LIABILITY OF LENDERS TO OTHER LENDERS FOR MISLEADING AND DECEPTIVE CONDUCT

— Recent Developments

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INTRODUCTION

This paper is written without the benefit of having seen the papers of Stephen Charles and Schuyler Henderson. Thus I may cover, albeit inadequately, areas which they may deal with more fully.

I understand that Stephen's paper will fully address the questions of inducement and causation. In particular, whether these questions are to be determined by reference to standards of reasonable behaviour. Accordingly this paper will not deal with these matters.

I will briefly mention some causes of action which are available to a plaintiff bank in an action against another bank where both banks are lenders to a borrower.

THE TORT OF DECEIT OR FRAUDULENT MISREPRESENTATION

There must be a misrepresentation of fact. The representation must be made with the knowledge that it is false or with reckless disregard as to its truth. It must be made with the intention that it should be acted on by the plaintiff in a manner which results in damage to him, and the plaintiff must have acted on the representation and suffered damage as a result.

Deceit may found an action for damages but also may be used as a basis for rescission of a contract which the plaintiff was induced to enter by the defendant's deceit.

INNOCENT MISREPRESENTATION

At common law a non-fraudulent misrepresentation inducing entry into a contract is not actionable unless it is also a term of the contract, in which case damages may be awarded if it is a warranty. If it is a condition, damages and rescission may be obtained.

NEGLIGENT MISSTATEMENTS

It is settled by **Hedley Byrne & Co v Heller & Partners Limited** ([1964] AC 465) and **MLC v Evatt** ((1968) 122 CLR 628) that certain persons, whose business it is to provide information or advice of a kind calling for a high degree of skill or competence, can be liable for financial loss resulting from a negligent misstatement of fact or opinion, although the misstatement was honestly made, and there was no fiduciary or contractual relationship between the parties.

A person is under a duty to take reasonable care that advice or information which he gives to another is correct if he knows, or ought to know, that the other person relies upon him to take such reasonable care and may act in reliance upon that advice or information, and if it is reasonable for the other to so rely and act: **Shaddock & Associates Pty Ltd & Anor v Parramatta City Council (No 1)** ((1981) 150 CLR 225 at 231). It is not reasonable to rely upon advice or information unless the person giving it either had some special skill which he undertook to apply for the assistance of another or was so placed that others could reasonably rely upon his judgment or his skill or upon his ability to make careful inquiry: **Shaddock v Parramatta** (at 231) and **San Sebastian Pty Ltd v The Minister** ((1986) 162 CLR 340 at 355).

These principles have been applied to information or advice provided by banks in the course of their business; eg **Hedley Byrne v Heller** (references regarding a company given by bankers to other bankers at customer's request); **Compafina Bank v Australia & New Zealand Banking Group Ltd** ((1984) Aust Torts Reports 80-546) (letter of introduction provided by ANZ to a Swiss bank about a customer).

Liability also attaches to a failure to disclose information where the defendant has so conducted himself that a false impression is created; eg **Curwen v Yan Yean Land Co Ltd** ((1891) 17 VLR 745); **Awaroa Holdings Ltd v Commercial Securities and Finance Ltd** ([1976] 1 NZLR 19).

BREACH OF FIDUCIARY DUTY

In certain relationships it may be argued that a bank owes a fiduciary duty to another bank in relation to negotiations with and in respect of a borrower. P D Finn in his book 'Fiduciary Obligations' wrote:

> *'A fiduciary for this purpose is, simply, someone who undertakes to act for or on behalf of another in some particular matter or matters. The undertaking may be of a general character. It may be specific and limited. It is immaterial whether the undertaking is or is not in the form of a contract. It is immaterial that the undertaking is gratuitous. And the undertaking may be officiously assumed without request.'*

The relevance of the existence of fiduciary obligations is the availability of equitable remedies, such as damages in equity.

