# CURRENT DEVELOPMENTS: FOREIGN CURRENCY LOANS

**PETER J PERRY**

**Freehill Hollingdale & Page**
**Sydney**

**and**

**TIM HAMMON**

**Mallesons Stephen Jaques**
**Solicitors, Melbourne**

## PETER J PERRY

One of the current hot topics is the duty of bankers to customers particularly in relation to foreign currency loans. The issues usually arise when a bank seeks to recover a foreign currency loan from a customer and the claim is resisted by a defence and a cross-claim or by separate proceedings in the Federal Court alleging breach of the Trade Practices Act and such other matters as can be brought within the pendent jurisdiction of the Federal Court.

The conduct of the bank of course may give rise to a number of grounds for defence and for cross-claim. These include breach of contract, negligence, fraud, duress, breach of fiduciary duty, unconscionable conduct, breach of the Trade Practices Act, breach of legislation such as the Contracts Review Act in New South Wales or that the loan is unenforceable as being a penalty or illegal. Now each of these topics could take up a full session. Tim and I have decided to limit the discussion to current developments in foreign currency lending primarily in contract, negligence and under the Trade Practices Act.

Assume, for the purposes of the analysis, facts similar to those in the Lloyd v. Citicorp litigation. That is, a loan of Australian dollars for a term of three years which could be drawn down in nominated foreign currency, other currencies could be negotiated, on roll over date the customer could change from one currency to another, the loan could be brought on shore at any time, further advances could be made and the loan could be hedged or not.

What is the bank's obligation initially to warn the customers of the risks in relation to foreign currency borrowing or to advise in relation to hedging and currency transactions? Subsequently, what are the obligations during the term of the loan? What are the obligations in contract? In negligence, is there any duty to warn or to advise? One question which arises in the absence of any statement at all about the loan is whether there can be negligence by mere silence? That is a question which also arises under the Trade Practices Act.

We will seek to find some answers to these questions where possible by reference to recent cases. Tim Hammon is going to start and outline the background to the relevant liability regime and then I will add a few comments on some legal and incidental aspects.

**TIM HAMMON**

The last eighteen months has seen the institution of many actions against lenders of foreign currency by borrowers who have suffered significant exchange losses. Few of these actions have to date proceeded through to judgment either because they have settled or not as yet come on for hearing. The lenders have to date fared reasonably well in those case that have proceeded through to judgment. There are at least two reasons for this.

The lenders are exercising great caution in deciding whether to settle or fight (the old question) as they are understandably concerned with the precedent which may be created by a loss. Amongst the banks of course there is a great concern that when the first bank goes down there might be a string of banks going down. Admissions as to the existence of a duty are not lightly made. Such admissions may have far reaching consequences for banks involved in other litigation. In one sense then, those that have proceeded through to finality have been obviously chosen by the banks as a good case to fight.

Those actions which have proceeded through to judgment have concerned alleged breaches of contract or negligence. As will be seen from some of my following comments, a cause of action based on breach of contract or negligence is by no means a lay down mizarre for the borrower. In recognition of these difficulties borrowers are now commencing proceedings in the Federal Court alleging breaches of s.52 of the Trade Practices Act and combining claims of breach of contract and negligence in that action.

I am unaware of any action in the Federal Court alleging a breach of s.52 in this type of matter which has as yet proceeded to judgment. Whilst it is clear that each case will turn on its facts there is a risk it seems to me that banks may not fare so well in actions based on s.52. I propose to examine briefly in this paper some of the causes of action which may be pleaded against a bank by a borrower.

I think it is appropriate to point out that I have drawn considerably on a paper recently prepared by Professor David Allan, the Professor of Business Law of Melbourne University who is a consultant to my firm. David and I have worked together in researching both his paper and an earlier paper of mine and we are both content to say that we have drawn off each other in forming the comments being made today.

At the outset it is important to emphasise that there is not a unique cause of action open to a borrower against a bank simply as a consequence of the loan being denominated in a foreign currency. The old well worn analysis needs to be carried out. You identify the loss and then you look to see whether you can find a cause of action to recover that loss.

