317.
[106] Supra note 41 at 853.

In *Garcia* the status of the surety is the essential element. The approach is to place on the financier the burden of inquiring into the status of the surety and to eliminate any potential disability, arising from a relationship of trust and confidence, that may exist between the surety and principal debtor. This is to ensure the financier will not be presumed to have acted unconscionably by taking advantage of the relationship.

To overcome the disability of the surety, which, as with the approach in *O'Brien*, is presumed to arise from the relationship, the requirement of independent legal advice represents the outer limits of the potential for contractual invalidity.

2. New Zealand

In New Zealand there is less case law and discussion regarding the issue of STD. The early cases are characterised by sureties arguing for the invalidity of their securities based on a multitude of legal and equitable claims,[107] resulting in a somewhat confused and inconsistent line of authority. Fortunately, in *Wilkinson v ASB Bank Ltd*[108] the Court of Appeal has provided guidance as to the applicable law that will govern future STD cases.

(a) Previous Responses

There is insufficient consistent authoritative case law from which to draw a clear picture of the previous legal response in New Zealand to the issue of STD. Until *Barclays Bank v O'Brien* the cases were resolved by the application of ordinary legal and equitable principles. Stated applicable legal principles tended to include agency theory, undue influence and unconscionability.[109] Interestingly there was also a brief attempt to impose a tortious duty of care on financiers when taking security.[110]

Prior to *Wilkinson v ASB Bank* Ltd the leading Court of Appeal decision was *Contractors Bonding Ltd v Snee*.[111] In this case Mrs Snee sought to avoid guarantees secured by a mortgage over her house given for her son's (Mr Savage) business debts. The guarantees were held to be procured as a result of Mr Savage's actual undue influence as Mrs Snee was a mentally impaired woman, lacking capacity to

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107 For example in *Dungey v ANZ Banking Group (NZ) Ltd* [1997] NZFLR 404 the surety sought to avoid liability by raising as causes of action; actual undue influence, presumed undue influence, breach of fiduciary duty, negligence, breach of the Credit Contracts Act 1981 and misleading conduct under the Fair Trading Act 1986.

108 [1998] 1 NZLR 674.

109 For example, *Shotter v Westpac Banking Corporation* [1988] 2 NZLR 316; *Contractors Bonding Ltd v Snee* [1992] 2 NZLR 157.

110 Introduced in *Shotter v Westpac Banking Corporation* ibid per Wylie J, criticised in *Westpac Banking Corporation v McCreanor* [1990] 1 NZLR 580 per Hardie Boys J; *Shivas v Bank of New Zealand* [1990] 2 NZLR 327 per Tipping J; rejected in *Alexander v Westpac Banking Corporation* (1991) 3 NZBLC 102188.

111 Supra note 109.

comprehend legal matters and having no appreciation of the security documentation executed.[112] Justice Richardson stated: [113]

> [I]n carrying through everyday financial transactions, such as those involved in the present case, financial institutions should not be fixed with any improper pressure applied by a third party in obtaining the execution of a document except where that party is their agent or constructive knowledge is sheeted home to them.

Mr Savage was held not to be acting as an agent for Contractors Bonding in procuring the mortgage. As Contractors Bonding had no knowledge of and could not be expected to have any awareness of Mrs Snee's incapacity and had no reason to believe she was under the influence of her son, they were entitled to rely on their enforcement rights under the mortgage.[114]

(b) Current Response: Wilkinson v ASB Bank Ltd[115]

(i) Early application of Barclays Bank v O'Brien

After the decision of *Contractors Bonding Ltd v Snee* there were no further cases of STD in New Zealand until subsequent to the decision of the House of Lords in *Barclays Bank v O'Brien*. In two cases prior to the decision in *Wilkinson* it appeared *O'Brien* had won the approval of the New Zealand courts.

In *ASB Bank Ltd v Harlick* the Harlicks, a couple possessing little commercial background, sought to prevent the Bank from exercising rights against them under a guarantee and a mortgage over their home on the basis of undue influence and unconscionability.[116] They alleged that their daughter and son-in-law exercised undue influence over them in procuring the guarantee and mortgage and that the Bank were put on inquiry as to this undue influence. Secondly, they alleged that the Bank acted unconscionably when taking the security.