In **UBAF Ltd v European American Banking Corp** ([1984] 2 All ER 226) Ackner LJ, at p236, said:

> *'... quite clearly the defendant was acting in a fiduciary capacity for all the other participants. It was the defendant who received the plaintiff's money and it was the defendant who arranged for and held, on behalf of all the participants, the collateral security for the loan. If, therefore, it was within the defendant's knowledge at any time while it was carrying out its fiduciary duties that the security was, as the plaintiff alleges, inadequate, it must, we think, clearly have been its duty to inform the participants of that fact and its continued failure to do so would constitute a continuing breach of its fiduciary duty.'*

SECTION 52 TRADE PRACTICES ACT

The making of a representation, or the failure to disclose certain information, by one bank to another may constitute misleading or deceptive conduct in breach of section 52 of the *Trade Practices Act* 1974

In Australia the breadth of section 52, notwithstanding the need to establish reliance on the breach leading to loss to obtain damages under section 82, probably has rendered other causes of action obsolete, except where the actions of one bank are a clear breach of a contract.

In other contexts, section 11 of the *Fair Trading Act* (Vic) and other equivalent State legislation, is relevant.

Scope

The terms 'misleading', 'deceptive' and 'likely to mislead or deceive' are not defined in the Act. In **Weitmann v Katies Limited** ((1977) ATPR 40-041 at p17,444) Franki J said:

> *'The most appropriate meaning for the word "deceive" in the Oxford Dictionary is: "To cause to believe what is false; to mislead as to a matter of fact, to lead into error, to impose upon, delude, take in." ... The most appropriate definition in that dictionary for the word "mislead" is: "To lead astray in action or conduct; to lead into error," "to cause to err."'*

Such definitions lack precision, but one thing which is clear from the cases is that the conduct as a whole must be considered in deciding whether there has been a breach of section 52. In **Parkdale Custom Built Furniture Pty Ltd v Puxu Pty Ltd** ((1982) ATPR 40-307 at p43,783) Gibbs CJ said:

> *'The conduct of a defendant must be viewed as a whole. It would be wrong to select some words or acts which, alone, would be likely to mislead if those words or acts, when viewed in their context, were not capable of misleading. It is obvious that where the conduct complained of consists of words it would not be right to select some words only and to ignore others which provided the context which gave meaning to the particular words. The same is true of facts.'*

Intent

A breach of section 52 does not require proof of intent. In **Hornsby Building Information Centre Pty Ltd v Sydney Building Information Centre Limited** ((1978) ATPR 40-067 at p17,693), Murphy J simply said:

> *'Conduct is deceptive or misleading if it has a capacity or tendency to mislead or deceive; intention to mislead or deceive is not required.'*

Conduct, which would be classified under common law as an innocent misrepresentation, may fall within the ambit of section 52.

Silence

The overall impression created by the conduct of the defendant is the test as to whether section 52 has been breached. Silence, coupled with the relevant circumstances, may mislead. This misleading or deceptive conduct may constitute a breach as much as will a positive assertion. Silence, which is not inadvertent, may well constitute engaging in conduct.

In **Lee Gleeson Pty Ltd v Sterling Estates Pty Ltd** ((1991) ATPR (Digest) 46-072) the owner of partially built units was in financial difficulties and following negotiations between the owner, the builder and the owner's bank, the builder alleged the bank bound itself to ensure that the owner paid certain monies to the builder. Initially the owner authorised the bank to make payments to the builder but later countermanded that authority, just before the settlement of the sale of one block of units.

The bank did not inform the builder that the authority had been countermanded. Brownie J held the bank was liable under section 52. The bank's letter did not say whether or not its authority was revocable, but the court doubted whether a layman would have appreciated the distinction and assume that the authority was revocable.

The bank's customer had authorised the bank to write the letter and the customer delivered that letter to the builder on behalf of the bank, so that the customer had authorised the bank to reveal information which otherwise would have been confidential to the owner and the bank. It followed that if the customer changed its instructions to the bank, it immediately authorised the bank to advise the builder of those changed instructions.

In these circumstances section 52 imposed on the bank a duty of disclosure. When the bank chose to go onto settlement without disclosing to the builder its changed instructions, it was engaging in conduct which was likely to mislead or deceive the builder.

