

THE APPLICATION OF THE DEFENCE OF NON EST FACTUM: AN EXPLORATION OF ITS LIMITS AND BOUNDARIES

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I INTRODUCTION

Non est factum is a defence which may be available to someone who has been misled into signing a document which is fundamentally different from what he or she intended to execute or sign. Accordingly, where the defence is established, the signing party may be able to escape the effect of the signature by arguing that the agreement was void for mistake.¹ This article is concerned with evaluating the limits and breadth of the defence as it is applied to contracts of guarantees, which are perhaps the most common form of security used in the business world today.

It is usually thought that the guarantor or surety knows that the guarantee secures the repayment of the borrower's loan and that dissatisfaction with the borrower's financial position is probably the reason for the creditor's stipulation that a contract of guarantee be entered into. The use of guarantees can be one of a number of ways of

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¹ See, eg, *Petelin v Cullen* (1975) 132 CLR 355; *PT Ltd v Maradona Pty Ltd* (1991) 25 NSWLR 643.

dealing with the sub-prime mortgage crisis, which has created a credit crunch that has a devastating effect on banks and financial markets and has pushed the major economies into a recession.² The fact that the Australian Government (like those of other developed countries) has decided to guarantee bank customers' deposits (as part of a stimulus package) to raise public confidence in the financial system following the world economic downturn means that it can no longer afford to rely on the usual claim that the banks are always secure, well regulated and capitalised. In this way, the Government has battled to prop up the banks, committing billions of dollars in the process. Yet action on the current scale has never been tried before and nobody knows when it will have an effect-let alone how much difference it will make.³

In a specific situation, where one party has signed a contract of guarantee, believing it to be something different from what it actually is, that party may be able, as alluded to earlier, to rely on the doctrine of non est factum to have the document set aside for mistake. Without such a defence, the mistaken party may be liable under a document appearing to be valid and binding. The rationale for the defence of non est factum is that in truth, the document has not been executed at all.

The article also questions the significance of the plea as a doctrine and its application. It is important to know, for example, that the extensive disclosure by the creditor as required by the *Banking Code of Practice* and the *Consumer Credit Code* may have the indirect effect of reducing the application of non est as a defence at law, since guarantors will now have less opportunity for claiming that they were under a misapprehension as to the terms of the guarantee. It is possible, under some circumstances, that a mistaken party who is unable to obtain relief by reason of non est factum may be able to set aside the guarantee for other reasons such as a breach of the creditor's duty of disclosure, misrepresentation, or unconscionable conduct which are wider in scope and are more likely to give a remedy.⁴

² Mathew Drummond and Katja Buhner, 'Bank Guarantee Delivers Revenue Windfall', *Australian Financial Review*, 20 January 2009, 1; J C Coffee Jr, 'Turmoil in the US Credit Markets: The Role of the Credit Rating Agencies', *Testimony before the United States Senate Committee on Banking, Housing and Urban Affairs*, 22 April 2008.

³ Danny John, 'Banks Raising Billions from New Guarantee', *Sydney Morning Herald*, 13 December 2008, 10; Siobhan Ryan and Scott Murdoch, 'Funds Call for Guarantee', *The Australian*, 27 December 2008, 1.

⁴ Thomson Reuters, *Modern Contract of Guarantee*, Part 4, 'Factors Affecting Validity', [4.500] at 22 January 2009.

II THE NATURE OF THE DOCTRINE OF NON EST FACTUM

The modern boundaries of the doctrine of non est factum can be found in *Saunders v Anglia Building Society*⁵ where the House of Lords restated the principles governing the availability of the defence. Stated in general terms, the criteria for a successful plea are the following:

- The person relying on the defence usually must belong to a class of persons who, through no fault of their own, are unable to have any understanding of the purport of a particular document, because of blindness, illiteracy or some other disability.⁶
- The signatory must have made a fundamental mistake as to the nature of the contents of the document being signed, having regard to the intended practical effect of the document; and the document must be radically different from the one the signatory intended to sign.⁷

The principles of *Saunders* were followed in *Petelin v Cullen*⁸ where the High Court stated that the person seeking relief 'must know that he signed the document in the belief that it was radically different from what it was in fact'.⁹ The court considered the scope of the defence of non est factum but indicated the narrow class of persons who are entitled to rely on the defence — namely, those who are unable to read owing to blindness or illiteracy or some disability and who through no fault of their own are unable to have any understanding of the purport of a particular document and who must rely on others for advice as to what they are signing.¹⁰

The defendant in *Petelin* has to show that he signed the document in the belief that it was radically different from what it was in fact and that his failure to read and understand it was not due to carelessness on his part. The court pointed out that there is a heavy onus on a defendant who wishes to establish the defence of non est factum as this

⁵ *Saunders v Anglia Building Society* [1971] AC 1004, in the Court of Appeal *sub nom Gallie v Lee* [1969] 2 Ch 17; [1969] 1 All ER 1062. See also *Muskham Finance Ltd v Howard* [1963] 1 All ER 81, 83.

