Common Law Rights and Liabilities in Relationship Debt

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ABSTRACT

Relationship debt is a term usually used to describe a situation where a woman becomes liable for the debt of her spouse or partner. This occurs when she becomes the guarantor for her partner’s loan or when she is co-borrowing with her partner. She becomes liable for the whole loan when her partner fails to meet the loan. Most of the time, woman will signed the loan agreement without acknowledging the legal and financial obligation. She signed it purely on a basis of relationship of dependence and emotional ties that exist between the woman and her partner. Is there a legal protection for them? This is a review paper on the common law position towards these women in the United Kingdom, Australia and Malaysia. It explores on the legal mechanism for which this woman can argue in the court of law so as to avoid being liable for her partner’s debt.

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INTRODUCTION

Relationship debt occurs when women accept the liability of becoming a guarantor to pay the debt of her spouse or partner due to the relationship that exists between them but not for financial reasons. The consequence of this is that if the spouse or partner is unable to meet the debt, the woman who is dependent upon the spouse or partner is liable for the debt. Because of such acceptance, no matter solemn it was, the debt is ‘transmitted’ to the woman. When the woman becomes the guarantor for her spouse’s loan, the creditor will have the right to call against the woman to repay the principal loan as well as any unpaid interest fees and penalties. Accordingly, if the woman is unable to meet this obligation, she may end up being a bankrupt person and need to surrender all her securities, including her home, savings and other assets, even she has no direct financial benefit from the principal debt.

1. Women and ‘Relationship’ Debt:

Woman sometimes feel obliged to show a commitment to the relationship by signing the agreement. However, it is important to acknowledge that there is no legal requirement that partners must become guarantors or co-borrowers. In most cases, women have been misled into believing that their signatures are important as a character reference. The worst scenario occurs when women did not realise that they have actually signed a continuing guarantee that will make them liable not only for the current loan but any other subsequent agreements.

The victims of relationship debt through guarantees are not limited to women who have poor understanding with regard to the contracts that they signed but also extend to highly educated and respected women. The fact that emotion was involved squeezes all level of women into the scene. It was even stated that the most common reason that women sign such contracts was because they love and trust their spouses and partners. Hence, women are exposed to both unforeseen and unintended financial obligations.

In Australia, the New South Wales Law Reform Commission Report shows that most women generally agreed to the transaction for emotional rather than financial reasons. It further states that women who signed the documents did it because they do not want to damage their relationship with the principal borrower (Lampe, 2009). On the other hand, women may feel obliged to help their spouses or partners. With phrases like ‘If you love me, you sign this’; it is not surprising that most of them sign the guarantee contracts against their judgments.

2. Issues in Relationship Debt:

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Problem arises when most women who accept the responsibility of a guarantor derives no “substantial benefit” from the guarantee agreement. In this regard, should women be burdened with the liabilities of a guarantor under the law? Perhaps the answer should be inferred from the nature of consent as she signs the contract. Under the common law, contract is voidable at the option of those whose consent is not free. Nevertheless, in the case of woman guarantor, the consent itself is dependent on several other factors. This may include limited business skill, knowledge and experience, inadequate involvement in her partner’s business affairs, lack of education and knowledge, especially in financial and legal matters, marital problem including domestic violence, and difficulty in understanding legal and business document.

A research confirms that regardless of how women described their family financial decision making, all perceived their powers over financial decisions of their spouse’s business as minimal (Fehlberg, 2009). For the majority of women, the man is the breadwinner. This is exacerbated by the tendency of women to work part time after the birth of the first child and reduces her contribution to the house funds. Thus, it is explicable that women suffered mostly in relationship debt. Her decision to guarantee her partner’s loan is more influenced by emotional ties than arm’s length commercial judgement. Her consent is questionable and to be investigated on a case-to-case basis.

As a whole, in assessing these cases, the key factor is the quality of the woman’s consent. A woman may have understood the legal and financial obligation of becoming a guarantor to her partner’s loan. On the other hand, a partner may obtain the signature after he has deliberately misled her. In some extreme cases the signature is procured from a psychological or physical violence. Despite all these, in reality most women will feel that she has no choice but to sign.

3. Rights and Liability under the Common Law:

From time to time cases involving woman guarantor have appeared before the court. What interesting to note is the judges’ approach in dealing with these cases and in deciding which matters: being a woman or being in a relationship? In an Australian case of Yerkey v. Jones, Justice Dixon stated that:

“If a married woman’s consent to become a surety for her spouse’s debt is procured by the spouse and, without understanding its effect in essential respects, she executes an instrument of suretyship which the creditor accepts without dealing with her personally, she has a prima facie right to have it set aside”.