The significant feature about foreign currency litigation is that it does afford banks and their lawyers an opportunity to consider in some detail the extent to which the liability of banks to their customers has increased or more correctly their exposure to liability has increased in a deregulated and broader market in which they now find themselves. Foreign currency litigation is but one example of the consequences for banks arising out of an expanded advisory role, and it provides a useful forum for the scope of a bank's duty to be fully tested by the courts on the old established principles of contract, tort and under the emerging decisions under s.52 of the Trade Practices Act.

The issues raised in these cases include the following. Whether the banker or other financing intermediary was initially under any duty to advise the borrower of the risks involved in borrowing in a foreign currency. That is, a person comes off the street, and wants to borrow in Swiss francs. The bank says nothing and just negotiates the loan. The question is whether at the outset the bank was under any duty to warn of the risks involved? The second issue is whether the bank was under any continuing duty during the life of the loan to advise the borrower of the deteriorating position and in effect to manage the loan by advising whether he should switch currencies or crystallise the loss? The third issue is, if the bank was under such a duty, what is the source of that duty? The fourth issue is, if the bank was under such a duty, what is the standard of care required? The fifth issue is the measure of damages bearing in mind that all such loans have a speculative element. A related question is whether there was any causal link between a loss which has been suffered and the bank's activities?

Clearly a borrower who is seeking to recover his loss has to establish a duty and Peter has already briefly outlined the circumstances in which the duty can arise. I am confining my comments to three areas, namely, contract, negligence and the Trade Practices Act.

**Contract**

In the contractual area it is not so much a question of what the duty was at the outset. It is more a question of inquiry as to whether there has been an assumption by the bank of management obligation during the currency of the loan. The relationship between banker and customer being essentially contractual, the enquiry is whether there is any such obligation either express or implied in the contract. Potentially relevant express terms may be found in either written documentation or more probably in oral statements made by keen bank managers or officers in terms to the following effect:

(a) the bank will ensure that the customer will suffer no loss because of movement in exchange rates (it is difficult to believe that such statements have been made);

(b) the bank will monitor exchange rates and advise the customer when they reach certain levels;

(c) the bank will manage the loan and either switch the currency itself or advise the customer of the desirability of switching;

(d) the bank will advise the customer of exchange rates and as to likely exchange rate movements.

As will be apparent, such terms suggest a future managerial role and are promissory in nature. Where such express terms exist the enquiry will not be s to the existence of the obligation but rather as to its nature or extent.

In the absence of any express term the question is whether there will be implied into a contract a term to the effect that the bank will monitor and generally advise in relation to foreign currency loans. It seems to me that it is doubtful whether the mere relationship of banker and customer will give rise to an implied contractual duty to advise the customer on financial matters having regard to the reluctance of the courts to imply terms into contracts except where they are strictly necessary to give the contract business efficacy.

As it is essentially a question of the examination of the circumstances of each case, it is always possible. Where advice has been tendered of the nature contracted for, the borrower will only succeed in establishing a breach, it seems to me, if he is able to establish that the bank failed to exercise proper professional skill and care in the formulation of that advice. Guidance as to the extent of that obligation may be found in the decision of Lloyd v. Citicorp.

I point out for the sake of completeness that there have been, as you are all aware, recent amendments to the Trade Practices Act which bring banks more squarely under some of the implied warranties that have been "created". It may be that by reference to those implied warranties we obtain a better understanding of the nature of the duty being imposed upon banks.

Liability for contractual negligence may be excluded by appropriately worded exclusion clauses and I simply draw your attention to the recent decision of Darlington Futures v. Delco Australia. I do not propose to comment further on this issue other than save to say that to the extent to which there is a trade practices "implication", it is not possible to contract out.

**Negligence**

Apart from contract, the banker/financier may be liable to his customer in tort. Since the decisions in Hedley Byrne v. Heller and MLC v. Evatt it has been clear that an action may lie in tort for breach of a duty of care in some circumstances where information or advice is tendered without appropriate care. Alternatively a failure to advise at all may constitute a breach of duty.