⁶ *Barclays Bank plc v Schwartz* (unreported, English Court of Appeal, 21 June 1995). See J O'Donovan, J Phillips, *The Modern Contract of Guarantee* (2003), 181.

⁷ *Saunders v Anglia Building Society* [1971] AC 1004, 1020, 1034. See J O'Donovan and J Phillips, *The Modern Contract of Guarantee* (2003), 181.

⁸ (1975) 132 CLR 355 ('*Petelin*').

⁹ *Ibid* 360.

¹⁰ *Ibid* 359.

plea is an exceptional defence.¹¹

It appears from the circumstances of this case that where the respondent's conduct was not innocent, the question of carelessness on the part of the appellant in terms of not taking reasonable precautions did not become a relevant issue. This being the case, the appellant's defence of non est factum was able to succeed and the respondent's suit for specific performance had to fail.

The plea will remain to be limited in its application.¹² In fact there has been an increasing tendency, particularly in Australia, to disallow the plea where the person signing had some idea about the nature of the document and what it was dealing with, even though he or she may have been unclear, or even mistaken, as to the nature of some of the obligations created by the instrument, or as to the particular class to which it belonged.¹³ It is even possible that if guarantors become mistaken about the terms of the guarantee, they may be aware of the general nature of the transaction in which case they will probably be unable to show that the document was fundamentally different from what they thought it to be. It is conceivable that many of the cases which have been previously decided on the basis of a successful plea of non est factum would now be decided according to the traditional rules of misrepresentation, mistake and unconscionability.¹⁴

III NON EST FACTUM IN THE CONTEXT OF GUARANTEES — A CRITICAL ANALYSIS

There is a heavy onus on a person seeking to rely upon the plea of non est factum due no doubt to the very strict requirements which have to be fulfilled. It is not surprising, therefore, to know that the plea failed where the defendant was not included in the limited class and had been careless in failing to read a power of attorney signed by him.¹⁵ The plea also failed where the evidence showed that a mortgagor (guarantor) was aware of the nature of the guarantee signed and that

¹¹ Ibid 359-360.

¹² *Muskham Finance Ltd v Howard* [1963] 1 QB 904, 912; *Lloyds Bank v Waterhouse* (1991) 2 Family Law 23. See also N C Seddon and M P Ellinghaus, *Cheshire & Fifoot's Law of Contract* (8th ed, 2002) 649-650.

¹³ See *Yerkey v Jones* (1939) 63 CLR 649, 689; *Australian Express Pty Ltd v Pejovic* [1963] 80 WN (NSW) 427.

¹⁴ See, eg, *Child v Commonwealth Development Bank of Australia* [2000] NSWCA 256.

¹⁵ *Turner v Jenolan Investments Pty Ltd* (1985) ATPR 40-571, 46.631.

the mortgage provided security for a loan to the mortgagor's son.¹⁶

In *Avon Finance Co Ltd v Bridger*¹⁷ the majority of the English Court of Appeal rejected the guarantors' defence of non est factum commenting that it was not possible on the facts of the case to find that the guarantors had 'exercised such reasonable care as was appropriate in the circumstances in entering into the transaction'. There, a chartered accountant in a good practice had on his coaxing made his elderly parents unwittingly execute a second mortgage over their home in order to secure his debt. When the son's payments fell into arrears, the plaintiffs sought to recover the loan by bringing an action for possession against the defendants who relied on the defence of non est factum. The Court of Appeal was not willing to enforce a transaction entered into without independent advice where the terms of such a transaction were unfair and where there had been an inequality of bargaining power together with undue pressure exerted on one party or for the benefit of the other. In the circumstances, the son had brought undue pressure to bear on the defendants by misleading them as to the nature of the documents both for his own benefit and that of the plaintiffs, and accordingly, the defendants' bargaining power was impaired by their ignorance of the true situation. For these arguments, the court would not uphold the transaction and the appeal was accordingly dismissed.¹⁸

In *PT Ltd v Maradona Pty Ltd*¹⁹ we have a case that deals with the effect of a successful defence of non est factum on a guarantee and mortgage. The decision indicates an important difference between this defence and defences based on mental incapacity. Lack of mental capacity does not itself invalidate the transaction unless the other party had actual or constructive notice of the incapacity. An important difference between that defence and non est factum is that in the latter the actual execution of the document is impugned.

In September 1985 Maradona borrowed \$500,000 from Equity Mortgage Fund, secured by various guarantees, and by a mortgage over a property and a guarantee by a Mrs Thompson. The borrower defaulted in payment and the lender sought to enforce the security and

¹⁶ *Brown v Ford Credit Australia Ltd* (unreported, Supreme Court of Tasmania, Slicer J, 30 June 1992).

