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ANOTHER LOOK AT THE GIVING OF INDEPENDENT ADVICE TO SURETIES: SOME UNCERTAINTIES AND EVOLVING CONCERNS

*Charles Y C Chew**

Abstract

It seems clear from the cases that independent advice can play a role where the lender or creditor attempts to argue that a guarantor or surety has entered into a guarantee in an act of free and independent will, and is aware of the nature and effect of such a security. The purpose of independent advice in this context is to ensure that the guarantor understands the nature and effect of the transaction and the documents to be signed. This article critically analyses the importance of the surety procuring independent advice before executing the contract of guarantee. It examines some of the evolving problems with independent advice and whether the presence of such advice can actually be used to protect a guarantee transaction from the taint of, for example, unfairness. It also considers whether current ideas of what constitutes independent advice are in general adequate to form the basis of an effective protective regime for guarantors.

Introduction

A common impetus for guarantors or sureties entering into contracts of guarantees is the existence of a relationship of some kind of emotional interdependence rather than an arms-length business decision. This is especially evident in situations where the sureties give guarantees to other family members. More and more claims are made by these sureties that their guarantee contracts should be vitiated on the basis of, for example, unfairness, undue influence or misrepresentation.

An important factor which the court will take into account is whether or not independent legal or other expert advice was given to the guarantor seeking relief.

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Yet it has been suggested that the lender or creditor is not under an obligation to ensure that the guarantor seek independent advice, but simply to urge the guarantor to seek such advice and give the guarantor an opportunity to do so.¹ It has also been suggested that independent advice, if given in the circumstances described above, may amount to little more than a 'futile endeavour' and may be of benefit only to lenders in terms of the certainty it provides to them in transactions with guarantors.² Nevertheless, some solicitors are of the view that independent legal advice may serve an important function for prospective sureties in tenuous relationships.³

In this article attention is given to the protective or curative properties of independent advice and its availability to the prospective surety. What needs to be considered in this context is whether there can be developed a set of measures to protect a guarantee transaction from being seen to be unfair, to make it immune from, or at least to minimise its risk of, being set aside or modified by the courts.

In giving independent advice, the solicitor should act or be understood to act solely for the surety, and should ensure that the advice offered is free from the influence of the lender or the principal borrower,⁴ and is given with a 'knowledge of all relevant circumstances'.⁵

It should be pointed out that since the decision of the NSW Court of Appeal in *Beneficial Finance Corp v Karavas*⁶ independent financial advice (apart from independent legal advice) seems to have also become an important requirement. There it was proposed that a solicitor should advise clients such as guarantors of limited understanding 'about the obvious financial un wisdom of a transaction, or to ensure that they receive competent and independent financial advice in order to bring home forcefully the risks which they will run'.⁷ Although the precise

meaning of effective financial advice was not considered in this case, it is submitted that similar principles which apply to independent legal advice should also apply to independent financial advice.⁸

The Giving of Advice: Post *Garcia v National Australia Bank*

Now that the High Court has determined in *Garcia v National Australia Bank*⁹ that *Yerkey v Jones*¹⁰ continues to apply to the law of guarantees in Australia, creditors should have a clear understanding of their responsibilities. Creditors should be careful about taking a guarantee from a third party volunteer (that is, someone who does not derive any financial benefit from the transaction) and must make sure that the latter is asked to obtain independent advice.

The principles as affirmed by the High Court in *Garcia*, however, represent a problematic approach to the use of independent advice. Independent advice is advocated primarily as a procedural mechanism enabling a lender to enforce a guarantee rather than as one particular ingredient in ensuring appropriate consent. The clear implication of *Garcia* is that through the use of independent advice a lender may enforce a guarantee notwithstanding the fact that it is subsequently revealed that a guarantor has no real understanding of the relationship created. The majority of the court stated their position as follows:¹¹

...the creditor may readily avoid the possibility that the surety will later claim not to have understood the purport and effect of the transaction that is proposed. If the creditor itself explains the transaction sufficiently, or knows that the surety has received 'competent, independent and disinterested' advice from a third party, it would not be unconscionable for the creditor to enforce it against the surety even though the surety is a volunteer...

