PART 9

GUARANTORS AND CO-BORROWERS

The Credit Act, and in particular Part VIII thereof, contains a number of provisions which are intended to provide protection for persons who guarantee the obligations of borrowers under regulated contracts.

There are basically two elements to that protection. In general terms the first is concerned to ensure that a prospective guarantor is provided with a copy of the contract before a guarantee can be entered into and with a document explaining the rights and obligations of guarantors. In general terms also, the second element is concerned to prevent the lender proceeding directly against the guarantor unless the lender also proceeds against the borrower. These protections are additional to and not in substitution for the rights afforded by common law to guarantors, such as the rights of subrogation and contribution.

Until June 1987 HFC did not require or permit persons to enter into contracts of guarantee in connection with regulated credit contracts. It did, however, have a policy and a practice of having persons who were not the principal borrowers sign loan contract documents in the capacity of co-borrower. HFC's form of lending manual as in force prior to June 1987 expressed the policy in these terms - "On applicants who represent future business, but who don't now qualify on their own, you should explore the availability of a co-borrower. When it appears that they would qualify, we should solicit the applicant for a loan or sales contract with the co-borrowers signing." (Ex. A156 Vol. 5, Tab 28 3-1, page 15).

That HFC regarded co-borrowers as security is made even more plain in the introduction to that manual, where the following passage occurs -

> "The taking of furniture as collateral may continue to provide some protection in certain Bankruptcy Courts, but for practical purposes, regular household furniture does not represent real security. Therefore, if the creditworthiness of the applicant is such that security is really needed, you will require saleable security of adequate value or a co-maker, or both."

In July 1986, the Australian Finance Conference sent to its members, of which HFC was one, a notice dealing with the subject of co-borrowers and guarantors. In part that notice read as follows:

> "The distinction between a principal debtor and a guarantor has always existed. Basically a guarantor promises to be answerable for the debt of someone else who has a primary liability for the debt. Liability arises, however, only on default of the principal debtor (the extent of the liability will depend on the terms of the contract of guarantee).
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> "Part VIII of the Credit Act 1984 reinforces this distinction by placing certain restrictions on recovery of debts from guarantors, and otherwise gives them a right to terminate their liability for prospective obligations on notice to the credit provider and debtor (Section 143).
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> "In all, particularly under the Credit legislation, a guarantor is in a quite different relationship with the creditor than the

principal debtor. It is something of a sham to sign up persons as co-borrowers who are not in fact joint borrowers of the monies lent, and such a practice obviously serves to defeat Part VIII of the Credit Act. These comments apply equally to those other jurisdictions operating under the Credit legislation."

Very shortly after HFC received that notice, discussions concerning it took place between Mr. Wilson and Mr. McRae. Mr. McRae followed up the matter on 30 July, 1986 with a memorandum to Mr. Wilson. In that memorandum Mr. McRae advised Mr. Wilson that "HFC should cease this practice and consider the taking of guarantees." He further informed Mr. Wilson that there was no difficulty in providing a simple form of guarantee and he further advised that he had a form of guarantee which had been approved by the Victorian Ministry of Consumer Affairs.

Nothing was done by HFC during the next six months to change its practice of using co-borrowers in lieu of guarantors. On 27 January, 1987 Mr. McRae wrote a further memorandum, this time to Mr. Ezzy (but copied to Mr. Wilson and other senior executives) in which he pointed out that HFC "may presently be 'avoiding' the Credit Acts' provisions in certain cases." Mr. McRae told Mr. Ezzy "We should immediately cease this practice and where appropriate commence using contracts of guarantee." (AC2. Annex 20) However, it was not until 12 June, 1987 that HFC put into place a change in procedures whereby persons receiving no tangible benefit were no longer to be signed up as co-borrowers and in lieu guarantees were to be taken.

HFC estimates that the number of cases in which co-borrowers signed loan contracts but apparently received no tangible benefit from the loans is something in excess of 860.

HFC has also admitted (see AC2 Vol.1, page 11) that -

> HFC employees were confused as to the distinction between co-borrowers and guarantors.
>
> HFC employees have asked or suffered persons to be asked to be guarantors of a loan contract but had them sign the loan contract as co-borrowers.

In its strict terms the first of those admissions does not make it plain whether HFC itself or, more realistically, its senior management were confused as to the distinction between co-borrowers and guarantors or whether the confusion was one which existed among employees at less senior levels.

Unfortunately the evidence of Mr. Wilson as to his own state of knowledge and understanding is itself confusing. In speaking of the time when HFC used co-borrowers rather than guarantors, Mr. Wilson first said that his personal belief at that time was that a guarantor was a person who did not get a direct benefit from a loan. He agreed that that has always been his personal belief. (4721). Yet almost immediately afterwards when he was asked "Let us take, say, the year 1986. During that year it was your understanding that a guarantor was a person who did not get the direct beneficial interest from the loan. That was your personal understanding in 1986?", Mr. Wilson answered

"That was a later understanding." He was then asked "When did you first get that understanding?". He answered "I believe in 87 when we were discussing the problem of guarantors versus co-borrowers or joint borrowers."