¹⁷ [1985] 2 All ER 281.

¹⁸ *Ibid* 286-7 per Denning MR. The court here applied the dicta of Vaughan Williams LJ in *Chaplin & Co Ltd v Brammall* [1908] 1 KB 233, 237.

¹⁹ (1992) 127 ANZ Conv R 513.

the guarantees. The plaintiff PT Ltd was an assignee of the mortgage from the original lender.

The guarantors used several defences all of which failed except the defence of non est factum raised by Mrs Thompson which succeeded. Mrs Thompson suffered a stroke the effect of which was confusion, a speech disorder, an inability to hold a train of thought, problems with memory, and a considerable degree of intellectual impairment. This guarantor was not being in a state to understand the implications of what she was doing when she signed the guarantee and mortgage without proper discussion or explanation. The medical evidence was able to show that the effect of the stroke on the guarantor was permanent.

In *Muskham Finance Ltd v Howard and Anor*²⁰ a finance company let a car on hire-purchase to the guarantor but when he fell into arrears under the hire-purchase agreement it gave him permission to sell the car. He entrusted the sale to a dealer who arranged for the reletting of the car on hire-purchase by the same finance company to the hirer. The hirer was offered a proposal form which he signed to take the car on hire-purchase. There was attached to the bottom of the proposal form a detachable indemnity form containing, inter alia, a guarantee for the payment of all moneys payable under the hire-purchase agreement which the hirer had not paid, and an indemnity against all loss or damage arising out of or consequent on the agreement. After the hirer had signed the proposal form, the dealer told the guarantor that he had sold the car and asked the guarantor to sign the indemnity form, which he said was the release note. He then told the guarantor that, by signing the supposed release note, the guarantor would be clear with the vehicle. The bottom part of the document was visible, including a clause providing that no relaxation or indulgence granted by the company was to operate as a waiver of its rights. The guarantor signed it without looking at its contents, but thinking that it transferred his interests in the car to the dealer, who would be able to sell the car.

On receiving the proposal and indemnity forms, the finance company accepted the hirer's offer and re-let the car to the hirer under the new hire-purchase agreement. The hirer defaulted on the instalments due under the agreement. When the finance company made a claim against the hirer under the agreement and against the guarantor on the indemnity, the hirer admitted liability and submitted to judgment, but the guarantor denied liability, relying on the plea of non est factum.

²⁰ [1963] 1 QB 904.

It was held that the doctrine of non est factum applied only where there was a mistake as to the class and character of a document, but not where the mistake was simply as to its contents; that in the present case the indemnity was wholly different in its class and character from the supposed release note and, accordingly, the guarantor was not bound by his signature and not liable on the indemnity, albeit that both the actual and the supposed document related to the same car. The court made the following concluding statement on the matter in the following terms:

We think that this is a document wholly different in its class and character from that which the guarantor intended to sign, and that the case would not truly be described as a case of misrepresentation as to the contents of a document alone. It is true that the supposed and actual document referred to the same motor-car, but this by itself is not enough to defeat the plea of non est factum.²¹

In *Lloyds Bank plc v Waterhouse*²² the pivotal issue was that an important requirement in establishing the defence of non est factum is that guarantors can demonstrate that they have taken all reasonable precautions to ascertain the nature of the document. In this case, the father, who was illiterate, signed the contract of guarantee under the belief that it related only to a particular loan which the bank advanced to his son, but which, in fact, contained the usual all moneys clause (relating to all the debts accumulated by the son).

The court contended that the father as guarantor should succeed on the basis that (a) he was under a disability, in this case illiteracy. There was no challenge to this as an existing fact, and it was irrelevant that the bank was not aware of this disability; (b) that the document which the father in fact signed was 'fundamentally different' or 'radically different' from the document which he thought he was signing; and (c) that he was not careless or that he did not fail to take precautions which he ought to have taken in the circumstances to ascertain the contents or significance of the document he was signing. Before the defence could succeed, the defendant had to establish strictly each component, particularly the third one.

In the Canadian decision of *Royal Bank of Canada v Interior Sign Service Ltd and Walker*²³ the defendant Walker was sued in respect of a personal guarantee given to secure a loan of money to a company of

²¹ Ibid at 913 (Donovan LJ).

²² *Lloyds Bank PLC v Waterhouse* [1993] 2 FLR 97, 101 (Purchas LJ).

²³ [1973] 2 WWR 272 (BC).

which she was a shareholder and the secretary. She claimed that she was under the impression that she was signing the document (in the presence of the bank manager and her husband, since deceased) for the company in her capacity as its secretary, and that, if she had known that she was giving a personal guarantee, she would not have executed the document and pleaded non est factum as her defence.