The emphasis is clearly upon enforcing guarantees against guarantors rather than upon striving to ensure the quality of a guarantor's consent to the terms of the guarantee. Indeed, the court seems to acknowledge implicitly that even when a

1 *Cresswell v Potter* [1978] 1 WLR 255 at 259; *Backhouse v Backhouse* [1978] 1 WLR 243; *Bawn v Trade Credits Ltd* (1986) NSW Conv R 55-290.

2 B Felberg, *Sexually Transmitted Debt: Surety Experience and English Law* (Clarendon Press, Oxford, 1997) at 192.

3 Ibid at 278.

4 See *Nolan v Westpac Banking Corp* (1989) 51 SASR 496 and *McNamara v Commonwealth Trading Bank of Australia* (1984) 37 SASR 232 at 241.

5 *Inche Noriah v Shaik Allie Bin Omar* [1929] AC 127 at 136.

6 (1991) 21 NSWLR 256 (CA).

7 Ibid at 266 per Kirby P. It is important to sound a warning here. In order to form the assessment referred to, it may be necessary for the solicitor to appreciate the extent

of the commercial risk involved, and in order to have that appreciation, the solicitor may need to undertake independent inquiries and investigations.

8 See *Bester v Perpetual Trustee Co Ltd* (1970) 3 NSWLR 30 at 32 per Street J; *Bursevitz v Brown* (1923) NZLR 1106 at 1116-7 per Salmon J; *Hogan v Howard Finance Limited* (1987) ASC 55-594 at 57,539 per Hope JA and at 57,535 per Kirby P.

9 (1998) 155 ALR 61. See Expert Group on Family Financial Vulnerability, *Good Relations, High Risks: Financial Transactions between Families and Friends* (Report, 1996) at 46.

10 (1939) 63 CLR 649.

11 (1998) 155 ALR 614 at 625.

guarantor receives 'competent, independent and disinterested' advice, the decision to become a guarantor may still be made from a position of ignorance or mistake. Such a consequence reflects the fundamental inadequacies of an approach founded entirely upon advice.

It is in situations with the potential to result in the emotional transfer of debt, for instance, marriage and other long term personal relationships that sole reliance upon independent advice is particularly problematic. This was highlighted in *Garcia* by the fact that one of the primary reasons Mrs Garcia signed the guarantee was that her relationship with her husband was at risk and she was trying to save her marriage.¹² In the vast majority of these cases women would assume the 'sexually transmitted debts' of their husbands regardless of any advice because of 'their relationships with the debtor'.¹³ As Fehlberg notes:

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.¹⁴

Such an analysis makes it clear that the effectiveness of independent advice as a mechanism for protecting guarantors can vary according to the circumstances in question.

Whilst the provision of advice to those individuals who might assume the debt of their partner because of undue influence, misrepresentation or deception will be relatively valuable, it may have little effect upon those who enter the transaction because of emotional ties. In most instances of emotionally transmitted debt, independent advice may not be a sufficient means of ensuring quality consent. Not only is it important to recognise that advice can be inadequate but that in some situations it may be unnecessary. The ultimate consequence of the emphasis placed upon independent advice in *Garcia* seems to be reflective of this problem of

requiring independent advice regardless of whether such advice is necessary or not.

Advice May Not Be Sufficient to Absolve the Lender from Liability

There has recently been some doubt as to whether the procuring of independent legal advice on the part of the guarantor is sufficient to free the bank from liability in the wake of the decision of the English Court of Appeal in *Credit Lyonnaise Bank Nederland NV v Burch*.¹⁵ There it was shown that some banks (despite judicial warnings) are still taking guarantees from guarantors who are not seeking independent advice, and more importantly, that even if these guarantors do seek such advice, that may not be sufficient to exonerate a bank from being liable.

In the *Credit Lyonnaise* case the bank's solicitors wrote to the defendant guarantor pointing out that the guarantee was unlimited both in time and amount and advising her to seek independent legal advice before entering into the transaction but she did not do so. The debtor company later went into liquidation and when the bank was unable to recoup the full amount owing on the overdraft, it demanded payment of the amount outstanding. The bank appealed to the English Court of Appeal, arguing that it had discharged its duty to the defendant by encouraging her to obtain independent legal advice and that it was not responsible for the consequences of her choosing not to do so.