Future Matters

Section 51A (1) deems a representation as to a future matter (including the doing of, or the refusing to do any act) misleading, unless the corporation has reasonable grounds for making it. Under section 51A (2) the onus of proving reasonable grounds rests with the maker of the statement.

In **Chiarabaglio & Anor v Westpac Banking Corporation** ((1989) ATPR 40-971) Foster J, at p50,630, stated:

> *'Even allowing that (the bank officer's) statement as to absence of significant risk was a statement of opinion rather than of fact, being, as I have found, an opinion that he in fact held, there was, in the circumstances, no reasonable basis for that opinion.'*

Whilst on appeal the factual basis for this statement became unsure, the judge's approach was not doubted.

Disclaimers

Another reason why plaintiffs may see little need to rely on the traditional causes of action when seeking damages is that disclaimers or contractual terms excluding liability may be ineffective in a claim brought under section 52.

In **Mackman v Stengold Pty Ltd** ((1991) ATPR 41-105) documents noting income projections for a franchise business to be purchased incorporated an attached disclaimer of the accountants which stated:

> *'We have prepared the attached Profit and Loss Statements on pages 1 and 2 supplied by officers of [the vendors] at their request and exclusively for their use and benefit. We have not audited either the basic records or the statements. Accordingly we express no opinion as to whether such statements present a true and fair view of the results of the company or of financial position, no warranty of accuracy or reliability is given, and we accept no responsibility whatsoever to any person other than our clients for any loss or damage occasioned by reliance on the information contained in these statements or for any error or omissions, therein however caused.'*

Evidence established that there was no analysis or compilation done by the accountants. Spender J, at p52,629, said:

> *'In my opinion the disclaimer, which gave to the representations a spurious authenticity, was an attempt to evade liability for the known and contemplated consequences of their conduct ... [being the conduct of the accountants].'*

His Honour continued, at p52,632:

> *'The attempt to disclaim in my view is an ingenuous but unsuccessful attempt to absolve its authors from liability for the dissemination and no doubt inducing quality of the document, when they knew that that was the purpose for which the documents were prepared.'*

In **Keen Mar Corporation Pty Ltd v Labrador Park Shopping Centre Pty Ltd** ((1989) ATPR (Digest) 46-048) Spender J again, at p53,161, commenting on a formal express disclaimer, said:

> *'Equally, however, it [the disclaimer] cannot be conclusive on the question of inducement. So to hold would in many cases be a convenient roundabout route of circumventing the policy of the statute.'*

Other Contractual Exclusions of Liability

It would appear that a provision in a contract specifically denying liability for material, which was misleading or deceptive to the very people by whom it was to be used, acknowledges that it was designed to induce those people to enter into a contract and may be ineffective. In **Collins Marrickville Pty Ltd v Henjo Investments Pty Ltd & Ors** ((1987) ATPR 40-782) Wilcox J, at p48,539, said:

> *'If in fact the misleading conduct of the respondent has induced an applicant to enter into an agreement, that inducement is not negated because, in the agreement itself, the applicant says to the contrary. Of course, the fact that the applicant so says may bear upon the question whether he or she should be believed in asserting that the misleading conduct was an inducement; although in the case of a printed exclusion clause this may be of little moment. And, once it is found as a fact that the conduct induced the transaction, the Act itself gives a remedy.'*

I will consider four areas where one bank may be liable to another under section 52.

1. **Where a bank is a manager of a syndicate and may incur liability to members of that syndicate.**

Until recently, no Australian case had proceeded to trial as to the obligations and liabilities of managers or agents of syndicates. However in Victoria, NatWest Australia Bank Limited sued Tricontinental Corporation Limited in respect in the negotiations for a syndicated loan. The trial has finished and the parties are awaiting the decision of Mr Justice McDonald.