In a short judgment, Gault J appeared to apply the reasoning of *O'Brien* but held that the circumstances were insufficient to raise a presumption of undue influence. As the evidence went no further "than to establish a normal family relationship in which parents readily agreed to assist children in their business ventures" neither cause of action could be sustained.[117]

In *Dungey v ANZ Banking Group (NZ) Ltd*,[118] a surety sought to avoid a mortgage securing the debts of her deceased partner. Justice Doogue held "[i]f there had been any basis for finding undue influence on the part of [the principal debtor], then

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112 Ibid 166 and 174.
113 Ibid 171.
114 Ibid 172.
115 Supra note 108.
116 [1996] 1 NZLR 655.
117 Ibid 661 per Gault J.
118 [1997] NZFLR 404 (HC).

I would have had no difficulty in finding the bank had constructive notice of that in accordance with the principles expressed by Lord Browne-Wilkinson in Barclays Bank".[119]

(ii) Wilkinson v ASB Bank Ltd[120]

In *Wilkinson* the Court of Appeal appeared to recognise that the issue of STD was of more importance than the previously dismissive attention given to it in *Harlick* would suggest. The leading judgment of Richardson P, Henry, Keith and Blanchard JJ was delivered by Blanchard J. Additional comments regarding the jurisprudential basis of the decision were made by Tipping J, with whom the other judges found "some force in the views [so] expressed".[121]

(iii) Facts and Decision

Mr Wilkinson and his son ran an accounting firm which came under pressure from its banker, TrustBank, to improve its position. They sought replacement finance elsewhere, and the ASB Bank Ltd ("the Bank") offered loans. These loans were conditional on the execution by Mrs Wilkinson of a mortgage over the family home (registered in her name), in addition to guarantees on each loan in favour of the Bank. The loans were also subject to the condition that Mrs Wilkinson take "independent legal advice" and that "independent solicitors [must] confirm to the Bank that her obligation and liability has been explained and fully understood".[122]

Mrs Wilkinson (aged 70) suffered from a disabling psychiatric condition and during the course of the security negotiations the Wilkinson's grandchild died unexpectedly. Nine days later the family solicitor visited Mrs Wilkinson at her home and at that meeting, where Mr Wilkinson was also present, Mrs Wilkinson executed the guarantees and mortgage. Subsequent to that meeting, certification that the effect of the guarantees had been explained and understood was sent to the Bank. Defaults occurred on the loan repayments and the Bank made a demand on Mrs Wilkinson under the guarantees. When payment was not forthcoming, the Bank sought summary judgment in its favour.

For the purposes of the argument between Mrs Wilkinson and the Bank, it was assumed Mr Wilkinson had exerted undue influence upon or misled Mrs Wilkinson in order to procure her to sign the documents which she did not comprehend, notwithstanding the advice given to her by the family solicitor.[123] The issue in both the High Court and Court of Appeal was "whether the bank's right to recover the outstanding debt and enforce the security is affected by constructive notice of these

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119 Ibid 411.
120 *Wilkinson*, supra note 108.
121 Ibid 690.
122 Ibid 676.
123 Ibid 675-676.

circumstances".[124] Mrs Wilkinson appealed against the grant of the summary judgment application in the High Court.

The Court of Appeal dismissed Mrs Wilkinson's appeal. The facts were sufficient to alert the Bank to the possibility of undue influence being exerted upon Mrs Wilkinson by her husband. Nevertheless, the Bank had insisted on independent advice being given and the Court did not see prior contact between the solicitor and the principal as an absolute barrier to the provision of independent advice to the surety. Accordingly, it was held that the Bank could reasonably take the view that it was for the solicitor to decide if he could properly act for Mrs Wilkinson. Furthermore, an outsider could reasonably conclude that there were good reasons for Mrs Wilkinson to lend her support to the borrowers, given the family nature of the business. For these reasons the Court held that the Bank was justified in relying on the professional judgment of the solicitor and the terms of the certification:[125]

> [The Bank] had done enough to allay suspicion .... Whilst there must be every sympathy for the position in which Mrs Wilkinson now finds herself ... no arguable defence exist[s].