The Court of Appeal looked at the type of independent advice that an innocent guarantor must obtain in order to exonerate the creditor bank from any liability for taking a guarantee which is improvident.¹⁶ It also questioned the role played by independent advice and remarked on the lack of understanding of such advice. Millett LJ said:¹⁷

Such advice is neither always necessary nor always sufficient. It is not a panacea. The result does not depend mechanically on the presence or absence of legal advice. I think that there has been some misunderstanding of the role which the obtaining of independent legal advice plays in these cases. It is first necessary to consider the position as between the complainant and the alleged wrongdoer. The alleged wrongdoer may seek to rebut presumption that the transaction was obtained by undue influence by showing that the complainant had the benefit of independent advice before entering into it. It is well established that in such a case the court will examine the advice which was actually given. It is not sufficient that the solicitor has satisfied himself that the complainant understands the legal effect

¹² Ibid at 618.

¹³ N Howell, 'Sexually Transmitted Debt: A Feminist Analysis of Laws Regulating Guarantors and Co-Borrowers' (1995) 4 *The Australian Feminist Law Journal*, 100 at 102. The label 'sexually transmitted debt' was first used in 1990 by the 'Women and Credit Task Force' which consisted of lawyers and community advocates who became alarmed at the number of cases involving unsuspecting wives or relatives, mostly women who were forced into major financial loss as a result of being made guarantors.

¹⁴ B Fehlberg, 'The Husband, the Bank, the Wife and her Signature' (1994) 57 *Modern Law Review* 460 at 472-3.

¹⁵ [1997] 1 All ER 144.

¹⁶ Ibid at 155-156.

¹⁷ Ibid at 156.

of the transaction and intends to enter into it. That may be a protection against mistake or misrepresentation; it is no protection against undue influence.

The *Credit Lyonnaise* case has the impact of reinforcing the position which already exists in Australia in respect of the effect of obtaining independent advice for the benefit of the guarantor. The fact that independent advice is not obtained should not on this basis alone taint the transaction. Independent advice is only one protective measure amongst others such as explanation and warning which may not provide adequate protection. It is not necessary for the enforcement of a guarantee and is only relevant to remedy any unfairness which was already in existence.

Independent advice for the guarantor may not protect the lender in all situations. For example, there are cases where even though legal or other expert advice was obtained, the contract has been declared unjust.¹⁸ It is open to doubt whether the bank in *Commercial Bank of Australia v Amadio*¹⁹ could have escaped liability by merely referring the guarantors to an independent lawyer, without disclosing facts which would have given the guarantors the opportunity to form a proper opinion or judgment as to whether to enter into the contract of guarantee.²⁰ Where a party has not obtained independent legal or other expert advice, whether the contract is declared unjust will depend primarily on whether the party seeking relief understood the provisions of the contract and their effect.²¹

Although independent advice is not essential to avoid liability as alluded to earlier, if it is to be relied upon, the creditor bank needs to have reasonable grounds for believing that the advice cured the vitiating factors. In this sense,

18 See, for example, *Albury v Gulror Pty Ltd* (1992) NSW Conv R 55-633 (SC) (independent advice received by mortgagors insufficient to obliterate earlier injustice); *Seinor v Wilson* (Unreported, SC, 7 December 1998) (party seeking relief obtained advice from solicitor, solicitor not 'independent', deed declared unjust) and *Esanda Finance Corporation Ltd v Tong* (1997) 41 NSWLR 482 (CA) (party seeking relief had solicitor advise on terms of security, contract declared unjust because solicitor negligently failed to give proper advice).

19 (1983) 151 CLR 491.

20 See *Garcia v National Australia Bank*, above n 11. See also W Weerasooria, 'Guarantees and Independent Advice' (1997) 13 *Australian Banking Law Bulletin*, No 6, Nov/ Dec 81.

21 See, for example, *Beneficial Finance Corporation Ltd v Karavas*, above n 6 (mortgage as security for loan to third party, parties seeking relief 'gained no adequate concept of the risk...and the likelihood of that risk coming home'); *White v Ormsby* (1988) ASC 55-665 (SC) (mortgage, party seeking relief 'had a full and clear understanding of the substance of the transaction'); *Burt v ANZ Banking Group Ltd* (1994) ATPR 46-123 (SC) (mortgage as security for loan to third party, bank adequately explained nature and provisions of guarantee and mortgage to plaintiff).

merely requiring advice will not be sufficient. Some proof that adequate independent advice was taken will be necessary.