Not only do those answers appear to be contradictory but the last of them is very difficult to accept, having regard to the terms of Mr. McRae's memorandum to Mr. Wilson of 30 July, 1986.

The Authority does not consider that Mr. Wilson was intending to mislead the Authority or was being evasive in his evidence on this matter. Our view is that he was genuinely confused and that his evidence of his own previous beliefs and HFC's prior practices was affected by that confusion.

The confusion and uncertainty in the evidence as to whether HFC's senior management was fully aware of the distinction between guarantors and co-borrowers is such that the Authority feels unable to conclude that senior management was fully conscious of the distinction prior to July 1986. From that it follows that, at least until July 1986, HFC was not, by requiring persons supporting loans to sign as co-borrowers, consciously engaging in avoidance of Part VIII of the Act.

It is now appropriate to examine HFC's failure to put an end to the practice promptly after receiving the notice from the Australian Finance Conference and Mr. McRae's memorandum of 30 July, 1986 referred to earlier.

Mr. Wilson was asked "Did Mr. McRae tell you that you had to stop treating those people as co-borrowers and start treating them as guarantors?". He answered "He may have told me that but he also advised me on the point that we have just been hearing about, that providing the borrowers understood they were jointly liable, it was also permissible to continue running them as joint borrowers..." He was then asked "So you have got a recollection of Mr. McRae saying to you 'If in fact they agree to be co-borrowers, that is okay' Is that your recollection?" Answer "Yes." (4728)

When asked whether he could find any statement to that effect in Mr. McRae's memorandum, his answer "The document's a forerunner to the discussion." (4728) Having regard to the terms of the Australian Finance Conference notice, the terms of Mr. McRae's memorandum of 30 July, 1986 and to the terms of his subsequent memorandum to Mr. Ezzy of January 1987, we do not believe that Mr. McRae would have so advised Mr. Wilson and we can only conclude that Mr. Wilson's recollection was again at fault.

The Authority finds that when HFC continued after July 1986 to use co-borrowers, it did so in the knowledge that that practice was a sham and an evasion of Part VIII of the Credit Act.

The Saunders/Healey and Carrigan/Baxter cases

There were two cases, namely the Saunders/Healy case and the Carrigan/Baxter case in which it was alleged that HFC staff told co-borrowers that they were guaranteeing amounts less than the amounts for which those persons were potentially liable. Both were cases in which the prime borrowers had taken out loans which, in part, refinanced

amounts owing under previous loans from HFC. HFC had not required co-borrowers to support those previous loans but had required co-borrowers for the new loans, presumably because greater amounts of credit were being extended.

In the Saunders/Healey case there is no doubt that the co-borrowers believed that the maximum amount which they were "guaranteeing" was $2,000, that being the amount of "new" credit being provided.
In the Carrigan/Baxter matter, Mr. Baxter did not sign the contract as a co-borrower but signed only a goods mortgage by which his motor vehicle became security for a loan made to his wife's parents, Mr. and Mrs. Carrigan. Although Mr. Baxter's evidence is not as consistent or as persuasive as that of Mr. and Mrs. Healey, we nonetheless find on the balance of probabilities that Mr. Baxter believed that his liability was essentially limited to the amount of new credit being extended to the Carrigans.

The Authority has concluded, however, that in neither case does the evidence justify a conclusion that the erroneous beliefs of the co-borrowers as to the extent of their liabilities were deliberately induced by the HFC staff concerned. The Authority believes that it is equally likely that the co-borrowers assumed, understandably but erroneously, from the circumstances that their liabilities were so limited. It is, however, clear in the Saunders/Healey matter and highly probable (as the Applicant has itself suggested) in the Carrigan/Baxter matter, that the HFC staff concerned failed to ensure that the parties understood the true extent of their liabilities. It must also be said that if HFC had complied with Part VIII of the Credit Act and provided the supporting parties with the complete documentation

required to be given to guarantors, there would have been a much better prospect of those parties understanding the true position.

In argument, the Applicant drew a distinction between a case where a person who signed as a borrower had been told that he or she was required to sign in that capacity and a case where a person who signed as a co-borrower was told that he or she was a guarantor. Indeed at one stage the Applicant asserted that there is nothing wrong with the former practice - see Mr. Charles, p.4723 - but it would appear from the Applicant's final submission that that is no longer pressed. (10409). The Applicant said further that while there were some cases in which it accepted that the co-borrowers had been informed that they were guaranteeing a loan (Clark, John/Johnson), there was no evidence as to how many other instances of that kind had occurred as distinct from cases where co-borrowers were not led to believe that they were signing as guarantors.