(iv) Reasoning

The Court of Appeal surveyed the previous case law from England, Australia and New Zealand and appeared enamoured by the approach taken by the House of Lords in *O'Brien*. Justice Blanchard stated:[126]

> The Court must balance the desirability of protecting vulnerable persons from loss of their assets, particularly their homes, against the undesirability of economically sterilising those assets. Sympathy for a victim of undue influence ... should not lead a Court into the error of imposing upon lenders an unrealistic standard.

Furthermore: [127]

> At issue is where a loss primarily incurred by a third party should lie. In this equitable area practical difficulties for financiers will inevitably arise as the law develops in its attempts to balance competing interests. Following the approach adopted in *O'Brien*, it is thought to be of some assistance to those directly involved with this type of situation to list a series of observations of a general nature, which are made in the light of the law as it presently stands.

Although the Court then recognised that the jurisprudential basis of *O'Brien* rests on shaky ground, in their view it was unnecessary to attempt any doctrinal resolution to decide the case.[128] Instead, the Court preferred to establish ten general

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124 Ibid 676.
125 Ibid 694.
126 Ibid 689.
127 Ibid 690 (emphasis added).
128 Ibid 689-690.

"observations" gathered from the law of different jurisdictions. Justice Blanchard stated these "observations" should not "be read as definitive statements of principle" or "as rules to be followed",[129] as each case will turn on its own facts and circumstances. Nevertheless, the "observations" would seem to have enormous significance, as essentially they establish the practical steps to be taken by financiers who wish to ensure the enforceability of their securities.[130]

(v) "Observations" of Blanchard J:[131]

1. A contract of guarantee or other security is not a contract requiring full disclosure on the part of the lender.
2. The questions to be asked about a situation which might appear to fall within class 2(B) in *O'Brien* (presumed undue influence) are:

(i) whether there was between the surety and principal debtor a relationship under which the surety reposed trust and confidence; and thus
(ii) whether there was at the time when the security was in contemplation a presumption of undue influence or misrepresentation.
(iii) If the financier was aware of facts giving rise to that presumption of undue influence, it must show that it took adequate steps to allay any reasonable suspicion of undue influence or misrepresentation.

3. Undue influence on a surety is likely to be presumed if the following features are present:

(i) limited commercial ability of the surety;
(ii) absence of more than minimal financial stake by the surety in the enterprise whose debts are secured; and
(iii) a relationship involving an emotional tie or dependency on the part of the surety towards the principal debtor.

4. A wife is no longer automatically regarded as being under a special disability vis-à-vis her husband.
5. It should not be overlooked that the surety may have been motivated by an indirect personal advantage in giving the security.
6. To allay reasonable suspicion the financier should insist that the surety obtain independent legal advice and certification from the solicitor that the effect and implications of the documents have been explained and that the guarantor appeared to have understood the explanation.

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[129] Ibid 690.
[130] Rickett, "Banks and their securities: more on the three party cases" (1998) 8 BCB 56, 57.
[131] Supra note 108 at 690-692.

7. If a surety declines to get independent legal advice the financier should ensure that someone explains the documents and their consequences and obtain the refusal in writing.
8. In giving the legal advice the solicitor should ensure that the surety has considered what he or she may be letting him or herself in for by way of financial exposure and loss of assets. Upon receiving an unqualified certificate the financier may usually assume that this has occurred.
9. It is not for the financier to tell a solicitor how to perform his or her duties or, other than in exceptional cases, to inquire about the independence of the solicitor or the adequacy of the advice.
10. There may be rare cases where the substance of the transaction is so disadvantageous that no solicitor could properly advise signature. A financier will be unwise in these exceptional circumstances to rely upon the appearance of independent legal advice.

(c) Summary

With its decision in *Wilkinson v ASB Bank Ltd* the Court of Appeal has provided much needed guidance as to their position regarding cases of STD. In adopting the ten "observations" the Court of Appeal has effectively imposed an equitable duty on financiers to take "adequate steps"[132] or "appropriate steps"[133] to "protect the guarantor from the potential wrongdoing (of the principal debtor) of which it has notice".[134]

From the content of the "observations" (particularly two, three, five, six, eight and nine) one can conclude that this duty will merely involve ensuring that a surety falling within the protected class of persons receives independent legal advice which explains the effect and implications of the proposed security. Such independent legal advice represents the boundaries of the "reasonable steps" requirement imposed on financiers in *O'Brien* and *Garcia*. Consistent with the post-*O'Brien* trend previously discussed, the result in *Wilkinson* indicates that the question of whether a surety received independent legal advice will be viewed from the financier's standpoint, not the surety's.