The *Credit Lyonnaise* case should not alter the analysis of the earlier law in Australia on the importance and the effect of independent advice. Independent advice is not essential to remedy every transaction of unfairness. However, if the creditor wishes to rely on the curative effect of independent advice, it should make certain that the advice obtained was comprehensive enough to redress the unfairness or disadvantage suffered by the guarantor. It is not sufficient merely to encourage that advice be taken.

Legislation Requiring the Guarantor to Receive Advice

One way of getting around the problem of the guarantor's lack of understanding of the guarantee document is to make the prospective guarantor receive independent legal advice by providing that the guarantee is void unless a certificate in a prescribed form is given by the legal adviser when the guarantee is signed. This is evident in South Australia where s 44 of the *Consumer Transactions Act 1972* (SA) requires a lender to ensure that a prospective guarantor executes the guarantee contract in the presence of an independent legal practitioner. The legal practitioner must certify in writing in the following way:

I certify that I am a legal practitioner instructed and employed independently of the Bank, and I certify that I am satisfied that A and B (Guarantors) understand(s) the true purport and effect of this Guarantee and Indemnity in my presence.

The advice given by the solicitor must itself be independent of the interests of the borrower and the creditor. This proposition finds support in *Powell v Powell*²² where the court said that the solicitor involved in giving advice must be independent of the stronger party to the transaction in fact as well as in name and therefore should not act for both parties. The professional obligations of solicitors giving advice to guarantors are forcefully stated in *McNamara v Commonwealth Trading Bank* thus:²³

It is essential that the solicitor act and be understood to act solely for the prospective surety.... Sound professional practice requires also that the solicitor be and be seen to be free to advise the prospective surety unencumbered by any ties to the principal debtor...

22 [1990] 1 Ch 243 at 246-247.

23 (1984) 37 SASR 232 at 241.

The requirement for independent legal advice under s 44 of the *Consumer Transactions Act* would, it is claimed, make it likely that guarantors will be able to understand their transactions more fully before entering them. Nevertheless, this section has a number of limitations.²⁴ In the first place, it may not be appropriate to impose a similar requirement in respect of all guarantors. Secondly, there is no absolute certainty that the guarantor will understand his or her obligations, and risks, as a result of receiving the legal advice which, in order for it to produce the intended or expected result, and to be effective, would have to take into account, not just the legal issues, but all relevant aspects of the situation and all the material facts.²⁵ Finally, the cost involved in getting advice must be carefully considered as it may be so prohibitive as to outweigh the advantages. Thus it has been said that:

it must be remembered that those services do not come for free and that the more the law requires either by regulation or by trend of judicial decision finance companies to be at risk unless they ensure lenders have independent expert advice the greater the cost of finance.²⁶

The s 44 requirement for a legal practitioner to be independently instructed and employed was examined in *Nolan v Westpac Banking Corporation*.²⁷ There the bank had put pressure on the guarantor (the plaintiff) to sign the guarantee and the security documents. The main source of the guarantor's difficulties was her lack of understanding of the debtor's financial position. She believed that an amount would be available to the business from the mortgage funds after payment of existing debts and that the availability of that amount would enable the business to survive and prosper. Evidence was adduced that none of the documents were explained to the guarantor although a local solicitor was asked by the bank at the last moment to be present at the extensive signing of the documents.²⁸

In *Nolan*, Ligertwood AJ pointed out that the certification requirements of s 44 had been met despite the fact that there had not been compliance with the section

because the solicitor was not independently instructed and employed.²⁹ His Honour thought that the solicitor should have been instructed by the guarantor at his office and he should have given her advice in the absence of the bank manager. In his opinion the solicitor should have ensured that the guarantor's decision should not be subject to the influence of the debtor. Instead the solicitor was seen by the guarantor for the first time at the bank in the manager's presence, 'hardly a situation of being free to advise the plaintiff unencumbered by ties to the Bank'.³⁰

The fact that the solicitor should be independently instructed and employed is strongly supported in *McNamara v Commonwealth Trading Bank*³¹ where King CJ said:³²

The solicitor, moreover, should be at pains to ensure that his client's decision is as free of the influence of the debtor as he can arrange...Sound professional practice requires that the debtor should not be present when the solicitor is advising the client and receiving his instructions.

