Developments in Banking and Financial Services Law over the past 20 years

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The year 1984 was a fitting one for the inauguration of a series of annual conferences on banking and finance law. There was much to discuss. In that year, consumer credit legislation was enacted in several states to give effect to recommendations of the Molomby Committee. Contracts review legislation had been enacted in New South Wales at the start of the decade. In 1983, the *Companies Act* and *Codes* were changed in an attempt to abolish the *ultra vires* doctrine – an attempt that was renewed in 1985. In July 1984, the Australian Law Reform Commission began work on its far-reaching review of the insolvency laws, including the provisions dealing with corporate insolvency. On 12 May 1983, the High Court gave judgment in the landmark case of *Commercial Bank of Australia Ltd v Amadio* (1983) 151 CLR 447; while in October it made important pronouncements about the calling up of on-demand debts in *Bunbury Foods Pty Ltd v National Bank of Australasia Ltd* (1983) 153 CLR 491. These topics are among those considered by the Association's annual conferences in the early years.

The next nineteen years saw a number of developments in policy and commercial areas that affected banking and finance law. The entry of sixteen foreign banks into Australia in 1986 gave rise to issues about competition and deregulation, as well as prudential questions about branches and subsidiaries. The world stock market crash of October 1987 focussed attention an various security and market stability matters. In 1988, the Australian Government announced new arrangements for superannuation, spurring increased activity and new directions for suppliers of collective investment products. The early 1990s saw a number of Australian corporate failures in and impacting on the finance sector (such as Pyramid Building Society, Regal and Occidental, Estate Mortgage, State Bank of South Australia, Bond Corporation amongst others), as well as similar overseas events affecting

Australia. The "related party" provisions of the *Corporations Law* were a reaction to some of the practices brought to light by those events. Similar calamities occurred at the start of the present decade (Enron, HIH, Ansett, Pasminco, One.Tel and Harris Scarfe, etc) and have sparked new debates about corporate governance. These and other events produced regulation, legislation and litigation much of which was examined at these conferences.

What are the themes that have predominated in banking and finance law over the last twenty years and how are they likely to develop in the years ahead? Any list will be incomplete. Any order of priority will be controversial. I therefore content myself with identifying a few points of reference and offering some comments about what the future may hold. In doing so, I concentrate on judge-made law, leaving largely to one side the considerable statutory developments.

Unconscionability and the High Court

It was in *Legione v Hateley* (1983) 152 CLR 406 and *Commercial Bank of Australia Ltd v Amadio* (1983) 151 CLR 447 that unconscionability or unconscionable conduct came to prominence in the High Court of Australia as a modern determinant or ingredient of equitable right. In *Amadio*, Mason J saw fraud, misrepresentation, breach of fiduciary duty and undue influence as "species of unconscionable conduct on the part of a party who stands to receive a benefit under a transaction which, in the eye of equity, cannot be enforced because to do so would be inconsistent with equity and good conscience". Mason J also said:

> "It goes almost without saying that it is impossible to describe definitively all the situations in which relief will be granted on the ground of unconscionable conduct."

Mason and Deane JJ, in separate judgments, drew a distinction between principles relating to undue influence and those relating to what they called "relief against unconscionable dealing". The former were seen as concerned with the quality of assent and the overbearing of will, the latter with attempts by a stronger party to obtain or retain a benefit as against a weaker where, as Deane J put it, "it is not consistent with equity or good conscience that he should do so".

In *Legione v Hately*, the established jurisdiction to grant relief against forfeiture was seen by Mason and Deane JJ as consistent with "the fundamental principle according to which equity acts, namely that a party having a legal right shall not be permitted to exercise it in such a way that the exercise amounts to unconscionable conduct". It was said that specific performance would be granted at the suit of a purchaser in breach of an essential condition only in exceptional circumstances; also that "[w]hether the exceptional circumstances exist in a given case hinges on the existence of unconscionable conduct". After observing that it is impossible to define or describe all the situations which may constitute unconscionable conduct on the part of a rescinding vendor, their Honours said:

> "None the less it may be said that where the conduct of the vendor, though not creating an estoppel or waiver, has effectively caused or contributed to the purchaser's breach of contract there is ground for exercising the jurisdiction to relieve. And if it also appears that the object of the rescission is not to safeguard the vendor from adverse consequences which he may suffer as a result of the contract remaining on foot, but merely to take unconscientious advantage of the benefits which will fortuitously accrue to him on forfeiture of the purchaser's interest under the contract, there will be even stronger ground for the exercise of the jurisdiction."

The observations in *Legione v Hateley* were substantially reinforced in *Stern v McArthur* (1988) 165 CLR 489. Mason CJ said that equity's refusal, before *Legione v Hateley*, to relieve against forfeiture of a purchaser's interest under a sale contract "must be ascribed to the compelling force of *pacta sunt servanda*". The equitable principle that came to the fore in *Legione v Hateley* – and, by clear implication, came to qualify *pacta sunt servanda* - was then described:

> "But, as *Legione* was to demonstrate, equity will relieve against an unconscionable exercise of legal rights. If the vendor's insistence on rescission and forfeiture of the purchaser's interest under the contract is, in the circumstances of the case, unconscionable, there can be no unfairness in depriving the vendor of the benefit of rescission with the forfeiture of the purchaser's interest entailed by rescission. That was the message conveyed by *Legione*."

The High Court had occasion in *Ciavarella v Balmer* (1983) 153 CLR 438, decided some four months after *Legione*, to describe in a joint judgment (Gibbs CJ, Mason, Wilson, Deane and Dawson JJ) the rationale for the decision in *Legione* and the aspect that distinguished the circumstances in that case from those with which the court was dealing in *Ciavarella* itself:

> "[I]n *Legione v Hateley* the material in evidence strongly indicated unconscionable conduct on the part of the vendor in seeking to insist on the rescission of the contract in circumstances where the statement of the vendor's solicitors had helped lull the purchaser into a belief that the vendor would accept completion provided it took place within a few days and where the consequence of rescission was that the vendor would reap the benefit of the very valuable improvements which the purchaser had effected to the property. Here there is a different situation. Far from acting precipitately the vendor refrained from making time of the essence for a period of nine months approximately."

Another attempt by defaulting purchasers to obtain relief against forfeiture on what was seen as the benign basis exposed in *Legione* was unsuccessful in *Stern v McArthur* (1998) 165 CLR 489. Mason J said:

> "Furthermore, to accept the respondents' submission and extend relief against forfeiture to instances in which no exceptional circumstances are established would be to eviscerate unconscionability of its meaning. The doctrine is a limited one that operates only where the vendor has, by his conduct, caused or contributed to a situation in which it would be unconscionable on the vendor's part to insist on the forfeiture of the purchaser's interest. Priestley JA thought that 'it would be unreasonable and unconscionable ... *to permit* [the vendors] to shut [the purchasers] out from ownership' (my emphasis), and consequently allowed relief against forfeiture. But, contrary to his Honour's view, the jurisdiction to grant relief against forfeiture does not authorize a court to reshape contractual relations into a form the court thinks more reasonable or

> fair where subsequent events have rendered one side's situation more favourable."

In the same case, Brennan J, who had dissented in *Legione*, recognised that unconscionability is "the only legitimate warrant for equity's jurisdiction". But Brennan J sounded a note of caution:

> "Although the categories of unconscionable conduct are not closed, the concept of unconscionability is not a charter for judicial reformation of contracts "for the Chancery mends no man's bargain": *Maynard v Moseley* (1676) 3 Swans. 651, at p. 655 [36 ER 1009, at p. 1011]. The courts have not sought a power to destroy the rights and obligations which the parties to a contract create. If unconscionability were regarded as synonymous with the judge's sense of what is fair between the parties, the beneficial administration of the broad principles of equity would degenerate into an idiosyncratic intervention in conveyancing transactions. It is worth recalling what Lord Radcliffe said in *Campbell Discount Co Ltd v Bridge* [1962] AC 600 at p.626:
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> > '"Unconscionable" must not be taken to be a panacea for adjusting any contract between competent persons when it shows a rough edge to one side or the other, and equity lawyers are, I notice, sometimes both surprised and discomfited by the plenitude of jurisdiction, and the imprecision of rules that are attributed to "equity" by their more enthusiastic colleagues. Since the courts of equity never undertook to serve as a general adjuster of men's bargains, it was inevitable that they should in course of time evolve definite rules as to the circumstances in which, and the conditions under which, relief would be given, and I do not think that it would be at all an easy task, and I am not certain that it would be a desirable achievement to try to reconcile all the rules under some simple general formula. Even such masters of equity as Lord Eldon and Sir George Jessel, it must be remembered, were highly sceptical of the court's duty to apply the epithet "unconscionable" or its consequences to contracts made between persons of full age in circumstances that did not fall within the familiar categories of fraud, surprise,

> accident, etc, even though such contracts involved the payment of a larger sum of money on breach of an obligation to pay a smaller sum.'

And in *Muschinski v Dodds* (1985) 160 CLR 583 at p.616, Deane J recalls that 'undefined notions of "justice" and what was "fair" had given way in the law of equity to the rule of ordered principle which is of the essence of any coherent system of rational law'."

