BANKING LAW ASSOCIATION CONFERENCE

"RECENT DEVELOPMENTS: CASE LAW AND LEGISLATION REVIEW"

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1. Introduction: Recent Developments - Today and Tomorrow

It is certainly an honour to follow a paper presented by a person as well versed in recent developments as the Chief Justice. In fact, it is difficult to think of ways in which an academic might add to the observations of one who sits on the bench and hears cases first hand. The Chief Justice is obviously better placed than I to observe the effects of the laws, and legal developments, on the parties to the cases. We academics can read the cases and form impressions of the law, but rarely do we have a chance to form impressions about the actual litigants.

What I thought I might add to the Chief Justice's reflections are some of my own observations about where perhaps the law is heading, and the issues that Australian courts (or parliaments) will need to resolve in coming years. Some of the cases referred to by the Chief Justice leave open obvious areas of doubt which will surely arise for future consideration in one or more Australian jurisdictions. Additionally, there are a few other pressing issues "waiting in the wings" for the right case to come before the courts.

In the interests of time I will confine my remarks to the following issues, rather than attempt to cover every area canvassed in the previous paper. Not all of these issues are raised by the Chief Justice's comments today. However, he has touched on most of them in previous papers.

The following represents my views on some of the more salient issues likely to come before Australian courts in coming years:

1. issues relating to obtaining electronic funds transfers by deception:
2. judicial responses to *Garcia*-type fact situations where the disadvantaged party is not a *de jure* female spouse;
3. clarification of the Australian position on creation and registration of securities over a bank deposit held with the financier; and,
4. judicial responses to some of the ways financiers have tried to take security over shares registered under the CHESS system.

First, an apology: I do not intend to analyse these issues in lengthy and vivid "academic" detail. If I did so, we should be here all day as all of them are worthy of at least a Masters, if not a doctoral, thesis. Following the tone of this session, my intention is merely to identify some of the salient points inherent in these issues for future legal development and practice. I leave it open to the audience, the courts and the legislators to develop the law so that I have something to say at the next conference.

2. Misappropriation of Electronic Funds

As noted by the Chief Justice, one of the more recent Australian High Court decisions involving banking law and practice, in this case somewhat indirectly, was the recent appeal in *Parsons v R*.[1] The facts of this case were covered by the Chief Justice in his paper. The case dealt with whether the obtaining of a cheque from a victim under false pretences could support a conviction under section 81 of the Crimes Act 1958 (Vic). This section provides that "a person who by any deception dishonestly obtains property belonging to another, with the intention of permanently depriving the other of it, is guilty of an indictable offence". Both the Court of Appeal in Victoria and the High Court held that such conduct would be in breach of the section.

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[1] [1999] HCA 1.

The appeals were mounted largely on the basis of arguments raised before the House of Lords in *R v Preddy*.[2] Basically, these arguments revolved around whether: (a) a cheque is really "property belonging to another" for the purposes of a similar offence in the United Kingdom; and, (b) there is "an intention permanently to deprive" the victim of the cheque. Neither the Court of Appeal in Victoria nor the High Court had any difficulty in answering each of these questions in the affirmative.

However, in modern banking practice, there may be some question as to whether the first of these views is correct. In relation to the second point, as the Chief Justice has indicated, there is apparently an intention permanently to deprive the victim of the cheque because standard practice in Australia is not to return cheques to drawers after presentation.

With respect to the first point, the description of a cheque as "property belonging to another", various courts have grappled with the basis on which a cheque meets this definition. The argument runs that as the cheque is always made out to the wrongdoer, it is never a chose in action belonging to the victim so that the wrongdoer has never actually taken property (that is, the chose) *belonging to* the victim. What the wrongdoer has done is either:

(a) gained a financial advantage by deception; or,
(b) appropriated rights in the original chose of the victim (that is, money owed by his / her bank to him / her) and caused the extinguishment of those rights in favour of new rights in the wrongdoer.

Each of these is arguably covered by other sections of the Crimes Act in Victoria.[3]

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2 [1996] AC 815.

3 Section 82(1) creates an offence of "obtaining financial advantage by deception". The interaction between section 72(1) and 73(4) effectively provides that a person is guilty of theft if that person "appropriates" as distinct from "obtains" property of another. "Appropriation" is defined in the statute as including "an assumption of the rights of the original owner". Arguably, this includes the taking of an interest in a fund of money where the original owner's rights to an equivalent chose are extinguished.