The Statement of Claim alleges that Trico approached a number of banks, including the plaintiff, and requested them to join with Trico to provide a facility to Pro Image. Trico had prepared a proposal concerning the facility to be offered to Pro Image and provided a copy of the proposal to the plaintiff. The proposal was provided and the statements therein were made to induce NatWest to join with Trico and the other lenders to provide the facility. The financial statements provided to NatWest did not disclose contingent liabilities under guarantees of about $60M. It was alleged that the making of the representations as to the financial statements constituted conduct that was misleading or deceptive or likely to mislead or deceive contrary to the provisions of section 52.

The Statement of Claim was also based on breach of fiduciary duty and negligent misstatements.

The defence of Trico claims that the guarantees were released. So I assume it has been argued that the existence of the guarantees did not cause any loss to NatWest. I also assume that NatWest has argued that, had it known of the existence of these guarantees, it would not have provided the facility at all and not have incurred a loss. The decision on this question of causation will be fascinating.

There are other examples where one can imagine a syndicate member making claims on the manager. If the manager asserted that certain securities in favour of the syndicate would be effective but, in fact, were not. A manager may assert that a guarantee or other engagement of support issued by a Government is enforceable without clear legislative power enabling it to be given and without an appropriation. If the effectiveness of such guarantee is not questioned by a syndicate member and that syndicate member has not engaged lawyers to consider the matter, is the manager liable to the syndicate member if the guarantee fails?

A further example may be where the manager passes on misleading information prepared by the borrower. I do not have in mind where the manager is a mere accessory (see **York v Lucas** (1985) ATPR 40-622). Rather, where the manager passes on information prepared by the borrower with the intention that the participants make their decisions to participate relying upon that material. What is the liability of the manager in these circumstances? How does it compare to the case where the borrower directly provides the material to the participants?

If the manager passed on the material specifically making no statement as to its truth or completeness, the question is what were the circumstances in which the material was provided. I suggest that in any meeting, more is going to be said other than 'I make no statement as to its truth or completeness'.

There may well be some cases where the only sensible course is for a manager to take reasonable steps to verify the information, perhaps by the appointment of investigating accountants. With published annual reports, can the manager take comfort from the fact that the borrower's financial statements have been audited?

Clearly, silence in the context of overall conduct may well amount to misleading and deceptive conduct. If reliance can be established and loss was incurred, damages may be awarded under section 82.

A disclaimer may appear in a proposal circulated by a manager to prospective syndicate members stating that the manager takes no responsibility for its accuracy or completeness and that it is provided to prospective participants solely on the basis that they will be responsible for making their own independent assessments and investigations.

Is this type of disclaimer effective? Clearly it may not be as effective as its terms indicate because the purpose of the memorandum is to inform participants and to induce them to participate, whilst alerting them to the fact that the manager takes no responsibility for its content and that the prospective participants should make their own enquiries.

Similarly a typical agreement between the manager and participants would provide that the manager shall not be responsible to the participants for the 'value, validity, effectiveness, genuineness, enforceability or sufficiency of the Information Memorandum or Transaction Documents', coupled with a provision that the entirety of the relationship between the manager and the participants is contained in the document.

If, for example, the proposed borrower and manager knew of a significant debt not disclosed in the proposal, is the manager liable? Further, if the manager knew that a proposed participant had asked the borrower whether any such liability existed and was told no, I suggest that the conduct of the manager would be misleading and deceptive and any disclaimer, either in the manager's proposal or subsequent contractual documentation, would not be effective to avoid liability. The participant was induced to execute the document by the misleading and deceptive conduct of the manager prior to its execution and the clear words of the legislation will not be overridden by such provisions.

Simply put, was the conduct of the manager misleading or deceptive or likely to mislead or deceive? If so it is liable, notwithstanding the provisions in the agreement, provided that the reliance and causation tests are satisfied by the plaintiff.

2. Where a bank indicates its intention to provide loans when no such decision has been made and no loan is made.

I can recall an occasion where our bank was asked to participate in the long term funding of a new proposal. Another lender wished to provide bridging finance and asked us to write that we were 'highly confident' that we would participate in the eventual funding. Needless to say as the matter had not been fully considered by our bank, we refused to provide such a letter.