Louth v Diprose (1992) 175 CLR 621 was a case in which a man found to have been infatuated with and emotionally dependent on a woman was awarded a house bought by her with money given to her by him. The basis for Mason CJ's decision was succinctly stated:

> "Her conduct was unconscionable in that it was dishonest and was calculated to induce, and in fact induced, him to enter into a transaction which was improvident and conferred a great benefit upon her."

Brennan J referred to the distinction between unconscionable conduct and undue influence drawn by Mason J and Deane J in *Amadio* and confirmed that "the two jurisdictions are distinct". He nevertheless noted that both depend upon the effect of influence (presumed or actual) improperly brought to bear by one party on the mind of another.

In *Bridgewater v Leahy* (1998) 194 CLR 457, an uncle's strong emotional dependence on his nephew was asserted as the foundation for a claim that the nephew should not retain a benefit conferred on him by the uncle. The majority (Gaudron, Gummow and Kirby JJ) referred to the distinction between equitable doctrines concerned with undue influence and unconscionable dealings or conduct noting, however, that each "may be seen as a species of the genus of equitable intervention to refuse enforcement of or to set aside transactions which, if allowed to stand, would offend equity and good conscience". Unconscionable conduct was then described in terms going back to the basis of equity:

> "In *Commercial Bank of Australia Ltd v Amadio* (1983) 151 CLR 447 at 474, Deane J spoke of unconscionable conduct as occurring

> where, in the circumstances, it is unconscientious to "procure, or accept, the weaker party's assent to the impugned transaction". It also should be noted that in *Hart v O'Connor* [1985] AC 1000, an appeal from New Zealand, the Privy Council described unconscionable conduct which provided a basis for equitable relief as 'victimisation, which can consist either of the active extortion of a benefit or *the passive acceptance of a benefit in unconscionable circumstances*', *Hart v O'Connor* (above) at 1024. In so giving the judgment of the Privy Council, Lord Brightman was reflecting a general proposition put by James LJ in *Torrance v Bolton* (1872) LR 8 Ch App 118 at 124. This was that it was the 'ordinary jurisdiction' of the Court of Chancery to deal with instruments and transactions 'in which the Court is of opinion that it is unconscientious for a person to avail himself of the legal advantage which he has obtained'."

Unconscionability in relation to the enforcement of a guarantee was considered in *Garcia v National Australia Bank* Ltd (1998) 194 CLR 395. The guarantee was given by a wife in respect of the indebtness of her husband. The factual circumstances thus resembled those in *Yerkey v Jones* (1939) 63 CLR 649. The High Court adhered to the principles that had been applied sixty years earlier. The joint judgment of Gaudron, McHugh, Gummow and Hayne JJ described them as follows:

> "The principles applied in *Yerkey v Jones* do not depend upon the creditor having, at the time the guarantee is taken, notice of some unconscionable dealing between the husband as borrower and the wife as surety. *Yerkey v Jones* begins with the recognition that the surety is a volunteer: a person who obtained no financial benefit from the transaction, performance of the obligations of which she agreed to guarantee. It holds, in what we have called the first kind of case, that to enforce that voluntary transaction against her when in fact she did not bring a free will to its execution would be unconscionable. It holds further, in the second kind of case, that to enforce it against her if it later emerges that she did not understand the purport and effect of the transaction of suretyship would be unconscionable (even though she is a willing party to it) if the lender took no steps itself to

> explain its purport and effect to her or did not reasonably believe that its purport and effect had been explained to her by a competent, independent and disinterested stranger. And what makes it unconscionable to enforce it in the second kind of case is the combination of circumstances that: (a) in fact the surety did not understand the purport and effect of the transaction; (b) the transaction was voluntary (in the sense that the surety obtained no gain from the contract the performance of which was guaranteed); (c) the lender is to be taken to have understood that, as a wife, the surety may repose trust and confidence in her husband in matters of business and therefore to have understood that the husband may not fully and accurately explain the purport and effect of the transaction to his wife; and yet (d) the lender did not itself take steps to explain the transaction to the wife or find out that a stranger had explained it to her."

The position of a guarantor had earlier been considered in *Vadasz v Pioneer Concrete (SA) Pty Ltd* (1995) 184 CLR 102 where a director had guaranteed past and future indebtedness of his company to a supplier which, on the strength of the guarantee, continued supplies. The supplier, it was found, had represented that the guarantee extended to future indebtedness only. The guarantor contended that, because of the misrepresentation, the guarantee should be set aside. The supplier argued that, as the court below had ordered, it should be enforceable as to the subsequent indebtedness. The High Court, in a joint judgment (Deane, Dawson, Toohey, Gaudron and McHugh JJ) agreed. They referred to Deane J's approval in *Amadio* of a passage in the judgment of Cussen J in *Bank of Victoria Ltd v Mueller* [1925] VLR 642:

> "Where appropriate, an order will be made which only partly nullifies a transaction liable to be set aside in equity pursuant to the principles of unconscionable dealing ... [T]he order will, in an appropriate case, be made conditional upon the party obtaining relief doing equity."

The High Court then observed:

> "Thus unconscionability works in two ways. In its strict sense, it provides the justification for setting aside a transaction. More loosely, it provides the justification for not setting aside the transaction in its entirety or in doing so subject to conditions, so as to prevent one party obtaining an unwarranted benefit at the expense of the other."

This balancing approach had been taken by the court in its earlier decisions concerning the constructive trust. In *Muschinski v Dodds* (1985) 160 CLR 583, it was held by majority that the interests of tenants in common in equal shares were held upon constructive trusts in such a way as to reflect their respective contributions to the acquisition of the property purchased in the course of their relationship. Deane J, with whom Mason J agreed, referred to the equitable principles inherent in the common count for money had and received which "operates upon legal entitlement to prevent a person from asserting or exercising a legal right in circumstances where the particular assertion or exercise of it would constitute unconscionable conduct". *Legione v Hateley* was cited. The application of the principle in *Legione* is reflected in the following passage of Deane J's judgment:

> "As has been seen, the relevant principle operates upon legal entitlement. It is the assertion by Mr. Dodds of his legal entitlement in the unforeseen circumstances which arose on the collapse of their relationship and planned venture which lies at the heart of the characterization of his conduct as unconscionable. Indeed, it is the very absence of any provision for legal defeasance or other specific and effective legal device to meet the particular circumstances which gives rise to the need to call in aid the principle of equity applicable to preclude the unconscionable assertion of legal rights in the particular class of case."

Similar circumstances arose for consideration in *Baumgartner v Baumgartner* (1987) 164 CLR 137 where, upon termination of a de facto relationship, one party asserted sole ownership of a property of which that party was the legal owner but to which both had made contributions through pooling of earnings. The result is summed up in this passage in the joint judgment of Mason CJ, Wilson and Deane JJ:

> "The case is accordingly one in which the parties have pooled their earnings for the purposes of their joint relationship, one of the purposes of that relationship being to secure accommodation for themselves and their child. Their contributions, financial and otherwise, to the acquisition of the land, the building of the house, the purchase of furniture and the making of their home, were on the basis of, and for the purposes of, that joint relationship. In this situation the appellant's assertion, after the relationship had failed, that the Leumeah property, which was financed in part through the pooled funds, is his sole property, is his property beneficially to the exclusion of any interest at all on the part of the respondent, amounts to unconscionable conduct which attracts the intervention of equity and the imposition of a constructive trust at the suit of the respondent."

The constructive trust is not the only remedial means by which property interests may be re-arranged to avoid unconscionable retention. As *Giumelli v Giumelli* (1999) 196 CLR 101 showed, an appropriate outcome may be that one party be recognised as having an equitable charge upon the relevant property to secure an ascertained sum.

Unconscionability also lies at the base of equitable estoppel. The way in which equity had generally intervened to prevent departure from an assumption induced by misrepresentation was described by Mason CJ in *Commonwealth v Verwayen* (1990) 170 CLR 394 by reference to *Waltons Stores (Interstate) Ltd v Maher* (1988) 164 CLR 387:

> "Equity was concerned, not to make good the assumption, but to do what was necessary to prevent the suffering of detriment. To do more would sit uncomfortably with a general principle whose underlying foundation was the concept of unconscionability. So, in *Waltons Stores*, a majority of this Court concluded that equitable estoppel entitled a party only to that relief which was necessary to prevent unconscionable conduct and to do justice between the parties. Mason CJ and Wilson J referred, (1988) 164 CLR at p.404, to the statement of Scarman LJ in *Crabb v Arun District Council*, [1976] Ch 179 atp.198, that the court should determine what was 'the minimum

equity to do justice to the plaintiff'. We went on to state, (1988) 164 CLR at p.405: 'Holding the representor to his representation is merely one way of doing justice between the parties'. Similarly, Brennan J said (1988) 164 CLR at p.419:

> 'The element which both attracts the jurisdiction of a court of equity and shapes the remedy to be given is unconscionable conduct on the part of the person bound by the equity, and the remedy required to satisfy an equity varies according to the circumstances of the case. As Robert Goff J said in *Amalgamated Property Co v Texas Bank* [1982] QB 84 at p.103: "Of all doctrines, equitable estoppel is surely one of the most flexible". ... However, in moulding its decree, the court, as a court of conscience, goes no further than is necessary to prevent unconscionable conduct.'"

Deane J referred to the way in which promissory estoppel gives rise to "an equity":

> "That equity is, as the cases on promissory estoppel seem to me to make plain, an entitlement in equity proceedings to preclude departure by the other party from the assumed state of affairs if departure would, in all the circumstances, be unconscionable. The content of the estoppel will, of course, vary according to the nature of the assumption."

