

CASE NOTE*

GARCIA V NATIONAL AUSTRALIA BANK LTD: RESURRECTING THE CORPUS OF YERKEY V JONES

I. INTRODUCTION

The principles applicable to married women as guarantors of their husband's debts have been the subject of vigorous legal debate. With the High Court's recent decision in *Garcia v National Australia Bank Ltd*,¹ a great deal of that debate must now be considered resolved. Yet at the same time, the case throws open new and greater questions: are we witnessing the growth of an entirely new category of unconscionability?

II. THE BIRTH AND DEATH OF YERKEY V JONES

A. The Birth

In *Yerkey v Jones*,² Dixon J enunciated the general principle that:

... if 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.³

Justice Dixon's principle has been widely expressed as a "special equity"⁴ favouring married women. There are in fact two limbs to this special equity. To succeed on the first limb, the wife must prove that her husband induced her to enter into the guarantee through undue influence. The legal propriety of this first limb is not in doubt. To succeed on the second limb (which is the subject matter

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1 (1998) 155 ALR 614.

2 (1939) 63 CLR 649.

3 *Ibid* at 683.

4 See for example *CIBC Mortgages Plc v Pitt* [1994] 1 AC 200 at 207; *Barclays Bank Plc v O'Brien* [1994] 1 AC 170 at 194; *Commonwealth Bank of Australia v McGlynn* (1995) ANZ Conv R 81 at 82-3.

of this note and shall be referred to for simplicity's sake as "the" rule or principle in *Yerkey*) the wife need not establish undue influence, but rather that she failed to understand the purport and effect of the guarantee.

Thus, the rule in *Yerkey*, as stated by Dixon J and subsequently developed in later cases, may be stated as follows:

Where the consent of a wife to guarantee her husband's debts was

- (a) procured by her husband;⁵ and
- (b) obtained by "impropriety" on the part of her husband (even if this impropriety amounts to nothing more than a neglect on the part of the husband to inform his wife of the exact nature of the guarantee to which she is giving her assent);⁶ and where
- (c) the wife did not have a substantial interest in the transaction,⁷

then if the wife did not understand the purport and effect of the guarantee,⁸ she has a prima facie right to have the guarantee set aside, unless the creditor can show that it took adequate steps to inform the wife of the purport and effect of the guarantee and that it reasonably supposed that the wife understood.⁹

B. The Death

However this principle has met with harsh resistance from the Bench, particularly in recent years. In *Warburton v Whiteley*,¹⁰ Kirby P, as his Honour then was, expressed grave reservations about the continued applicability of the principle in *Yerkey*, citing considerable changes in social circumstances since the days in which Dixon J wrote his judgment.¹¹ Although ultimately, his Honour considered himself bound by the principle, he suggested that the High Court might consider subsuming it within "the more appropriate, modern and satisfactory principle elaborated in *Amadio*".¹²

Five years later, the rule in *Yerkey* was rejected by the New South Wales Court of Appeal altogether in the case of *Akins v National Australia Bank*,¹³ which proceeded upon the basis that relief for unfair guarantees should be granted according to the principles of unconscionability propounded in *Commercial Bank of Australia v Amadio*.¹⁴ In *Akins*, Clarke JA noted that the principle in *Yerkey* had been criticised upon the basis that it failed to pay regard

5 Note 2 *supra* at 675.

6 *Ibid* at 685.

7 *Warburton v Whiteley* (1989) 5 BPR 97,388 per McHugh JA at 11,634, *semble* Kirby P at 11,631 and Clarke JA at 11,643.

8 See for example *Commonwealth Bank of Australia v Cohen* (1988) ASC 55-681; *Akins v National Australia Bank* (1994) 34 NSWLR 155.

9 Note 2 *supra* at 685.

10 (1989) NSW Conv R 55-453.

11 *Ibid* at 55,286.

12 *Ibid* at 55,287.

13 (1994) 34 NSWLR 155 (Hereafter referred to as *Akins*).