At the same time, a solicitor's duty to a client who consults him or her for advice before the signing of a guarantee extends further in the following terms:³³

The solicitor should raise with the client questions relating to the prudence of entering into the guarantee from a practical point of view. The state of the financial affairs of the principal debtor should be discussed as well as the extent of the assets of the client. A client whose assets are few and who will be putting the whole of his assets, perhaps including his home, at risk obviously needs careful and perhaps quite forthright advice. The need is even greater where, as so often is the case, the affairs of the principal debtor are precarious....³⁴

This is in keeping with s 44 (1) which may require the adviser to: read over and explain the transaction to the guarantor; examine the guarantor 'touching his knowledge of the agreement'; and be satisfied that the guarantor understands 'the true purport and effect of the agreement'. Yet advice of this kind may not be

24 There are a number of restrictions on the application of s 44. A contract of guarantee where the guarantor is a body corporate is excluded from the Act. See *Consumer Transactions Regulations*, Second Schedule. Guarantees may not be given in the course of carrying on a business and the legislation only applies to guarantees of 'consumer credit contracts'.

25 See, for example, *Collier v Moreland Finance Corp (Vic) Pty Ltd* (1989) ASC 55-716 at 58,430 per Hope JA.

26 *Goldsborough v Ford Credit Australia Ltd* (1989) 55-946 at 58,588.

27 [1989] ASC 55-930 at 58,511.

28 Ibid at 58,515-58,516 per Ligertwood AJ.

29 Ibid at 58,517 per Ligertwood AJ.

30 Ibid.

31 (1984) 37 SASR 232.

32 Ibid at 241.

33 Ibid.

34 It appears that to be effective, the giving of useful advice would require the solicitor to be involved in spending a substantial amount of time, effort and work. Since the requirements would apply to all guarantors within the ambit of the provisions, besides only those who appear to be in a special need of such assistance, the disadvantages in respect of extra costs and delays may exceed in value the benefits.

sufficient to get the guarantee vitiated in terms of unconscionability. In *Beneficial Finance Corporation Ltd v Adams*³⁵ guarantees were given in respect of a loan taken out to finance the acquisition of a business and the guarantors received advice of the type described above from an independent solicitor. It was held that the contracts were unjust within the meaning of the *Contracts Review Act 1980* (NSW). Giles J was of the view that since the borrowers were relying on the business income to service the loan, the guarantor in these circumstances, should also be given advice concerning the viability of the business being purchased; and the risk of the borrowers defaulting under the loan. The case emphasises the need for any independent advice which is given to the guarantor to be adequate to cover the risks of entering into the guarantee, and to include matters known to the credit provider that are likely to affect the borrower's ability to repay the loan.³⁶ Thus the fact that independent advice has been given may not mean that the situation is favourable to the lender because as far as the court is concerned, the advice may not be comprehensive enough.

Solicitor's Certificate Testifying to Having Given Independent Advice

It is possible for a solicitor to be asked to provide a prospective guarantor with a certificate testifying to the fact that independent legal advice has been given. In New South Wales, when a solicitor has been asked to furnish such a certificate to a guarantor, whether or not the Consumer Credit Code applies, Rule 45 of the Solicitors' Practice Rules regulates the issuing of such a certificate, and until recently, laid down detailed guidelines governing the format that such certificates were required to adhere to.³⁷ These certificates have attracted much criticism and, consequently, the Law Society Council amended Rule 45 with effect from January 2000.