In New South Wales, questions about the existence of a clog on a mortgagor's equity to redeem may now fall to be considered against considerations of unfairness and unconscionability – or according to "equity's modern remedial jurisdiction based on unconscionability": see *Westfield Holdings Ltd v Australian Capital Television Ltd* (1992) 32 NSWLR 194; *Thomas v Silvia* (1994) 35 NSWLR 96; *Wily v Endeavour Health Care Services Pty Ltd* [2003] NSWSC 616. In England, the House of Lords has said that a stay of proceedings or anti-suit injunction may be granted in respect of proceedings which it is "unconscionable for a party to pursue": *Turner v Grovit* [2002 1 WLR 107. The High Court's approach in *CSR Ltd v Cigna Insurance Australia Ltd* (1997) 189 CLR 345 was the same:

> "If the bringing of legal proceedings involves unconscionable conduct or the unconscientious exercise of a legal right, an injunction may be granted by a court in the exercise of its equitable jurisdiction in restraint of those proceedings no matter where they are brought."

But what is "unconscionability" and where do its boundaries lie? How do we recognise it? In *Commissioner of Taxation v Murry* (1998) 193 CLR 102, Kirby J, referring to Lord Macnaghten's description of "goodwill" in *Inland Revenue Commissioners v Muller & Co's Margarine Ltd* [1901] AC 217 as "a very easy thing to describe, very difficult to define", commented that "in this sense goodwill is rather like unconscionability". This is a reflection of a remark of Mahoney JA in *Antonovic v Volker* (1986) 7 NSWLR 151:

> "The role of unconscionability is better described than defined."

This is borne out by the following statement by Murray J (with whom Hasluck and Pullin JJ agreed) in *Lloyd v Tedesco* [2002] WASCA 63:

> "What then does the principle of unconscionability involve? The answer, I think, will depend upon the multitudinous circumstances of different cases and I do not think there can be any exhaustively defined list of circumstances which will constitute unconscionable conduct of a kind which will prompt the intervention of a court of equity ... ."

One thing at least is clear. Unconscionability as such does not amount to a cause of action. In *Australian Broadcasting Commission v Lenah Game Meats Pty Ltd* (2001) 208 CLR 199, the High Court rejected the notion that an interlocutory injunction might be granted to restrain certain action judged "unconscionable" and without any attempt to identify and characterise the legal or equitable right deserving protection pending suit. Gummow and Hayne JJ said that "the notion of unconscionable behaviour does not operate at large". Gleeson CJ said:

> "Unconscionability is a concept that may be of importance in considering the nature and existence of the claimed right which a plaintiff seeks to vindicate ... But, in these circumstances it

> cannot be used to conjure up a right to interlocutory relief where there is no right to final relief."

There was emphasis in *Lenah* on the nature of unconscionability as a "driving force" that underwrites the availability of equitable relief in circumstances and under headings already recognised and established. It is thus clear that, whether it affects the process by which a benefit was obtained or concerns the circumstances in which a benefit is sought to be retained, unconscionability is no more than a catalyst (and, it may be said, a strong one at that) in a process of assessing the justice of the case for the purpose of deciding whether some recognised equitable doctrine or principle warrants the grant of some recognised equitable remedy. This matter was put thus by Gleeson CJ in *Lenah*:

> "No doubt it is correct to say that, if equity will intervene to restrain publication of the film by the appellant, the ultimate ground upon which it will act will be that, in all the circumstances, it would be unconscientious of the appellant to publish. But that leaves for decision the question of the principles according to which equity will reach that conclusion. The conscience of the appellant, which equity will seek to relieve, is a properly formed and instructed conscience. The real task is to decide what a properly formed and instructed conscience has to say about publication in a case such as the present. If the Attorney-General is correct, it will take account of a number of factors additional to the circumstances in which the film was obtained, including (although this is not spelled out) what the appellant knew or ought to have known about those circumstances.
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> The necessary first step is to say that, subject to possible qualifications of the kind set out in proposition 3, the circumstances in which the film was made, known as they now are to the appellant, mean that the appellant is bound on conscience not to publish. That proposition is not self-evidently correct, and cannot be established by mere assertion."

The "mere assertion" that something is unconscionable leads nowhere. It is necessary first to establish the legal context and to examine the nature of the legal rights. Unconscionability or unconscionable conduct, whether attending the circumstances of the creation of the legal rights or the context in which it is sought to enforce them, may then play a part in determining whether equity should intervene.

Deane J's reference in *Muschinski v Dodds* to the equitable principle inherent in the action for money had and received has already been noted. *Roxborough v Rothmans of Pall Mall Australia Ltd* (2001) 208 CLR 516 reinforced the notion that an action for recovery lies where there is unconscientious retention in reliance on a legal right. The concept of unjust enrichment elucidated in *Pavey & Matthews Ltd v Paul* (1987) 162 CLR 221 may thus be seen to have unconscionability at its centre.

From here it is but a short step to describe unconscionability in a way that echoes part of Deane J's description of unjust enrichment in *Pavey & Matthews*, characterising it as

> "a unifying concept which explains why the law recognises, in a variety of distinct categories of case, an obligation on the part of a defendant ..."

So, the message that comes from *Lenah* is that unconscionability is a characteristic of action or inaction which may preclude assertion of or reliance on legal rights in circumstances where equity has the capacity, in any event, to intervene. It is a "unifying concept" explaining intervention rather than a self-contained and independent basis for intervention. Matters were put into context by Justice Hayne in an address to the Judicial Conference of Australia in 1999:

> "What Gleeson CJ referred to some years ago as the Holy Grail of individualised justice has seen life instilled in equitable doctrines. It has also seen the development of the commonly held belief that 'unconscionability' is a sufficient statement of reasoning to warrant a conclusion. 'Unconscionability' was said by Gleeson CJ to have 'an alarming capacity to provoke judicial disagreement as to its application to the facts of even fairly straightforward cases' [Gleeson, 'Individualised Justice – The Holy Grail, (1995) 69 ALJ 421 at426. It may be that this very uncertainty will come to be seen as making the attempt to analyse cases by reference to it so difficult or unsatisfactory as to warrant discarding reliance upon it. But whether

or not that happens, one feature of the emergence of unconscionability as some overarching concept should be identified.

The uninformed observer might think that reference to and reliance upon 'unconscionability' as a criterion for decision requires no more than the application of the individual judge's intuitive response to the particular facts and circumstances without resort to any more precise or refined guiding principle. Something of the same approach is reflected in statements that a decision is a 'discretionary' decision as if that were a complete and sufficient description of all that needs to be known about the process of making the decision.

Especially is that so in adjectival law like evidence. Sometimes, provisions of the *Evidence Act* 1995 of the Commonwealth and of New South Wales, seem to be treated as if the discretions that are given to judges under those Acts are to be exercised with no signposts, let alone any principles, to guide the judges. On analysis, it can be seen that there are guiding principles but all too often they have not been sufficiently identified before a decision is made.

I mention these two examples of unconscionability and judicial discretion because unless we are to treat judges as philosopher kings, our search must always be for the principles that guide the making of decisions. Resort to a slogan, no matter whether that slogan is, that 'the party's conduct was unconscionable', or that there is a discretion which is 'to be exercised judicially' seldom, if ever, identifies the relevant principles which should inform the judge's decision. And a failure to identify principle will inevitably lead to inconsistency of results."

The quest for the identification of principle must therefore continue.

<u>Statutory unconscionability</u>

Unconscionability is now also an established head of statutory liability. Provisions of the *Trade Practices Act* 1974 (some of which are not now applicable to the provision of financial services: s.51AAB) proscribe, in certain circumstances, "conduct that is, in all the circumstances, unconscionable" (ss.51AB and 51AC) and, in others, "conduct that is unconscionable within the meaning of the unwritten law, from time to time, of the States and Territories" (s.51AA). Similar provisions exist at State level (*Fair Trading Act* 1987 (NSW)) and in Commonwealth legislation dealing with financial services (*Corporations Act*, s.991A; *ASIC Act*, ss.12CA to 12 CC). In some instances, there is specification of the matters that are to be taken into account in deciding whether conduct is "unconscionable". In others, the term is used without explanation, while yet others resort to the meaning to be derived from "the unwritten law".

Provisions referring to conduct that is unconscionable according to "the unwritten law" pose difficulties of interpretation. The "unwritten law" does not provide a cause of action for unconscionable conduct. Rather, as we have seen, such conduct may provide a basis on which equity will not allow a party to enjoy or rely upon independently generated rights. This difficulty was recognised in *Australian Competition and Consumer Commission v C G Berbatis Holdings Pty Ltd* (2003) 77 ALJR 926. As Gummow and Hayne JJ observed:

> "The term 'unconscionable' is used as a description of various grounds of equitable intervention to refuse enforcement of or to set aside transactions which offend equity and good conscience. The term is used across a broad range of the equity jurisdiction."

