LIABILITY OF LENDERS TO OTHER LENDERS FOR MISLEADING AND DECEPTIVE CONDUCT

— Recent Developments

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Part V of the *Trade Practices Act* (TPA) is beguilingly headed 'Consumer Protection'. As Heydon has put it:[1]

> *'Consumerism is today as virtuous as motherhood and apple pie .... Consumerism demands that only safe products be sold, that no lies be told in the selling of products, that all information relevant to the value and operation of a product be disclosed when it is sold, that redress be available against sellers despite standard form exemption clauses, and against manufacturers despite the law of negligence and the doctrine of privity of contract.'*

Section 52 of the TPA provides that *'a corporation shall not, in trade or commerce, engage in conduct that is misleading or deceptive or is likely to mislead or deceive'.*

Taken with section 82 of the TPA, the section creates a new cause of action which permits a person who has suffered *'loss or damage'* to recover damages by action against that person or against any other person involved in the contravention of section 52.

In **Brown v Jam Factory Pty Ltd** Fox J said:[2]

> *'Section 52(1) is a comprehensive provision of wide impact, which does not adopt the language of any common law cause of action. It does not purport to create liability at all, rather does it establish a norm of conduct, failure to observe which has consequences provided for elsewhere in the same statute, or under the general law. The possible width of its operation and the fact that it may overlap other sections in Divn 1 of Pt V is recognised by sub-section (2). In my view effect should be given to the ordinary meaning of the words used. They should not be qualified or (if it be possible) expanded, by reference to established common law principles of liability. At the same time, known concepts, such as those concerning the torts of deceit and passing off and the analyses made of them over the years, may prove helpful in deciding a case under section 52(1). It does not matter that a representation constituting "conduct" relates to a future event, or that what is said may not amount to a warranty. The view has not been taken that "conduct" necessarily involves a continuing course of conduct, or of repeated events, or of conduct known to the public or a group of the public. ... Intention is not a necessary ingredient. ... The tort is more objective, but it is not precisely correct to apply the concept of the hypothetical reasonable man. One looks to the audience, or the relevant part of it, and, eccentricities and absurdities aside, asks whether the conduct complained of was to them misleading or deceptive; but the question is not simply whether they (or he) were (or was) misled. Whether the conduct was misleading or deceptive is a matter for the court. Doubtless, the audience to be considered can be classified as "consumers". Conduct will not mislead or deceive a person having a conscious awareness of the true facts or correction information.'*

Furthermore in **Henjo Investments Pty Ltd v Collins Marrickville Pty Ltd** Lockhart J said:[3]

> *'Misleading or deceptive conduct generally consists of representations, whether express or by silence; but it is erroneous to approach s 52 on the assumption that its application is confined exclusively to circumstances which constitute some form of representation. The section is expressed briefly, indeed tersely, in plain and simple words which, if I may be forgiven for repeating them, say simply: "a corporation shall not, in trade or commerce, engage in conduct that is misleading or deceptive or is likely to mislead or deceive". There is no need or warrant to search for other words to replace those used in the section itself. Dictionaries, one's own knowledge of the developing English language and ordinary experience are useful touchstones, but ultimately in each case it is necessary to examine the conduct, whether representational in character or not, and ask the question whether the impugned conduct of its nature constitutes misleading or deceptive conduct. This will often, but not always, be the same question, as whether the conduct is likely to mislead or deceive.'*

It will be seen that the intent of the defendant is not relevant in an action based on section 52. The sole question is whether the conduct was misleading or deceptive or likely to mislead or deceive. Not only is the intention of the defendant irrelevant, but so also is the question of negligence. A mis-statement made without negligence is as actionable as a statement fraudulently made, under section 52. It makes no difference whether the mis-statement is one of fact or law. A statement of opinion is capable of constituting misleading conduct and a prediction or statement as to the future will be false and misleading if it contains a false statement as to an existing or past fact which may include the state of mind of the maker of the statement or a person whose state of mind may be imputed to the maker of the statement.

