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**Hostage to the Vibe -  
The Future of Statutory Unconscionability  
In Banking Transactions**

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# ‘Hostage to the Vibe’

## ‘The Future of Statutory Unconscionability in Banking and Finance Transactions’

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## **Unconscionability Relates to ...**

- **Various equitable (and some common law) causes of action**
- **Statutory unconscionability under Trade Practices Act**
- **Statutory unconscionability under Fair Trading Acts**
- **Unconscionable financial services licensee conduct under Corporations Act**
- **Unjust contracts laws (eg some Fair Trading Acts, NSW Contracts Review Act)**
- **Related consumer credit laws**
- **Code of Banking Practice**
- **State retail/commercial leasing laws**



## Common Unconscionability Arguments Made Against Financiers

- 'The financier's standard terms are unfair/unjust/unreasonable/ unconscionable ... and are about to appear on the Federal Government's "unfair contract terms" blacklist!'
- 'The finance and security arrangements were executed in circumstances of misleading/unconscionable conduct by the financier'
- 'The financier extracted additional security from a financially stressed debtor unconscionably or in bad faith'
- 'The aggressive debt recovery tactics of the financier (and its agents) amounted to unconscionable conduct'
- 'The refusal of additional finance or the conditions attached to the granting of additional finance were each unconscionable'
- 'The way in which the financier exercised or threatened to exercise its security rights was unconscionable'
- 'The financier exercised its rights capriciously or in bad faith'
- 'The financier knew or should have known about its customer's unlawful conduct, and cannot benefit unconscientiously from that unlawful conduct to the detriment of another party with whom the financier also dealt'



## Ongoing Statutory Unconscionability Reforms

- **Recent withdrawal of monetary limits for tertiary statutory unconscionability in TPA & ASICA**
- **Recent Productivity Commission and Senate Economics Committee reports**
- **Current Australian Consumer Law Bill before Parliament folds statutory unconscionability breaches under TPA & ASICA into new regimes for:**
  - pecuniary penalties, disqualification orders
  - redress loss/damage to non-party consumers
  - infringement notices, public warning notices
- **Separate Rudd Government review of B2B statutory unconscionability**
- **Ongoing judicial test cases on the elements/boundaries of non-statutory and statutory unconscionability**



## **Spigelman CJ in *A-G (NSW) v World Best Holdings* [2005] NSWCA 261**

- ‘Over recent decades legislatures have authorised courts to rearrange the legal rights of persons on the basis of vague general standards which are clearly capable of misuse unless their application is carefully confined. Unconscionability is such a standard ... Unconscionability is a concept which requires a high level of moral obloquy. If it were to be applied as if it were equivalent to what is “fair” or “just”, it could transform commercial relationships.’



## de Jersey CJ (2005)

‘The inherent vagueness of the concept of good faith when given contractual force stands to be contrasted with the general law’s development of the principle of unconscionability. While obviously informed by considerations of fairness and reasonableness, that field is left in a state of reasonable definition and clarity, so that contracting parties can know where they stand. Others may not agree with that assessment (cf. B Horrigan: “The expansion of fairness-based business regulation – unconscionability, good faith and the law’s informed conscience” (2004) 32 ABLR 159, 161). I note, though, that the High Court in *Tanwar Enterprises* (p 1857), deemed parties’ positions in this area may be determined by reference to what it called “well developed principles”!’





## Areas of Focus in Advice & Litigation

- **‘Well developed principles’**

**v**

- **Some of the elements of non-statutory unconscionability**
- **Many of its applications**
- **All of its correspondence with statutory unconscionability’s forms**
- **State and non-state regulatory implications of periodic statutory unconscionability reform amidst a torrent of related reforms**





## Current State of Play I

- **Meaning & Forms:** ‘unconscionability’ has more than one meaning at law, but its specific meanings in each of what I shall call ‘primary’, ‘secondary’, and ‘tertiary’ statutory unconscionability remain insufficiently determined under Australian law
- **‘Unconscionable Conduct’:** there is a range of equitable and other doctrines that draw upon specific ideas associated variously with conduct that is unconscionable and against ‘good conscience’, although legally the term ‘unconscionable conduct’ has a more discrete conventional meaning;
- **Judicial Discretion:** Commonwealth-level statutory unconscionability is one of a number of areas of statutory law whose interpretation and application successive legislatures have decided should be characterised by bounded discretion according to a matrix of unweighted indicative factors, and hence left largely in the hands of the judicial branch of government;
- **Gravitational Pull:** equitable notions of unconscionable conduct in general and the strand of unconscionable conduct associated with ‘special disadvantage’ in particular have to this point arguably exerted an overly strong gravitational pull upon the interpretation and application of all forms of statutory unconscionability