Their Honours went on to refer to defaulting fiduciaries, relief against forfeiture, misrepresentation, mistake, estoppel. In all these areas, applicable equitable doctrine may overcome the unconscionable conduct or prevent its being rewarded. Gummow and Hayne JJ continued:

> "It will be unconscientious for a party to refuse to accept the position which is required by the doctrines of equity. But those doctrines may represent, as the above examples indicate, the outcome of an interplay between various themes and values of concern to equity. The present editor of *Snell* has noted the use of the terms 'unconscionable' and 'unconscientious' 'in areas as diverse as the nature of trusteeship and the doctrine of laches'; he rightly observed

> that 'this may have masked rather than illuminated the underlying principles at stake' [McGhee (ed), *Snell's Equity*, 30th ed (2000), Preface]".

References to conduct that is "unconscionable within the meaning of the unwritten law" are not, according to Gummow and Hayne JJ, to be construed by reference to some concept of unconscionability that "is at large or reflects an ordinary or natural meaning in general usage". There is, as they observed, "the question as to which particular manifestations of equity's concern with unconscientious or unconscionable conduct are reached" by the statutory provision.

Gummow and Hayne JJ referred to a difference of opinion within the Federal Court on the meaning of "unconscionable" in s.51AA of the *Trade Practices Act*. On one view (adopted by Gyles J in *GPG (Australia Trading) Pty Ltd v GIO Australia Holdings Ltd* (2001) 117 FCR 23), the section is not concerned with a general doctrine of unconscionability recognised by equity and does not encompass all circumstances where behaviour which can be described as unconscionable plays a part in the entitlement to equitable relief. The other view (expressed by French J in *Berbatis* at first instance (2000) 96 FCR 491) is that the criterion employed is one that has no settled technical meaning and entails a standard determined by judicial decision rather than a rule, although the existence of specific doctrines may "for the present" subject it to limitation in its factual field of operation.

Gummow and Hayne JJ declined to enter upon this debate, thus leaving what Sackville J described in *Deangrove v Commonwealth Bank of Australia* [2003] FCA 470 as "unresolved questions of construction". That particular lack of resolution relates to the statutory formulation that expressly resorts to the content of the "unwritten law". It is even more pronounced where the term "unconscionable" is used without explanation or elaboration. In those contexts, there seems to be no alternative but to resort to some more general meaning, as explained by the Full Federal Court in *Hurley v McDonald's Australia Ltd* (2000) ATPR 41-471:

> "For conduct to be regarded as unconscionable, serious misconduct or something clearly unfair or unreasonable, must be demonstrated – *Cameron v Qantas Airways Ltd* (1994) 55 FCR 147 at 179. Whatever 'unconscionable' means in s.51AB and s.51A, the term

> carries the meaning given by the Shorter Oxford Dictionary, namely, actions showing no regard for conscience, or that are irreconcilable with what is right or reasonable – *Qantas Airways Ltd v Cameron* (1996) 66 FCR 246 at 262. The various synonyms used in relation to the term 'unconscionable' import a pejorative moral judgment – *Qantas Airways Ltd v Cameron* (1996) 66 FCR 246 at 283-284 and 298."

Unconscionability in the future

A general message for the future, so far as general law and statutory unconscionability and its impact upon banks is concerned, was offered by Professor Bryan Horrigan in "Unconscionability Breaks New Ground – Avoiding and Litigating Unfair Client Conduct After the ACCC Test Cases and Financial Services Reforms", [2002] Deakin Law Review 4:

> "In terms of banking policy and practice, recent changes in statutory and judge-made laws on unconscionability mean the following:
>
> 1) Some conventional banking assumptions need rethinking – eg what counts as a benefit flowing from a loan, whether someone on the record as a company officer is really involved in the business for unconscionability purposes, what counts as a 'high risk' category of relationship etc;
> 2) While nobody needs to hit the panic button yet in terms of standard banking policy and procedures, given the slow progress in extending the *Garcia* principles to other personal and business relationships, the recent extension of unconscionability criteria under sections 51AA and 51AC of the *Trade Practices Act* beyond the pre-existing law opens the way for more rather than less judicial review of banking conduct in both consumer and business transactions;
> 3) Banking policy should maintain strong reliance on suggesting and requesting evidence of independent legal and financial advice but should also recognise the limits of this safeguard;

> 4) Some banks might need to revisit the match between their current procedures, legal changes in the last 12-18 months, and how they classify and handle 'high risk' and 'low risk' transactions at the policy level; and
>
> 5) All banks should monitor the results of ongoing ACCC test cases on unconscionability and equivalent banking code changes."

Professor Horrigan added:

> "In addition, there are important recent developments in the law of unconscionability and personal guarantors which affect not only the liability of solicitors who advise guarantors or financiers, but also the assumptions of banks and their officials and lawyers about who can rely on *Garcia* principles in terms of not receiving a benefit from the transaction and being regarded legally as a volunteer. For example, can a wife who guarantees her husband's business debts be a 'volunteer' capable of invoking the *Garcia* doctrine if she is a director and secretary of the business whose debts are secured, the loan is paid into a joint account but funds are immediately diverted elsewhere, they receive the benefit of the discharge of another liability, and there is some beneficial impact on their standard of living? [*Bylander v Multilink* [2001] NSWCA 53] An intangible benefit flowing through to the family unit from a spousal guarantee is unlikely to undermine reliance on unconscionability to overturn the guarantee. Clearly, the expansion of the categories of people beyond wives who can invoke the *Garcia* doctrine and the loosening of the criteria for being characterized as a volunteer in ways disadvantageous to banks are significant twin developments which reinforce each other. Banks might need to revisit some standard assumptions and risk assessment criteria concerning categories of special disadvantage."

I also mention, as a possible indicator of future trends, the decision of the New South Wales Court of Appeal in *Davey v Challenger Managed Investments Ltd* [2003] NSWCA 172, a case concerning guarantees and mortgages over their homes given by two elderly mothers to support borrowings to further a business venture undertaken by a company controlled by their children – a fact situation which, on the surface, would sound alarm bells for a lender. The evidence showed, however, that the guarantors had received advice on the transaction from an independent solicitor and that one of them had entered into a similar transaction a few months earlier. Claims by the guarantors based on unconscionability in equity and the relieving provisions of the *Contracts Review Act* were unsuccessful. On the first matter, Handley JA (with whom Hodgson JA and Grove J agreed) said:

> "The children should probably never have asked the appellants to hazard their homes in this business venture, but misrepresentation or undue influence on their part have never been alleged. The age and status of the appellants as pensioners did not deprive them of the legal capacity to do what they did. If the business had been successful the children would have been launched on a business career and the mortgages would have been discharged.
>
> The Court has no way of knowing how many business ventures financed by parents in this way are successful for the benefit of the community and all concerned. Courts only ever see the cases where the business has failed and the mortgages are enforced. The Court might be doing a disservice to the community if it treated age and pensioner status as disabling parents from helping their children in this way. The law has not taken that step, and under ordinary principles the appellants have no proper claim for relief."

In relation to the *Contracts Review Act*, his Honour said:

> "Although the appellants relied on the *Contracts Review Act* there was in truth no separate basis for relief under it. It was not said that the terms of the contracts and mortgages were unfair, and it was not suggested that the transaction itself was unfair. This was not a case where negotiations on the terms of the contracts was either needed or appropriate. The appellants had to decide whether they would proceed with the transaction, but if they did there was nothing to negotiate.

> If there was any unfairness the lender was not responsible for it, and had no notice, actual or constructive, of that unfairness. As a general rule the Court will not grant relief under the Act against a party who is in that position. See *Esanda Finance Corporation Ltd v Tong* (1997) 41 NSWLR 482."

These comments emphasise (if it needs to be emphasised) that the law is concerned with principle, objectively applied, without undue emphasis upon factors such as age and pensioner status for their own sake.

The implied obligation of good faith

An aspect of non-statutory law to which financial institutions must pay increasing attention concerns contractual terms implied by law without resort to the presumed intentions of the particular parties in the particular context. In *Peters (WA) Ltd v Petersville Ltd* (2001) 205 CLR 126, the High Court confirmed that terms so implied include a positive obligation on the grantor of a right to do all things necessary on his or her part to enable the grantee to have the benefit of the subject matter of the grant (*Secured Income Real Estate (Australia) Ltd v St Martins Investments Pty Ltd* (1979) 144 CLR 596) and a negative obligation on any promisor not to hinder or prevent the fulfilment of express promises given (*Shepherd v Felt and Textiles of Australia Ltd* (1931) 45 CLR 359). A question for the present and future is whether there is likewise implied in contracts an obligation of good faith performance or good faith dealing and, if so, how its precise content should be understood. In New South Wales, at least, it appears to be the law that such an obligation is implied in every commercial contract: *Burger King Corp v Hungry Jack's Pty Ltd* [2001] NSWCA 187. There are indications to similar effect in other jurisdictions: *Far Horizons Pty Ltd v McDonald's Australia Pty Ltd* [2000] VSC 310; *Garry Rogers Motors (Aust) Pty Ltd v Subaru (Aust) Pty Ltd* (1999) ATPR 41-703. Such a position is consistent with that found in both United States and European law and, in certain respects, imported by legislation into United Kingdom: see *Director-General of Fair Trading v First National Bank plc* [2000] 2 WLR 1353.