Clearly the attraction of an action in negligence (for a borrower) is that relief may be given for representations made during the course of negotiations which do not form part of the contract. It gives scope to the borrower to contend that the bank was under a duty to advise at the time the loan was entered into at least in relation to potential risks associated with a foreign currency loan and in relation to hedging.

There has not been, so far as I am aware, any decision in foreign currency litigation which has held that a bank has at the outset been under a duty of care to give advice as to the nature of the risks associated with that loan. In Lloyd v. Citicorp, Citicorp conceded that it was under a duty to monitor the plaintiff's account and to advise him from time to time. The court was accordingly not called upon to consider whether at the outset such a duty did exist. While there is no such decision as yet litigation on foot will, unless it is settled, see this issue readily resolved.

It is inappropriate in this paper to go into great detail as to what is the state of authorities. The recent decision of the High Court in San Sebastian indicates that, at least in this area, a liability will arise by applying the usual test of reasonable foreseeability and applying an overriding requirement of proximity. The key element at all times will be the element of reliance. In short it seems that in Australia the duty will be imposed from a relationship of proximity and foreseeability. It seems to me that it is not going to arise simply from the banker/customer relationship. There will need to be some other active participation by the bank to create a duty.

In the context of foreign currency loans it seems to me that the relevant factors will be the degree of sophistication of the customer, the previous relationship of the parties, the terms of the contract, and generally whether the bank has sought to disclaim responsibility.

Essentially a case by case analysis is required. I do not propose to go into too much detail as to the Lloyd v. Citicorp case. It suffices to say that the plaintiff was saved $50,000 in interest but saw borrowings blossom from $500,000 to $700,000 as a result of plummeting exchange rates. In that case the Court expressed the view that the bank is not an insurer. It is not a case of res ipsa loquitur - you find a loss therefore you find a bank liable (see also Stafford v. Conti [1981] 1 All ER 691). What Rogers J was at pains to emphasise is that you need in this area to look at the market. He saw the market place for these transactions as not far removed from a gamble. That being his primary finding he then went on to make comments which indicated that, as a consequence, the content of a duty owed by a bank is not going to be very high. Hence, the plaintiff was unsuccessful as, while the duty had been conceded by the bank, Rogers J found that it had in fact been clearly discharged. The banks have taken some comfort from the decision. It is considered that a borrower may have difficulty other than in some extreme cases in either establishing a duty at the outset or establishing a breach.

There is insufficient time to examine the question of causation. It is sufficient to note that, if a borrower is able to establish a duty and a breach of it, there will still be difficult questions of causation which will need to be addressed before he will recover his loss.

**Trade Practices Act**

There are certain attractions for a borrower to try to take his action under that Act in the Federal Court.

First, section 51A has been introduced into the Act and as a consequence, representations by corporations as to future matters are taken to be misleading if the corporation does not have reasonable grounds for making the representation. Many of the representations that allegedly have been made in the foreign exchange area do have that requisite element of futurity i.e. we will look after you, you will be fine, the dollar will not fall. Section 51A casts an onus on the bank, a specific statutory onus, that it must show that it did have reasonable grounds at the time it made the representation. I do not propose to consider whether the section is retrospective. To the extent to which it is, it will facilitate the borrower's task.

Section 52 is still having its limits defined. It may not be as difficult for a borrower to fit his conduct into the objective tests imposed thereby as it is under the common law and a borrower may well be able to cast onuses onto banks which do not presently exist in the other jurisdictions. The ability to disclaim in the s.52 cases is more a question of whether you are able to establish at the outset conduct of a type which infringes the section. If you have used an effective disclaimer in your initial negotiations you will be able to establish that no misrepresentation was made. If that is not the case, disclaimers will not afford the same potential expression under the Trade Practices Act, as they do at common law.