In **James v ANZ Banking Group Ltd** Toohey J said that:[4]

> *'A statement involving the state of mind of the maker of the statement, eg promises, predictions and opinions, ordinarily conveys the meaning that the maker of the statement had a particular state of mind when the statement was made and that there was basis for that state of mind. If the meaning contained in or conveyed by the statement is false in that or in any other respect, there will have been a contravention of section 52.'*

In **Thompson v Mastertouch TV Service Pty Ltd** Franki J held that,[5] for the purposes of section 52, statements as to future events or conduct would be misleading or deceptive when made only if the maker of the statement either knew it to be false or made it recklessly not caring whether it was true or false. To overcome the decision in **Thompson**, Parliament introduced section 51A in 1986, the effect of which is that the representee no longer has to prove the falsity of a statement with respect to any future matter. The statement is taken to be false, unless the defendant had reasonable grounds for making the representation and adduces evidence that it had such reasonable grounds. Silence may constitute misleading or deceptive conduct, where circumstances give rise to a duty to disclose something. In these situations, a party may be entitled to draw an inference, eg that something does not exist, because the other remained silent. The consequence of all the foregoing is that a person may be in breach of section 52, but with no reasonable means of knowing that a breach has taken place.

Partly because intent is not an element in determining whether conduct is in breach of section 52, a disclaimer of the truth or otherwise of a particular representation will not, of itself, absolve the maker of the representation from liability. Similarly a statement that no representations have been made or relied on, will not necessarily absolve the maker of the representation. In each case the section requires proof that the defendant has engaged in misleading or deceptive conduct. The next inquiry is whether any party has been damaged *'by conduct'* of the relevant kind, which usually means by acting in reliance upon such conduct. Disclaimers of truth or reliance may have little relevance to the court's decision on the question of reliance or inducement. An exclusion clause is likely to be equally unhelpful. For example in **Clarke Equipment Australia Ltd v Covcat Pty Ltd** Sheppard J said:[6]

'The remedy conferred by section 52 of the Trade Practices Act will not be lost whatever the parties may provide in their agreement. If a vendor of goods has engaged in misleading or deceptive conduct, the law makes that person accountable for loss and damage suffered as a result of the unlawful conduct. That conduct will usually have been committed, as in this case, prior to the signing of any contract. If, as a result of the conduct, a person is induced to enter into a contract and suffers loss, an action to recover it lies. The terms of the contract are irrelevant.'

STATE BANK OF SOUTH AUSTRALIA v ROTHSCHILD AUSTRALIA LIMITED AND OTHERS[7]

This litigation was caused by the financial collapse of the National Safety Council (NSCA) in March 1989. In February 1989 NSCA had been indebted to Rothschild Australia Limited (Rothschild) for financial accommodation of some $16 million for various advances made in August and September 1988 under a finance facility granted in 1986 and accrued interest. NSCA and its chief executive, John Friedrich, arranged during February 1989 to borrow from State Bank of South Australia (SBSA) sufficient to discharge the debt owed to Rothschild under the 1986 finance facility. SBSA then paid the $16 million to Rothschild in discharge of the indebtedness of NCSA to Rothschild and NSCA became correspondingly indebted to SBSA. SBSA's case was that it paid on the understanding that the money NSCA had borrowed under the 1986 finance facility provided by Rothschild had been used to acquire certain safety and rescue equipment of a kind used by NSCA in its operations, and that Rothschild had security over that equipment for the debt and that SBSA would obtain the benefit of security over the same equipment. SBSA alleged that it was encouraged in that understanding by a representation made to it by Rothschild before SBSA paid Rothschild. The representation was said to be conveyed in a letter, the relevant parts of which read as follows:

'We refer to our telephone conversation this morning. We understand that equipment purchased by the National Safety Council of Australia - Victorian Division and financed by Rothschild Australia Limited under a secured finance facility is to be refinanced by the State Bank of South Australia under a lease facility. We confirm that upon repayment of all loans relating to the purchase of this equipment, title to this equipment will pass to the State Bank of South Australia free from all claims encumberances [sic] liens or other adverse interest of any kind.

We have been advised that the State Bank of South Australia will be advancing the necessary funds on Friday 17 February 1989 and that you have instructions to remit the funds directly to Rothschild Australia Limited.

Kindly arrange for the amount of $16,053,005.72 to be telegraphically transferred to our bank account on 17 February 1989. The details of our bank account are as follows ....'

The letter was duly sent to SBSA by Rothschild on 15 February 1989 and the money paid as requested on 17 February. In fact Rothschild had no security over equipment that SBSA understood had been charged in favour of Rothschild. A chattel mortgage taken by SBSA over what it understood to be equipment that had been charged in favour of Rothschild was apparently worthless. Indeed the equipment that SBSA supposed was to provide its security probably did not exist. The trial judge, Tadgell J, said that the transaction between SBSA and Rothschild *'laboured under a regrettable and expensive misunderstanding between the two people who represented those parties in negotiating it. ... The misunderstanding seems to have been fostered by Friedrich, who was largely, if not wholly, responsible for bringing SBSA and Rothschild together.'* Tadgell J found that both of the negotiating parties acted throughout in complete good faith, and that each was generally favourably impressive as a witness.

