CAN YOU *GUARANTEE* YOUR SECURITY?

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TRICKS AND TIPS FOR LENDERS, BORROWERS AND LAWYERS

Alceon Group Pty Ltd v Rose [2015] NSWSC 868

In the lending business, personal guarantees are common practice. However, any financial transaction can pose substantial risks for guarantors, lenders and lawyers.

Below, we outline a recent important Supreme Court of New South Wales decision in which a guarantor was successful in having a guarantee set aside, despite having received legal advice prior to executing the guarantee.

ClarkeKann's new Litigation & Insolvency Partner, Chris Kintis, represented the successful guarantor in the Supreme Court and together with Sophie Clark, provides an insight into the case.

SUMMARY OF KEY FACTS

At the age of 81, Mrs Rose executed a personal guarantee that was secured by a mortgage over her family home. At the time she provided the guarantee, Mrs Rose had not been in the workforce for over 40 years and substantially relied on her husband to take care of the family's financial affairs.

The borrower was a company associated with the husband and son of Mrs Rose. Prior to executing the guarantee, certain legal advice was provided to Mrs Rose, at the request of the lender, by way of a brief telephone discussion. The advice was provided by the borrower's solicitor.

Subsequently, the borrower defaulted and the lender sought to enforce Mrs Rose's personal guarantee and the mortgage over her home. Mrs Rose sought to have the guarantee and mortgage set aside.

LEGAL PRINCIPLES APPLIED BY THE COURT

The Court held that Mrs Rose's case was to be determined by the application of the High Court's decision in *Garcia v National Australia Bank Ltd* [1998] HCA 48 and the application of the *Contracts Review Act 1980* (NSW).

In *Garcia*, the High Court stated that if a lender either:

- takes no steps itself to explain the transaction's purport and effect to the guarantor; or
- does not reasonably believe that the transaction's purport and effect has been explained to the guarantor by a competent, independent and disinterested stranger;

then that guarantee cannot be enforced because it would be unconscionable to do so.

When determining whether a lender reasonably believes that the purport and effect of the transaction has been explained, certain circumstances need to be considered,

including whether:

- in fact, the guarantor understands the purport and effect of the transaction;
- the transaction is voluntary (in the sense that the guarantor obtains no gain from the contract the performance of which is guaranteed); and
- the lender itself takes steps to explain the transaction to the guarantor or to determine that a stranger has explained it to them.

KEY FINDINGS AND DECISION

The key to the success of Mrs Rose's defences were the circumstances in which the documents were signed.

Although the Court was satisfied that Mrs Rose was not entirely ignorant of the documents she signed and, in theory, she had an understanding of the transaction, the Court found that:

- there was a requirement that Mrs Rose receive independent legal advice (which the lender appreciated) however the lender arranged for the borrower's solicitor (an interested party) to provide the advice and stated that the advice "need only be brief";
- the advice received by Mrs Rose was inadequate, superficial, and incomplete at best and was not provided by an independent solicitor (it was provided by the borrower's solicitor who was involved in attempts by the borrower to secure the loan from the lender);
- the lender was taken to have understood that, as a wife, Mrs Rose may repose trust and confidence in her husband in matters of business and therefore to have understood that the husband may not fully and accurately explain the purport and effect of the transaction to his wife;
- Mrs Rose had no personal benefit in the transaction and was simply a "volunteer" who trusted her husband and son; and
- Mrs Rose had no appreciation of the magnitude of the risk of default in respect of the proposed loan.

In this case, it was the lender who actively encouraged the borrower's solicitor to advise Mrs Rose, whilst it was fully aware that the solicitor:

- had a conflict of interest;
- knew of the borrower's dire financial position;
- knew the financially severe terms of the arrangement the lender was offering; and
- must, therefore, have been cognisant of the very high degree of risk associated with arrangement.

In doing so, the lender entirely undermined the protection it had sought to provide for itself. As the high risk of default was evident at the time Mrs Rose signed the documents (to everyone except Mrs Rose), the Supreme Court held it would be unconscionable to enforce the guarantee and mortgage.

The lender sought to justify its actions by relying on the fact that it had complied with the NSW Law Society Rules. However, the Supreme Court held that the rules do not permit avoidance of the principles of law stated by the High Court, specifically the obligation that Mrs Rose be given "competent, independent and objective" advice.

WHAT DOES THIS MEAN FOR GUARANTORS, LENDERS AND LAWYERS?

Inevitably, refinancing in any commercial situation can involve significant pressures and urgency.

ClarkeKann appreciates the complexities of financial transactions and can assist either lenders or borrowers protect themselves whether they are already in a difficult situation, or whether they want to avoid one.

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