Again I consider that one of the difficulties confronting a borrower either in the common law courts or in the Federal Court, will be the proof of a causal link between the conduct of the bank and the loss itself. Professor Allan seems to be of the view that in the foreign currency cases the immediate cause is the fall in value of the Australian dollar which would have occurred in any event and that as most borrowers who undertake the transaction will be hard pressed to assert successfully that they were unaware of any foreign currency risks, the banks will only be liable potentially if there is an excessive loss. I tend to think that there may well in fact be plaintiffs who can establish that they were unaware of the risks involved.

Another question of a general nature which will arise is contributory negligence (which might either lead to an apportionment of the loss or break the causal chain in whichever court the action is commenced). Of course, if the action is successful in the Federal Court there will be a greater range of remedies available to a borrower. These should be of concern to a bank because the powers vested in the Federal Court enable it to rewrite transactions in effect and in some cases to set transactions aside.

In conclusion it seems to me that the courts have been reluctant to impose too high a standard on banks to date. They are not insurers and they can be wrong even though they have been careful. The standard is a flexible one which will vary from case to case. I think if litigation lawyers are invited back at this time next year we will be far better able to assess whether those statement hold true.

**PETER J PERRY**

I think the first point to stress is that each case will be decided on its own facts. Each case will depend upon who did what and who said what to whom and when. The courts will then consider what legal consequences flow from this evidentiary base. Those consequences include the terms of the contract, whether it was to transact the deal only, to manage and if so whether there was some degree of discretion, whether there was a breach of that contract, whether statements amount to representations or misrepresentations, whether they were relied upon and whether conduct was misleading or deceptive.

Now the second point to note is that in many of these cases there will often be competing oral evidence. The courts take great comfort from contemporaneous documents which constitute or evidence the facts. In Stafford which was a 1980 futures case the judge described as an outstanding feature the fact that there were no documents. Rogers J in the Lloyd v. Citicorp case also noted a lack of paperwork and a lack of written documents. Cases which depend substantially on competing oral evidence absent relevant documents are fairly much a 50-50 proposition and accordingly seem to me to be high risk for a bank.

The third point to note is that often the continued financial existence of a customer depends upon success in a law suit. In these circumstances a customer may prefer to spend his available funds on funding the law suit rather than effecting only a partial reduction of his liability. These cases are often hard to settle on a commercially attractive basis to the bank and may in some cases have to be settled on a more commercially realistic basis. Now it is true that there have been no recent cases in Australia where a bank has been held liable for a loss arising out of a foreign currency loan. However I think it is also fair to say that the courts have yet to deal with a case involving a truly meritorious plaintiff.

Now just making a few random comments on some of the matters covered by Tim. It is fairly trite to say that whether there is a breach of contract will depend upon the terms of that contract, whether they be express or implied and whether there was a breach of those terms. In relation to implied terms the two relevant cases are BP Refinery v. Hastings which was a 1977 Privy Council case and Codelfa v. State Rail Authority which was a 1982 High Court case.

BP Refinery laid down the conditions which must be satisfied in order for a term to be implied. I will not go into those save to say that that decision was approved of in Codelfa and the court noted that courts are slow to imply a term and that it is not sufficient that it is a reasonable term to imply. Accordingly absent an express term whether that be oral or written and in the absence of special considerations a customer would usually have significant difficulty in seeking to imply a term into a contract for a foreign currency loan to the effect that the bank had a contractual obligation in effect to warn or advise the customer.

Tim has already commented on Darlington Futures v. Delco. That case is authority for the proposition that in Australia the courts will interpret exclusion clauses and also clauses of limitation according to the natural and ordinary meaning of the words.

In negligence, the law of negligent misstatement is reasonably well settled. The San Sebastian case was the last word on that. But what is not quite as clear is whether and when silence alone will constitute negligence. That is when there is no advice tendered and nothing is said.