But if such a term is implied by law, a question remains as to its content and operation. Two propositions may be advanced. First, any implied obligation of good faith on the part of a contracting party means that the party must not seek to prevent reasonable enjoyment of a benefit arising from the contract (*Byrne v Australian Airlines Ltd* (1995) 185 CLR 410) but is not thereby required to subordinate his or her own interests in the way required of a fiduciary: see *Overlook Management BV v Foxtel Management Pty Ltd* [2002] NSWSC 17. Second, the content of any such implied obligation cannot be discovered except by reference to what the parties have expressly agreed, since an implied term cannot govern or contradict an express term. The second point was succinctly made by Allsop J in *Evans Deakin Pty Ltd v Sebel Furniture Ltd* [2003] FCA 171:

> "It is not a legitimate judicial technique to have regard to what might be seen as a developing view as to the imposition of the obligation of good faith on parties to contracts (see generally Baron "`Good Faith' and construction contracts - from small acorns large oaks grow" (2002) 22 *Aust Bar Rev* 54), to identify dishonourable conduct or conduct which might be said to be "in bad faith" (disembodied from the contractual framework set up by the parties) and then to impose or sculpt an otherwise logical and reasonable contractual structure which gives a remedy for the impugned and unworthy conduct."

The implied contractual obligation of good faith has been referred to in several recent cases in the banking field. In *Australia and New Zealand Banking Corporation v Ciavarella* [2002] NSWSC 1186, actions taken by a bank in apparent disregard of moratorium arrangements were held to entail breach of such an implied term. In *Commonwealth Bank of Australia v Spira* [2002] NSWSC 905, allegations of breaches of an implied term requiring good faith were advanced on numerous bases but found to be unsustainable. The result in *Commonwealth Development Bank v Cassegrain* [2002] NSWSC 965 was similar.

The Full Court of the Supreme Court of Western Australia has reserved its position on these matters: *Central Exchange Ltd v Anaconda Nickel Ltd* [2002] WASC 94. The High Court has not yet had occasion to consider them. In *Royal Botanic Gardens and Domain Trust v South Sydney City Council* (2003) 76 ALJR 436, all members of the court found it unnecessary to deal with the submissions on the question, seeing the case purely as one involving construction of express terms. Gleeson CJ, Gaudron, McHugh, Gummow and Hayne JJ simply said:

> "The result is that, whilst the issues respecting the existence and scope of a 'good faith' doctrine are important, this is an inappropriate occasion to consider them."

Callinan J referred to "the rather far-reaching contentions of the appellant". Kirby J alone gave some insight into his thinking on the subject:

> "However, in Australia, such an implied term appears to conflict with fundamental notions of caveat emptor that are inherent (statute and equitable intervention apart) in common law conceptions of economic freedom. It also appears to be inconsistent with the law as it has developed in this country in respect of the introduction of implied terms into written contracts which the parties have omitted to include."

Other sources of lender liability

In referring to these emphases on unconscionability and good faith, I do not intend to detract from the ongoing relevance of other bases of liability traditionally asserted against providers of finance. Claims founded on negligent misstatement are a well-established part of the liability landscape for financiers. In *Blacker v National Australia Bank Ltd* [2000] FCA 681, Katz J expressed the opinion that recent developments in the High Court concerning claims for damages for purely economic loss (eg, *Perre v Apand Pty Ltd* (1999) 198 CLR 180) do not appear to require any approach different from that dictated by *San Sebastian Pty Ltd v The Minister* (1986) 162 CLR 340. From the perspective of lenders and borrowers, there is thus nothing in particular to report on this front; nor is anything obviously on the horizon.

Section 52 of the *Trade Practices Act* and equivalent State provisions, now supplemented by Part 2 Division 2 of the *ASIC Act* in relation to financial services, remains at the forefront of lender liability claims. In *Henville v Walker* (2001) 206 CLR 459 and *I & L Securities Pty Ltd v HTW Valuers (Brisbane) Pty Ltd* (2002) 76 ALJR 1461, the High Court considered issues of causation and reliance relevant to the question whether a person suffers loss or damage "by" misleading or deceptive conduct prohibited by s.52. For damages to be recovered under the Act, the proscribed conduct need not be the sole cause of the plaintiff's loss, although it must be a material cause. Regardless of the extent to which the conduct operates to produce the loss, it is the whole loss that is to be compensated – or, more precisely, so much of the plaintiff's overall loss as is suffered "by" the conduct. Furthermore, there is nothing in the Act or its underlying policy to suggest that any carelessness on the plaintiff's part is to be taken into account in assessing damages. The approaches in these recent High Court decisions emphasise the wholly statutory nature of the cause of action and the need to give full effect to the statutory language.

The possibility that lenders may become liable as fiduciaries in certain advisory circumstances (as in *Commonwealth Bank of Australia v Smith* (1991) 42 FCR 390) is one that continues to be aired: eg, *Golby v Commonwealth Bank of Australia* (1996) 72 FCR 134, *Truebit Pty Ltd v Westpac Banking Corporation* [1997] FCA 1290, *Boogadah Investments Pty Ltd v Westpac Banking Corporation* (NSWCA, 18 March 1998), *Finding v Commonwealth Bank of Australia* [2001] Qd R 168, *Babsari Pty Ltd v Wong* [2000] 2 Qd R 576. The idea that a lender may owe fiduciary duties to a borrower will be sustainable if the lender is seen to have come under an obligation to act in the lender's interest, with a resultant duty "not to obtain any unauthorised benefit from the relationship and not to be in a position of conflict": *Breen v Williams* (1996) 186 CLR 71 per Gaudron and McHugh JJ. And as Justice Gummow observed in "Equity: too successful?" (2003) 77 ALJ 30, referring to *Pilmer v Duke Group Ltd* (2001) 207 CLR 165, notions of "contributory fault" drawn from tort law are "not translated into the fiduciary realm".

In *Finding v Commonwealth Bank of Australia* (above), it was contended, on the basis of an essay by Professor Finn (as he then was), that, if not subject to a fiduciary duty as such, the bank nevertheless owed to its customer "some lesser special duty" of an innominate kind based on "reasonable expectation". Davies, Pincus JJA and Derrington J found no factual basis for any such duty and, as to the abstract proposition, said:

> "One of the disadvantages of this doctrine, as it seems to us, is that, heaping Pelion upon Ossa, it produces an additional layer of uncertainty in an area of the law whose essential defect is unpredictability of operation; it is still quite unclear what is the basic concept, if any there be, by which one can identify a fiduciary

relationship: see McPherson JA, 'Fiduciaries: Who Are They?" (1998) 72 ALJ 288. And two thirds of a century of analysis have left the scope of the 'neighbourhood' rule in its original field, that of negligence, quite obscure, outside the case of direct physical damage; one wonders whether use of this vague notion in a new area would be an advance."

The last word, for the moment, may be left to Justice Hayne who, in opening the Centre For Commercial Law Conference at the Australian National University on 30 September 2002, said:

"[I]t is, I think, the common experience of judges sitting in commercial lists that expressions like 'fiduciary' and 'unconscionable' are sprinkled through pleadings or submissions much as caster sugar is sprinkled upon a bowl of strawberries in the hope that the consumer may find the dish more palatable. All too often the attachment of the label 'fiduciary' ignores the dictum of Frankfurter J [*Securities and Exchange Commission v Chenery Corporation* 318 US 80]: 'to say that a man is a fiduciary only begins the analysis; it gives direction to further inquiry. To whom is he a fiduciary? What obligations does he owe as a fiduciary? In what respect has he failed to discharge these obligations? And what are the consequences of his deviation from duty?' As Finn said in his seminal work on fiduciary obligations [Finn, Fiduciary Obligations, (1977) at 2]: "[i]t is not because a person is a 'fiduciary' or a 'confidant' that a rule applies to him. It is because a particular rule applies to him that he is a fiduciary or confidant for its purposes.' That is, a fiduciary is not subject to fiduciary obligations because he or she is a fiduciary; it is because he or she is subject to fiduciary obligations that he or she is a fiduciary."

Corporate insolvency – voluntary administrations

It is probably not going too far to say that the voluntary administration procedure available under Part 5.3A of the *Corporations Act* has revolutionised approaches to corporate insolvency in Australia.

A paper presented to the May 1994 conference by Bruce Hambrett reviewed the operation of the voluntary administration system over the first eleven months of its life. Statistics published by the Australian Securities Commission were quoted. In the period 23 June 1993 to 31 March 1994, some 6,441 cases of external administration were reported. Of these, 27% were cases in which a court had ordered winding up or the appointment of a provisional liquidator, 46% were voluntary windings up and 15% entailed appointment of a receiver or other controller. Cases of voluntary administration (including those in which a deed of company arrangement had been executed) accounted for 11%. The success of the voluntary administration system is illustrated by the corresponding figures for the four months ended 30 April 2003. In that period, court ordered winding up and provisional liquidator appointments represented 29% of new external administrations. Voluntary windings up accounted for 17%, while appointments of receivers and other controllers accounted for 7%. More than 45% were new external administrations under Part 5.3A.

The main attraction of the voluntary administration provisions lies in their simplicity. Directors of a company which finds itself in financial difficulties have at their disposal a simple method of fulfilling their responsibility to avoid insolvent trading. They do not need to apply to the court. The company obtains a short time in which to take stock of its position under the guidance of an insolvency practitioner. The objective, enshrined in the legislation, is to see whether a way can be found to secure a better result for creditors and shareholders than would result from an immediate winding up, assuming that the business is found not to be sustainable.