Judgment was given to the plaintiffs for the reason that the plea of non est factum had been defined in the authorities which had established that when a person of ordinary understanding signed a document careless of what it contained he or she was bound by it. Reinforcing this principle, the court argued additionally that it was not necessary that the guarantor knew the contents or meaning of the document, provided that the guarantor was not misled by the profferor. There was no duty on the bank manager to explain the meaning of the document, his duty being not to misrepresent or mislead. The court said:

There is no evidence to suggest that the plaintiff bank, through its employee, in any way misrepresented the document to her, nor is there any evidence that any other person misrepresented the document to her in any way. She knew that the document had to be signed before the plaintiff bank would advance further funds to the company of which she was a shareholder and officer. She was given the opportunity of reading the document but declined to do so. She admitted being told that, in signing the document, she was guaranteeing a loan by the plaintiff to the company.²⁴

The court here is attempting to keep the plea of non est factum closely confined within its proper narrow limits and in this way put the onus on a party who is intending to disown the signature.²⁵ It, for example, disagreed with the wider duty of the bank, as explained by the trial judge, that having come to the conclusion that the defendant guarantor could not read English sufficiently to understand the guarantee (which is known by the bank manager), there was a duty cast on the bank manager to give a full and complete explanation of the guarantee to the defendant.²⁶ Thus, it pointed out that 'if she did not know what a

²⁴ Ibid 274 (McKay J). See also *Canadian Bank of Commerce v Dembeck* [1929] 24 Sask LR 186, [1929] 2 WWR 586, [1929] 4 DLR 220 (CA).

²⁵ See *Saunders v Anglia Building Society* [1971] AC 1004, 1016 (Lord Reid) where it was said that non est factum could only be pleaded by 'those who are permanently or temporarily unable through no fault of their own to have without explanation any real understanding of the purport of a particular document, whether that be from defective education, illness or innate incapacity'.

²⁶ *Royal Bank of Canada v Interior Sign Service Ltd and Walker*, [1973] 2 WWR 272, 275

guarantee was and wanted to know, she should have asked the bank officials or her husband'.²⁷

In *Bradley West Solicitors Co Ltd v Keeman*²⁸ the court stressed that the doctrine of non est factum rides between the law increasing focus on consensus and the reliability which has to be placed on signed documents. In applying the doctrine to a contract of guarantee, the court indicated that the signatory must have believed the document to have a particular character and effect which in reality the document did not have; the mistaken belief must have resulted from an erroneous explanation by someone else; the signatory must have acted with all reasonable care, and if acting in reliance on a trusted adviser must have taken all steps to read and understand the document. In this case, the defence could not be made out, as the defendants had been advised by a solicitor.

The court analysed the plea of non est factum generally, and found that it was not available to a signatory who had not taken all reasonable care in the circumstances. In the case of a person of full age and capacity that would include steps to read and understand the document. If such a person elected not to do so, and instead decided to rely upon his or her adviser, the plea of non est factum will not be available.

In the situation where a person who signs the document does so with a definite objective in mind which could be attained by signing a document of that kind, the defence of non est factum will fail.²⁹ At the same time, if the signatory would have signed the document even if he or she had been told the truth about its character and the nature of the transaction, the defence will not succeed.

It is only in rare cases that those who can read, but who fail to read a document before signing it, would be able to establish the lack of negligence necessary to make good a defence of non est factum, even if they act in reliance on persons whom they trust. In *Saunders*, it was said that a director who, for example, signs a bundle of documents handed to him with only the spaces for his signature exposed may not be negligent in the ordinary sense of the word.³⁰ However, he may be

(McKay J).

²⁷ Ibid.

²⁸ [1994] 2 NZLR 111.

²⁹ *Mercantile Credit v Hamblin* [1965] 2 QB 242; *Saunders v Anglia Building Society* [1971] AC 1004, 1031.

³⁰ *Saunders v Anglia Building Society* [1971] AC 1004, 1031.

taken to have intended to sign those documents whatever they might be, and therefore to have assumed the risk of a fraudulent substitution or insertion in the bundle.

The final point to be made here is that in *Petelin v Cullen*³¹ which was discussed earlier, the High Court had taken a new approach to the doctrine of non est factum when no innocent party's rights are at risk. Here attention should be given not only to the signer and his or her state of mind, but also to the other party to the transaction. The emphasis is on whether that other party ought to have known that the signer was, or might have been, in difficulties. If that were so, the signer's claim that no consent is given by him or her is accorded credence and the other party may not benefit from the transaction. Such a test is similar to the tests applied by the High Court in *Taylor v Johnson*³² and in cases on unconscionable transactions.³³ What the High Court did not argue in *Petelin v Cullen* was that the application of this test as between the two parties should render the contract voidable, not void. If this is the correct approach, the doctrine of non est factum could wither away or be absorbed into the rubric of unconscionability which allows a contract to be set aside. What this means in the long-run is that the principle of non est factum may no longer be available to defeat the rights of innocent third parties.