One criticism that has been levelled at the previous Rule 45 is that under it there was a tendency for lenders to use the encouragement to seek independent legal advice as a way of shifting responsibility from themselves to solicitors.³⁸ While the previous Rule 45 set out the criteria and processes to be followed by solicitors in giving certificates of independent advice, the effect of the 2000 Rule 45 is to do away with such certificates altogether and instead, to establish a process for the

provision of legal advice that, in the view of the Law Society, 'should forestall any subsequent claims (against solicitors) based on a faulty or feigned recollection of the advice given'.³⁹

A solicitor is required under the 2000 amendments to Rule 45 to advise a proposed guarantor on a number of matters the important ones of which are listed as follows:

- the legal consequences of a guarantor's failure to remedy a borrower's default;⁴⁰
- whether the guarantor's liability is limited to a specific amount or not;⁴¹ and
- any additional obligations, rights and remedies of the guarantor if the *Consumer Credit Code* applies.⁴²

The solicitor under the amendments to Rule 45 must advise the proposed guarantor that he or she only gives legal advice, and does not profess any qualification to offer financial advice; and that any questions concerning any financial advice should be sought from an accountant or other financial counsellor of the guarantor's choice.⁴³

This is in keeping with judicial decisions in respect of the giving of legal advice to guarantors which make a clear distinction between legal and general financial advice. For example, in *Micarone v Perpetual Trustees*⁴⁴ there is an examination of policy reasons that exclude the provision of financial or practical advice from the scope of legal advice. These are to the effect that solicitors are not always qualified to give such advice, and may not be able to ascertain all the relevant information, and will often refuse to advise if the duty and risks attached are too onerous.⁴⁵

35 Unreported, NSW Supreme Court, Giles J, 19 May 1989.

36 Ibid.

37 Law Society of New South Wales, *Revised Professional Conduct and Practice Rules*, 1995, amended November 1997.

38 See the covering memorandum in *Caveat* (No 207, 30 December 1999). Following some actions against solicitors in South Australia, the South Australian Supreme Court has noted that the South Australian Law Society has advised its members not to provide certificates of legal advice.

39 Law Society of New South Wales, *Caveat* (No 207, 30 December 1999) at 1.

40 Law Society of New South Wales, *Professional Conduct and Practice Rules* (1995, amended January 2000) Rule 45.6.3.2.

41 Law Society of New South Wales, *Professional Conduct and Practice Rules* (1995, amended January 2000) Rule 45.6.3.5.

42 Ibid.

43 Law Society of New South Wales, *Professional Conduct and Practice Rules* (1995, amended January 2000) Rule 45.6.4.1 and Rule 45.6.4.2.

44 (1999) 75 SASR 1.

45 Ibid at paras 698 and 699.

Before the amendments to Rule 45, solicitors signed a statutory declaration that they had provided independent legal advice to the guarantor. After the amendments, a prospective guarantor is required under Schedule 2 to sign a statutory declaration⁴⁶ to the effect that he or she has executed the relevant documents after receiving independent legal advice. At the same time, under Schedule 4 Part 2,⁴⁷ a proposed guarantor must be explicitly made to know that the advice obtained comprised a number of matters. One is that in the event of the borrower failing to comply with the terms of the loan, the lender can sue the guarantor personally. In addition, the lender can take possession of any property secured and, if that property is sold but the proceeds of the sale are not sufficient to satisfy the debt, the lender can sue the guarantor for the deficit. The guarantor is also required to attest that he or she understands a number of other issues, including the fact that the lender can pursue its remedies against the guarantor even if it has not done so against the borrower, and that the guarantor understands that the solicitor does not profess any qualification to give financial advice.

The potential for conflict of interest is sometimes present where, for example, the borrower who organised the legal advice often retained a solicitor known to him or her and not to the guarantor. In *Tong v Esanda Finance*,⁴⁸ for example, the certificate of independent advice given by the supposed independent solicitor claimed an absence of professional interest in the transaction on behalf of the lenders or on behalf of the borrowers. Nevertheless, in evidence, the solicitor demonstrated that he believed he was acting as solicitor for the borrowers and not in the interests of the guarantors.⁴⁹

There are guidelines about conflict in the NSW Law Society Practice Rule in respect of the provision of advice to guarantors. The Rule provides that the solicitor who advises a borrower or guarantor must not also act for the lender and that in cases where there is potential conflict between parties to the guarantee transaction (i.e. between the borrower and guarantor) the solicitor cannot provide advice to more than one of those parties without the written consent of each party.⁵⁰

46 Schedule 2: Declaration by Third Party Mortgagor, Guarantor, Surety Mortgagor or Indemnifier for the Borrower.

47 Schedule 4 Part 2: Acknowledgement of Legal Advice by Proposed Guarantor.

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

49 *Tong v Esanda Finance*, above n 48. See also *Janesland Holdings Pty Ltd v Simon* [2000] ANZ Conv R 11.