One of the keys to the success of Part 5.3A, at least in more recent years, is the particular flexibility injected by s.447A. As interpreted by the High Court in *Australasian Memory Pty Ltd v Brien* (2000) 200 CLR 270, that section confers on the court a broad power to mould the statutory prescriptions to fit a particular case. The section says, quite simply, that the court may "make such order as it thinks appropriate about how this Part is to operate in relation to a particular company". This jurisdiction is not, in express terms, subject to any limitation although, as the High Court found, the scheme of the legislation does entail some constraints. Section 447A was described by the court as "an integral part of the legislative scheme found in Pt 5.3A", with the result that resort to it for a particular purpose could not be regarded as somehow circumventing a specific provision in some impermissible way. Modification of the effect of specific provisions is the very task that s.447A is intended to perform; and it may do so in ways that change, as to their future effect, matters already in existence. The statutory objective stated in Part 5.3A represents the only stated criterion to which a court must pay attention in exercising this jurisdiction.

The comprehensive operation afforded to s.447A by the High Court has resulted in several successful applications under that section to modify the incidents of the particular form of creditors voluntary winding up that will follow Part 5.3A administration if creditors do not opt for some other outcome. It has been held in several recent cases that s.446A – the provision that brings about transition to winding up – remains, after the transition, the source of the operation of the voluntary winding up provisions in the particular case. That being so, it is possible, by application of s.447A, to vary what would otherwise be the effect of the winding up provisions applied by s.446A itself: see *Gibbons v LibertyOne Ltd* (2002) 41 ACSR 442, *Re Walker (as liquidator of One.Tel Ltd)* [2002] NSWSC 705; *Re One.Tel Ltd* (2002) 43 ACSR 305.

Another example of practitioners' innovative resort to s.447A is illustrated by cases where the interests of large numbers of employees with rights as creditors are being pursued by a trade union. In both the Ansett and Pasminco administrations, orders were made under the section which had the effect of enabling the relevant industrial organisation to exercise voting rights on behalf of the employee creditors: see *Re Ansett Australia Ltd* (2001) 39 ACSR 296; *Re Pasminco Ltd* (2003) 45 ACSR 1.

Despite its popularity and flexibility, the voluntary administration system has given rise to certain tensions. Because an administrator is chosen and appointed by the directors, there is the danger of lack of objectivity. While the creditors, at the first meeting, may make a substitute appointment, they will not necessarily be fully informed about the initial administrator's connections. Because most forms of debt and security enforcement are precluded during administration except with the leave of the court and any pending winding up application must be adjourned unless the court affirmatively finds that creditors' interests will be better served by winding up, directors may be tempted to resort to voluntary administration as something of a diversionary tactic.

These and other possible anomalies are currently under review. In May 2003, the Parliamentary Joint Committee on Corporations and Financial Services published an issues paper entitled "Improving Australia's Corporate Insolvency Laws". Possible future developments in the voluntary administration sphere are suggested by those of the issues identified in it that relate to that matter:

> "Is there a need to further strengthen the independence of administrators?
> What additional measures may be adopted to do so?
>
> Are there any concerns about the mode of appointment and removal of liquidators and administrators? Can the procedures for the appointment of administrators and liquidators be improved? Should administrators or liquidators be able to be removed in a wider range of circumstances than is presently provided for under the law?
>
> Is it appropriate that companies are able to circumvent winding up proceedings (where a winding up application is pending but not yet determined) by appointing an administrator?
>
> Can the operation of the law be improved where different forms of administration are potentially open and the parties seek different forms of external administration (e.g. voluntary administration or liquidation)?
>
> What measures can be adopted to enhance the provision of information to creditors at statutory meetings of creditors under the VA procedure?
>
> Would it be appropriate to extend the timeframe for the first and second statutory meetings of creditors under voluntary administration?
>
> Is there a tendency for some administrators to recommend deeds of company arrangement that have little or no chance of succeeding (ie

where liquidation would be the more appropriate course)? If so, what changes are needed to allow more flexibility in the choice of external administration?

...

Is the voluntary administration procedure achieving the objectives set for it? What features of the procedure are open to abuse or improvement?

Are the rules for voting by creditors under voluntary administration appropriate? Is the 'casting vote' device appropriate?

Does the method of voting and the method of resolving deadlocks fairly reflect creditors' wishes? Should greater weight be given to the value rather than the number of creditors in some circumstances?

Should the law give clearer guidance as to the manner in which a casting vote may be exercised by an administrator?"

Another question which may need attention is whether the Part 5.3A process in its present form is wholly apt in cases involving large companies. The Ansett and Pasminco administrations threw up a number of issues of a kind not encountered in the ordinary run of case. One of them, concerning participation in creditor decision making by large numbers of employees has already been mentioned. Another involving interplay between creditor protection under Part 5.3A and shareholder protection under Chapter 6 was addressed by the Takeovers Panel in *Re Pasminco Ltd* (2002) 41 ACSR 511.

Derivatives

During 2002, the International Swaps and Derivatives Association Inc (ISDA) published a revision of its standard form agreement for over-the-counter derivatives. Practitioners in that field are still coming to grips with the new form, the first for ten years. Commentators agree that about half the content is new. Conferences to explore its ramifications are to be held in London, Tokyo, Singapore and presumably other places.

For banks, derivatives play a major role in balance sheet management and the maintenance of equity ratios. Instruments such as collateralised debt obligations may be issued by banks to obtain capital relief. Investors may be attracted to opportunities for exposure to a diversified portfolio through a single investment. There is, in theory, no limit to the extent of re-packaging that may be undertaken. There apparently now exist "CDOs squared", that is, collateralised debt obligations backed by collateralised debt obligations. These are not necessarily well regarded by rating agencies.

Looking back over 20 years, we have seen a burgeoning in the use of derivatives, particularly in contexts divorced from physical markets, and ongoing debate about the classification of derivatives for certain regulatory (as distinct from prudential) purposes: whether they fell within definitions of "securities" or "futures contract" or were outside established categories. One of the objects of the *Financial Services Reform Act* was to resolve such issues of regulatory classification. Whether it has succeeded in doing so may be a matter for debate: see T. Ciro, "The Regulation of Equity Derivatives: Functional Rhetoric v Economic Substance", (2002) 20 C&SLJ 276.

At the 1994 conference, James Watkins referred to the publication by the Bank of England of a report of an Internal Working Group on Derivatives, based on discussions and interviews with market participants. He observed:

> "It is, I suppose, an indication of the considerable lack of awareness and understanding, on the part of the regulators, of the markets and the products, that necessitates their basing their findings and their recommendations almost entirely on detailed consultation of this nature with market participants."

The policy makers referred to by James Watkins in 1994 are not alone in their lack of first hand experience of such matters. Judges (or at least the vast majority of them) are in the same position. Doing the best they can, they may, on the basis of what they see to be plain words, come to conclusions that at least some lawyers working closely with market operators consider to be problematic or unwarranted. This is borne out by three items in recent journals.

Writing in the March 2003 issue of the International Financial Law Review, Andrew Fernbach commented on a first instance decision of the Supreme Court of New South Wales concerning calculation of a close-out amount under an ISDA master agreement: *Enron Australia Finance Pty Ltd v Integral Energy Australia* [2002] NSWSC 753. The author's conclusion was that the court favoured and applied "a valuation method radically different from the one commonly accepted" and that the decision gave rise to "causes for concern". In the Journal of International Banking Law for 2001 (Vol 16, p 84), Andrew Lenon reviewed the decision of an English court in *Peregrine Fixed Income Ltd v Robinson Department Store Ltd* [2000] Lloyd's Rep Bank 304 and concluded that the conclusion reached appeared to be "a sensible one on the facts" but that "the judge's reasoning was unsatisfactory".

Less restrained in its criticism was a comment by S.K. Henderson in the May 2003 issue of the Journal of International Banking and Finance Law on the decision of an English court about the expression "obligation ... which is not subject to any contingency" in the 1999 ISDA credit derivatives definitions: *Nomura International plc v Credit Suisse First Boston International* [2002] EWHC 1160 (Comm). He said that the court "made four fundamental errors", including by limiting "unnecessarily, and in the context of the financial markets, uncommercially" the concept of contingency. The writer's trenchant conclusion was:

> "This case is another unfortunate example of an English court narrowly reading (indeed misreading) a portion of a clause, missing its broader meaning and arriving at a poor decision."

Mr Henderson did not identify the other instances to which he referred. English courts have, in recent years, considered various matters involving construction of derivatives contracts. Among cases of this kind are *Nova Safim spa v Sakura Bank Ltd* [1999] 2 All ER (Comm) 526 and *Australia and New Zealand Banking Group Ltd v Societe Generale* [2000] 1 All ER (Comm) 682, in addition to *Peregrine Fixed Income v Robinson Department Store*. There is no indication that any of these was the object of the adverse comment. But all the cases mentioned make clear what one already knows: that derivatives stand or fall according to the contracts by which they are constructed, that those contracts are, in some respects, complex and that their provisions have to be applied in particular commercial and financial contexts which often have cross-border aspects. Is there a need, then, for some specialist dispute resolution tribunal?

