



Equity and its Operation

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Abstract

In terms of the world's legal systems, common law was originated in England and permeated into nations colonised by Britain, in contrast to its counterpart – civil law which was well developed in the Western European continent. One of the distinctive features of common law that differs from civil law is '*equity*' or the '*equitable principles*'. Often, quite a few lawyers from civil law jurisdictions misunderstand that *equity* means justice, fairness, or impartiality. In fact, *equity* is another branch of common law, providing equitable remedies when the application of common law rules would result in unfairness.

In order to comprehend how *equity* functions, this paper needs to call the readers' attention to the history of *equity*, starting from being a supplement of common law rules until becoming a rival before it eventually bequeathed its spirits (equitable principles) towards common law jurisdictions. It will end with a classic case of Australia, namely *Garcia v National Australia Bank (1998) 194 CLR 395*, where the equity played more significant role in giving justice to an inferior party (Mrs. Garcia) than that the common law rules did. This case will explain why the equity has been a vitally important element of the common law system so far.

Keywords: Collateral, Common Law, Equitable Principle(s), Equity, Guarantee(s), Mortgage, Loan, Technicality, the Chancellor, the Court of Chancery, Undue Influence, Unconscionable, Vulnerable, and Writ.

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I. Introduction

What is the equity? It is commonly referred either to fairness and impartiality or law. But in the legal terms, it goes beyond that meaning. However, it is still a debatable opinion amongst the scholars that what the accurate definition of equity is, or should be. One of the practical solutions is to master the English legal history relating to the equity because it was substantially developed from Britain where common law and its system were also originated. At least we are supposed to know how and why the equity is opposed to common law as this is the significantly rudimentary perception of legal systems of common law. In addition, we should perceive the application of equity to a common law case, resulting that we will not only know of what the equity is, but also comprehend how it operates in particular.

II. Development of Equity

By the early of twelfth centuries, when litigation process under the Crown was primarily originated by a writ, through which to arise controversies before the courts, the writ was issued by the Chancellor. Due to a sharp increase in the number of claims by the end of this period, the Chancellor was required to formalize specific formats of writs² so as to systemize the writ filing.

Moreover, over the time the increasing figures of various types of writs were represented not only formality but also technicality³ in the legal proceedings. However, the Chancellor's sole authority regarding issuance of new forms of writs had been constrained by the Provision of Oxford in 1258, requiring the creation of new writs with both the approval of the king and the council. Rather, in 1285, the Statue of

Westminster II authorised the Chancellor to issue the new writs only if they were 'in like' to the forms of action already existing.⁴ That word, in this term, had precluded the judges from simply extending or developing equitable remedies. Meanwhile, the

² Zweigert, K. and Kötz, H., (1998), **Introduction to comparative law**, 3rd ed., (Oxford: Clarendon Press), 184.

³ Parkinson, P., (2013), **Tradition and change in Australian law**, 5th ed., (Australia: Robert Wilson), 78-79.

⁴ Ibid.



medieval legal systems were initially seen as injustice because of its rigorousness and inflexibility. In short, the Chancellor's jurisdiction was mainly involved in the areas of administrative affairs rather than judicial ones.

Between the 1400s and 1600s, it might be regarded as the age of enlightenment of the Chancellor because there was an establishment of the Court of Chancery independently separate from the three common law courts, and the emergence of equity distinct from common law. By the early of 1400s, frustrated petitioners had given up to the legal proceedings of common law courts due to unfairness resulting from 'technicality', 'extremity', and 'regardless of merits'.⁵ Subsequently, they began to lodge the petitions directly to the king for equitable relieves. The Chancellor thus was authorized to hear lawsuits on the king's behalf. Given the significantly increasing demands for justice and the complication of cases, the Chancellor, who was accustomed to ecclesiastical laws but lack of legal apprehension⁶, therefore inevitably made its decision based on merits rather than the substantive laws. Later, while the courts of common law were gradually devalued, the court of conscience became more outstanding thanks to its simplicity, flexibility, and informality⁷.