## Current State of Play II

- **Political/Stakeholder Dissatisfaction:** the continuous series of legislative reforms and political reviews of statutory unconscionability in the areas of most relevance to the banking community reflects a degree of political and stakeholder dissatisfaction with the state of the law on statutory unconscionability and how Australian courts have generally approached it to this point, which financiers and their advisers ignore at their peril;
- **Reform 'Domino Effect':** political reform and judicial interpretation of statutory unconscionability in the contexts of most interest to banking lawyers and other banking industry professionals affect cognate laws and national uniform schemes throughout Australia, and hence can neither be done in a vacuum nor sealed off from the corresponding non-banking statutory unconscionability regimes;
- **'Greenfield' Unconscionability Areas/Issues:** the multiplier effect of post-GFC litigation, ongoing governmental reviews of statutory unconscionability, and a wide range of unexplored 'test case' issues means that statutory unconscionability is likely to remain in a state and with a forward trajectory that are beyond the comfort levels of many banking lawyers and their clients



## Pre-GFC & Post-GFC 'Greenfield' Statutory Unconscionability Litigation I

- **calling up bank guarantees**
- **making margin calls on share portfolios**
- **using class actions and litigation funders in unconscionability-related actions against financial advisers after the collapse of investment groups and markets**
- **targeting financially inexperienced investors with exploitative share purchase offers**
- **advantage-taking of financially distressed borrowers by 'fringe-dwelling' mortgage brokers who extract unreasonable fees for arranging unsustainable refinanced loans**
- **recalibrating pre-GFC and post-GFC prices for credit in conditions attached to financier consents and provision of financial assistance in ongoing relationships, at least where concessions are extracted that fall outside legitimate commercial interests**
- **knowing and taking advantage of security-giving companies without complete freedom to act in their own interests**



## Unconscionability's Interface with Corporate Law and Major Corporate Deals

- ***Bell Group v Westpac* litigation not the last word on raising unconscionability in corporate contexts:**
  - result reinforces difficulty of dealing with unconscionability arguments at interlocutory stages
  - result influenced by available relief on other grounds
  - narrow reading of 'situational' disadvantage
  - conventional reading of disabling effect of disadvantage
  - heavy reliance on availability of legal advice (contrast French J in *Berbatis* litigation)
  - statutory unconscionability extends beyond special disadvantage



## Pre-GFC & Post-GFC 'Greenfield' Statutory Unconscionability Litigation II

- **making mid-transaction changes in conditions of finance that travel beyond what is reasonably necessary to protect legitimate banking interests**
- **guarding against misunderstanding or miscommunication in whether loan approval is conditional, provisional, or absolute, when it is later withdrawn on valuation, loan ratio, security assessment, material adverse change, or other ground**
- **meeting disclosure obligations in the reorganisation of debt, reclassification of liabilities, and reporting of materially adverse conditions (linked to disclosure under statutory unconscionability)**
- **extracting additional security from financially stressed corporations, engineering work-out situations for financially troubled corporate borrowers, and rearranging and refinancing corporate group debts, in circumstances (eg disproportionate security burdens, absence of corporate benefit etc) that invite exploration of the relationship between statutory unconscionability and corporate law**
- **safeguarding reverse mortgages, home equity loans, and asset lending arrangements involving vulnerable groups (eg aged family members)**





## **FSR Legislation & Unconscionability (s991A(1) CA)**

**“A financial services licensee must not, in or in relation to the provision of a financial service, engage in conduct that is, in all the circumstances, unconscionable.”**



## Unconscionability Under TPA s51AA & ASICA s12CA

- **“A corporation must not, in trade or commerce, engage in conduct that is unconscionable within the meaning of the unwritten law, from time to time, of the States and Territories.”**
- **“A corporation must not, in trade or commerce, engage in conduct in relation to financial services if the conduct is unconscionable within the meaning of the unwritten law, from time to time, of the States and Territories.”**





## Meanings & Levels of Unconscionability Regulation

***Under 'the Unwritten Law' (4 categories as described by Paul Finn):***

- **Unconscionability as the underlying concept for Equity as a whole**
- **Unconscionability as an underlying policy rationale for or element of specific equitable/other actions (eg estoppel, relief against forfeiture, constructive trusts, economic duress, breach of fiduciary obligations, unilateral mistake, doctrine of penalties, unjust enrichment etc)**
  - Coercion/exploitation/advantage-taking
  - Unconscionable exercise of rights, retention of benefits etc
- **Doctrines & remedies associated with unconscionable dealings & inequality of bargaining power:**
  - 'spousal guarantees' rules (eg *Yerkey v Jones*, *Garcia*)
  - 'special disadvantage' rule (eg *Amadio*)
  - Others (eg *Bridgewater v Leahy*)
- **Unconscionability as a direct ground of relief in its own right, unmediated by conventional doctrines (eg *Lenah Game Meats v ABC*)**