IV APPLICATION OF NON EST FACTUM IN GUARANTEE CASES: RESTRICTIONS AND LIMITATIONS

The defence of non est factum has been drastically circumscribed and is available to a signer who could prove, for example, that the guarantee was entered into as a result of misrepresentation, that it was fundamentally different from what the signer thought he or she was signing and that there was no negligence involved in making the mistake.³⁴ This increased protection accorded to third parties can be seen to have a useful social purpose, namely, that it is essential that there should be reliance on documents that are relied upon.

³¹ (1975) 132 CLR 355.

³² (1983) 151 CLR 422.

³³ For example, *Commercial Bank of Australia Ltd v Amadio* (1983) 151 CLR 447; *Blomley v Ryan* (1956) 99 CLR 362.

³⁴ See, for example, *Dorsch v Freeholders Oil Co Ltd* (1965), 52 DLR (2d) 658 where it was held that a plea of non est factum cannot be sustained where there was no misrepresentation as to the nature of the document which the challenging party was asked to sign, and it is immaterial that he did not read the document before signing it, although he was given every opportunity to do so.

Where the guarantor fails to prove an absence of negligence, it must then be shown that he or she took all reasonable precautions in the circumstances to ascertain the nature of the document. This could happen in situations where the guarantor entered into the contract of guarantee without reading it and showing no interest or indifference as to what he or she was signing.³⁵

In *Beneficial Finance Co of Canada v Telkes and Telkes*³⁶ the defendants executed a guarantee on a promissory note and a conditional sales contract for a couple Mr and Mrs Topa who wished to borrow money from the plaintiff finance company. The defendants were familiar with the necessary procedures, as they had done this on other occasions. They admitted liability on the conditional sales contract but pleaded non est factum on the promissory note guarantee, claiming that they had not intended to execute and did not know they had executed the guarantee. When the Topas became bankrupted, the plaintiff now claimed against the defendants on their guarantee of the promissory note.

The court here followed the broad arguments of *Saunders* and would not hesitate to apply the principles of the House of Lords decision in declaring 'that the document signed was 'fundamentally' or 'radically' or 'totally' different from what the defendants believed that they were signing'.³⁷ However, the court said that the issue here was the complete indifference of the defendants to what they were signing making it difficult to support a defence of non est factum.³⁸

The guarantor may have difficulty in satisfying the criterion that the mistake has to be sufficiently fundamental. Such a mistake does not have to be related to the legal character of the transaction but may also be related to its contents. *Saunders v Anglia Building Society*³⁹ endorsed this principle and disagreed with earlier decisions such as *Australian Express Pty Ltd v Pejovic*⁴⁰ which espoused the view that the plea was only successful if the mistake was one as to the legal character of the transaction.

It is not clear as yet if the guarantor is discharged where the guarantor mistakenly believes his or her liability is limited to a specific amount,

³⁵ See, for example, *Avon Finance Co Ltd v Bridger* [1985] 2 All ER 281.

³⁶ [1977] 6 WWR 22.

³⁷ *Ibid* 22 (Dewar CJ).

³⁸ *Ibid* 22-23 (Dewar CJ).

³⁹ [1971] AC 1004.

⁴⁰ [1963] 80 WN (NSW) 427.

or extends only to particular transactions, where it is in fact more extensive. One line of authority seems to be suggesting that such mistakes are not fundamental or substantial. An example is *Bank of Australia v Reynell*.⁴¹ There a solicitor arranged with the appellant bank for advances to be made to him to the extent of £5,000 on a guarantee by the respondent. He took the printed guarantee form from the bank and filled it in as a guarantee up to £5,000, but asked the guarantor to guarantee his account with the bank up to £500. The guarantor signed the guarantee but did not read the guarantee himself. The solicitor handed the document to the bank, which took it in good faith as a guarantee for £5,000, and made advances against it to the solicitor to the amount. Eventually, the guarantor discovered the fraud and repudiated the guarantee which was admitted to by the solicitor who then died insolvent. The bank sued the guarantor for the £5,000 on the guarantee and the court held that the bank was entitled to recover the amount. It appears from this case that a difference between £500 and £5,000 was considered not to be fundamental or substantial, although it must be conceded that the case was decided before it was settled that the rule that a mistake as to the contents of the document was not sufficient to a successful defence of non est factum.