14 (1983) 131 CLR 446 (Hereafter referred to as *Amadio*).

to the advance in the status and education of women, the increasing role of women (including wives) in business and commercial affairs and the variety of personal relationships that exist in the modern world.¹⁵ His Honour also noted that the principle had been unanimously rejected by the House of Lords in *Barclays Bank Plc v O'Brien*.¹⁶ Further, his Honour questioned whether a ratio could be extracted from *Yerkey* at all, claiming that in *Yerkey*, "Dixon J alone propounded the principles which have been relied on in courts in Australia since that time".¹⁷ His Honour then stated:

For these reasons I would conclude that the special rule [in *Yerkey*] should no longer be applied and that the principles discussed in *Commercial Bank of Australia Ltd v Amadio* should be applied in the resolution of a case such as the present.¹⁸

Sheller JA agreed with Clarke JA.¹⁹ The decision of the third member of the Court, Powell JA, was, in his own words, "radical in the extreme"²⁰ and involved a definitive assertion that "there never was a 'principle in *Yerkey v Jones*'".²¹

In the two later cases of *National Australia Bank Ltd v Garcia*²² and *Teachers Health Investments Pty Ltd v Wynne*,²³ the Court of Appeal continued to hold the principle in *Yerkey* inapplicable in New South Wales as having been supplanted by the principles in *Amadio*.

It was thus ostensibly clear that in New South Wales, the principle in *Yerkey* had been consigned to the earth.

C. Position in England

The Courts in England have also taken an unfavourable view of *Yerkey*. In *Barclays Bank Plc v O'Brien*²⁴ the House of Lords rejected a submission that Justice Dixon's principle in *Yerkey* formed a part of the law of England, adopting instead an approach to unfair guarantees based upon an extended doctrine of constructive notice. Although Lord Browne-Wilkinson, who delivered the unanimous ruling, rejected the proposition of a "special equity" favouring married women, his Lordship nevertheless held that in circumstances where a guarantor has been induced to guarantee the debts of another as a result of undue influence, misrepresentation or other legal wrong, the creditor will be fixed with constructive notice of that legal wrong if the security transaction was not on its face to the guarantor's advantage, and there was a substantial risk of the debtor committing a legal wrong against the guarantor. The creditor will not be able to enforce the security against the guarantor unless the creditor took

15 Note 13 *supra* at 168.

16 [1994] 1 AC 180 (Hereafter referred to as *Barclays*).

17 Note 13 *supra* at 169.

18 *Ibid* at 173.

19 *Ibid* at 175.

20 *Ibid*.

21 *Ibid* at 176.

22 (1995) 30 NSWLR 577.

23 (1996) NSW ConvR 55-785.

24 [1994] 1 AC 180.

reasonable steps to satisfy itself that the guarantor entered the transaction freely and with knowledge of all the facts.

III. THE RESURRECTION OF *YERKEY V JONES*

Despite the widespread judicial suspicion of Justice Dixon's principle in *Yerkey*, and what appeared to be its final end, the principle has made an astonishing comeback. A majority of five (out of six) members of the High Court affirmed Justice Dixon's principle in the recent case of *Garcia*.

A. *Garcia*: The Facts

In August 1979 Mrs Garcia and her then husband executed a mortgage over their home in favour of the Commercial Banking Company of Sydney Ltd (which later merged with the National Australia Bank Ltd). The mortgage secured all moneys which the mortgagors might owe the mortgagee, including moneys owing under future guarantees given by either of them to the mortgagee. On 25 November 1987, Mrs Garcia signed a guarantee in favour of the Bank, to secure the debts of Citizens Gold, a company run by Mrs Garcia's husband. The husband pressured Mrs Garcia to sign the guarantee. He constantly pointed out what a fool she was in financial matters. He assured her that there was no real risk associated with the interests she was guaranteeing. The bank took no steps to explain the extent of the obligations under the guarantee nor to recommend, or insist, that she obtain independent advice concerning the new obligations which she was assuming. Ultimately, she failed to understand that the guarantee to the bank was secured by an "all moneys" mortgage which put in danger the matrimonial home. For all this, however, Mrs Garcia was a practicing physiotherapist. She was clearly an intelligent woman, who was fully aware that she was guaranteeing her husband's transactions, and those of Citizens Gold. Further, she was herself involved in Citizens Gold as both a shareholder and director. Mrs Garcia and her husband dissolved their marriage, the decree becoming absolute on 1 January 1990. In August 1990, the Bank demanded payment by Mrs Garcia under the guarantee.