Until the end of 1400s, the Chancellor did develop its practice associated with the deciding the cases and eventually established its own court known as the Court of Chancery.⁸ Consequently, the Chancery's jurisdiction would be able to extend to any cases where a litigant, a victim of the unfair or unjust lawsuits (either pending or already made), could resummon a new claim against the Chancery for equitable remedies. Note that there were also by-products of the Chancery's jurisdiction, that is, 'an injunction' protecting or preventing the party's right according to common law⁹, the 'trust'¹⁰ and the doctrine of *proprietary estoppel*¹¹.

⁵ Baker, J.H., (2002), **An introduction to English legal history**, 4th ed. (London: Butterworths), 106 -107.

⁶ Parkinson, P., **Tradition and change in Australian law**, 82-83.

⁷ Zweigert, K. and Kötz, H., **Introduction to comparative law**, 187.

⁸ Parkinson, P., **Tradition and change in Australian law**, 83.

⁹ Huges, R.A., Leane, G.W.G. and Clarke, A., (2003), **Australian legal Institutions: Principles, structure and organisation**, 2nd ed., (Sydney: Lawbook Co.), 51.

¹⁰ Parkinson, P., **Tradition and change in Australian law**, 84.

¹¹ Zweigert, K. and Kötz, H., **Introduction to comparative law**, 190.



Over two hundred years (1400-1600) even though the Britain had two different court systems, the equity, as the cohesive rule of common law, played its key role to maintain the relationship between the Chancery and the common law courts¹². As Maitland's statement below:¹³

"We ought to think of the relation between common law and equity not as that between two conflicting system, but as that between code and supplement, that between text and gloss."

After 1600s, the relationship of both legal systems, however, went to break up mainly because of the controversy, between the Lord Ellesmere (the Chancellor) and Sir Edward Coke (the Chief Justice), about the supremacy of equity over the common law. Subsequently, this controversial issue was resolved by James I. But the decision later had justified Ellesmere's argument. According to the decision in this case, 'where there is a conflict between common law and equity, the latter should prevail' becomes one of equitable maxim.¹⁴ Thereafter, the Chancery had engineered the equitable principles properly and systematically until the middle of 1900s. At that time, the Chancery nonetheless was facing the disruption from its own mechanism – discontinuance of trial¹⁵ and costly fees¹⁶. Finally, the Judicature Act 1875 was introduced so as to handle those shortcomings. The separate jurisdiction of England had been later merged into a single one; yet equity was not combined with common law but has been flourished by the judges until now.¹⁷

III. Equity Applicable to a Case

Even though the Court of Chancery had no longer functioned since the nineteenth centuries, the equity still has been playing its significant roles in softening the extreme application of common law rules which would result in injustice. However,

¹² Baker, J.H., **An introduction to English legal history**, 108.

¹³ Ibid.

¹⁴ Cook, C. et al., (2012), **Laying down the law**, 8th ed., (Australia: LexisNexis Butterworths, NSW), 21-22.

¹⁵ Baker, J.H., **An Introduction to English legal history**, 112.

¹⁶ Ibid.

¹⁷ Parkinson, P., **Tradition and change in Australian law**, 87-88.



either party who is relying on the equity is required to have acted in good faith or good conscience.¹⁸ An Australia case to which the equity applied is *Garcia v National Australia Bank* (1998) 194 CLR 395.

Facts:

Mr. Garcia took out a mortgage loan in favor of a bank for purposes of securing guarantees under his gold trading business, using the family house as a collateral, and had his wife countersign the mortgage with the bank. Her decision was made by her husband's assurance that there was no 'danger' in the mortgage transaction, while the bank did not provide her the explanation of purport and effect of such transaction. Once the business collapsed, the loan repayments were not in turn made. Accordingly, the bank sought to seize the house to pay off the loan.¹⁹ After that, Mr. Garcia and Mrs. Garcia separated, and she therefore requested the Trial Court to declare the transaction void on the ground of 'undue influence'.

