WIFE DOES A HOUDINI AND ESCAPES LIABILITY UNDER PERSONAL GUARANTEE FOR BUSINESS LOAN

Some lenders may think that sending a proposed guarantor for a loan to get independent *legal advice* about the personal guarantee before they sign is enough.

In the recent case of *La Trobe Financial Asset Management Limited -v- Nikolyn Pty Ltd ACN 078 833 977 in its own right and as trustee for Nikolyn Unit Trust* [2022] WASC 264, the Court held that was not good enough.

What the lender was required to do (at least in the circumstances of that case) was ensure that the guarantor also received financial advice so as to understand the *financial position* of the borrower.

It didn't do that.

Justice Smith held that the taking of the guarantee and mortgage by the lender from Mrs Liliana Lupini ("**Mrs Lupini**") in respect of a loan of $2,898,000 to a business (CPL Plumbing) was unconscionable under the second category of Yerkey v Jones unconscionability and pursuant to s 12CB of the Australian Securities and Investments Commission Act, and as a result the guarantee was held to be unenforceable and void as a result.

Mrs Lupini's understanding of the guarantee

Mrs Lupini argued that the lender acted unconscionably towards her as, amongst other things, she did not understand the true effect of the guarantee and it would be against conscience for her be held to the terms of the mortgage.

Mrs Lupini's background is as follows:

1. In May 2016, Mrs Lupini was 51 years old and had been married to Domenic Lupini for about 29 years. They have five children together. Mrs Lupini completed high school education up to year 10 at Perth Modern School.
2. At the time she gave evidence, she was employed at Royal Perth Hospital as a casual ward clerk and also had a second part-time job as an administrative assistant at a freight company in Welshpool. Mrs Lupini had no experience in running a business.
3. Mrs Lupini is a beneficiary of the Lupini Family Trust. The business of CPL Plumbing was operated through the Lupini Family Trust. It was Mrs Lupini's evidence that she did

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not understand how the Lupini Family Trust worked and they had never received any distributions from the trust. She left matters relating to the Lupini Family Trust to an accountant.

Justice Smith found that Mrs Lupini was under a special disadvantage as it was clear that for Mrs Lupini to have an adequate comprehension of the purport and effect of the guarantee and mortgage, steps should have been taken by the lender to require that she received independent financial advice (in addition to legal advice) about the financial affairs of the business of CPL Plumbing.

The financial position of the borrower (which the lender knew)

It was held that at the time of taking the guarantee from Mrs Lupini the lender knew that:

(a) Mrs Lupini only had a relatively small amount of equity in her home when compared to the amount of the loan; and

(b) because of the bleak financial position of the business of the borrower (CPL plumbing) at that time, there was a substantial and real risk that the borrower would not be in a position to repay the loan in full at the end of the term and she would lose the equity in her home. In circumstances where there was so much risk to the guarantor, and where the guarantor was not privy to the workings and financials of the borrower, and where the lender knew the guarantor would need assistance to appreciate the level of risk that existed (by having explained to her the financial position of the borrower), the lender should have ensured that the financial position of the borrower was explained to the guarantor.

In short, an appreciation of the *legal risk* of something happening (default, and enforcement of the guarantee and mortgage) must be coupled with advice about the *financial probability* that it would happen.

The Court held that:

1. In closing their eyes to these circumstances, and not making any inquiry of her as to whether Mrs Lupini had any knowledge about or had received financial advice about the then current circumstances of the CPL Plumbing business before she signed the guarantee and mortgage, the lenders exploited her disadvantage.

2. By failing to require that Mrs Lupini obtain such advice, the lenders engaged in unconscionable conduct; their conduct towards her could be described as not only wilfully ignorant towards her circumstances but also conduct that is so far outside societal norms of acceptable commercial behaviour as to warrant condemnation as conduct that is offensive to conscience.

Comment

Guarantees are often obtained by lenders (or suppliers under Credit Applications) to mitigate the risk that a borrower will default on a loan, after the lender or credit provider has investigated that risk.

Perhaps the test should be that if the lender would not sign a personal guarantee themselves in a similar situation, there is a heightened obligation to ensure that the guarantor obtains advice about the *probability* of default.

But at the very least, if a lender or credit provider determines that a personal guarantee is necessary due to the poor financial position of a borrower/customer, and there is a possibility that the guarantor is not involved in the borrower's business, then it would be prudent to ensure

that the guarantor understands both the legal effect of the guarantee, and the probability that it will be acted upon. To be safe, perhaps that should be done anyway.

Whether this case might unintendedly expand the scope of what constitutes a Special Disadvantage (for unconscionable conduct purposes) to someone who is unaware of the financial position of the borrower is yet to be seen.

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