## Full Fed Ct in *ACCC v Samton Holdings* (2002)

- Unconscientious exploitation of a party's special disadvantage (eg *Amadio*)
- Defective understanding, relationship of influence, and absence of independent explanation (eg *Garcia*)
- Unconscionable departure from previous representation (eg estoppel – *Verwayen*, *Waltons Stores v Maher*)
- Relief against forfeiture and penalty (eg *Legione v Hateley* and *Stern v McArthur*)
- Rescind contracts for unilateral mistake (eg *Taylor v Johnson*)



## ***ACCC v CG Berbatis Holdings Pty Ltd*** **[2000] FCA 1376**

- **The [tenants] suffered what might be called a ‘situational’ as distinct from a ‘constitutional’ disadvantage. That is to say it did not stem from any inherent infirmity or weakness or deficiency. It arose out of the intersection of the legal and commercial circumstances in which they found themselves. That disadvantage, not being constitutional in character, was not able to be mitigated by the fact of legal representation which they had available to them at all material times.**



## ‘Situational’ Disadvantage

- Not personal disadvantage, but flows from relationship circumstances (eg imbalance of financial/legal power or information): trial judge (French J) in *ACCC v Berbatis*
- Lukewarm reaction but not clearly ruled out: High Court in *Berbatis*
- Included by the Full Fed Ct in list of ‘unconscionable conduct’ categories in *ACCC v Samton Holdings*, but in a more confined way (eg ‘Or it may be situational, deriving from particular features of a relationship between actors in the transaction such as the emotional dependence of one on the other – *Louth v Diprose*; *Bridgewater v Leahy*’)
- Potential cross-over into s51AC/s12CC criteria, which are more relational/circumstantial
- Still being argued/pleaded in later cases: eg *Leslie v GE Commercial Corporation* (2007) and *Optus v Telstra* (2009)
- Independent legal advice does not neutralise ‘situational’ disadvantage: French J in *Berbatis*
- Possible counters to ‘situational’ disadvantage:
  - High Court in *Berbatis* emphasises being disabled from making judgments in own best interests (versus being unable to act in your own best interests because of financial/legal/bargaining imbalances)
  - Won’t necessarily help where the imbalance is informational, as that goes to judgment



## Unconscionability Under TPA s51AC (cf s12CC ASIC Act)

- “A person/corporation must not, in trade or commerce, in connection with (a) the supply or possible supply of goods or services to a corporation/person or (b) the acquisition or possible acquisition of goods or services from a corporation/person, engage in conduct that is, in all the circumstances, unconscionable.” (s51AC TPA)
- “A person must not, in trade or commerce, in connection with (a) the supply or possible supply of financial services ... to another person (other than a listed public company) or (b) the acquisition or possible acquisition of financial services ... from another person (other than a listed public company), engage in conduct that is, in all the circumstances, unconscionable.” (s12CC ASIC Act)



## Unconscionability under TPA s51AC & s12CC ASIC Act – A Different Result?

- Parties' relative bargaining strengths
- Whether conditions extend beyond *what is reasonably necessary to protect legitimate interests*
- Understanding of the documents
- Any undue influence, pressure, or unfair tactics by a party or someone acting on their behalf
- Comparative prices and terms for availability of goods and services elsewhere
- Consistent with treatment of similar parties/transactions
- Compliance with any relevant industry codes
- Unreasonable failure to disclose (i) intended conduct which might affect the other party's interests and (ii) risks to the other party arising from that conduct which reasonably they might not foresee
- Willingness to negotiate terms and conditions
- Whether parties act in *good faith*
- Whether contractual right exists to vary unilaterally a term or condition of a contract





## ACCC v Westfield Clause

- ‘The Lessees irrevocably undertake that they will not at any time commence nor recommence or continue any action, claim, prosecution, litigation, arbitration, proceedings or administrative or governmental investigation or challenge whatsoever against or involving all or any of the Lessors and/or Westfield or any other person arising out of, in connection with:
  - the circumstances set out in the recitals above;
  - allegations arising out of or in any way connected with the Issues;
  - any contract, arrangement or understanding between the Lessees or anyone on their behalf relating to the Lessors and/or Westfield;
  - allegations arising out of or in any way connected with the Proceedings;  
or
  - the Lease.’