B. The Trial Judge's Ruling

The trial judge, Young J, granted relief to Mrs Garcia on the basis of the principles set out by Dixon J in *Yerkey*. Although alternative causes had been raised upon the basis of relief for *Amadio* unconscionability, relief for undue influence, and relief under the *Contracts Review Act* 1980 (NSW), Young J ultimately rejected these alternative claims. *Yerkey* offered the only basis upon which relief could be granted. The Bank thus appealed to the New South Wales Court of Appeal, challenging the status of *Yerkey* as law.

C. The Court of Appeal

The Court of Appeal held that it was not bound to follow *Yerkey v Jones*. Sheller JA concluded that what had been said to be the principle in *Yerkey v Jones* is "a principle to which one judge only adhered",²⁵ namely Dixon J, and "at its heart ... is based upon general assumptions about the capacity of married women rather than upon evidence of the circumstances of the particular case".²⁶ Sheller JA identified in some recent cases expression of "doubts about a principle founded on the assumption that a married woman is ipso facto under a special disadvantage in any transaction involving her husband and that the husband is in this context the stronger party".²⁷ Accordingly, Sheller JA concluded that "the so-called principle in *Yerkey v Jones* should no longer be applied in New South Wales".²⁸ The Court of Appeal also found difficulty in accepting the reasoning of *Barclays*, determining instead, that *Amadio* properly described the jurisdiction of equity to relieve a guarantor against an unfair guarantee.²⁹ On this basis, Mrs Garcia was not entitled to any relief. She appealed to the High Court.

D. The High Court

Five out of the six members of the High Court reaffirmed Justice Dixon's principle in *Yerkey*. A majority of four of the judges reinterpreted the foundations of the principle, opening up the opportunity of extending the classes of those who may claim relief under *Yerkey*. Within the Majority's judgment may possibly exist the seeds of an entirely new category of unconscionability altogether.

(i) *The Majority: Gaudron, McHugh, Gummow and Hayne JJ*

Gaudron, McHugh, Gummow and Hayne JJ, in their joint judgment, overturned the decision of the Court of Appeal. Whereas the Court of Appeal had found that Justice Dixon's principle in *Yerkey* did not form the ratio of the case as it was the opinion of Dixon J alone, the joint majority of the High Court stated that the better view was that the reasons for the decision of Dixon J in *Yerkey* "were not significantly different from the reasons of the other members of the Court".³⁰ This is a statement, however, that the majority expects us to take on faith, for nowhere do they attempt to identify precisely how the other members of the Court in *Yerkey* provided reasoning that paralleled that of Justice Dixon. In fact, given the extensive criticism of the foundations of Justice Dixon's principle,³¹ it is exceedingly difficult to have such faith at all. Nevertheless, the majority chooses to avoid altogether a doctrinal analysis of *Yerkey*, stating:

25 Note 22 *supra* at 598.

26 *Ibid.*

27 *Ibid* at 593.

28 *Ibid* at 598.

29 *Ibid* at 597.