Whether or not the decision in *Parsons* ultimately remains authoritative in Australia in relation to cheques, it does raise a question mark over the issue of obtaining an electronic funds transfer ("EFT") by deception. The High Court decision in *Parsons* appropriately focused on Australian cheque law and practice. Having done so, it gives little to no guidance on situations likely to arise in the future in Australia involving the fraudulent obtaining of an EFT.

When this issue arose in the United Kingdom in *Preddy's* case, the law was so ill equipped to deal with the situation that new legislation was promptly enacted.[4] The question remains as to how Australian courts will deal with the issue.

It is unlikely that current Australian authority on cheques will assist in EFT cases because of the differing nature of the two payment mechanisms. Even if a cheque can be effectively regarded as a form of property belonging to another, there is a clear argument that: "an EFT is not a form of property. We cannot rectify, and regard as property, a mere process by which instructions are communicated and debts settled between banks."[5] It has been suggested that an EFT: "has consequences for the parties' property, without being property itself."[6]

At least cheque payments involve a tangible piece of paper which can be appropriated or obtained by a wrongdoer. EFTs do not operate in this way so there is nothing "physical" that can be appropriated by a wrongdoer for the purposes of the "obtaining by deception" offences. Additionally, the choses involved in an EFT transaction are clearly not the same property; that is to say, the chose ultimately obtained by the

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4 See section 15A of the Theft Act 1968 (UK) which creates offences relating to the obtaining of a "money transfer" by deception, and the 1996 amendments to section 1 of the Theft Act 1978 (UK) in relation to the obtaining of loan services by deception.

5 Fox, D. "Property Rights and Electronic Funds Transfers" [1996] *Lloyd's Maritime and Commercial Law Quarterly* 456, p 457.

6 *ibid.*

wrongdoer in his / her bank account is a different chose to that originally in the victim's bank account.

Perhaps for the purposes of "theft", as opposed to "obtaining by deception", one could argue an "appropriation of the victim's ownership rights" by extinguishment of the victim's original chose (see above). However, this proposition is open to question and does not resolve the "obtaining by deception" issue raised in *Parsons* and *Preddy*.

The matter is perhaps ultimately going to prove more complicated in the Australian context than in the United Kingdom. In Australia, these offences are a matter of state law and cannot be resolved with one stroke of a drafter's pen as in the United Kingdom. In Victoria, for example, the simple use of prosecutorial discretion to bring charges under an existing offence such as that in section 82 of the Crimes Act might solve matters. As noted above, this section relates to obtaining financial advantage by deception. However, the applicability of this section to conduct involving EFTs will depend on how the section is interpreted by Victorian magistrates and judges in the future. The position in other jurisdictions may require different approaches depending on the wording and judicial interpretation of relevant legislative provisions.

Ultimately, it must be recognised by courts, prosecutors and legislators that the fraudulent obtaining of EFTs will not necessarily fall under the same heads of criminal liability as transactions involving fraudulent obtaining of cheques and other negotiable instruments. It remains to be seen how Australian courts and prosecutors will handle these issues in the future. However, if I may be so bold, one might hope that Australia does not go down the United Kingdom path of enacting piecemeal offences for different types of electronically-generated conduct as they evolve. It would be much better to take a broad and uniform approach to matters of criminal fraud and leave it to prosecutorial and judicial discretion to determine where lines should be drawn in practice.

3. *Garcia* and Friends...

I will not refer to *Garcia* in detail as the legal and practical issues raised by the case have been thoroughly debated, as indicated by the Chief Justice. However, I must myself lend some support to the views of Kirby J as to the limitations of maintaining a "special wives' equity" without considering the broader implications. There are obvious relationships where unconscionability is equally likely to thrive as that of a de jure marriage between a man and a woman. Relationships between consenting adults of the same sex, familial relationships such as brother and sister or parent and child are obvious examples. It makes little sense to have a special rule for wives and leave the other situations to general principles of unconscionability or undue influence. In my view, it makes little sense to make legally married women a "special case".