SBSA's case was that Rothschild, by its letter of 15 February, represented to SBSA:

(i) that the money lent by Rothschild to NSCA had been applied by NSCA to purchase equipment;

(ii) that Rothschild held security over **that** equipment, (which necessarily existed);

(iii) that, upon paying Rothschild sufficient to discharge the debt for money lent by Rothschild to NSCA, SBSA would (or could) obtain in substitution for Rothschild, security over the same property as that over which Rothschild had had security.

The judgment of Tadgell J includes the following passage:

> *'Mrs C (the SBSA negotiator) had no idea at all of the form of the security held by Rothschild. She never sought to find out and could not have ascertained it from the letter. Nor did she know or seek to discover what property furnished Rothschild's security, and she could not have ascertained that from the letter. Moreover Mrs C did not know until the morning of 17 February what property NSCA was offering as security to the plaintiff. When she received what purported to be a description of it she unfortunately took no steps to seek to match it with any equipment over which Rothschild might have had security; or indeed to ascertain where it was or to identify it otherwise than by reference to the cryptic descriptions given in the draft equipment schedule that had been prepared by NSCA for the chattel mortgage. Mrs C expected that NSCA would provide invoices from the suppliers of the equipment but did not sight them or seek to sight them before arranging for SBSA to pay over the money on 17 February. She assumed that NSCA owned the equipment described in the equipment schedule because Friedrich had told her so, and must therefore have assumed that it was not on lease to NSCA from Rothschild.'*

On the evidence Tadgell J found that the letter of 15 February was capable of conveying the first of the representations alleged by SBSA, but was not reasonably capable in the circumstances of conveying the second or third of the alleged representations. Tadgell J found that the first representation was true and that even if the letter had conveyed the second and third representations, he was not satisfied that SBSA was induced by either of them to act in causing SBSA to advance the money to NSCA.

On appeal, the Appeal Division of the Victorian Supreme Court (Fullagar, Brooking and Beach JJ) reversed the decision of the trial judge, holding that each of the representations alleged was contained in the letter of 15 February, and that the trial judge had been wrong in declining to find that the misrepresentations induced SBSA to pay the money to Rothschild, having regard to what was said to be the inducing tendency of the representations. Particular reliance was placed on **Gould v Vaggelas**[8] which contained the following statement of principles applicable to inducement:

> '1. *Notwithstanding that a representation is both false and fraudulent, if the representee does not rely upon it he has no case.*
>
> 2. *If a material representation is made which is calculated to induce the representee to enter into a contract and that person in fact enters into the contract there arises a fair inference of fact that he was induced to do so by the representation.*
>
> 3. *The inference may be rebutted, for example, by showing that the representee, before he entered into the contract, either was possessed of actual knowledge of the true facts and knew them to be true or alternatively made it plain that whether he knew the true facts or not he did not rely on the representation.*
>
> 4. *The representation need not be the sole inducement. It is sufficient so long as it plays some part even if only a minor part in contributing to the formation of the contract.'*

None of the four judges involved raised any difficulty about the application of section 52 of the TPA to the facts of the case. No question of assessment of damages or apportionment of loss has yet arisen in the trial, since the proceedings thus far have considered only the question of the liability of Rothschild. The High Court declined special leave to appeal, and the case will now return to the trial judge for consideration of assessment of damages, and related questions.

NATWEST AUSTRALIA BANK LTD v TRICONTINENTAL CORPORATION LTD AND ANOTHER

In 1988 Pro Image Studios (the borrower) gave a mandate to Triconintental Corporation (Trico) to arrange and lead a syndicate of lenders to Pro Image Studios in the amount of $50 million. An information memorandum was prepared and distributed to the syndicate members. The information memorandum did not disclose that the borrower had acted as a guarantor for related companies. The potential liability under the two such guarantees was in excess of $60 million. One of these guarantees had in fact been given to Trico itself. Trico did not disclose to the other syndicate members the existence of the guarantees. During the course of NatWest Australia Bank's (NatWest) due diligence, it enquired of a Trico representative whether or not there were any contingent liabilities and was told that these were nominal. Furthermore as part of the offering memorandum, the 1987 audited accounts of the borrower had been provided. These accounts did not disclose the existence of the Trico guarantee that was in place before the end of the 1987 financial year. NatWest advanced $10 million under the syndicated facility to the borrower. In May 1989 a dispute arose between Pro Image Studios and another lender, the ANZ Bank, which threatened to register a mortgage debenture and precipitate the appointment of a receiver. Ultimately a work out plan was proposed by other banks which had not been part of the syndicate, and agreed to by the syndicate. During the course of a syndicate meeting in May 1989, Trico disclosed the existence of the guarantees to the syndicate and agreed to their discharge which occurred shortly afterwards. The syndicate continued to roll over bills pursuant to the facility until December, 1989 when it went into default. Ultimately a loss of some $7.6 million was suffered by NatWest on the lending when the loan receivable was sold for 23 cents in the dollar in July 1990.