30 Note 1 *supra* at 17.

31 See note 22 *supra*.

... we do not base our decision upon some confined analysis of the case intended to identify its ratio decidendi. Rather, we consider that the principles spoken of by Dixon J in *Yerkey v Jones* are simply particular applications of accepted equitable principles which have as much application today as they did then.³²

The majority proceed to state that the rationale of *Yerkey* is not to be found in notions based on the subservience or inferior economic position of women, or on their vulnerability to exploitation because of their involvement in a marital relationship.³³ Instead they argue:

So far as *Yerkey v Jones* proceeded on the basis of the earlier decision of Cussen J in *The Bank of Victoria v Mueller*, it is based on trust and confidence, in the ordinary sense of those words, between marriage partners. The marriage relationship is such that one, often the woman, may well leave many, perhaps all, business judgments to the other spouse. In that kind of relationship, business decisions may be made with little consultation between the parties and with only the most abbreviated explanation of their purport or effect.³⁴

But they state that this is not always attributable to any intended deception, or to any power imbalance between the parties, but is simply often "a reflection of no more or less than the trust and confidence each has in the other".³⁵ Thus, the majority state that:

the lender is taken to have understood that, as a wife, the surety 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.³⁶

It is as a consequence of the possibility that the surety may repose trust and confidence in her husband, that the enforcement of the guarantee in circumstances where the creditor did not take steps to explain the transaction to the wife, or satisfy itself that the wife received independent advice, would be unconscionable. In this sense, the principle in *Yerkey* is said not to be an entirely new principle, but simply a particular application of unconscionability:

To hold, as *Yerkey v Jones* did, that in those circumstances the enforcement of the guarantee would be unconscionable represents no departure from accepted principle. Rather it "conforms to the fundamental principle according to which equity acts, namely that a party having a legal right shall not be permitted to exercise it in such a way that the exercise amounts to unconscionable conduct".³⁷

Taken in this way, the decision of the majority reaffirms the principle in *Yerkey* by recognising a separate head of unconscionability. No longer is *Yerkey* to be understood as simply providing a "special equity" for guarantor wives. Instead, it is to be understood as deriving, at bottom, from relationships of trust and confidence (in the ordinary sense of those words). Reinterpreted in this principled way, the doctrine in *Yerkey* is set to expand. As the majority state:

It may be that the principles applied in *Yerkey v Jones* will find application to other relationships more common now than was the case in 1939 - to long term and

32 Note 1 *supra* at 18.

33 *Ibid* at 20.

34 *Ibid* at 21.

35 *Ibid*.

36 *Ibid* at 31.

37 *Ibid* at 32.

publicly declared relationships short of marriage between members of the same or of opposite sex - but that is not a question that falls for decision in this case.³⁸

(ii) *Callinan J*

Callinan J, as with the members of the joint majority, held that Justice Dixon's principle in *Yerkey* was not to be taken as the opinions of one judge alone.³⁹ Consequently his Honour took the view that the principles stated by Dixon J must be accepted as law of long standing in Australia.⁴⁰ His Honour was not prepared to interfere with the doctrine, nor did he attempt, as the joint majority did, to reassert the foundation of *Yerkey* as a particular application of a broader principle.

(iii) *Kirby J*

Justice Kirby's analysis differs from that of the majority in that his Honour concentrates heavily upon a doctrinal analysis of *Yerkey*. Kirby J ultimately agrees with the New South Wales Court of Appeal, that the principles stated by Dixon J are not in line with the other members of the Court. Kirby J states that his analysis of, and ultimately rejection of any, ratio decidendi in *Yerkey*:

cuts away the binding authority of what was said by Dixon J, leaving it as a judicial statement worthy of the greatest respect but not commanding obedience as a matter of binding precedent ... [T]he opinion of Dixon J in *Yerkey* is neither expressly nor impliedly a statement of a holding of this Court. Should it nonetheless, in light of its provenance, apparent durability and suggested continuing applicability now be accepted by the Court, as the majority think? In my opinion, it should not.⁴¹

His Honour continues:

[W]hy should this Court, in 1998, endorse a principle expressed to apply specifically to one class of citizens only, namely "married women"? For several reasons it should not. It should instead search for, and identify, a broader principle which is not confined to one group whose members have attributed to them particular needs and vulnerabilities which are certainly not confined to that group and which, in many cases, will not be present in members of that group.⁴²

He then proceeds to address specific reasons as to why the Court should not endorse Justice Dixon's principle. These may be summarised as follows:

1. It is an historical anachronism;
2. It is based upon a discriminatory stereotype (that is, "on their supposed need for protection");
3. That the category of "marriage" is an inappropriate basis for assuming vulnerability, particularly given the growth of alternative domestic relationships;

38 *Ibid* at 22.