Following J Dixon's principle²⁰ in *Yerkey v Jones*²¹, the Trial Judge granted the declaration that none of the guarantees which Mrs. Garcia had given bound her. Even though she was a director and a shareholder of the gold trading company, the judge believed that her husband (Mr. Garcia) had a complete control over the company, and also found that she decided to undertake the mortgage by what her husband repeatedly told her that 'if the money isn't there [the company] the gold is there'. In other words, her decision was made by the unconscionable behavior of her husband. The Trial Judge therefore granted her relief on the basis of 'undue influence'.

On the contrary, the Court of Appeal following *Commercial Bank of Australia v Amadio*²² overturned the decision of the Trial Judge. This court contended that Mrs. Garcia should not have been assumed that she was ipso facto weaker than her husband

¹⁸ Sanson, M. and Anthony, T., (2015), **Connecting with law**, 3rd ed., (Melbourne: Oxford University Press), 156.

¹⁹ Ibid.

²⁰ "... 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 creditor accepts without dealing directly with her personally, she has a prima-facie right to have it set aside."

²¹ *Yerkey v Jones* [1939] HCA 3; (1939) 63 CLR 649 (6 March 1939)

²² *Commercial Bank of Australia Ltd v Amadio* (1983) 151 CLR 447



whenever she was engaged in any transaction of her husband because she knew that she was countersigning the mortgage loan and also worked as a ‘capable and presentable professional.’²³ The above assumption which was of great importance to the principle in *Yerkey v Jones* would no longer be applied in this case. The Court of Appeal held that she was neither an unfair guarantor nor granted from any relief.

Mrs. Garcia in turn appealed to the High Court of Australia (HCA).²⁴

HCA’s judgment:

A majority of five (out of six) members of HCA reaffirmed J Dixon’s principle in this case; a majority of four of judges reinterpreted the rudimentary of such principle by way of extending the protective measure for married women as guarantors or mortgagors of their husband’s debt, notwithstanding that the women are willing to undertake the debt being incurred down the road.

(a) The Majority of Joint Judgement: Gaudron, McHugh, Gummow and Hayne JJ

Their Honors reversed the decision of the Court of Appeal. While the Court of Appeal was of the view that the J Dixon’s principle in *Yerkey v Jones* could no longer be the precedent because of being just a sole opinion, their Honors argued that the reasons Dixon J gave in his judgement were not ‘not significantly different’ from other members of the court.²⁵ In addition, the majority considered J Dixon’s principle as a special relief for two circumstances: 1) ‘actual undue influence by a husband over a wife’ and 2) there is no actual undue influence but there is ‘a failure to explain adequately and accurately the suretyship transaction in which her liability may arise’²⁶

The former is noted by their Honors that:

[para 21] So far as Yerkey v Jones proceeded ..., 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

²³ Yerkey v Jones at 10.

²⁴ Sean Bogan, ‘Case Note’ (1998) UNSW Law Journal 849.

²⁵ Yerkey v Jones at § 14 – 18.

²⁶ Yerkey v Jones at § 23.



relationship, business decisions may be made with little consultation between the parties and with only the most abbreviated explanation of their purport or effect. Sometimes, with not the slightest hint of bad faith, the explanation of a particular transaction given by one to the other will be imperfect and incomplete, if not simply wrong. ...