Hence, special treatment has been afforded to married women in this Australian case. They are allowed to enjoy special equity when they guaranteed their spouses’ loan. The equitable principles that can be applied here are the doctrines of unconscionable conduct and undue influence. The former allows a contract to be set aside where there is an unequal bargaining power between the parties and the stronger parties has used his position to take advantage of it.

Under the common law system, the doctrine of unconscionable conduct normally related to the special disability cases, which include illiteracy, lack of education or sickness. The doctrine focuses on the conduct and conscience of the stronger party and his knowledge of the special disability of the weaker party. This however is a difficult element for a guarantor to prove. The only known cases have showed some supervening disability like a medical evidence that the wife has been under such stress that her judgement was impaired (Borg-Warner v. Diprose) or blatant misconduct or manipulation by the lender (Nolan v. Westpac Bank).

The case of Garcia v National Australia Bank Ltd held that it is unconscionable for a creditor to enforce a guarantee given by a wife for the benefit of her spouse if she did not understand the transaction; the transaction was voluntary, i.e. she received no gain from it; the creditor is taken to understand that, as a wife, she may repose trust and confidence in her spouse in matters of business, and the creditor did not itself take steps to explain the transaction to the wife or find out that a stranger had explained it to her.

In Commercial Bank of Australia v Amadio, the High Court decided that the inequality of bargaining power, the questionable way in which the parent’s signature was elicited and the parent’s age and lack of knowledge of English amounted to unconscionable conduct. In Malaysia, the principle falls under the doctrine of undue influence under section 16(3) Contract Act 1950 rather than the unconscionable conduct. In this regard, s. 16 (1) of the Contract Act 1950 provides that a contract is said to be induced by “undue influence” where the relations subsisting between the parties are such that one of the parties is in a position to dominate the will of the other and uses that position to obtain an unfair advantage over the other. In the case of National Westminster Bank plc v. Morgan, although no undue influence is presumed to exist in wife guaranteeing her spouse, it can be proven from the fact that the wife has neither an interest in, nor gains a benefit from the transactions.

The leading authority for undue influence is Barclays Bank plc. v. O’Brien where a wife agreed to stand as a guarantor for spousal business debts. In this case the court has restated the law in Yerkey v. Jones by holding that not only a married woman, but also other vulnerable person, to have an equity to set aside such transaction. Lord Browne Wilkinson also attempted to balance the susceptible guarantor against the difficulty of financial institution in ensuring the guarantor’s consent is free. In this regard, he reminded the creditors that if they are aware that the guarantor is the partner of the debtor, they are fixed with constructive notice of the surety’s right to set aside the transaction if the debtor exert undue influence, misrepresentation or other legal wrong in making
the surety signed the agreement. They will only be released of such notice if they warn the surety of risks and liability involved.

Further, in *Bank of Credit and Commerce International S A v. Aboody*, the English Court of Appeal classified two classes of undue influence. First, actual undue influence and it is necessary for the claimant to prove affirmatively that the wrongdoer exerted undue influence on the complainant. Secondly, under the presumed undue influence category, complainant has to show that there was a relationship of trust and confidence. Here the burden shifts to the wrongdoer to show that the complainant entered the transaction freely, for example, by having independent legal advice.

The positions discussed above were accepted in Malaysia in *Southern Bank Bhd. v. Abdul Raof bin Rakinan & Anor*. In this case, the creditor bank applied for summary judgement against the second defendant, the guarantor who was the wife of the defendant, and issued the letter of demand for the payment of her spouse’s debt. The Session Court judge dismissed the application. When the bank appealed to the High Court, K C Vohrah J, in dismissing the appeal, held that there were triable issues in this case, and they are: (i) whether the bank was put on inquiry and would have constructed notice of the wife’s rights; (ii) whether the bank took reasonable steps to ensure that the contract to stand surety had been properly obtained; and (iii) whether the plaintiff had entrusted the debtor with the duty to obtain the consent of his wife to become guarantor.

The learned judge held that there was no presumption of undue influence between spouse and wife. He quoted Lord Browne-Wilkinson’s judgement in *O’Brien* as follows:

“This special tenderness of treatment afforded to wives by the courts is properly attributable to two factors. First, many cases may well fall into the Class 2(B) category of undue influence because the wife demonstrates that she placed trust and confidence in her spouse in relation to her financial affairs and therefore raises a presumption of undue influence. Second, the sexual and emotional ties between parties provide a ready weapon for undue influence: a wife’s true wishes can easily be overborne because of her fear of destroying or damaging the wider relationship between her and her spouse if she opposes his wishes.”