It is true that there is no evidence to establish how many cases fell into each category but we think it highly probable that there were numerous cases in which co-borrowers were told that they were to be guarantors. In all of the cases with which we are concerned, the co-borrower was required because HFC considered the loan to be too risky if made with the prime borrower alone. In other words, a co-borrower represented security. We think it likely that HFC staff, without consciously intending to deceive, would on many occasions have used the terms guarantor and guarantee to the supporting parties for such terms in common parlance better explained the purpose for which their signatures to the contracts were being required.

In summary we find that -

(i) from the commencement of the Credit Act until mid 1987, HFC had a practice of requiring persons who were supporting loans but receiving no benefit thereunder, to sign as co-borrowers rather than as guarantors, and in so doing avoided the provisions of the Credit Act;

(ii) prior to mid 1986, HFC was not conscious that its practice was a sham or an avoidance of the provisions of Part VIII of the Credit Act;

(iii) HFC, having become aware in mid 1986 of the shortcomings of its practice, failed for almost 12 months thereafter to take any action to adopt practices in compliance with the Act, notwithstanding the advice of its Corporate Attorney and notwithstanding that appropriate documentation had been drafted;

(iv) in some cases the co-borrowers were told that they were signing in that capacity but in others they were told that they were signing as guarantors; and

(v) in two cases, the Saunders/Healy and Carrigan/Baxter cases, HFC failed to adequately inform the supporting parties of the full extent of their liabilities.

The Taking of Guarantees after June 1987

On 12 June, 1987 HFC instructed its staff to cease having persons sign loan contracts as co-borrowers unless the persons were to receive tangible benefits under the loans. Guarantees were to be used and forms of guarantee were provided to the branches.

Mr. Wilson informed the Authority in his statement (Ex. A157, para 92) that with effect from 4 September, 1988 HFC had ceased to accept any guarantees in relation to any of its customers' loans. Under this policy, where a person applying for a loan does not qualify in his or her own right, the loan application must be refused.

It appears that there is a qualification to that apparently unlimited abandonment of the taking of guarantees. Mr. Miller told the Authority that HFC would continue to take guarantees in circumstances where loans are refinanced (or restructured) for collection purposes, that is solely for the purpose of assisting borrowers having difficulty with repayments under existing loans.

Remedying of past cases

Although HFC ceased using co-borrowers as security in June 1987, it was not until June 1988 that HFC decided to look at the position of certain persons who, prior to June 1987, had been asked to be guarantors but had signed as co-borrowers. HFC's memorandum to all branch managers and other HFC officers read in part as follows:

"3. It has been alleged that in a number of cases where there are co-borrowers, one of the borrowers is really a guarantor. In such cases where we are satisfied that the co-borrower was asked to act as a guarantor but signed as a co-borrower the following policy is to be adopted: -

(a) Proceedings will not be taken against that co-borrower unless all borrowers are sued at the same time in the same proceedings or judgement has been obtained against the principal borrower and remains unsatisfied more than 30 days after written demand is made on the principal borrower for the payment at the judgement debt.

(b) No action will be taken to enforce a judgement against a co-borrower at any time unless a judgement has been obtained against the principal borrower and that judgement remains unsatisfied for more than 30 days after written demand has been made on the principal borrower.

(c) If the principal borrower is bankrupt, or we are unable to locate him after making reasonable enquiries, enforcement proceedings may be taken against to (sic) co-borrower immediately and any judgement enforced immediately.

4. In assessing whether or not the co-borrower should be treated as guarantor for these purposes, reference will

have to be made to the original application and file. If there is any doubt, reference should be made to Corporate Attorneys office." (AC2, tab 21)

The shortcomings of that measure are obvious.

First of all it did not apply to cases where co-borrowers had been required purely for security purposes unless such persons had been specifically told that their capacities were as guarantor. Secondly, it was for the co-borrower/guarantor to raise the matter with HFC. Thirdly, it appears to be implicit in the measure that HFC considered itself entitled to proceed against persons who had been misled as to the capacities in which they were signing. It also appears to be evident that in June 1988 HFC saw nothing wrong, or at least nothing warranting remedying, in its former practice of taking co-borrowers for security purposes only, provided that those persons had not been told that they were acting as guarantors.

These deficiencies were subsequently recognised by HFC. In his statement to the Authority of October 1988, Mr. Wilson announced that HFC had further considered the position of persons who had signed as co-borrowers but had not received any tangible benefit under the relevant contract. It had been decided that HFC would make no claim against such persons and would only claim against the relevant borrower and that where any such persons had already made payments to HFC, HFC would refund those payments if so desired by the co-borrower. HFC did not propose to automatically refund such payments, but only for the reason that some co-borrowers might have made payments to HFC intending

to reduce the liability of the principal borrower and would not wish that liability to be increased. (Ex. A157, para 91).

HFC has proceeded to implement the measures announced by Mr. Wilson. It caused a search to be made of branch records in order to identify cases where payments appear to have been made by co-borrowers on behalf of principal borrowers and in February 1989 it wrote to all co-borrowers so identified offering to refund the amount of any payments which they had made.