I make no comment on the particular decisions in *Enron Australia v Integral Energy, Nomura International v CSFB* and *Peregrine Fixed Income v Robinson Department Store* except to say that the courts concerned were called upon to construe contractual provisions which had been adopted by parties who regularly traded in markets of a specialised kind on the basis of certain expectations as to the meaning and effect of the standard form contracts used. There is, after all, no shortage of commentary on the way such contracts are meant to work. Lawyers regularly give opinions about them, predicating what a court will decide. According to all accepted canons of construction, these matters are irrelevant, except to the limited extent that pre-contractual conduct may be admitted to resolve ambiguity on which it casts light: *Codelfa Construction Pty Ltd v State Rail Authority* (1982) 149 CLR 337; *Brambles Holdings Ltd v Bathurst City Council* (2001) 53 NSWLR 153. Is this restrictive rule unduly inhibitory in cases where, for the kinds of reasons I have mentioned, parties enter into highly specialised contracts in an environment replete with received assumptions as to their effect?

The two questions I have posed are raised in a rhetorical vein. Particularly in circumstances where contracting parties are in different countries, and transactions are undertaken in accordance with standardised models, it may not be sensible always to look to one system of law and its existing judicial system for resolution of disputes. From here, Australia's present position on issues of cross-border insolvency may be examined.

Cross-border insolvency

One possibility arising from the Australian Government's CLERP8 proposals is the adoption, as part of Australian statute law, of the UNICITRL Model Law on Cross-border Insolvency. That proposed measure is based on the threefold aim of securing co-operation among the courts of different countries, rights of access into one country for insolvency administrators duly installed under the law of another and recognition of foreign insolvency proceedings by participating states.

Existing Australian law goes some distance along these roads. Our courts have long been accustomed to recognising winding up orders made elsewhere and, in appropriate circumstances, administering within their own jurisdiction an ancillary winding up. As was said almost a century ago by a Tasmanian judge (*Sack v Lord Aldenham* (1911) 7 Tas LR 84):

> "Undoubtedly this court recognises the English liquidation and, when called in aid, will assist in effectuating it."

The general principles to be applied in cases of dual insolvent administration were stated in *Re Union Theatres Ltd* (1933) 35 WALR 89:

> "In the case of the liquidation of a company which carries on business in the place of its incorporation and elsewhere, where such liquidation is proceeding in such several places, the place of incorporation should be treated as the forum of domicile, and the administrator there as the principal administrator, and all others as ancillary; and assets available for distribution should be transmitted and distributed from the principal administration ....
>
> The administration should be such as to provide for equal treatment of all creditors of equal degree, wherever their claims arise or are proved. There should be no preference or priority in the distribution of the assets found in any forum contrary to the statutes or laws of that forum .....; and, as a corollary, any preference or priority subsisting under such statutes or laws should, in the distribution of those particular assets, be preserved."

The closing words of this last passage reflect one of the things the uniform law aims to prevent or, at least, regulate, namely, the predominance of local law in respect of property or claims in such a way that it distorts the application of assets provided for by the law of the principal insolvency (see also *Re Air Express Foods Pty Ltd* (1977) 2 ACLR 523). Under existing law, ancillary administration is founded in part on statutory provisions permitting the making of winding orders in respect of bodies formed elsewhere and the somewhat uncertain operation of judicial comity.

Co-operation between courts in the case of both individual and corporate insolvency also has a limited statutory basis under existing law: see s.29 of the *Bankruptcy Act* and s.581 of the *Corporations Act* which enable Australian courts to act in aid of the courts of certain foreign countries administering an insolvency, as well as creating jurisdiction for an Australian court, by letter of request, to seek such aid from a foreign court. Aspects of the latter jurisdiction were considered by Australian courts in *Re Dallhold Estates (UK) Pty Ltd* (1991) 6 ACSR 378, *Joye v Beach Petroleum NL* (1996) 67 FCR 275, *Re AFG Insurances Ltd* (2002) 20 ACLC 1588 and *Re AFG Insurances Ltd* (2002) 43 ACSR 60 and by an English Court in *Re Dallhold Estates (UK) Pty Ltd* [1992] BCLC 621.

These cases illustrate several of the problems that attend this type of dual administration. The court asked to act in aid of that which already has the carriage of an insolvency may only do so by means of some form of relief known to its system of law. Resort to the inherent jurisdiction to appoint a receiver, as an adjunct to the specific jurisdiction to assist the foreign court, may be considered an appropriate means of collecting and preserving assets for a bankruptcy trustee or liquidator appointed by the foreign court. In *Dallhold*, the English court made an order for administration under the *Insolvency Act* to supplement the Australian winding up.

The *AFG* cases highlight questions posed by Australia's voluntary administration system in this context. An administration does not proceed from any court order. The administrator is not an officer of the court. Restraints upon creditors, property owners and others with claims upon the assets of the company during administration are directly imposed by statute and do not proceed from any court order. Unless and until an Australian court has had occasion to make some order in relation to the administration or some aspect of it, it is difficult to identify any matter of which the court is seised and in respect of which it stands in need of aid.

The inability of present regimes to cope comprehensively with multi-jurisdiction insolvency indicates a need for some reform. One possibility is a system that enables courts in the countries concerned to devise a protocol to deal with a particular case. This is the solution that has been adopted to deal with insolvencies affecting both the United States and Canada. The basis lies in statutory provisions allowing courts to make such orders and grant such relief as they consider appropriate to facilitate, approve or implement arrangements that will result in a co-ordination of proceedings under local insolvency law with any foreign proceeding. Under such a system, much is left to judicial discretion, although not necessarily in way that allows all problems to be resolved.

The results that seem most desirable, at least in an abstract sense, are that creditors affected by an insolvency should be treated equally regardless of their location and that all assets, wherever situated, should be marshalled for their benefit according to one system of law. Those objectives underlie the cross-border insolvency regulation that came into force in the European Community on 31 May 2002 and applies to all kinds of administration, whether court imposed or voluntary.

Clauses protecting lenders

Under this heading, I shall deal first with some recent cases about the kind of "material adverse change" clause commonly found in financing documents. Such a clause may take various forms but serves the central purpose of allowing one party to take action of some kind in an "adverse change" event the clause describes. Much depends on the precise terms of the clause.

The Scottish case of *Scottish Enterprise v McGeachy* [2001] ScotCS 47 illustrates difficulties that may arise from one form of the clause. In an agreement for the financing of a company acquisition, the sellers warranted that "there has been no event since 31 August 1996 which has led to a material adverse change in the financial position of the Company and its subsidiaries". The plaintiffs, relying on this provision, pleaded breach of contract on the basis that, between 31 August 1996 and the date of contract, a radical and adverse change had occurred because the relevant company became insolvent. The response was that that circumstance was insufficient to support an action for breach of warranty: the clause was predicated upon the happening of an "event which has led to" a material adverse change, not such a change alone.

On a strike-out application, the Inner House of the Court of Session held that the words referring to a causative event could not be ignored and that proof of no more than a material adverse change would not be sufficient to sustain an action for breach of the warranty. But the court was prepared to hold, at the preliminary stage, that the pleading was sufficient to raise each and every event that in fact led to the insolvency. Referring particularly to the impact of adverse trading conditions, the judges said:

> "[I]t cannot in our view be said at this stage that general adverse trading conditions, leading to such a rapid and significant decline in the company's financial position, could never be capable of constituting an 'event' or a series of 'events' within the scope of the warranty."

A different form of "material adverse change" clause was considered by the High Court in *Pan Foods Co Importers & Distributors Pty Ltd v Australia and New Zealand Banking Group Ltd* (2000) 74 ALJR 791. The clause was predicated upon the bank's forming of a certain opinion as to material adverse change. Various events were defined as "events of default" upon the happening of which the bank could take certain actions against the customer, including

> "if an event occurs or circumstances arise which, in the opinion of the Bank may have a material adverse effect on the business, assets or financial condition of the Customer, or a Relevant Company or on the ability of the Customer or a Surety to perform its obligations under any Transaction Document ..."

It was also provided that, upon the happening of an event of default, the bank might take certain actions, including declare all relevant moneys to be due and payable, "in which case [all such moneys] will be immediately due and payable by the Customer".

Following receipt by the bank of a report by an accountant showing very bad trading results and expressing the opinion that losses would probably continue at about $200,000 per year, a manager of the bank made written demand for payment upon certain directors of the customer by whom the bank considered the customer's indebtedness to be guaranteed. The manager also gave notice that, if payment was not made, enforcement action might be taken without further notice.

The recipients of these documents contended that the moneys demanded had not become due and payable. There had been no explicit manifestation of the opinion of the bank upon which the "material adverse change" clause was based; nor had there been any express declaration that all moneys were due and payable. The High Court considered both these elements to be sufficiently comprehended by the demand and notice given, even though neither explicitly addressed the matters in question. The majority (Gleeson CJ, McHugh and Hayne JJ) said:

> "An Event of Default, within the meaning of 10.1(j) of the General Conditions, occurred. When Pan Foods' facilities came up for review in 1994, an investigating accountant was appointed to report to the bank. It became obvious that Pan Foods was incurring large losses. The bank officer in charge of the account told his superiors that the company was performing "disastrously". The accountant expressed the opinion that, if the bank enforced its security, there would be a substantial shortfall. The evidence makes it plain that circumstances had arisen which, in the opinion of the bank, had a material adverse effect on the business, assets, and financial condition of Pan Foods and on its ability to perform its obligations to the bank. It was submitted that there was no specific evidence of the formation of such an opinion. In truth, on the information before the bank, no other opinion was reasonably available, and what was said and done by the officers of the bank makes it clear that they held such an opinion."