4. Recurring Themes

The legal responses from England, Australia and New Zealand to STD cases, are all variations on a recurring theme. All apply the law of contract and its equitable supplements,[135] requiring the surety to invoke the sufferance of a wrong at the hands

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[132] Ibid 690, per Blanchard J.
[133] Ibid 695, per Tipping J.
[134] Ibid.
[135] Supra note 9 at 97.

of the principal debtor or the financier, in the contracting process, for which the financier should bear ultimate responsibility. The wrongs operating to invalidate the security contract involve either a legal or equitable presumption: of undue influence, misrepresentation or unconscionable dealing. All three jurisdictions consider information disclosure and the provision of legal advice as rebutting the applicable presumption, being seen as measures sufficiently curative of the initial wrong suffered by the surety. Further, all three jurisdictions view independent legal advice as representing the boundary for invalidation of security contracts.

IV: CRITICISMS OF THE CURRENT LEGAL RESPONSES

The leading judgments of *O'Brien*, *Garcia and Wilkinson*, articulating the current legal responses to STD, are initially impressive. They are impressive for their attempts to resolve the confusion surrounding this area of the law. They are also impressive for their express recognition of competing policy factors, social change and current social attitudes, in addition to their wide application, to not only wives, but also to cohabitees, de factos and other relationships where a surety reposes trust and confidence.

Many criticisms have, however, been levied against these responses to STD. Underlying these criticisms is one central unified criticism, namely that the strict application of contract law is not an entirely appropriate mechanism by which to resolve such cases.[136]

1. Application of Contract Law to STD

Both the current and previous legal responses to STD cases utilise "public" contract law concepts.[137] Contract law is founded on the assumptions that parties to an agreement are rational creatures, possessing equal bargaining power, and who are free, throughout the bargaining process, to act to secure the best possible deal from the transaction.[138] Accordingly, this traditional model of contract embodies, as fundamental tenets, the notions of voluntariness and free choice, coupled with self-interested arm's-length bargaining. As a corollary, the current responses to STD assume all sureties who are motivated to enter a security contract by fact of a "private" relationship enter pursuant to these notions. Consequently, criticisms of the current legal responses are inherently directed at the appropriateness of the application of contract law to STD situations, as arguably such surety transactions demonstrate neither of these fundamental tenets.

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[136] For example the view expressed by Howell, ibid 104.

[137] Supra note 13 at 17.

[138] Naffine, *Law and the Sexes: Explorations in Feminist Jurisprudence* (1990) 52.

(a) The Assumption of Voluntariness and Free Choice

The application of traditional contract law and its equitable supplements to STD situations assumes the sureties enter into the transaction and undertake the obligations voluntarily, with unconstrained decision-making capacity. The correctness of this assumption is debatable, as the facts of the cases and empirical research tend to demonstrate this is not so.[139]

> To other people, the pressure that [my husband] put me under wouldn't have been particularly great. He didn't hit me, he didn't scream at me, he didn't do anything like that. [But] because of the relationship we had, the pressure was considerable, looking at it from my point of view. And I had thought, very, very carefully, about what the alternatives would actually mean ... [But] practically, there was no real choice at all.