It is interesting to note that in a book entitled 'Highly Confident, The Crime and Punishment of Michael Milken' by Jesse Kornbluth, the development of 'Highly Confident' letters in the 1980s was considered. Typically such a letter advised that Drexel Burnham Lambert was highly confident that it could raise the money for a purchase (usually by the issue of junk bonds subordinated to the loans of the commercial banks). Drexel Burnham Lambert was stating that it could sell junk bonds to assist in financing what may have been regarded previously as an unbankable transaction. Commercial banks, with the comfort of subordinated funding, could more readily supply long term funding to finance a takeover. The book suggests that this type of letter transformed US corporate culture overnight - any company could be a takeover target.

This book says the idea of the letter was presented to senior management at Drexel Burnham Lambert on the basis that it was not legally binding. 'Drexel's president agreed that the lack of legal commitment made the letter an interesting experiment - if it worked, great; if not, nothing significant was lost.'

I have no doubt that in Australia a bank which issued such a letter would incur a liability under section 52, as expanded by section 51A, unless the issuer of the letter had reasonable grounds for believing that the finance would be available. If an Australian bank issued such a letter in relation to its own commitment to provide finance it would be bound to provide that finance. Bankers may seek to qualify such a commitment, but the question remains what was the overall impression created by the bank's conduct and its statements.

In **Adour Holdings Pty Ltd (in liquidation) v Commonwealth Bank of Australia** ((1991) ATPR 41-147) the plaintiff sought a loan from the bank for $5.4M for a development project, the first stage of which was the acquisition of land for $1.45M. The administration of the bank approved the first loan of $1.45M but stipulated that this approval was not to be construed as a commitment to the proposed development as a whole. In particular the manager was asked to impress this upon the applicant. The manager wrote to the applicant confirming the approval of $1.45M and mentioned there was no commitment as to the balance. In a number of subsequent discussions the branch staff made statements to the effect that the bank would not have approved the finance for the purchase of the land unless it was satisfied with the total project. The encouragement given to the applicant by the branch continued over a number of months until, finally, the application for the second loan was rejected. Burchett J, at p53,100, quoted Davies J with approval:

> *'But it was not misleading or deceptive unless it inferred a greater degree of commitment to the project than there actually was.'*

Burchett J continued:

> *'This neatly encapsulates the basis on which I think that, in the present case, the conduct in question was misleading and deceptive; it inferred (indeed expressly stated) a greater degree of commitment to the project on the part of the Bank than there actually was.'*

3. **Whether a member of a syndicate has an obligation to pass on information to other syndicate members.**

It is possible that the conduct of a syndicate member, viewed as a whole, may be misleading or deceptive where that syndicate member knows of matters, which may be destructive of the viability of the borrower, and fails to inform other syndicate members. Typically, an agreement between the manager and participants would not require a participant to pass on such information. However, I suggest it is not difficult to imagine circumstances where the conduct of that participant, perhaps as the transactional banker for the borrower, including his silence as to adverse matters, could constitute misleading and deceptive conduct. Perhaps the syndicate decided to waive a breach of the facility agreement in the mistaken belief that the borrower continued to be viable.

4. **Where two lenders have independently lent to one borrower and subsequently with the approval of the borrower, consult as to their loans and the customer.**

Incorrect information as to the extent of a borrower's indebtedness to one bank, the continuing viability of the borrower's business or the extent or the enforceability of securities which, if passed to the other bank to induce it to act in a certain way, may well result in a breach of section 52. If the information was relied on, the bank making the statement could well be liable to the other.

CONCLUSION

The only safe course of conduct for a bank is to tell the truth and the whole truth. No omission can be permitted which would render what was said misleading or deceptive.

A bank should not make a statement as to facts without actual knowledge and certainly without informing the recipient of the statement of the extent of the bank's knowledge and warning the recipient that, accordingly, the bank may have no basis for believing the statement to be true. In appropriate cases, it, perhaps, should refuse to pass on information provided by others, without seeking to verify the information.

A disclaimer or contractual exclusion of liability, in the context of certain overall conduct, may not be effective.

It is certainly clear that a bank should not make a statement that it will act in a certain way without having formed a firm intention to act in that way.