Callinan J, who delivered a concurring judgment, said of the clause contemplating a declaration that all moneys were due and payable:

> "The declaration required by the clause is not a declaration in the formal, legal sense of a declaration made by a court. In context, the declaration which the clause requires is a clear expression of the reaching of a state of satisfaction of the mind of the respondent Bank that a relevant Event of Default in fact has occurred, and that the Bank has resolved to act by taking steps that it is entitled to take consequent upon that. The fact that the Bank has so acted indicates the formation of the requisite state of mind. A declaration was therefore at least implicit in the decision of the Bank to give notice, and the giving of the notice with the content, and in the form that it did."

The implied message here is that procedural and default clauses will be construed in a commercial way without resort to undue formalism and by reference to business realities. Kirby J, who also concurred in the result, delivered the same message in clearly stated terms:

> "In my view, such documents should be construed practically, so as to give effect to their presumed commercial purposes and so as not to defeat the achievement of such purposes by an excessively narrow and artificially restricted construction. The law facilitates and upholds commercial contractual obligations and the expectations that derive from them. Statute and equity may sometimes come to the aid of parties where various forms of unfairness or inequality can be shown. None was invoked in this appeal. But as between a commercial enterprise and a finance provider, such as a bank, the law should be the upholder of agreements. It should eschew artificialities and excessive technicalities for these will not be imputed to the ordinary businessperson. Business is entitled to look to the law to keep people to their commercial promises. In a world of global finances and transborder capital markets, those jurisdictions flourish which do so. Those jurisdictions which do not soon become known. They pay a price in terms of the availability and costs of capital necessary as a consequence of the uncertainties of the enforcement of agreements in their courts."

The same notion was expressed a few months later by Callinan J in *McCann v Switzerland Insurance Australia Ltd* (2000) 203 CLR 579:

> "In my view, such documents should be construed practically, so as to give effect to their presumed purposes and so as not to defeat the achievement of such purposes by an excessively narrow and artificially constructed construction."

An event of default of the kind considered in *Pan Foods* – that is, predicated upon the lender's state of mind ("... which, in the opinion of the bank, may have a material adverse effect") – is no doubt assumed to be more advantageous for the lender than one defined in purely objective terms (for example, "if a material adverse change occurs"). A potential disadvantage, however, is the possible need for the lender to prove that it held the opinion and did so on rational grounds. A point relevant to that possibility arose for consideration by the Supreme Court of Victoria in *Liquorland (Australia) Pty Ltd v Anghie* [2003] VSC 73 which concerned a material adverse change provision in relation to a company acquisition.

The plaintiff's takeover offer contained a condition that there not occur during the offer period a "material adverse change" in certain respect in relation to the target company. After the acquisition was completed, the plaintiff formed the view that certain disclosures in the target company's statutory response to the offer were defective. It sued for damages upon a statutory cause of action, part of its case being, by implication, that it believed that the information in the response was complete and accurate. The defendants then sought discovery of documents going to the plaintiff's state of mind at the relevant time, including documents in relation to communications with its lawyers as to its state of mind in deciding to declare the offers unconditional. The plaintiff resisted on the ground of legal professional privilege. Byrne J was then required to decide what he described as "a short but surprisingly difficult point: whether, by asserting that it acted in reliance upon a matter, a party to litigation is putting in issue its state of mind in so acting, so as to waive legal professional privilege with respect to legal communications which might have had a bearing on its arriving at that state of mind".

The question was answered in the affirmative. After a comprehensive review of authority, Byrne J stated the dilemma:

> "Like Heerey J in the *Kamisha* case [*Equuscorp Pty Ltd v Kamisha Corp Ltd* (1999) ATPR 41-697], I recoil from a principle which would have the consequence that a client litigant's plea of reliance in a negligent misstatement case, a misleading or deceptive conduct case or an estoppel case, ipso facto strips the privilege from legal communications which occurred about the time of the reliance. Furthermore, I am resistant to an argument that would have privilege waived in respect of any privileged document which might be relevant to the state of mind which has been pleaded into issue. To my mind, the putting in issue by the client of its relevant state of mind, whether

> it be one of reliance or otherwise, is merely the starting point for an examination of the waiver question."

Given that the central issue was whether privilege had impliedly been waived, his Honour addressed the question of "unfairness":

> "'Unfairness' in the sense that this word is used in this area of law, is typically characterised as an inconsistency between the position of the client seeking a finding as to an issue upon which the privilege communication had a bearing and, at the same time, withholding the content of the communication from the opponent and the court. [*Mann v* Carnell (1999) 201 CLR 1]. This will usually involve the consideration of what is the precise issue and how it is said that the communication impacts upon that issue."

The conclusion of Byrne J was:

> "In my opinion, it would be relevantly unfair for Liquorland to make these implied assertions and, at the same time, to assert privilege with respect to any legal communication which is likely to have had a bearing upon those very matters. In short, Liquorland cannot come to the court seeking a determination that it had a certain view of its legal rights and at the same time withhold from the court and its opponents privileged communications which are likely to have informed its corporate mind as to those matters. Discovery must be made by Liquorland of documents containing such communications."

Brief reference may next be made to the kind of evidentiary clause with which the High Court's decision in *Dobbs v National Bank of Australasia* Ltd (1935) 53 CLR 643 is most often associated. The effect of a clause of this kind purporting to make binding a creditor's certificate as to the sum owing was considered by the Queensland Court of Appeal in *Julong Pty Ltd v Fenn* [2002] QCA 529. Because of the terms of a Queensland statute, such a certificate cannot be more than prima facie evidence of what it purports to make conclusive as between the contracting parties. The effect of the certificate was held to be that the creditor was entitled to judgment for the certified sum unless the debtor discharged the onus of proving either that the certificate did not correctly reflect the amount of the debt or that the debt had been paid. That may be regarded as an uncontroversial result consistent with not only the decision of the same court in *Noble v State of Victoria* [2000] 2 QdR 154 but also earlier High Court authority: *Young v Queensland Trustees Ltd* (1956) 99 CLR 560.

That, however, was not the end of matters in *Julong Pty Ltd v Fenn*. The debtor contended that the creditor had breached the contract by failing to provide the debtor with an accounting of the sums received by it. There was no express contractual term requiring such an accounting by the creditor. The debtor argued that such a term was implied because it was reasonable and equitable and necessary to give business efficacy to the contract.

The court accepted that there was such an implied term. Central to that finding was the fact that the source of the debt was a factoring agreement under which trade debts due to one party were assigned by it to another party on a continuing basis in return for a fraction of their face amount. That circumstance caused Atkinson J (with whom McMurdo P agreed) to resort to the following observation of Lord Langdale MR in *Clarke v Tipping* (1846) 9 Beav 284:

> "Among the most important duties of a factor, are those which require him to give to his principal the free and unbiased use of his own discretion and judgment, to keep and render just and true accounts, and to keep the property of his principal unmixed with his own or the property of other persons."

Her Honour then said:

> "Such a term is, in my view, necessary to give business efficacy to a factoring agreement, and it is obvious and capable of clear expression. It would appear that a term requiring Keradale to account should be regarded as an implied term in any factoring agreement unless there is a specific term to the contrary."

It was held, however, that breach of the implied term did not mean that the borrowers could terminate the contract and avoid the debt. If any right of termination did arise, they would still be liable for any pre-existing debt. The onus of displacing the prima facie position as to quantum of debt arising from the certificate had not been discharged.

Proceeds

Finally, a word may be said about recent cases on "proceeds" and the thing from which they proceed.

In *Associated Alloys Pty Ltd v ACN 001 452 106 Pty Ltd* (2000) 202 CLR 588, the High Court held to be effective a contractual provision of the "Romalpa" kind purporting to subject to a trust proceeds derived from manufacture and sale of products incorporating goods supplied by a seller who retained title until payment. That seller could not maintain a claim to the goods after their identity had been lost in the manufacturing process: title retention clauses contemplating consumption or on-sale will generally be taken to imply a licence to convey or extinguish the seller's pre-existing title (see *CSR Ltd v Casaron Pty Ltd* [2002] QSC 21; *BHP Steel Ltd v Robertson* [2002] NSWSC 336). But there is no reason why the title retention agreement should not be effective to constitute an express trust over future acquired monetary receipts of the buyer received as the result of manufacture and sale of products using the seller's goods.

Shortly after *Associated Alloys*, the Privy Council considered the relationship between proceeds of book debts themselves. In *Agnew v Commissioner of Inland Revenue* [2001] 2 AC 710, it was held, in effect, that because a charge over book debts left the chargor free to use and dispose of the proceeds, the charge could not take effect as a fixed charge upon those debts and operated as a floating charge only. The Privy Council did not follow the decision of the English Court of Appeal in *Re New Bullas Tradings Ltd* [1994] 1 BCLC 449, a decision that has previously been both followed (*Whitton v ACN 003 266 886 Pty Ltd* [1996] 14 ACLC 1799) and distinguished (*Mullins v The Queen*, unreported, 26 September 1994, Western Australian Court of Criminal Appeal; *Elgin Abattoir Pty Ltd v Elders Burnett Moore (WA) Pty Ltd*, unreported, 25 March 1997, SCWA).

We must await further developments in perceptions of the relationship between cash generated by an asset or process and the asset or process itself.