The definition of STD[140] recognises that it is the fact of the relationship that dominates a surety's entry into the transaction, not the assumption a surety voluntarily undertakes responsibility for the debt, as a result of his or her own free choice. This conclusion is supported by the findings of Belinda Fehlberg. In summarising her central findings, Fehlberg found the sureties she surveyed consistently stated they felt, at the time of signing the debt contract, that they had no choice about whether or not to enter into it.[141] To some sureties the concept of having a choice never entered their minds, it was merely assumed they would sign.[142]

Influencing this lack of choice perceived by a surety are the private pressures and dependence that exist within intimate or otherwise close relationships. Fehlberg found such private pressures to include a surety's economic dependence upon the principal debtor, and emotional pressure ranging from subtle forms of pressure inherent in any relationship, to emotional blackmail and in some cases extreme physical abuse. Such factors operate to constrain a surety's effective decision-making capacity, rendering the concept of choice largely irrelevant for many.[143]

Similarly, a desire to preserve their relationship with the principal debtor also acts to constrain a surety's ability to enter voluntarily into a transaction.[144] As discussed by Howell,[145] sureties in a STD situation execute the security for numerous reasons, many of which are not recognised by the law.[146]

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139 Supra note 13, at 178. Surety interview, Mrs Parkes (emphasis added). It was also clear in *Pitt* from the evidence that Mrs Pitt perceived herself to have no such choice. Discussed in Fehlberg, "The Husband, the Bank, the Wife and her Signature" (1994) 57 Modern Law Review 467, 473.

140 Supra note 4 and accompanying text.

141 Supra note 3 at 330.

142 Ibid 331.

143 Ibid 332.

144 Ibid.

145 Supra note 9 at 107.

146 Ibid.

> They sign because of emotional pressure. They sign because they are expected to sign. They sign because the nature of the document is misrepresented to them. They sign because they believe that their relationship with their partner obliges them to .... They sign because they value their relationship with their partner and do not want to create a situation that may adversely affect that relationship.

Although it is recognised within the current legal responses to STD that a private relationship may influence the giving of a security, the practical effect of the relationship and the private pressures and dependence embodied within are generally not. The problem is that the tests for establishing conduct that constitutes a legal wrong that is sufficient to invalidate the security remain more attuned to the motivation, perspective and interests of financiers than to sureties.[147] The tests do not take into consideration the more subtle pressure, misleading behaviour and economic dependence likely to occur within intimate relationships. Empirical research underscores the reality that sureties will not always be able to recount such pressures or articulate logical and rational reasons for providing security. Such reasons often lie in having to live with the consequences of refusing to co-operate with a partner's request.[148] Such pressures, although very real to sureties, are likely to fall short of a legally recognised wrong that is sufficient to invalidate the contract.[149] Consequently, these private pressures and economic dependence that constrain the independent will of the surety and inhibit their ability to exercise free choice when faced with a surety transaction are insufficiently acknowledged within the current legal responses.[150]

Accordingly, the assumption that traditional contract law makes regarding the concept of a rational creature entering into a contract of his or her own free choice does not reflect the reality for sureties in STD situations. Their entry into a surety transaction could not be described as an example of voluntariness or an exercise of free will. A lack of choice results from a combination of complicated and difficult factors involving economic dependence, emotional pressure and occasionally physical abuse.[151]

(b) The Assumption of Self-Interested, Arm's-Length Bargaining

In addition to the assumption of voluntariness and free choice, contract law theory utilises the assumption that parties entering into an agreement do so at arm's length, each acting to secure the best deal from the transaction.[152] Such an assumption arguably does not hold true for sureties entering into STD contracts. A surety's decision to provide security is influenced more by emotional ties than arm's length commercial judgment.[153]

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147 Supra note 13 at 32.
148 Supra note 21 at 679.
149 Ibid.
150 Supra note 3 at 331.
151 Ibid 333.
152 Supra note 139 at 52.
153 Supra note 1 at 243.

The disparity between the ideal state reflected by the assumption and the reality of a surety's situation arises for a number of reasons. Perhaps most controversial are the arguments adopted by feminist commentators: that the disparity results from the inequality of bargaining power between a woman and her male partner (the surety in STD cases predominantly being female),[154] or that a strong societal expectation that women should behave altruistically exists. The desire to conform to their perceived social role of helping and supporting their loved ones means that women undertake contractual obligations even though they either do not understand those obligations or recognise those obligations as disadvantageous.[155]

Perhaps less controversial are the findings of Fehlberg as to why a surety will enter into a security contract which is not to his or her commercial advantage.[156] As discussed, emotional ties and pressure, in addition to economic dependency, constrain the voluntariness and free will of a surety when entering a surety transaction. These elements, combined with a lack of involvement in, understanding of and potential gain from the transaction, operate to ensure that a surety does not conform to the contractual assumption of being a self-seeking negotiator.[157]