Additionally, the focus on the disadvantage of the wife and the suggestion that the bank do all it can to ensure that she is independently advised and aware of the ramifications of proposed transactions will not necessarily solve the practical problem. If it gets the banks "off the hook", then maybe this is all that risk management departments need to consider.

However, if banks and other financial institutions are truly concerned about the position of parties who may be disadvantaged by being asked to provide security, they should be aware that those at a relational disadvantage may well sign documents with or without independent advice. Ultimately, there may be little that a bank can do to prevent such situations short of relying on alternate forms of security. In the "family company" context, there may be few other options in practice.

Suffice it to say that Australian courts in the future will be hard pressed to answer questions relating to:

(a) non-spousal relationships;
(b) levels of inquiry a bank should make of proposed sureties as to their knowledge of the nature and effect of security documentation; and,

(c) levels and types of advice a bank suggests should be taken by a wife asked to provide security for a loan to her husband.

4. To *BCCI* or Not to *BCCI*?

This may well be the question! Australian judges hearing finance cases are likely to be the deciders as to whether Australia should follow the position taken by the House of Lords in 1997 in *Re BCCI (No 8)*[7] in relation to the creation and registration of "charge-backs".

Prior to this decision, Australian and English courts had basically accepted the proposition that it is not possible for a financier to take a mortgage or charge over a deposit of funds placed with it by the borrower or an associated security provider. This has been referred to as a "charge-back" for obvious reasons. This position was based on the premise that it is not possible to take such security over a chose in action which the debtor effectively owes to the creditor, a bank account being a debt owed by the financier to the customer-borrower.

There is some limited Australian authority which takes this position,[8] limited in the sense that the proposition has been accepted by Australian courts without much debate. Many of the Australian cases simply follow previous decisions from the United Kingdom, notably the well known judgment of Millett J (as he then was) in *Re Charge Card Services*.[9] Thus, there has never been a particularly detailed Australian judicial debate as to the validity of purported "charge-backs" as a matter of law, although there has always been healthy academic debate on the issue both within Australia and internationally.[10]

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7 [1997] 4 All ER 568.

8 See, for example, *Broad v Commissioner of Stamp Duties* [1980] 2 NSWLR 40; *Griffiths v Commonwealth Bank of Australia* (194) 123 ALR 111; *Esanda Finance Corporation v Jackson* (1993) 11 ACLC 138.

9 [1986] 3 All ER 289.

10 See, for example, Pollard, D. "Credit Balances as Security" [1988] *Journal of Business Law* 127; Everett, D. "Security Over Bank Deposits" (1988) 16 *Australian Business Law Review* 351; Segal, N. "Conceptual Implausibility in the Court of Appeal" [1996] 8 *Journal of*

Despite the lack of agreement on the validity of charge-backs, they are frequently employed in finance practice, often in international transactions. To accommodate this practice, a number of jurisdictions have enacted legislation deeming such arrangements to be valid security devices.[11] Additionally, the practice has developed of drafting such arrangements in the form of a "triple cocktail" which incorporates the alternatives of a charge-back, set-off or flawed asset device within the one document. This is intended to circumvent the risk that a court will find the "charge-back" itself to be invalid by providing other options that the parties can fall back on if the charge itself fails.[12]

These contractual arrangements are reflected in the position historically taken by courts as to the operation of purported "charge-backs". In a bipartite situation, a court will often replace a purported charge-back with a court-imposed set-off. This was, in fact, the option suggested by Millett J in the original *Charge Card* decision. The argument is that a charge is not necessary because there will be mutual obligations between the financier and the borrower that may simply be set off against each other.

However, this argument does not work in a tripartite situation where the "security deposit" has been provided not by the borrower, but by an associated third party surety. In such a situation, there is no mutuality of obligations between the financier and the security provider so courts cannot impose a set-off. In such a case, courts can

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International Banking Law 307; Parsons, R. "Re-Drafting Bank Security Documents Following Charge Card Services" [1987] 3 *Journal of International Banking Law* 165; Baxt, R. "Commercial Note – Whether a Charge Can Be Taken Over a Customer's Account – Effect of Mutual Dealings" (1987) 61 *Australian Law Journal* 662; Millett, R. "Pleasing Paradoxes" (1996) 12 *Law Quarterly Review* 524; Lipton, J. "Creation and Registration of Security Interests in Bank Deposits and Other Book Debts" (1998) 9(2) *Journal of Banking and Finance Law and Practice* 101.

