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When does the pressure become too much?

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Written by JHK Legal, Lawyer Daniel Paratore

In the ordinary course of business, there will be times when a debtor simply cannot pay your invoice on time but still requests goods or services from you; alternatively, you may be a debtor asking for a little extra credit to help you get through a rough patch. In both circumstances, how much pressure, and what kind of pressure, can the creditor put on the debtor? Put another way, when will the pressure become illegitimate and entitle the “victim” to rescind the contract?



Duress

Duress operates in contract where a party has threatened, or exerted unlawful pressure on, another party to enter into the contract or perform certain acts. Previously, the focus of duress was whether the victim’s will was overborne by the threat or pressure and the victim had no other option but to accede. The modern approach is not as much focused on the victim’s will and options but the nature of the threat. This is a two-step process: has a party applied pressure to another in order to induce entry into a contract or perform a certain act? If so, was the pressure legitimate?

The answer to the first question will ordinarily be obvious but the second question allows a significant amount of latitude and will generally be the crux of the dispute. Putting aside the clear case involving threats of violence, the question of legitimacy can become complex in commercial disputes.

In the example above, the creditor wants to be paid but may wonder how they can lawfully pressure the debtor to pay or perhaps secure the creditor’s position further. For example, the creditor may say to the debtor: “pay the debt or I will sue you” or “here’s more credit but sign this deed of guarantee.” The creditor may even go one step further and say “pay the debt and sign the deed of guarantee or I will sue you.”

The question in these situations is – are the “threats” legitimate?

Legitimacy of the threat

Whether a threat is legitimate or illegitimate will ultimately turn on the facts of each dispute but the Courts have provided some guidance on the question. Generally speaking, ordinary commercial pressure will not be considered illegitimate unless it involves unconscionable conduct or unlawful threats. Further, a threat

If, however, the creditor demands payment before the due date and threatens to sue unless payment is received, the creditor may have applied illegitimate pressure – the creditor does not have a right to payment until the due date and therefore a right to sue has not arisen, making any threat to sue for non-payment unlawful and illegitimate.

Reading between the lines, it pays to know your position. Consider the following situation: a consumer enters into a credit agreement with a supplier and a credit limit of \$100,000 is approved. The consumer orders \$100,000 worth of goods on credit and the goods are subsequently delivered. The consumer is required by the agreement to pay the debt within 30 days. On the 25th day, the supplier extends the credit limit and the consumer orders another \$20,000 worth of goods. On the 31st day, the consumer has failed to pay the \$100,000 due and owing and the second lot of goods is now available for delivery. Can the supplier withhold delivery until payment is made? Can the supplier make other demands prior to delivery of the second lot of goods?

When determining whether the threat is legitimate, it is critical to keep in mind the legitimate business interests of the supplier. The creditor is now exposed to considerable risk if the consumer refuses to pay but the goods are supplied. It is arguably legitimate for the supplier to refuse delivery of the second lot of goods until the first payment has been made because the consumer is in breach of the credit agreement. It is also legitimate for the supplier to demand that the consumer (or its directors) sign a deed of guarantee before delivery of the second lot of goods. These actions protect the commercial interests of the supplier while the consumer is in breach of the agreement and would amount to mere commercial pressure.

However, if the second lot of goods is available for delivery on the 26th day but the supplier refuses to deliver unless a deed of guarantee is signed by the consumer, the supplier may be exerting more than mere commercial pressure and the consumer may have a claim for duress. This is primarily because the debt is not due and owing and there has not been a breach of contract. In these circumstances, any deed of guarantee signed by the consumer may be rescinded within a reasonable time.

Australian Consumer Law (ACL)

It is important to note that the ACL has made provision for duress in section 50. Rather than use the term duress, the ACL states that a person must not use “physical force, or undue harassment or coercion”. Despite the different terminology, the existing legal principles would generally apply under section 50 and mere commercial pressure will not be enough.

Overlap with unconscionable conduct

In relation to duress, there is a degree of overlap with unconscionable conduct – a threat may be considered illegitimate if it involves unconscionable conduct. Frequently, where there is a claim for duress, there is likely to be a claim for unconscionable conduct. Like duress, unconscionable conduct is primarily focused on the actions of the person who carried out the unconscionable conduct. Where a person is under a special disadvantage and the stronger party exploits that disadvantage, a Court may intervene.

For the purpose of unconscionable conduct, it is important to bear in mind that a debtor’s financial hardship on its own is not enough to demonstrate unconscionable conduct. It requires that the stronger party exploited the debtor’s financial hardship as opposed to the stronger party protecting its legitimate business interests.

Under section 21 of the ACL, there is a non-exhaustive list of factors which a Court may consider when determining whether a party has engaged in unconscionable conduct. Some of these include:

1. the relative strengths of the parties' bargaining positions;
2. whether a consumer was required to comply with conditions which were not reasonably necessary to protect the legitimate business interests of the supplier;
3. whether the supplier has consistently engaged in the same conduct in similar transactions with other customers;
4. the conduct of both parties in complying with the terms and conditions of a contract; and
5. the extent to which the parties have acted in good faith.

Although there is no statutory basis for applying these factors to a situation in which duress has been alleged, the factors provide useful and practical guidance. For example, where a debtor fails to pay a debt once it becomes due and owing and the creditor's policy (which is consistently applied) is to refuse further credit unless a deed of guarantee is signed by the debtor, a creditor's demand for the debtor to sign a deed of guarantee is likely to be considered prudent business practice and mere commercial pressure as opposed to duress.