Fehlberg discovered the majority of sureties sampled were not involved in planning their security transaction.[158] Sureties tended to be informed of the transaction and their role and not treated as independent contracting parties by the financier, thus dispelling the assumption that the surety would negotiate to maximise his or her position. Although the sureties generally possessed some understanding of the legal effect of the security, they remained unaware of the practical consequences of the principal debtor defaulting. When required to execute the security documentation, sureties found the experience highly intimidating and typically did not ask questions or read the documents they signed. Commonly lacking business experience, the sureties did not know what questions to ask to understand the documentation; consequently their decision to execute the transaction was based on trust in the principal debtor and the financier, not a commercial decision.[159]

Also questionable is the assumption that the security contract is the result of a self-seeking bargain. While the courts have often regarded security given by a surety to protect the principal debtor's business as being of potential financial benefit to the surety,[160] such a stance is debatable. This is on the basis that the surety, in giving the security, is in effect making a sacrifice by assuming potential liability in order to maintain their pre-security position.[161]

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154 For example Baron, supra note 2 at 28; Kaye, supra note 4 at 37.
155 Supra note 2 at 27.
156 Supra note 3 at 327-333.
157 Ibid.
158 Ibid 327.
159 Ibid 330.
160 For example, *National Westminster Bank plc v Morgan* [1985] 1 AC 686.
161 Supra note 3 at 333.

Consequently, when sureties provide securities pursuant to such conditions, in addition to not exercising a voluntary free will, they are clearly not the self-seeking maximisers of self-interest assumed by contract law. Arguably therefore, the substance of surety transaction contracts in STD cases does not conform to the assumptions upon which traditional contract law, the basis for the legal response to STD, is founded.

2. The Cure: "Independent Legal Advice"

The concept of "independent legal advice" has surfaced as suitable to remedy the problems presented in STD cases, namely the presence of any "sexual or emotional ties [which] affect the free exercise of the individual's will".[162] "Independent legal advice" has evolved as the core component of the "reasonable steps" requirement in *O'Brien*, the boundary of financier liability. Similarly, the judgments in *Garcia* and *Wilkinson* indicate "independent legal advice" will be sufficient to fulfil the "adequate steps" requirement imposed on financiers, the boundary of security invalidation for both jurisdictions.

The notion that "independent legal advice" cures any invalidating features of a STD transaction is problematic. It fails to address the disparity existing between the assumptions made by applying contract law and its equitable supplements (which have lead to the introduction of the concept), and the practical realities of the situation. A solicitor operating in the role of independent adviser is in no position to ascertain whether a surety's agreement is truly voluntary.[163] In a short advisory interview a surety is unlikely to reveal or even be able to recount and articulate the pressures to which she or he has been subject, which have influenced the decision to sign.

Post-*O'Brien* interpretation has resulted in meetings between a solicitor and surety being classified as "independent" and as providing legal "advice" when they have not involved any "advice" to the surety and have invariably been attended by solicitors not truly "independent" of the principal debtor or financier.[164] Viewing the concept of "independent legal advice" from the standpoint of the financier has resulted in the current legal response to STD representing no more than the triumph of form prevailing over legal substance.[165] The existence of a meeting between a surety and solicitor is viewed as sufficient to constitute "independent legal advice", regardless of the content of the meeting and regardless of whether the meeting places the surety in a position to protect his or her own interests.[166] As a result, the term "independent legal advice" is something of a misnomer.[167] As stated in a surety interview:[168]

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[162] Supra note 12 at 191, per Lord Browne-Wilkinson.
[163] Supra note 4 at 53.
[164] For example supra note 20.
[165] Supra note 13 at 64.
[166] Ibid.
[167] Ibid 268.
[168] Supra note 3 at 329. Surety interview, Mrs Parkes (emphasis added).

> *Real* informed, independent advice would have been a great help but who would have been qualified to give it? All those who knew the state of the business were on the same side.