11 See, for example, section 15A Law Amendment and Reform (Consolidation) Ordinance 1991 (Hong Kong); Charge and Security (Special Provisions) Act 1990 (Bermuda); Property (Miscellaneous Provisions) Law 1994 (Cayman Islands); section 9A Civil Law Act, Cap 43 (Singapore).

12 See, for example, discussion in Evans, M. "Triple Cocktail Becomes Single Malt? Some Thoughts on the Practical Consequences of the Decision of the House of Lords in Morris v Agrichemicals Ltd" [1998] *Journal of International Banking Law* 115.

impose a "flawed asset" arrangement in place of the purported charge-back. This involves an express or implied agreement[13] between the parties that the security provider will not be at liberty to withdraw any funds from the security deposit unless and until the primary liability to the financier is repaid. This was the preferred option by the Court of Appeal and even by the House of Lords in *Re BCCI (No 8)*.[14]

This position created problems of uncertainty and lack of uniformity between jurisdictions in relation to charge-backs. Certainly, there was much unrest within the banking and finance community in the United Kingdom in the wake of the Court of Appeal decision in *BCCI (No 8)* which basically affirmed and extended the *Charge Card* position.

Then in 1997, the change came. The House of Lords held that a charge-back *per se* was valid at law in an appeal from the Court of Appeal decision in *BCCI (No 8)*. Although Lord Hoffmann, delivering the Lords' judgment, was not personally convinced that this was the correct legal position,[15] he was prepared to bow to the concerns of the English financial community. Noting the importance of the issue to that community and the lack of adverse consequences that would arise from accepting the validity of a charge-back arrangement, Lord Hoffmann held that a purported charge-back will now operate as such in the United Kingdom.

However, there was a brief, but worrisome, passage in the judgment in which Lord Hoffmann queries the registrability of charge-backs as charges under the Companies Act 1985 (UK). His grounds are that a charge over a bank account is not required to be registered under the English provisions which effectively mirror section 262(1)(f) of the Corporations Law in Australia. This section requires the registration of charges

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13 Where the documents are drafted in the "triple cocktail" formula, a court can easily find an express intention. If the document is merely drafted in terms of a charge, such an intention would have to be implied. However, the courts have been prepared to imply set-off arrangements so there is no reason to suppose that a flawed asset could not equally be implied.

14 [1997] 4 All ER 568, p 575 (per Lord Hoffmann).

15 *ibid*.

over "book debts". In the *BCCI (No 8)* judgment. Lord Hoffmann suggested that a charge over a bank account is not a charge over a "book debt" as that term is understood by the English common law. His view was that the term "book debt" refers basically to trading debts and not to a chose in action which is generally regarded in accounting parlance as "cash at bank".

This view has created some practical concerns in the United Kingdom and would certainly cause concern if the same position was ultimately adopted by an appellate court in Australia. It is particularly problematic as Lord Hoffmann's comments on this point. although strongly made. were clearly *obiter*. Arguably. it would have been better if he had not commented on the issue at all.

The ramifications for Australian finance practice are as follows. In Australia. despite the questionable validity of charge-backs. the practice has generally been to draft the documents as a "triple cocktail" or variation thereof and register them as charges over book debts for the purposes of section 262(1)(f) of the Corporations Law. The Australian Securities and Investments Commissions ("ASIC"). and its predecessors. have generally been prepared to accept such documents for registration without making any representations as to their validity as a mortgage or charge.

It would certainly be a matter of concern for the Australian finance community if an Australian appellate court were to question the registrability of purported charge-backs on the basis of Lord Hoffmann's comments in *BCCI (No 8)*. It will also be generally interesting to see whether Australian courts will ultimately follow the *ratio* of Lord Hoffmann's decision on the validity of charge-backs.

If *BCCI (No 8)* is followed by Australian courts. the effect would be to reverse the current practical position on charge-backs. Currently such arrangements are not legally deemed to be charges properly so defined. However. they are nevertheless generally accepted for registration with ASIC. Even if not required to be registered, such registration may nevertheless provide notice of the existence of the arrangement to third parties. If *BCCI (No 8)* is adopted here. charge-backs will become valid

security arrangements properly so-called. However, ASIC may have to refuse their registration on the grounds that they are not registrable under section 262(1)(f) of the Corporations Law.