NatWest claimed that Trico owed it a duty to disclose the existence of the guarantees. That duty was owed as a fiduciary, in negligence, and pursuant to section 52 of the TPA. Trico denied any duty to NatWest and relied, inter alia, on disclaimers in the information memorandum. The Syndicate Management Agreement included the following provisions:

'3.11 *Nothing herein shall be construed as constituting a partnership between the lenders and nothing herein shall constitute the Syndicate Manager a trustee for the Borrower, any Lender or any other person, or the agent of the Borrower or as acting in a fiduciary capacity to the Lender. The Syndicate Manager shall not be liable to the Borrower for any breach of the Syndicated Facility Agreement by any Lender or to any Lenders for any breach of the Syndicated Facility Agreement by the Borrower.*

3.12 *Save as herein provided neither the Syndicate Manager nor any of its employees shall be responsible to any Lender for:*

...

(c) *any action taken or omitted by any of them under or in connection with the Syndicated Facility Agreement in good faith;*

(d) *the accuracy of any statements, representations or warranties (whether written or oral) made by or on behalf of the Borrower in or in connection with the Syndicated Facility Agreement and passed on to any Lender in connection therewith; ...*

5.3 *Each of the Lenders severally represents and warrants to the Syndicate Manager that it has made its own independent investigation and assessment of the financial condition and affairs of the Borrower in connection with its participation in the Facility and has not relied on any representation or information provided to it by the Syndicate Manager to induce it to enter into the Syndicated Facility Agreement. Each Lender warrants and undertakes to the Syndicate Manager that it shall continue to make its own independent appraisal of the credit worthiness of the Borrower while the Facility continues or the Commitment is in force.'*

It was conceded by NatWest that the guarantees were released. On one view of the evidence, the guarantees increased NatWest's losses, but NatWest conceded that most of the losses arose because the borrower traded unprofitably. However NatWest argued that but for the non-disclosure, it would not have entered into the syndicate agreement and that the loss of its capital was one of the risks associated with the syndicate agreement. It should therefore recover its losses from Trico. Evidence was given on behalf of NatWest that the fact that the guarantees had not been disclosed by the borrower, the syndicate manager, nor appeared in the audited accounts, raised real doubts about the integrity of the borrower, the auditors and the syndicate manager, and that if it had had the slightest doubt about the integrity of the borrower, the auditors and the syndicate manager, and that if it had had the slightest doubt about the integrity of the borrower, its audited accounts or the syndicate manager it would never have entered into the syndicate. As to the reliance by Trico on the exonerating clauses in the Syndicate Management Agreement, the case made by Trico was that clauses 3.12 and 5.3 were completely ineffective in the face of a section 52 claim unless, on the evidence, they had the effect that the plaintiff did not rely on the misleading conduct of the defendant.

Again, no party to the proceedings suggested that section 52 was inapplicable in the circumstances of a claim between members of a lending syndicate, although Trico submitted that the commercial sophistication of NatWest was a factor tending to negate the existence of a duty for Trico to disclose the existence of the guarantees. Hearing of the trial was recently completed, and judgment is presently reserved. I know of no other case where action has been taken between members of a lending syndicate, based on section 52.

AWA LIMITED v DANIELS AND OTHERS

In 1985, AWA decided to embark on managed hedging of the cost of imported goods for the manufacture of electronic and electrical products. The estimated annual cost of AWA's imports was said to be approximately $200 million, payable in various foreign currencies. In December 1985 Mr Andrew Koval was appointed as the foreign exchange manager of the plaintiff and was believed, both by AWA and its auditors, to be brilliantly successful in that task, so much so that AWA's budget in 1987 anticipated that 25% of the profit of the company would come from managed hedging. However, by the time proceedings were brought, AWA's claim was that Koval's activities had led AWA to a loss of $50 million from its foreign exchange transactions.