39 *Ibid* at 100.

40 *Ibid* at 107.

41 *Ibid* at 64.

42 *Ibid* at 66.

4. That a principle that too easily impeaches guarantees of matrimonial homes would render the matrimonial home unacceptable as security to financial institutions;
5. That a principle affording a specially protected status to married women, whatever the facts of their vulnerability or lack thereof, is likely to encourage a particular category of borrowers, and those associated with them, to seek to escape their lawful obligations by challenging the adequacy of the explanations given to their wives for the documents they have signed, beyond the protection now amply provided by statute;
6. The High Court should, where possible, refuse to "classify unnecessarily and overbroadly by gender when more accurate and impartial" principles can be stated; and
7. The High Court should reject the unnecessary compartmentalisation of equitable principle.

However, much of this criticism of *Yerkey* is inapplicable given the majority's reinterpretation of the foundations of *Yerkey* by reference to principles of trust and confidence (in the ordinary sense of those words). Although it is true that in the context of *Garcia* the majority would not say definitively whether the principle applied beyond the class of married women,⁴³ it is inevitable now that *Yerkey* is explained by reference to broad principle, that it certainly will be applied beyond that class, so long as the facts of the case compel it.

Ultimately, Kirby J espouses a re-formulation of the principle expressed by Lord Browne-Wilkinson in *O'Brien*. He says, the principle should be expressed as follows:

Where a person has entered into an obligation to stand as surety for the debts of another and the credit provider knows, or ought to know, that there is a relationship involving emotional dependence on the part of the surety towards the debtor:

1. The surety obligation will be valid and enforceable by the credit provider unless the suretyship was procured by the undue influence, misrepresentation or other legal wrong by the principal debtor;
2. If there has been undue influence, misrepresentation or other legal wrong by the principal debtor, unless the credit provider has taken reasonable steps to satisfy itself that the surety entered into the obligation freely and in knowledge of the true facts, the credit provider will be unable to enforce the surety obligation because it will be fixed with notice of the surety's right to set aside the transaction;
3. Unless there are special exceptional circumstances or the risks are large, a credit provider will have taken such reasonable steps to avoid being fixed with constructive notice if it warns the surety (at a meeting not attended by the principal debtor) of the amount of the surety's potential liability, of the risks involved to the surety's own interests and advises the surety to take independent

43 *Ibid* at 22.

legal advice. Out of respect for economic freedom, the duty of the credit provider will be limited to taking reasonable steps only.⁴⁴

IV. CONCLUSION

Now that the High Court has clearly established that the principles in *Yerkey* were not subsumed or overruled by *Amadio*, and that *Barclays* is not to be followed in Australia, much of the debate surrounding the applicable principles in cases of unfair guarantees has been resolved. Yet at another level, new debates have just begun. If *Yerkey* is to be understood as a particular application of unconscionability, what are its limits? Which debtor-guarantor relationships will it provide relief to? Will the principle expand to other types of transactions as well? But perhaps most fascinating of all, if *Yerkey* (as reinterpreted by *Garcia*) creates a new category of unconscionability based upon trust and confidence (in the ordinary sense of those words), and if there is a single thread running through unconscionability, will there ever arrive a time when categories of equitable trust meet up with categories of trust in the ordinary sense of that word? Are we seeing the beginning of a process that could theoretically lead to the opening up of fiduciary duty beyond the narrow equitable categories?

44 *Ibid* at 73.