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

Evaluation: Some Practical Proposals

There is no requirement that a creditor is under a duty to see that the guarantor obtains independent advice before entering into a contract of guarantee. It would nevertheless be imprudent of creditors to ignore, for their own protection, the clear warnings and guidelines that have been laid down by the courts in respect of the importance of obtaining such advice. This is because it is safe to assume that courts will continue to steadfastly apply a restraining hand where the guarantee is unfair to the guarantor and the lender is aware, or ought to be aware, of that fact. And one way in which a creditor can rebut the presumption of a guarantor who is entering into such an unfair contract (effected under undue influence or a special disability, for example) is to show that the guarantor was given independent advice.

The main purpose of independent advice here is not to just protect the creditor but to protect the surety and to make certain that the surety understands the obligations that he or she is proposing to enter.⁵¹ Independent advice plays an important substantive role in the formation of the contract of guarantee: its main purpose being to ensure the proposed guarantor who receives it is capable of making an independent and informed decision as to whether to give the guarantee.⁵²

It can be seen from the above that adequate independent advice should be 'truly independent informed advice which not only explains the transaction and its implications but also evaluates the risks involved and advises whether the surety should enter into the transaction'.⁵³ The advice can be certified to the surety by the adviser. The fee for the advice which should reflect the degree of professional skill involved should be paid by the lender and later charged to the borrower.

The detailed independent advice as discussed above is better than the superficial or perfunctory advice which some lenders seem to require. As far as lenders are concerned, the risks to solicitors of their transactions being later impugned is minimised, though not altogether eliminated, by certified independent advice which can offer effective protection for vulnerable sureties. There is no doubt therefore that independent advice and independent solicitors' certificates are not foolproof protection mechanisms. However, if advice is given with due regard to the legal and practical aspects of advice as required by the courts, and the certificate of advice is carefully drafted, then comprehensive independent legal

51 *Royal Bank v Scherbey* (1993) 117 Sask. R 97 (QB).

52 *Banco Exterior Internacional v Mann* [1995] 1 All ER 936 (CA).

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

advice of this kind can provide a balance of benefit and risk for all parties involved (this being superior to any of the alternatives available at present).

It is not necessary to insist on the requirement of independent advice in all cases and its use should be limited to transactions with a high risk of impeachment for unfairness such as the transactions of wives who are sureties for their husbands' debts. An example of where independent advice may be necessary can be seen in *Garcia v National Australia Bank* where the High Court re-established a contentious principle as espoused in *Yerkey v Jones*: that banks have no right to recover money from married women who guarantee their husbands' debts (if these women did not fully understand what they were signing). Not long after the *Garcia* case was handed down, the Australian Bankers Association had made it a requirement for guarantors to seek independent legal advice, and to obtain a signed solicitor's certificate to prove it.⁵⁴

In the long run, however, any response to *Garcia* remains voluntary until the *Trade Practices Act* is amended (or new Commonwealth legislation is introduced) to require a credit provider to take all reasonable steps to see that a prospective guarantor is advised in detail.⁵⁵ In the meantime the *Garcia* principle is a narrow one and it is still unlikely to open the 'floodgates' of litigation by wives against creditor banks.

As has been shown in the *Credit Lyonnaise* case, where independent legal advice is obtained without more, it is not likely that much protection will be given to the creditor bank. Independent advice provides effective but not total protection. In certain situations, the court may assess or evaluate any independent advice given. Where such advice is inadequate the guarantor may be released from liability in whole or in part.⁵⁶

Traditionally, independent advice as discussed in the cases has been almost legal advice. Important though legal advice is, it can be said that the current ideas of what constitutes such advice are not adequate to form the basis of an effective protective procedure. The guarantor should be given an informed and comprehensive explanation of the various alternatives available including advice that there is no legal obligation to enter into the transaction, factors affecting the risk and, perhaps, also the consequences of default. The creditor is entitled to assume that a solicitor who gives the guarantor advice would regard it as his or her professional duty not merely to explain the nature and effect of the documents

but also to advise the guarantor of his or her freedom to decide whether independent advice should, if need be, extend beyond legal advice in respect of the nature and terms of the documents. This is certainly the case these days as commercial transactions become more complicated and sophisticated resulting in the guarantor requiring even accounting or financial advice to truly appreciate more comprehensively the effect of a guarantee transaction and the risks involved in entering into such a transaction.