## ACCC Media Statement on Westfield

- **“The ACCC considered that the condition might have impeded the tenants from approaching or assisting the ACCC in any investigation into Westfield’s conduct.”**
- **“Westfield acknowledged that the condition may have had the effect of discouraging the tenants from approaching or assisting the ACCC, although this effect was not intended.”**
- **“The ACCC was concerned that this condition was not reasonably necessary for the protection of Westfield’s legitimate interests in ensuring the finality of the private action between Westfield and the former tenants, and arose in circumstances where there was a significant difference in the relative bargaining strengths of the parties.”**



## Not a Clean Slate for Unconscionability Arguments ...

- In 2007, High Court reinforces its *ASC v Marlborough* rule that trial courts and intermediate appellate courts should follow earlier intermediate appellate court rulings on Commonwealth or uniform national legislation, unless they are 'clearly wrong': *Farah Constructions P/L v Say-Dee P/L*
- High Court extends that to one national common law too: *Farah Constructions*
- This affects both equitable *and* statutory unconscionability
- Clear intermediate appellate court authority saying that s51AA/s12CA unconscionability arguably extends beyond unconscionable dealings: eg *ACCC v Samton Holdings*
- Clear intermediate appellate court authority saying that s51AC/s12CC extends beyond equitable grounds: eg Full Fed Ct in *Hurley v McDonald's Australia* (2000) and *ASIC v National Exchange* (2005)
- Already State Court of Appeal precedent in 2007 in unconscionability context for following Full Fed Ct approaches: *Canon Australia v Patton* (NSWCA)
- Practical/advice implications:
  - Creates quasi-presumption in favour of earlier intermediate authority – ie can't just argue on a 'clean slate' basis
  - Precedent from outside your own judicial hierarchy (eg your own state of practice) is relevant
  - Makes strike-out/summary judgment applications harder, given the inherent nature of unconscionability-based arguments



## Bank Guarantees & Unconscionability

- **Unjustified call on a performance guarantee or letter of credit can amount to unconscionable conduct (*Clough Engineering* and *Orrcon* cases):**
  - ‘Suggestions that performance guarantees or bonds should be treated as ‘good as cash’ should not, therefore, be treated as conveying some proposition of general legal application’
  - ‘There is authority that clearly supports the proposition that an inappropriate threat to call, or a call, on performance guarantees can be unconscionable conduct within s51AA of the Act’
  - ‘The principle of autonomy, applicable to a standby letter of credit, cannot override the Statute’ (echoing Austin J in *Boral Formwork*)



## Implications for Financiers and Advisers

- **Unjustified calls on performance guarantees can implicate banks and their lawyers in:**
  - Assessing whether standard exception for fraudulent call-ups applies
  - Assessing whether unconscionability under any equitable forms applies (eg relief against forfeiture where one party's breach contributes to the other party's breach, unconscionable/unreasonable exercises of contractual rights, equitable relief where insistence upon strict rights is harsh/oppressive: see *Clough Engineering*)
  - Assessing whether s51AA TPA/s12CA ASICA, or s51AC/s12CC ASICA applies to the contracting parties
  - Assessing whether implied obligation of good faith or implied negative stipulation prevents call-up of performance guarantee
  - Ensuring that client banks are not exposed to risk of 'proposing to engage in conduct that constitutes or would constitute aiding or abetting ... to contravene s51AA under Part IVA of the Act, or would, thereby, be directly or indirectly knowingly concerned in or party to the contravention' (see *Clough Engineering*)



## Unresolved/Untested Issues - Advice/Litigation

- Constitutional validity of primary statutory unconscionability
- Whether judicial attitude to statutory unconscionability will change in light of politico-regulatory reform pressures
- Further judge-made extensions of *Amadio* and *Garcia* relationships
- How far 'unconscionable conduct' extends beyond *Amadio* and *Garcia* contexts
- Unclear spread of equitable, common law, and new notions of unconscionability across the various statutory unconscionability provisions (eg how much of unconscionable dealings, relief against forfeiture etc is imported)
- Status of *Berbatis*-like 'situational' special disadvantage for B2B & B2F contexts
- Difference between 'acting in commercial interests' (*Berbatis*) v 'going beyond legitimate commercial interests' (s51AC) v good faith synchronicity with legitimate commercial interests (s51AC and 'implied good faith' cases) v 'good faith' as unconscionability indicator
- Interaction between statutory unconscionability & corporate law
- How far courts technically adhere to the HCA's instruction to follow what other intermediate courts have already ruled in this area