Similarly, in *Canadian Imperial Bank of Commerce v Dura Wood Preservers Ltd et al*⁴² it was held that a guarantor who signs a guarantee form thinking that his liability is limited to a secured obligation of \$15,000, when in fact the form made him liable to a much larger and less secured obligation, cannot rely on a plea of non est factum. The implication here is that liability in respect of the greater obligation is not essentially different in substance or in kind from the lesser liability.⁴³

Another line of authority supports the view that mistakes as discussed are fundamental or substantial. In *Lloyd's Bank plc v Waterhouse*⁴⁴ which was cited earlier, it was noted that the liability of the guarantor in respect of an all-moneys guarantee was fundamentally different from the liability under a loan account for the purchase of a farm. This was so even though the all-moneys guarantee imposed an upper limit on the guarantor's liability to the extent of the amount of the loan. The reasoning given here was that the all-moneys guarantee had the effect

⁴¹ (1891) 10 NZLR 257.

⁴² (1979) 102 DLR (3d) 78.

⁴³ See also *Stearns v Ratel et al* (1961) 29 DLR (2d) 718; *Prudential Trust Co Ltd v Cugnet* (1956) 5 DLR (2d) 1.

⁴⁴ [1993] 2 FLR 97.

of making the guarantor liable for debts incurred in activities other than farming.⁴⁵

There are situations where an incorrect understanding that the principal transaction is secured is not fundamental. *Chiswick Investments v Pevats*⁴⁶ is a case where the mistake was as to capacity. There, Pevats, a chartered accountant and secretary of a company, was required to execute a deed of covenant, which contained provision for a personal guarantee by the 'undersigned shareholders'. Pevats became aware of the personal guarantee and said that he was not prepared to personally guarantee the loan, and signed the deed in the place reserved for attestation to the placing of the company seal, and in his capacity as company secretary, but not in the place reserved for the signatures of individual shareholders. The company defaulted on the loan and the appellant sued on the guarantee. It was contended that Pevats never intended to sign a guarantee and, in signing where he did, believed he was doing no more than attesting to the affixing of the company seal. He did not sign in that part of the document which was appropriate for a person signing as guarantor, and he could not be said to have been negligent in failing to ascertain the character of the document before signing it, and his plea of non est factum was successful.⁴⁷

Closely related to the abovementioned criterion that the mistake has to be sufficiently fundamental is the requirement that the guarantee must be 'radically different' from what the guarantor believed it to be – a difficult requirement to be satisfied. First of all, guarantors must show that they did in fact hold a mistaken belief as to the nature of the contract. Where, for example, a mother signs a guarantee without giving any thought at all to the subject matter of the document 'because she trusted her son',⁴⁸ she will not have formed any belief as

⁴⁵ A guarantor will refer to the obligations guaranteed, and an 'all moneys' guarantee will not be limited to the obligations of the debtor as borrower of money, but will also extend, for example, to the principal debtor's liability as a guarantor under a cross guarantee: *Coghlan v SH Locke (Australia) Ltd* (1987) 8 NSWLR 88. It should be noted that the conduct of the creditor may influence the court in the construction of an all moneys guarantee. This may end up in a guarantee of this kind being read down: *Bank of New Zealand v Hault* (unreported, Supreme Court of Queensland, 14 February 1991).

⁴⁶ [1990] 1 NZLR 169.

⁴⁷ See *Canadian Imperial Bank of Commerce v Dura Wood Preservers Ltd* (1979) 102 DLR (3d) 78.

⁴⁸ *Park Avenue Nominees Pty Ltd v McMullen & Anor* (unreported, NSW Supreme Court, Howie AJ, 13 March 1998): [1998] NSWSC 57.

to the nature of the document and cannot avail herself of the defence. In this way, the absolute trust which some guarantors may have in the debtor or creditor will disentitle them from relief. This greatly limits the operation of the doctrine since it is well recognised that

many people do frequently sign documents put before them for signature by ... trusted advisers without making any inquiry as to their purpose or effect.⁴⁹

Secondly, even where guarantors are able to show that they formed a mistaken belief as to the nature of the contract, they will be required to show that, on viewing the document as a whole, there was a radical or substantial difference between the document as it was and the document as the guarantors believed it to be.⁵⁰ It has been established that a radical or substantial difference will exist where, for example, the guarantors believed that they were guaranteeing a loan solely in their capacity as company secretary whereas they were actually guaranteeing the loan in a dual capacity so as to bind them both as an individual and as the company secretary.⁵¹ On the other hand the difference will not be sufficiently radical if the guarantors believed that they were merely guaranteeing a loan to a company they themselves were forming where, in fact, they were being bound as principal debtors.⁵²

From what has been said, it can be seen that to make use of the plea of non est factum, guarantors will have great difficulty in establishing that the mistake is sufficiently fundamental, and the document concerned is radically different from what they believed it to be. It should be pointed out that the disclosure requirements of the *Code of Banking Practice*⁵³ and the *Consumer Credit Code*⁵⁴ will have the potential effect of making it even more difficult for guarantors to establish the two mentioned requirements.