Further, while true "independent legal advice" can be useful, there are considerable limits on its effectiveness and in some cases it can be counter-productive.[169] Legal advice is generally of secondary value. The focus should be on independent *financial* advice.[170]

The concept of "independent legal advice" poses the further problem that it fails to address the underlying applicability of contract law principles and merely shifts the burden from financiers to solicitors. The involvement of solicitors in the process by which financiers ensure their own protection may mean that the focus in future litigation could well be on solicitors. The requirement that financiers take steps to avoid responsibility may mean that the current nature of those practical steps may simply result in shifting the gatekeeper role to the advising solicitor.[171]

3. Summary

The legal responses to the issue of STD involve the application of "public" contractual principles and associated assumptions to a surety transaction involving a "private" aspect: an intimate or close personal relationship. This application has been criticised on the basis that it has been made without consideration of whether the assumptions embodied within the principles applied reflect the realities of the situation. This adoption of an individualistic, materialistic, contract-based standpoint is ultimately financier-sympathetic as the law of contract reflects particular (male, market) interests within society. This conceals the reality that opportunities and choices are not equally available, and that some exchanges are far from voluntary.[172] Given this nature of contract law, surety vulnerability in cases of STD is not appreciated. The insistence by a financier that a surety receive independent legal advice is seen as the cure to any potential vulnerability of the proposed surety. The formal gesture of requesting independent legal advice, however, totally fails to address the practical problems faced by sureties in a situation of STD.

V: PROSPECTS FOR REFORM

The criticisms discussed indicate that the current legal responses to STD are inadequate to protect a vulnerable surety who enters into a security arrangement on

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169 Supra note 1 at 256.
170 Ibid.
171 Supra note 130 at 59.
172 Supra note 13 at 14.

the basis of emotional ties rather than commercial reasons. Clearly there is a need to protect such sureties, the problem is how this can be achieved. Banning suretyship or limiting the use of the family home as loan security are seen as unrealistic options given the prevailing view that it would not be good for families or for commerce if people were prevented from "choosing" to use the family home as security for business borrowing.[173] Significantly, sureties themselves are not in favour of measures that would prevent individuals from using the family home as security.[174]

Existing statutes may assist to a certain degree. The Contractual Remedies Act 1979, Credit Contracts Act 1981 and Fair Trading Act 1986 provide alternative statutory avenues of legal redress for sureties in situations of misrepresentation, oppression or misleading and deceptive conduct.[175] These provide only limited grounds for invalidation, however, and do not adequately begin to address the complicated issues presented by STD contracts. [176]

Increasingly, banks and financial institutions have become aware of the need to respond to the injustices created by third party guarantees and STD. Consequently the Code of Banking Practice was issued in 1992 and revised in 1996.[177] In this Code the New Zealand Banking Association have formulated standards governing good banking practice, standards their member banks agree to observe when dealing with personal customers. Specifically, the Code stipulates that all persons providing security should be advised, in absence of the principal debtor: of their potential exposure to liability; to seek independent legal advice; the extent of potential liability; or alternatively, whether the security is unlimited.[178]

Significantly, this Code is not legally binding. Its role is merely to reflect the standards considered by the banking industry to be good practice. Moreover, this attempt at self-regulation merely redresses the problems of a surety's susceptibility to misinformation or the principal debtor's misrepresentations. It does little to alleviate more fundamental issues concerning STD securities.

It is suggested that the current law fails to recognise and address the problems sureties face, specifically their lack of involvement, choice, understanding and direct benefit from providing the security.[179] It is further suggested that this stems from the application of traditional contract law assumptions. Thus practical measures for reform require these assumptions to reflect the reality of STD transactions. This would involve ensuring

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173 Supra note 3 at 339; Supra note 19 at 188.

174 Supra note 13 at 275.

175 For example in *Dungey v ANZ Banking Group (NZ) Ltd* [1997] NZFLR 404 the surety claimed based on a failure to disclose under the Credit Contracts Act 1981 and misleading conduct pursuant to the Fair Trading Act 1986.

176 The Credit Contracts Act 1981, pursuant to s 10, provides the courts with discretion to re-open a credit contract on the grounds of oppression. Technically this remedy is broad enough to recognise the experiences and position of sureties but in practice has been applied more narrowly; see *Dungey v ANZ Banking Group (NZ) Ltd* ibid. Similar legislation exists in Australia and the ALRC has pointed out the weakness in the application of such legislation to cases of STD. See Australian Law Reform Commission, supra note 1, at 251.