Perhaps this will become a matter for parliament in Australia if confusion is generated over coming years by the position in the United Kingdom. Failing this, however, it will be a matter for the courts. Hopefully, Australian judges faced with these issues will have a critical eye to what has happened in the United Kingdom and will take account of all practical implications of new legal developments in this area.

5. CHESS: Staying Ahead of the Game

This leaves me with my final point which basically relates to finance arrangements involving shares registered under the Clearing House Electronic Subregister System ("CHESS"). Even though the Chief Justice did not mention this issue, I felt it deserved a brief mention because of its topicality and the fact that, four to five years after the introduction of CHESS in Australia, litigation involving these finance arrangements is now starting to filter through the courts. The first and only case I am aware of which touches on these issues is the interlocutory judgment of Chernov J in *Whiting v Prudential-Bache Securities*.[16] The decision was handed down on 18 September 1998 and, although arguably insignificant in itself, leads the way towards more litigation on relevant issues.

In this context, moves continue to be made by the Australian banking and finance community to address some of the difficulties caused for financiers and margin lending programs under CHESS. The Law Institute of Victoria is currently working on further submissions to the Australian Stock Exchange ("ASX") on relevant issues. Many of you here today may well be involved in submissions to the ASX or the development and implementation of financing strategies to circumvent some of the practical problems caused by CHESS.

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[16] [1998] VSC 86.

Most financiers will be well versed in the difficulties created by moving from a paper-based share trading system to an electronic transfer and registration system. Without paper share certificates and transfer forms, it is not possible to take traditional equitable mortgages over company shares supported by deposit of title and transfer documents. Additionally, where an electronic securities trading system does not itself make provision for the taking and noting of security interests, financiers wishing to accept shares as loan collateral have a difficult time protecting their security interests. This has been one of the criticisms launched at the ASX by the banking and finance community. As there is provision in the system to place locks on shareholdings to protect interests in shares in certain contexts, financiers have often questioned why such procedures cannot be extended to protect equitable security interests in shares.

A significant amount of literature has been generated since the introduction of the CHESS system addressing the problems for lenders and suggesting alternate security strategies.[17] I need not address that literature in detail, as it will be well known to most of you. Suffice it to say that the most viable suggestions for taking security over CHESS shares have proved to be:

(a) relying on legal mortgages rather than equitable mortgages supported by deposit of title documents: and,

(b) setting up "sponsored brokerage" arrangements under which the lender, or more usually its nominee company, acts as broker for the mortgaged shares and, in this capacity, ensures that no dealings take place in the shares inconsistent with the lender's security interets.[18]

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[17] See, for example, Lipton, J. "Security Over Electronically Registered Shares" (1995) 6(3) *Journal of Banking and Finance Law and Practice* 165; Lipton, J. "Security Over Electronically Registered Shares and Section 47 of the Trade Practices Act 1974 (Cth)" (1994) 22(6) *Australian Business Law Review* 426; Dwyer, E. "Shares as Security in Australia's CHESS System" [1998] *Journal of International Banking Law* 258; Wappett, C. "Securities Over Shares Held in the Clearing House Electronic Sub-Register System (CHESS)" [1996] *Queensland Law Society Journal* 207; Hammond, G and Wappett, C. "Dematerialised and Immobilised Securities" (Chapter 7 in Wappett, C and Allan, D (eds), *Securities Over Personal Property* (Butterworths, Sydney, 1999)).

[18] A number of other options are also possible including seeking re-certification of uncertificated shares or relying more heavily on contractual undertakings rather than proprietary security in shares. For a detailed discussion of the options, see, for example, Lipton, J. "Security Over

Each of these options raises its own particular difficulties. Legal mortgages force the financier to take on various ownership rights and duties in relation to shares which are undesirable in a financing situation. "Sponsored brokerage" arrangements raise a number of difficulties, including possible complications under section 47 of the Trade Practices Act 1974 (Cth). The *Whiting* case dealt with some of the issues raised in practice by the latter option.

The case involved margin lending facilities provided by the defendant lender to the plaintiff involving the equitable mortgage of CHESS shares. The transaction included a tripartite arrangement under which the plaintiff accepted the brokerage services of a nominee company at the request of the defendant lender to protect its security interest in the shares.