The latter is also noted below:

[Relief where there is no actual undue influence] depends upon the surety being a volunteer and mistaken about the purport and effect of the transaction, and the creditor being taken to have appreciated that because of the trust and confidence between surety and debtor the surety may well receive from the debtor no sufficient explanation of the transaction's purport and effect. To enforce the transaction against a mistaken volunteer when the creditor, the party that seeks to take the benefit of the transaction, has not itself explained the transaction, and does not know that a third party has done so, would be unconscionable. ... [para 23]

Their Honors were of the opinion that this case was not concerned with the former (the actual undue influence) because Mrs. Garcia brought a free mind and will to execute the mortgage loan. Yet she made the decision with lack of proper information about the purport and effect of the transaction. In other words, the bank took no steps itself to explain its purport and effect to her or gave her no independent advisor before entering into the mortgage loan. To enforce the loan against Mrs. Garcia, who was a mistaken volunteer, would be unconscionable.²⁷ Therefore, she was granted a relief from the asset reprocess by the bank.

(b) Callinan J

His Honor considered J Dixon's principle in Yerkey as the law of long standing in Australia, resulting that the present case should be decided in light of Yerkey as his Honor stated that:

²⁷ Yerkey v Jones at § 31 - 33.



[para 113] I do not doubt however that there are likely today to be many married women still in need of the special protection that Yerkey offers. Furthermore, I do not think that there is any injustice to a lender in requiring it to be diligent in the way in which Yerkey prescribes in the case of married women who enter into transaction advantageous to husbands or legal personalities controlled by them, but which are disadvantageous or potentially so to the wife. No occasion arises in this case to express any different principles from those stated in Yerkey. ...

(c) Kirby J

His Honor also conceded that the appeal ought to be allowed, notwithstanding that nothing concerns about whether equity should be given to Mrs. Garcia in this case in particular:

[para 53] The wife was not deluded nor coerced by the husband into signing the guarantee. Nor was her will overborne in a technical sense. ... If the financial transactions [involving the business] had proved profitable, and if the personal relationships of the husband and wife had improved, it scarcely seems likely that the wife would have disclaimed the economic benefits as vigorously as she has now sought to escape the economic burdens.

[In addition it was] specifically found that she would have appeared to the Bank as ‘an intelligent articulate lady with a professional position calling at the bank, appear[ing] to be voluntarily signing a guarantee in respect of an account of which she was a director of the company concerned, and there was nothing to give the bank even suspicion’. The wife knew what a guarantee was. She knew that the document she was executing was a guarantee. If the transaction at the Bank took only a minute, this was, at least in part, because the wife asked no questions. She sought no information or advice. She gave the appearance of knowing what she was doing. She had previously set up her own professional business as a physiotherapist. ...

Whilst Kirby J considered the equitable presumption [of undue influence] applied in this case, he was of the view that such presumption should not be confined to a ‘married woman’ in need of special protection, but instead broaden the equitable



protection by, for example, giving full information regarding the adverse effect of the mortgage transaction against Mrs. Garcia who is more vulnerable party than her husband. As he concluded that:

[para 81] ‘The Bank knew, or could readily have discovered, that Mrs Garcia reposed trust and confidence in her husband in relation to her financial affairs. Mrs Garcia was thus in a position of potential vulnerability to demands that she should act as a surety, even if the Bank had no reasonable means of knowing the details of the particular stresses of her personal relationship. Breakdown of personal relationships is sufficiently common in Australia to have alerted a credit provider, such as the Bank, to the potentiality of this surety’s vulnerability. This is particularly so where (as here) a domestic home in which the borrower lived was put at risk by the surety arrangements. The Bank could readily, without unduly intrusive questions, have discovered the nature of the parties’ relationship. It was already aware that they were cohabitees. ... Sufficient that basic questioning disclosed a transaction on its face of little or no specific advantage to the proposed surety and that such party stood at high risk in relation to the roof over her head.