The Codes require creditors to provide extensive information in respect of their position as guarantors. The effect of this is to reduce the scope for guarantors to claim mistake and non est factum to negate any liability under the contract of guarantee. Guarantors who have received a warning in writing that they will be liable to pay if the

⁴⁹ *Saunders v Anglia Building Society* [1971] AC 1004, 1016 (Lord Reid).

⁵⁰ *Ibid* 1017, 1019, 1021, 1034.

⁵¹ *Chiswick Investments v Pevats* (1990) 1 NZLR 169.

⁵² *ICF Securities Ltd Sewell* (1990) 1 NZLR 17.

⁵³ See eg, Clause 24.

⁵⁴ See eg, s 51(1).

debtor defaults and a summary or copy of the obligations to be guaranteed can hardly, in the absence of a relevant disability, complain that they made a mistake. Similarly, the provision recommending the prospective guarantor to obtain independent advice would make the plea of non est factum a lot more difficult to succeed.

V THE PLEA OF NON EST FACTUM IN GUARANTEE CASES: DIMINISHED AND CIRCUMSCRIBED

Judging from the aforesaid, if there is any justification for retaining the plea of non est factum in guarantee cases where third party rights would be defeated, it must be in very unusual situations.

It is hard to envisage any circumstances in which a person of full capacity would be able to rely on the defence, because if someone has taken reasonable care to ascertain what she was signing, it would be most unusual if she does not realise what the document actually is. Nevertheless, it is possible that the defence may still succeed, although in rare cases. The kind of case in which it is most likely to succeed is one of misplaced trust, where the nature and contents of the document would not be readily apparent to the person reading it. As an illustration, if the contract of guarantee is written in a foreign language which the signatory does not understand, and the signatory requests a translation before he signs it, but someone gives him a fraudulent translation which relates to a document of a radically different nature, the defence might be available to him.⁵⁵

It is worth being reminded that the plea was originally available to people whose signatures had been forged where to assert that 'it is not my deed' was perfectly true.⁵⁶ However, it became available to illiterates and others who had to have documents explained to them before they signed.⁵⁷

The plea thus served a useful purpose at a time when there was widespread illiteracy, although with the advent of universal education and general adult literacy, the continued existence of the rule was put in doubt. So it was ironic that when the justification for the use of the plea was diminishing, it was reaffirmed and applied in *Saunders* where, as alluded to earlier, the House of Lords declined to abolish the defence, and took pains in fact to revive it and apply it to cases where

⁵⁵ *Lewis v Clay* (1897) LJ QB 224; *Lloyds Bank plc v Waterhouse* [1993] 2 FLR 97.

⁵⁶ See judgment of Salmon LJ in *Gallie v Lee* [1969] 2 Ch 17, 42.

⁵⁷ *Thoroughgood v Cole* (1584) 2 Co Rep 9a; 76 ER 408.

the defendant was not illiterate.⁵⁸ In this way the plea became fictitious because the truth of the matter was not that the person had not signed but had merely misunderstood.

Thus the plea as applied to guarantees will not be successful if a prospective guarantor understands the nature of the document, but is mistaken about its contents or legal effect, or if it is brought about by the person's carelessness or negligence as when he or she is not taking reasonable precautions to determine the nature of the document.

This is confirmed by the peremptory dismissal of the rule by the Court of Appeal in *Avon Finance Co Ltd Bridger*.⁵⁹ Yet the defence had not quite been laid to rest. It was relied upon, for example, by the English Court of Appeal in *Lloyd's Bank plc v Waterhouse*,⁶⁰ a decision which stressed the close links between non est factum, misrepresentation, undue influence and unilateral mistake.

What has been discussed in respect of the plea of non est factum has understandably wide implications for the law of guarantees where it affords a defence to a guarantor against whom action is brought in reliance upon a signed written agreement, and where that guarantor is able to show that he or she was unaware of the true meaning of the document when signing it.

In contracts of guarantee non est factum can be pleaded in innocent third party cases where the person who signed the document is to be relieved of contractual obligations. One class of case is where the defences of say fraud or unconscionability are not available as against the other party to the contract because that party was in no way responsible for or had knowledge of the circumstances which caused the mistake. In this set of circumstances, the signature has usually been procured by the fraud of an intermediary or someone who stands to benefit from the transaction such as a debtor whose overdraft at the bank is guaranteed by the person who signs.⁶¹ Another class of case is where a third party has acquired an interest in the subject matter of the alleged contract without notice of any defect in title.⁶²

⁵⁸ *Foster v MacKinnon* (1869) LR 4 CP 704; [1861-73] All ER Rep 1913. See also, *Lewis v Clay* (1897) 67 LJQB 224.

⁵⁹ [1985] 2 All ER 281.

⁶⁰ [1993] 2 FLR 97.