The recent relevant development is the case of Sutherland Shire Council v. Heyman which was a 1984 local authority case where the High Court considered this question. The Court said in that case, nonfeasance comes within the rule in Donoghue v. Stevenson as much as misfeasance. Negligence includes omissions as well as acts. However, as a general rule the failure to act is not negligent unless there is some duty to act. That duty may arise by the conduct of the defendant, i.e. the banker.

Foreseeability of injury alone is not sufficient. But Brennan J, with whom Mason J agreed, said that the duty to act to prevent foreseeable injury to another may arise when a transaction which may be no more than a single act had been undertaken by the alleged wrongdoer and that transaction or act has created or increased the risk of that injury occurring. Accordingly in circumstances involving heavy reliance upon a banker to the knowledge of the banker there may be a self imposed duty on the banker to warn or advise the customer.

For example there might be a financially unsophisticated farmer who had relied heavily on the manager of the local bank for guidance in most of his business dealings. That you will recall was how the plaintiff presented himself in the Lloyd case. The judge however found that the plaintiff, the farmer, had previously been a banker, a businessman, a property developer and an accountant. I am not sure whether that progression evidences an improvement in his life status. The judge said the plaintiff was no where near as financially or commercially naive as he had painted himself. Accordingly I think it is fair to say that absent a statement and absent some special circumstances, it may well be difficult for a customer to establish negligence on the part of a bank based solely on the failure to warn or to advise - that is solely on silence.

It is quite clear that the courts will have regard to a number of factors in assessing the existence or otherwise of a duty. One recent New Jersey case Erlich v. First National Bank of Princeton said that the duty to give prudent advice obligated an investment manager to carefully assess the customer's circumstances both at the outset and during the term of the account. The customer's age, health, family obligations, assets and income stream both current and prospective should be evaluated to determine his ability to absorb losses in the event that that investment was unsuccessful.

I do not think the Australian courts have gone quite that far although it is clear from the recent cases that two of the factors that are looked at very closely are the nature of the market and the identity of the customer. In Lloyd Rogers J drew the distinction between the treasurer of a multinational corporation and a farmer in the western district of New South Wales. He said that in determining the extent of the duty it was essential to have regard to the nature of the market to which the plaintiff committed his financial future.

Now just turning to the area of trade practices the recent development in terms of cases is a case called Rhone-Poulenc which was a 1987 Federal Court case. That dealt with the sale of unregistered product which was subject to seizure and forfeiture, and the question arose in that case whether mere silence could constitute misrepresentation. The decision was a 2-1 decision. Mr Justice Lockhart noted that misleading or deceptive conduct under the Act generally although not always consisted of a misrepresentation. He did say that he thought it difficult to conceive how mere silence by an alleged contravener could be sufficient to attract the operation of s.52 of the Act but he did add that when all the relevant circumstances of the case are analysed silence may be a critical matter upon which reliance is placed to establish misleading or deceptive conduct. Mr Justice Jackson said it was not correct to treat s.52 cases as applying only to cases where the conduct of the respondent could amount to a misrepresentation under the general law. The ultimate question in each case is whether the particular circumstances, the respondent's conduct, whether constituted by act or omission, by communication or by silence is or is likely to be misleading or deceptive. Accordingly it seemed to him that it followed that silence in circumstances where the common law would not impose a duty to speak could constitute conduct which was likely to be misleading or deceptive under the Trade Practices Act.

Section 51A of the Act is also a new development being a recent amendment. This provides that a representation as to a future matter may be taken to be misleading unless the corporation has reasonable grounds for making the representation. The onus of establishing such grounds is on the corporation. Accordingly to the extent that a bank makes representations with respect to future matters it will have the onus of establishing reasonable grounds for the making of that representation. And that in certain cases may be a very significant disadvantage to banks.

I have been directed to finish. Perhaps if I could just add, leaving fiduciary duty aside, a point about foreign currency judgments which was raised a little earlier. In New South Wales it is the day to day practice to give judgments in foreign currency. There have be two 1986 Queensland cases where the court has allowed a claim for a foreign currency judgment to be asserted. As far as I know this matter has not been considered by any appellate court and it has certainly not been considered by the High Court of Australia.