177 New Zealand Bankers' Association ("NZBA") "Code of Banking Practice" (2nd ed, 1996).

178 Ibid para 9.

179 Supra note 3 at 339.

that sureties are encouraged to promote their own commercial self-interest. To do so, sureties need access to commercial information about the principal debtor and the business of whose debts they are securing, in a manner that makes the information meaningful to them. Fehlberg recommends reforms directed at financiers requiring them to involve proposed sureties in security transactions at a practical level and informing them of the potential implications and effects, in a manner in which they understand.[180]

Such proposed reforms include:[181]

(i) Reducing surety isolation from the transaction by the mandatory holding of *Barclays Bank v O'Brien* meetings between appropriately trained financiers and sureties, rather than independent legal advice alone;[182]
(ii) using plain English in security documentation to enhance understanding;
(iii) encouraging careful consideration by prospective sureties of their obligations, by ensuring that sureties are given a separate copy of the documentation before they are required to sign, so that they may read over the document themselves, seek partisan advice, and discuss the matter with the principal debtor;
(iv) increasing understanding and further reducing surety isolation by insisting on truly independent legal and financial advice, with financiers being responsible for ensuring that there are reasonable grounds to believe that advisers are in fact independent and are truly in a position to advise the surety.

Such reforms would arguably damage the interests of sureties by increasing transaction costs (ultimately passed on by the financiers to their customers), but would offer greater protection to sureties as they enter transactions.[183]

Nonetheless, such options for law reform will do little to resolve the fundamental problem faced by sureties in STD contracts: the lack of choice experienced by the surety, constraining their ability to enter voluntarily into the transaction. Recognising this, Fehlberg suggests the provision of a "cooling-off" period to aid sureties who have signed but later have second thoughts, in addition to the abolition of "unlimited guarantees" (to remove the most onerous of liabilities).[184]

The reality is that even if these suggestions are implemented many sureties will still continue to provide security out of emotional commitment to, and economic dependence on their debtor partners. Nevertheless, this reality does not justify the failure to recognise and attempt to address the problems faced by sureties in such situations and does not provide an excuse for not meaningfully informing sureties of their obligations and ensuring that they are appropriately and adequately advised.[185]

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180 Supra note 13 at 276-277.
181 Ibid.
182 Also recommended in Australia by the Australian Law Reform Commission, supra note 1 at 251.
183 Supra note 13 at 278.
184 Ibid.
185 Supra note 20 at 694.

VI: CONCLUSION

It has been suggested that the current legal responses to the issue of STD are inadequate to respond to the fundamental problems encountered by sureties when faced with the request for security by someone with whom they are emotionally involved. It has further been suggested that the inadequacy of these responses is the result of the application of the law of contract and its equitable supplements without the consideration of whether the assumptions underlying traditional contract principles reflect the reality of the situation.

Prospects for law reform have been suggested that attempt to redress the disparity between the assumptions underpinning contract law and the reality of STD. Such reforms essentially aim to ensure that financiers, in taking such securities, assist sureties to help themselves. Such options for law reform, however, will not resolve the lack of choice facing many sureties due to the existence of economic dependence and emotional commitment and will be of little avail in the situation where a surety feels compelled to act: [186]

> Although the extent to which creditors or the courts can protect people from themselves is limited, it is important to recognise that while providing information may reduce the number of operative misrepresentations, it is unlikely to dispel ongoing private emotional pressure, ranging from physical abuse to the more subtle "if you love me you will do this for me". In many cases the reality is that, for the sake of the marriage, the wife will feel that she has no choice but to sign, whatever she is told.

Arguably, this lack of choice is a social issue, a result of gender inequality, public education and discussion rather than legal change proving a more effective and appropriate mechanism by which to assist sureties.[187] However, the fact that many sureties will sign as a result of constrained decision-making, should not provide an excuse for failing to inform sureties of their obligations and ensuring they are appropriately advised, legally and financially.

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[186] Fehlberg, "The Husband, the Bank, the Wife and her Signature" (1994) 57 Modern Law Review 467, 472-473.

[187] Supra note 13 at 281-282.