In the wife’s defence, it appears that she agreed to sign due to her pregnancy and her desire to have matrimonial harmony. There were continuous quarrels, scolding and assaults by the spouse, thus make her vulnerable and succumbed to her spouse’s undue influence. Implicit in these allegations was that the bank did not make any inquiry as to whether the agreement had been properly obtained since her signing was not to her financial advantage.

4. Relationship and Undue Influence after Etridge (No. 2):

The House of Lords’ decision in the *Royal Bank of Scotland v. Etridge (No. 2)* was a conjoined appeal of eight cases involving eight wives signing security agreement under undue influence to secure the borrowings of their spouses. Lord Bingham of Cornhill, in his opening remark, stated that the transactions that lead to the appeal were commonplace but of great social and economic importance. Much of the case law preceding *Etridge (No. 2)* concerned with determining situations in which lender could rely on the involvement of a solicitor. The House of Lords clarified this principle by requiring the lender to ensure that the solicitor is actually acting for the wife. The lender cannot assume this to be the case by merely requesting the solicitor to advise the wife or that the solicitor witnessed the wife’s signature on the security documents.

The learned judges had laid down the core minimum requirements for both the lenders and the solicitors when dealing with the partner guarantor, amongst others; (i) if the lenders is unwilling to explain the nature and implication of the guarantee agreement to the wife or partner of the borrower, the lenders need to ask the wife to nominate a solicitor to advise her; (ii) explain to the wife that she will not be able to dispute once she has signed them upon receipt of legal advice; (iii) the solicitor needs to explain the nature and seriousness of the risk involved and use suitable non-technical language; and (iv) he also need to inform clearly that she has a choice, and if she wishes to proceed, she is content that the solicitor should write to the lenders that she has been properly advised.

The effect of *Eridge (No. 2)* is clearly to put the lending institution on enquiry if the woman becomes a guarantor to another and their relationship is non-commercial. The back will be on a constructive notice of the undue influence if it had not provided independent legal advice to the guarantor. In this regard, Lord Nicholls stated:

“As to the type of transactions where a bank is put on inquiry, the case where a wife becomes surety for her husband’s debts is, in this context, a straightforward case. The bank is put on inquiry. On the other side of the line is the case where money is being advanced, or has been advanced, to husband and wife jointly. In such a case the bank is not put on inquiry, unless the bank is aware the loan is being made for the husband’s purposes, as distinct from their joint purposes.”

The House of Lords appeared to have abolished the “presumption” of undue influence. However where there is a clear case of wrongdoing by the spouse, the lender will bear the risk unless it ensures that it has fulfilled the core minimum requirements above. The whole episode is a potentially helpful development for the
lenders in preparing themselves in the future. They however will need to develop procedures for communicating directly with wives and solicitors. The wives on the other hand can claim that the lenders failed to ensure that they have been properly advised but will run a risk of paying greater fees for the advice they receive. This rule has been followed by the later House of Lord’s decision of National Westminster Bank v Amin.

5. Conclusion:

Women should aware of their rights when accepting the liabilities of their spouses or partners. One of the rights is the setting aside of a contract of guarantee. A guarantee can be set aside on the ground of the relationship that exists between the guarantor and the principal debtor. The term ‘relationship’ suggests that there should be some special connection between the guarantor and the debtor. General reposed of a wife’s trust and confidence in the spouse would meet this definition of relationship. This exposes the risk of exploitation in the relationship. This is crucial when the transaction is, on the face of it, not to the financial advantage of the wife or partner. It appears that the basis the court gives relief to woman guarantors is the relationship but not gender. The courts were not ready to suggest that relief should be given upon gender or woman. Thus, a woman would not have an automatic right to set aside a contract but must prove that her willingness has been affected by some other factors through relationship. Therefore, relationship is a paramount basis in order to set aside a contract of guarantee, i.e. the existence of the imbalance position between the two contracting parties, which could affect the consent of the other. It is pertinent that the judges to be gender sensitive so as to protect woman guarantor. To certain extent, this has been acknowledged in the case of Etridge (No. 2) where the creditors will have a responsibility to ensure that the guarantor had understood the implications of her guarantee agreement.

REFERENCES


CASES

Royal Bank of Scotland v. Etridge (No. 2) [2002] 2 AC 773.