For the most part, Koval disclosed to his superiors the contracts showing a profit. Contracts on which losses were made generally were not disclosed and the losses were concealed either by rolling over the contracts, at historic rates, or by paying the losses out of what were claimed to be unauthorised borrowings of funds by Koval from a number of different banks. AWA claimed that the existence of these loans had also been concealed by Koval. The losses were successfully hidden because Koval was able to control day to day operations, he being the only person with any technical knowledge of foreign exchange dealing. Koval was left at liberty to enter into transactions with any foreign exchange dealer, and effective dealing limits were not imposed by AWA management. In these circumstances, AWA's claim against its auditors was that the auditors had failed to report appropriately on the inadequacy of AWA's books and records and on the absence of the necessary internal controls. When the auditors eventually made a report to the chief executive, it was claimed that this report was inadequate. AWA claimed that its auditors were negligent in the execution of two audits, one in June 1986 and the second in December 1986. The auditors then filed cross-claims for contribution under section 5 of the *Law Reform (Miscellaneous Provisions) Act* 1946 (NSW) against Westpac Bank and Lloyds Bank. It is noteworthy that AWA itself decided not to proceed against the banks. The auditors however, standing in the shoes of AWA, claimed that both banks had been negligent in two separate respects, which either enabled Koval to carry on his loss making, speculative activity, or prevented the auditors from revealing that activity. The auditors first alleged that the banks had extended unauthorised loans to AWA at Koval's request; and the second claim made by the auditors was that in response to audit circularisation requests sent to the banks, for the purposes of the second audit, the two banks failed to disclose the existence of borrowings in foreign currency of very large sums by Koval in the name of AWA, which enabled Koval to conceal his activities for very much longer than otherwise would have been the case.

In relation to the first claim made against both banks, it was said to be important that each bank provided ordinary banking services to AWA, and had had communicated to it by AWA the names of persons authorised to conduct banking business on AWA's behalf, including the pledging of its credit, and that Koval was not one of those persons. It was contended that each bank knew that Koval did not have authority to borrow on behalf of AWA. The trial judge, Rogers CJ of the Commercial Division, (NSW) found that Koval did in fact have actual authority, implied actual authority and ostensible authority to act on behalf of AWA in seeking foreign currency loans, but further that even if any request for confirmation of authority in relation to a loan had been made to some senior person in AWA, Koval would have been able to have AWA management respond positively to any such enquiry that either bank might have initiated within AWA. Accordingly the first claim failed.

The second aspect of the cross-claims was based on the claim that AWA had in January 1987 written to each bank requesting the bank to confirm to the auditors the state of accounts between AWA and the bank, and that each bank had answered this request failing to disclose substantial foreign currency loans which were then owed by AWA to each bank. In the case of each bank, the audit circularisation request was account specific. That is to say the request for confirmation was directed to particular numbered accounts held by the bank in relation to its general banking business with AWA, and relating to a specified amount in that account. Since the auditors had made the assumption that neither bank was dealing in foreign currency with AWA and Koval at the relevant time, the audit circularisation requests did not directly request either bank to provide information in relation to outstanding foreign currency loans, and neither bank made enquiries of its foreign exchange department for the purpose of establishing what foreign currency loans were outstanding. In the result the trial judge found that the responses were not compiled negligently, the banks had no reason to anticipate that reliance would be placed on them to disclose Treasury products, there was no evidence that the auditors had placed any reliance, or at least the reliance claimed on the form of response.

The **AWA** case has relevance in the context of a paper on liability of lenders to other lenders for misleading and deceptive conduct, in that both Westpac and Lloyds were forced by the taking of proceedings alleging negligence against them, to make cross-claims against the other for contribution, notwithstanding that neither bank had any direct relationship, or indeed knowledge of, the activities of the other in relation to the making of loans to AWA and Koval. Section 52 of the TPA was not relied upon by the auditors in either claim against the banks. However a claim under section 52 might conceivably have been mounted in relation to the alleged failure to disclose foreign currency loans in response to the audit circularisation request, and in relation to the former claim, silence may constitute misleading or deceptive conduct in circumstances where there is a duty upon the supposed representor to reveal a matter if it exists, and where the other party is therefore entitled to infer that the matter does not exist from the silence of the representor; see **Henjo Investments Pty Ltd v Collins Marrickville Pty Ltd** Lockhart J.[9]

THE APPLICATION OF SECTION 52 TO BANKS

Both **SBSA v Rothschild** and **NatWest v Trico** involved the application of section 52 of the TPA in cases between lenders, without any appearance of surprise on the part of the courts concerned at the intrusion of section 52 into a dispute between two banks, with no obvious reference to consumers. In **Westham Dredging Co Pty Ltd v Woodside Petroleum Development Pty Ltd**[10] St John J, relying on some remarks of Mason J in **R v Credit Tribunal; ex parte General Motors Acceptance Corporation**[11] said:

> *'It is not enough that conduct damages a rival trader; it must mislead or deceive or be likely to mislead or deceive members of the public in their capacity as consumers.'*

However in **Lubidineuse v Bevanere Pty Ltd** the Full Federal Court (Morling, Neaves and Spender JJ) rejected the **Westham** doctrine saying:[12]

> *'It is plain from the decision of the High Court in **Hornsby Building Information Centre v Sydney Building Information Centre Ltd** that the operation of the unambiguous words of section 52 should*

> *not be given a confined meaning because of the heading to Part V: especially per Stephen J. It is true that conduct falling within section 52 frequently occurs when statements are made by a corporation to members of the public, but, as Toohey J pointed out in* ***Menhaden v Citibank NA****, it does not follow that section 52 is confined to statements directed to the public or some identifiable section of it.'*

More recently in **Concrete Constructions (NSW) Pty Ltd v Nelson** Mason CJ, Deane, Dawson and Gaudron JJ said:[13]

> *'An action to restrain a contravention of section 52 can, in appropriate circumstances, be maintained by a person who is not a consumer and ... while the cases make it plain that consumer protection lies at the heart of the legislative purpose to be discerned in section 52, the precise boundaries of the territory within which that section operates remain undetermined.'*

The tendency of Australian courts has been to give the TPA an expansive and benevolent, rather than a confined, construction. For example section 52 can only apply within the constitutional power of the Commonwealth in this area, limited as it is to the corporations power and various other specific heads. The ambit of the expression *'trade and commerce'* was discussed by the High Court recently in **Concrete Constructions (NSW) Pty Ltd v Nelson.**[14] The expansiveness with which the court is prepared to approach section 52 may, however, be demonstrated by an examination of the judgments of Morling J and the Full Federal Court[15] in the passive smoking case, **Tobacco Institute of Australia Limited v Australian Federation of Consumer Organisations Inc**, where the TIA was alleged to have published in a number of Australian newspapers an advertisement including the comment *'and yet there is little evidence and none which proves scientifically that cigarette smoke causes disease in non-smokers'*. No evidence was called as to the activities of the Tobacco Institute, no direct evidence was given as to whether the activities of the Tobacco Institute did or could amount to activities in trade and commerce, nor was there any evidence to establish whether the Tobacco Institute was a trading corporation. There is a noisy and continuing public debate as to the impact of passive smoking on non-smokers. The TIA contended that the statement was a statement of opinion, and a contribution to that public debate. Furthermore the statement itself was one which on its face gave the appearance of a statement of opinion (if it was such) and there was a substantial body of evidence that the opinion expressed in the sentence was held by a number of qualified experts in the area. Notwithstanding each of these matters, the trial judge and a majority of the Full Court held that the respondent was a trading corporation, relevantly engaged in trade and commerce, and that its publication of the statement was misleading and deceptive conduct.

THE RELEVANCE OF SECTION 52 TO BANK SYNDICATION AGREEMENTS

Facilities which are the subject of loan participations or syndicate management agreements, will usually contain a number of provisions designed to limit or exclude any possible liability on the part of the manager or agent. An Exoneration Clause will usually provide that the agent is not to be responsible to the participants for any statement representation or warranty contained in any loan proposal, offering circular or information memorandum. It is likely there will be a provision relating to the indemnity to be given to agents, by participants, against all liabilities losses, costs, expenses or damages the agent may sustain or incur in any way under or in relation to the transaction documents. It is likely that such documents will contain a provision calling for the exercise of due diligence and an independent investigation of credit on behalf of the participants, such as a provision that each participant agrees that it has made or will continue to make independently and without reliance on the agents, its own investigations into the affairs of the proposed borrower and its own analyses and decisions as to taking or not taking action under any transaction document. It is highly probable that any such provision will be seriously affected, if not destroyed, in any case where a participant successfully invokes section 52. A statement that the agent is not to be responsible to the participants for any statement representation or warranty contained in any proposal, cannot stand against section 52, if any such representation has in fact been made by the agent to the participants, and the participants have acted in reliance upon that representation. An assertion that each participant will act without reliance on the agents, will be relevant to the question whether the participant is able to establish on the facts that it relied upon any representation it claims was made by the agent, but if the court finds that a representation was made by the agent and relied upon by a participant to its detriment, a provision asserting the contrary must fall to the ground. Similarly a provision calling upon the participants to indemnify the agents would in the first instance be construed by a court so far as possible not to include the liability of the agent to pay damages for contravention of section 52. If, however, it covered any such liability, the term would probably be held ineffective as a matter of public policy, to the extent that it purported to oust the operation of the statute, or permitted the agent to recover by the indemnity amounts the agent had been required to pay in respect of a contravention; cf **Henjo Investments Pty Ltd v Collins Marrickville Pty Ltd** where Lockhart J said:[16]