In this regard, it has been recommended that there should be a consultation by the various Law Societies (which approve solicitors' certificates) with credit providers and financiers as well as consumer groups to settle on more comprehensive guidelines for solicitors who attempt to give this independent advice. In order to provide the guarantor with a truly comprehensive kind of advice it has also been recommended that the Institute of Chartered Accountants in Australia and the Australian Society of Certified Practising Accountants, for example, should consult with financiers and consumer groups to settle upon similar guidelines for the giving of independent advice of a financial nature to potential guarantors.⁵⁷

In the long run, any statement of the precautions bankers should take must be tested by common sense, and should take into account practical experience. Cases will inevitably turn up which have exceptional circumstances, for example, those which are manifestly improvident.⁵⁸ A wise lender will be flexible and fair in following a set of prudent rules, and keeping them under review in light of experience and of the decisions of the courts. Such an approach should strike a fair balance between the interests of all parties involved: lender, borrower and guarantor.

Conclusion

Independent legal advice is primarily an educative process to assist a guarantor to make informed decisions in relation to whether to enter into a contract of guarantee. This would be useful for potential guarantors of loans to save, for example, a failing family business. The process of seeing a solicitor and being required to attest to a clear understanding of the consequences of the guarantee document allows the guarantor an opportunity and time for reflection and evaluation before execution of the guarantee.

54 Anthony Duggan, 'Till Debt do us Part: A Note on National Australia Bank Ltd v Garcia' (1997) 19 *Sydney Law Review* 220 at 227.

55 Ibid.

56 Ibid. See also *St Claire v Petricevic* [1988] ASC 55-668 and *White v Ormsby* [1988] ASC 55-665.

57 See Expert Group on Family Financial Vulnerability, above n 9, at 46.

58 In *Teachers Health Investments Pty Ltd v Wynne* (1996) NSW Conv 55-785 in rejecting the universality of any invalidating tendency for married women, there was a discussion of the variety of cases and circumstances.

The provisions in regard to independent legal advice are limited in the kind of issues which they require legal practitioners to take into consideration. Therefore, it is sometimes doubtful that they will enable the guarantors to obtain the type of information and advice they need. This means that current ideas of what are required in independent advice are not sufficient to form the basis of a protective regime for sureties. Ultimately, independent legal advice as it is given at present may not be a complete solution because its desired effect is dependent on the level of professional expertise, experience and knowledge of the legal practitioner.

The provisions, however, could be made more effective if, as discussed earlier, they required a more comprehensive kind of advice to be given to prospective guarantors.⁵⁹

Such a system would certainly be much more effective, although it would involve disadvantages, in terms of increased expense and delays, which may seem to eventually outweigh the benefits.

The disadvantages would be even greater if the provisions were extended to apply to guarantees involving those of large commercial transactions. These commercial transactions can be very complex in their facts and documentation. Effective advice in those circumstances would frequently be a difficult and time-consuming procedure for the legal practitioner. The additional expense and delays incurred would often greatly exceed those involved in advising guarantors of small consumer-type transactions.

Nevertheless, it is suggested that there are incentives and advantages in the adoption of a system of giving effective comprehensive advice to the hapless guarantor. Cost-benefit considerations may encourage creditors to use a system of certified adequate independent advice only in 'high risk' cases, such as the large commercial ones mentioned above, as well as those involving, for example, guarantor wives as in *García* and parents guaranteeing their children's debts as in *Amadio*. This would be a sensible reform measure, and from the viewpoint of the creditor, may stave off a broader and more expensive statutory alternative.⁶⁰

59 See *Royal Bank of Scotland p/c v Etridge (No 2)* [2002] 2 AC 773 at 808, per Lord Nicholls.

60 Above n 53, at 345.