[para 82] Misrepresentation by Mr Garcia to his wife being established, together with constructive notice of the potential vulnerability of the wife, the Bank is unable to enforce the surety obligation against her because it is fixed with constructive notice of her right to set aside the transaction having regard to its failure to take reasonable steps to satisfy itself that she entered the obligation freely and with knowledge of the relevant facts. It is here that the principal weakness in the Bank’s case is obvious. As the primary judge found, in this case the Bank’s ordinary procedures were not followed. Mrs Garcia was given no advice or explanation of the documents which she was signing. Still less was she told to seek independent advice or that such evidence would be a pre-condition to the Bank’s acceptance of her guarantee. The fact that she was a director of the company and that she presented as an “intelligent articulate lady” in a professional position is certainly relevant. But it is not ultimately determinative. To the knowledge of the Bank, the home in which she lived was being placed in jeopardy. The Bank failed to insist that she was



made fully aware of that risk. In such circumstances, there being no exceptional reasons to hold otherwise, the Bank was unable to enforce the surety obligation. Although the case is not clear cut and some of the evidence supported the Bank's arguments, I have concluded that the primary judge was right to hold as he did. Banks and other credit providers can protect themselves from this result. Most already do so.

[para 83] The result to which I have come flows not from the fact that Mrs Garcia was a married woman in need of special protection, as such, from the law of equity. It flows from a broader doctrine by which equity protects the vulnerable parties in a relationship and ensures that in proper cases they have full information and, where necessary, independent advice before they volunteer to put at risk the major asset of their relationship for the primary advantage of those to whose pressure they may be specially vulnerable.

Eventually, Kirby J flavored a re-formation of the principle expressed by Lord Browne-Wilkinson in *Barclays Bank Plc v O'Brien*. His Honors stated that the principle should be expressed as follows:²⁸

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 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;

²⁸ *Yerkey v Jones* at § 73.



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 legal advice. Out of the respect for economic freedom the duty of the credit provider will be limited to taking reasonable steps only.²⁹

In short, only if applying the common law rules, the bank would have exercised its right to seize the collateral (home) to pay off the loan. However, employing the law of equity, the bank that had failed to ensure that Mrs. Garcia would grasp the legal effect after signing the mortgage loan could not reprocess the house accordingly.³⁰

IV. Conclusion

In summary, equity was not created by the Chancellor in the medieval time, but in fact it had existed before that period. Yet during 1200s the equity was initially frozen by a couple of legislations in order to prevent the Chancellor from issuing a new writ and decrease the volume of claims. Litigants could no longer seek for equitable reliefs. Since then common law, through which the judges had made their decisions irrespective of merits, became more rigorous, technical, and expensive. Inevitably the Chancellor was asked for mitigating the extremity of common law by expanding its jurisdiction over unjust and unfair cases. As seen in the *Earl of Oxford's Case* (1615) 21 ER 485, 486-7, it stated that:³¹

"The Office of the Chancellor is to correct Men's consciences for Frauds, Breach of Trusts, Wrongs, and oppressions, of what Nature soever they be, and to soften and mollify the Extremity of the Law ... [W]hen a Judgment is obtained by Oppression, Wrong and a hard Conscience, the Chancellor will

²⁹ Ibid

³⁰ Sanson, M. and Anthony, T., **Connecting with law**, 156.

³¹ Ibid, 156-157.



frustrate and set aside, not for any error or Defect in the Judgment, but for the hard Conscience of the Party”

This looked as if the Court of Chancery attempted to interfere the common law courts' jurisdiction. Indeed, the Chancery was striving to supplement or complement the common law. By the mid-1900s, even though the Judicature Act 1875 had ceased the wider jurisdiction of the Chancery, equity has never stopped its function and is still influential over all British legal systems and common law countries across the world. As obviously seen in an Australian case, the bank could have taken Mrs. Garcia's home to pay off the loan if the HCA had relied only on the common law rules. By virtue of the law of equity she should have been provided more comprehensive information of purport and effect of such mortgage loan by the bank, yet the bank failed to do so. The HCA therefore held in favor of Mrs. Garcia, ruling that the guarantee was set aside and she was thus given the relief from the repossession by the bank.



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