> *'There are wider objections to allowing effect to such clauses. Otherwise the operation of the Act, a public policy statute, could be ousted by private agreement. Parliament passed the Act to stamp out unfair or improper conduct in trade or in commerce; it would be contrary to public policy for special conditions such as those with which this contract was concerned to deny or prohibit a statutory remedy for offending conduct under the Act.'*

LENDER LIABILITY BETWEEN PARTICIPATING BANKS IN SYNDICATIONS UNDER US LAW

The *Magnuson-Moss Warranty - Federal Trade Commission Improvement Act* defines standards for written warranties primarily in connection with the sale of consumer products. This Act has a relatively narrow scope. On the other hand, section 5 of the *Federal Trade Commission Act* deals with unfair methods of competition, but expressly excludes banks from the jurisdiction of the FTC.

Section 5 provides:

> *'(a) (1) Unfair methods of competition in or affecting commerce, and unfair or deceptive acts or practices in or affecting commerce, are hereby declared unlawful. (FTC Jurisdiction)*
>
> *(2) The Commission is hereby empowered and directed to prevent persons, partnerships, or corporations, except banks, savings and loan institutions described in section 18(f)(3), Federal credit unions described in section 18(f)(4), common carriers subject to the Acts to regulate commerce, air carriers and foreign air carriers subject to the Federal Aviation Act of 1958, and persons, partnerships, or corporations insofar as they are subject to the Packers and Stockyard Act, 1921 as amended, except as provided in section 406(b) of said Act, from using unfair methods of competition in or affecting commerce and unfair or deceptive acts or practices in or affecting commerce.'*

In the United States national banks[17] are regulated by the Comptroller of the Currency, usually called by the abbreviation OCC for Office of the Comptroller of Currency.[18] The starting point is Banking Circular 181 which was issued on 19 December 1983 and reissued in a revised form on 2 August 1984. The purpose of the circular was expressed to be to *'address safety and soundness concerns arising from the purchase of loans and participations in loans'*.[19] A participation is defined as occurring *'when a bank makes a loan and then sells it entirely or in part to another bank'*.[20]

The circular attempts to set out *'those principles of prudent banking which generally apply to any multibank lending transaction. For example, a prudent member of a loan syndication would obtain full and timely credit information to conduct an informed and independent analysis of the credit in a manner consistent with its formal lending policies and procedures'*.[21]

The release and circular are annexed to this paper, however the most significant paragraphs of the circular appear under the heading 'Independent Credit Analysis' and state:

'To make a prudent credit decision, a purchaser conducts an independent credit analysis to satisfy itself that a loan, loan participation, or loan portfolio is a credit which it would make directly. The nature and extent of the independent analysis is a function of the type of transaction at issue and the purchaser's lending policies and procedures. Where loans are purchased in bulk, for example, a prudent purchaser might assess the credit of the class of obligors rather than each obligor ...

The acceptance by a purchaser of a favourable analysis of a loan issued by the seller, a credit rating institution, or another entity does not satisfy the need to conduct an independent credit analysis. A prudent purchaser may, however, consider such analysis obtained from the seller and other sources ***as factors*** *when independently assessing the loan.'* (Emphasis added.)

In the light of the terms of Banking Circular 181, the approach of US courts has been to give exoneration clauses, and other exclusionary provisions of syndication agreements their appropriate force and effect - and in the light of such clauses to deny relief to plaintiff banks which have not acted properly in the protection of their own interests. Of course, if the standard laid down in Banking Circular 181 had been applied to SBSA, the lack of independent assessment by that bank would probably have prevented any action against Rothschild from succeeding.

While the Reserve Bank of Australia issues prudential statements from time to time, there is, so far as I am aware, no statement which attempts to cover any of the ground covered by Banking Circular 181.

The United States courts have interpreted the circular on a number of occasions. Two examples follow.

In **First State Bank of Wheatland & Anor v American National Bank & Ors**[22] a decision of the Supreme Court of Wyoming delivered on 11 April 1991, the respondent (appellee) lent $US800,000 to a Shirley L Brown and then sold off the loan to each of eight banks, including the appellants, for $US100,000 each. The participants each signed a certificate of participation which contained a clause whereby they acknowledged that the respondent had made no representation regarding the collectability of the loan or the validity of any security.