⁶¹ *Bank of Australasia v Reynell* (1892) 10 NZLR 257; *Newman v Ivermee* (1989) NSW Conv R 55-493.

⁶² *Carlton and United Breweries Ltd v Elliot* [1960] VR 320; *Cansdell v O'Donnell* (1924) 24 SR (NSW) 596.

VI CONCLUSION

This article has explored in some detail the grounds on which a guarantee can be set aside by the defence of non est factum. However, the nature of the guarantee is such that the plea will only void the guarantee in limited circumstances. As a result, stringent tests of various layers for the defence have been developed to ensure that such a situation is brought about. The rationale and policy considerations leading to this pattern are founded on the balancing of the rights of innocent third parties against the injustice of holding guarantors to contracts to which they did not bring a consenting mind.

The law here is being applied narrowly and thus effectively restricts the application of the defence. This is evident from the dearth of case law on the subject and the infrequency of the application of the defence to guarantees generally as the courts have proven to be unwilling to extend the doctrines so as to benefit guarantors at the expense of innocent creditors. And despite the limited duty of disclosure which the creditor owes to the guarantors, the latter are generally expected to look after themselves.

The suggestion of extensive disclosure by the creditor as required by the *Banking Code of Practice* and the *Consumer Credit Code*, as mentioned earlier, may have the indirect effect of reducing the availability of non est factum being used as a defence at law, since sureties will now have less opportunity of claiming that they were under a misapprehension as to the terms of the guarantee. In the case of the *Consumer Credit Code*, this may have limited the impact on the common law as it only applies to certain types of guarantees. The fact that guarantees must be clearly expressed in 'plain English'⁶³ suggests that the *Consumer Credit Code* essentially requires very short documents in the language that an average person would understand.⁶⁴ Presumably, documents expressed in such language would make it harder to prove that guarantors fall within the class of persons who are mistaken about a contract of guarantee or who are unable to understand the document, believing it to be radically different from the one they have in mind, and thus making it difficult to raise the plea of non est factum.

The *Consumer Credit Code* and the *Banking Code of Practice* do not allow for unlimited guarantees, but in fact limit the guarantor's liability to

⁶³ J Pascoe, 'Guarantees and Law Reform - New Directions for Consumers?' (1996) 4(1) *Current Commercial Law* 33, 36.

⁶⁴ D Turner, 'New Consumer Credit Code: A Banking Lawyer's Perspective' (1996) 12(6) *Australian Banking Law Bulletin* 89, 95.

that of the debtor under the credit contract.⁶⁵ The guarantor's liability cannot be increased without consent.⁶⁶ In this way, if the debtor's credit is increased, the guarantor's liability is not automatically increased.⁶⁷ A large number of cases where non est factum would have been pleaded may be rendered unnecessary in cases where the guarantor is mistaken about the liability under the guarantee. However, the Codes are not that helpful to people who are most likely to fall into the class of persons (eg, migrants) who may be mistaken as a result of language deficiencies. This is because they do not require that the transactions be provided in any language other than English.⁶⁸

In some cases, a mistaken party who is unable to obtain relief on the grounds of non est factum may be able to set aside the guarantee on other grounds such as a breach of the creditor's duty of disclosure, misrepresentation, or unconscionable conduct (which are wider and more likely to give relief) under the principles as espoused in *Commercial Bank of Australia v Amadio*⁶⁹ or *Garcia v National Australia Bank*.⁷⁰ In this sense, the assertion that it is rare in practice to find cases of non est factum 'which are not obviously and easily disposed of on some other ground is of some significance in the case of contracts of guarantee'.⁷¹ In the case of unconscionable conduct, for example, its rise as a predominant force, together with the recourse to a range of appropriate legislative provisions have reduced the need for the doctrine of non est factum further, especially in an era where there is a decline in the supremacy of the signed document.⁷²

⁶⁵ *Consumer Credit Code* s 5 (1); *Code of Banking Practice* (2004), Clause 28.2 (a) (b).

⁶⁶ *Consumer Credit Code* ss 54, 56.

⁶⁷ See A Smith, 'The New Consumer Credit Code' (1996) 6(3) *Australian Corporate Lawyer* 20, 21.

⁶⁸ See Pascoe, above n 63, 36.

⁶⁹ (1983) 151 CLR 447.

⁷⁰ (1998) 155 ALR 614.

⁷¹ P S Atiyah, *An Introduction to the Law of Contract* (4th ed, 1984) 94.

⁷² This is evident in the importance of 'ticket' cases in contractual dealings and the erosion of the parol evidence rule as shown by *Codelfa Construction Pty Ltd v State Real Authority of NSW* (1982) 149 CLR 337, 352; *Air Great Lakes Pty Ltd v KS Easter (Holdings) Pty Ltd* [1985] 2 NSWLR 309.