Before Chernov J, the plaintiff sought an interlocutory injunction to prevent the nominee company from selling shares which the defendant lender claimed were part of its equitable security under the margin lending program. Chernov J was ultimately not prepared to grant the relief sought by the plaintiff at the interlocutory stage.

Even though it was only an interlocutory injunction application and much of Chernov J's decision rested on the balance of convenience in the circumstances, a number of interesting issues were generated in the course of the litigation. They included the following.

1. Despite the flurry of literature on taking security over CHESS shares since 1994,[19] the judge was unfamiliar with the problems raised by taking security over CHESS shares and the alterative strategies being put in place by lenders in practice. Apparently, much time was spent in the courtroom relating to the judge the operation of the CHESS system and its implications for lenders.

Electronically Registered Shares" (1995) 6(3) *Journal of Banking and Finance Law and Practice* 165, pp 172-177.

[19] See note 17.

Australian judges are likely to be increasingly faced with such issues as more disputes relating to CHESS securities are generated in practice. Chronologically, it does seem about "right" for these cases to start coming before the courts now, that is, four to five years after the new security arrangements are first put into place. Australian finance lawyers and judges may therefore expect a "rush" of such litigation in this area over the next few years.

2. It was evident from the judgment that the tripartite arrangement relied on by the parties gave rise to some confusion in practice as to which shares were and which shares were not subject to the equitable mortgage at a particular point in time. Unlike the standard security arrangement where the financier holds the title certificates to mortgaged shares, the tripartite arrangement did not allow for such levels of certainty. Without the paper title documents, it can obviously be somewhat difficult to determine which precise shares are subject to a security arrangement at any given point in time. This problem will be exacerbated in cases where share trading by a particular borrower under a margin lending program is relatively active. It will also be exacerbated by the fact that there are no share "numbers" under the CHESS system so it is not possible to identify mortgaged shares in this way as it is under a paper based system.

3. Interestingly, Chernov J did not foresee any particular problems under section 47 of the Trade Practices Act 1974 (Cth) in relation to the tripartite "sponsored brokerage" arrangement. It remains to be seen whether this position will ultimately be upheld by the Australian Competition and Consumer Commission ("ACCC")[20] and / or other Australian judges.

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[20] The position of the ACCC and possible options for lenders in dealing with concerns about section 47 are canvassed in some detail in Dwyer, E. "Shares as Security in Australia's CHESS System" [1998] *Journal of International Banking Law* 258.

As noted above, the interlocutory decision went in favour of the financial institution. This should provide some comfort to lenders adopting tripartite sponsored brokerage arrangements in relation to CHESS shares. However, perhaps lenders should not take too much comfort in the decision. It must be kept in mind that this was only an interlocutory application in which the court was not altogether familiar with the arrangements in question and much rested on the balance of convenience. A full-fledged decision calling into play some of the more complex legal and financing issues may not be as favourable to lenders.

As an aside, it is also worth noting that Chernov J did highlight some sloppiness in the drafting and execution of the finance documentation as causes for concern. Although ultimately these things did not cause judgment against the lenders, it reinforces the point made by Chief Justice de Jersey in relation to the *Pan Foods* case[21] that banks and financial institutions must be very careful about the precision with which they draft, execute and take action under financing documents.

The implications of *Whiting* and recent moves in the finance community to re-ignite the debate with the ASX about financiers and the CHESS system goes to show that this issue is far from resolution. It is likely to crop up in courts and political debate in future years and it is important for finance lawyers and judges to be ahead of the game and have a solid understanding of relevant factors in order to deal with future disputes.

6. Parting Words

There is nothing left for me to say in conclusion other than to thank Chief Justice de Jersey for this thought provoking remarks relating to recent developments in finance law and practice. I am grateful to have had the opportunity to follow and comment on his remarks and on some issues which I think are inherent in the nature of any discussion on "recent developments" in banking and finance law. In my view, the coming years are likely to raise diverse, and often complex, issues in the area of

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[21] *Australia and New Zealand Banking Group Ltd v Pan Foods Co Importers and Distributors Pty Ltd* (Victorian Court of Appeal, unreported, 19 June, 1998).

banking and finance law and practice. I look forward with great interest to following and commenting on the future judicial and academic debates on these matters.