A further $US600,000 was advanced and this also was participated. Once again the participants executed a participation certificate containing the same clause. Raper J in delivering the opinion of the court (which comprised five judges) said the following:

'[The] appellants are national banks administered primarily by the Comptroller of Currency who publishes policy guidelines covering loan participation. A participation occurs when a bank makes a loan and then sells it entirely or in part to another bank. As revised in 1984, in Section 60,799 of the OCC Guidelines, it is set out that the purchase and sale of loans and participation in loans are established banking practices but the associated risk must be controlled. It is provided in such Guideline that to make a prudent credit decision, a purchaser must conduct an independent analysis to satisfy itself that a loan participation is a credit which it would make directly. The acceptance by a purchaser of a favourable analysis of [a] loan issued by the seller does <u>not</u> satisfy the need to conduct an independent credit analysis. There is no evidence that such independent analysis was made by [the] appellants.

The appellants can only blame themselves for any loss they may have incurred in failure to read the clear terms of the participation certificate and it appears they also failed to read the OCC Guidelines. They were plainly steered by imprudent bankers as herein defined.'[23]

Banco Totta e Acores v Fleet National Bank[24] is a decision of the United States District Court, handed down in July, 1991 in which Fleet sold a $US2 million participation in a large long term credit arrangement to Banco Totta. A subsequent default on the loan caused loss to the syndicate including Banco Totta who brought an action against Fleet for misrepresentation and failure to disclose. During the period in which these representations were supposed to have been made, a participation agreement was signed and it contained the following clause:

'10. *Participant Representations and Warranties. The Participant represents and warrants to the Bank that -*

(a) *its execution and delivery of this Agreement has been duly authorised; the Participant has full power and authority to purchase the Participation; and the Participant's decision to purchase the Participation was based solely upon its own independent evaluation of the Loan, the Borrower's creditworthiness and the value and lien status of the Collateral and all other matters relating thereto.'*[25]

The court held that:

> *'[t]he impact of this clause ... renders legally irrelevant all misrepresentations, innocently, negligently, or intentionally, made by Fleet to BTA (Banco Totta) before the Participation Agreement was signed ...*
>
> *Having asserted in unambiguous contract language that it based its decision to participate in the loan solely upon its own independent evaluation, BTA cannot now claim that it was relying upon Fleet's representations. Furthermore, the Court holds that if BTA did indeed rely on Fleet's representations, and not on its own appraisal, then that reliance was not justifiable in light of the contract between the parties.'*

It has also been held in the United States that, in participation transactions, the participants must apply the marketplace standards of vigilance and independent inspections.[26] The Oklahoma Court concerned found that this was dictated in part by the guidelines of the Office of the Comptroller of the Currency.

It is interesting to note that contrary to the submissions made by NatWest in the undecided Trico case mentioned previously, this Oklahoma Court was of the view that banks involved in commercial arm's length transactions do not stand in a fiduciary relationship and this was true for loan participations.

REMEDIES FOR BREACH OF SECTION 52

One of the most difficult areas remains the question what remedies are available for breach of section 52 and how those remedies can be applied. A defendant bank may face a claim for damages, for rescission of the contract or for any of the variety of orders available under section 87(2). These include an order varying the contract in such manner as the court specifies and an order directing the person who engaged in the conduct to supply specified services to the injured party. But one of the least explored areas remains the apparently simply question of damages. Take the situation exposed in the **AWA** case with the following slight variations - suppose that the plaintiff had been negligent in relation to its own protection, that one bank made unauthorised loans in circumstances where knowledge of the foreign exchange dealer's excesses imposed upon it a duty to inquire whether the dealer was authorised to obtain such loans, and that the second bank was sent an audit request inquiring after foreign currency loans which was incorrectly answered. Both banks are then sued under section 52. The plaintiff succeeds against the second bank, which was not negligent in its response, but on the basis of section 52. The plaintiff fails against the first bank, which **was** negligent, but on the ground that there was no relevant misleading or deceptive conduct. The interesting questions arising out of this purely hypothetical example are, of course, contribution, apportionment and contributory negligence, not to mention the quantum of damage.

It has not yet been finally decided whether contributory negligence or contribution are available to a defendant successfully sued under section 52. In two recent issues of the *Australian Law Journal* J C Campbell QC[27] has considered the topic, and pointed to many of the problems that arise. The TPA makes no express provision for contribution between respondents. In **Re La Rosa; Norgard v Rodpat Nominees Pty Ltd**[28] French J dealt with an argument based on section 87 (in particular sub-sections (1A) and (2)(d)) that the section enabled the court to make such an order for indemnity or contribution upon the application of a respondent found liable in respect of a contravention. In rejecting the contention, French J said:

'In my opinion, there is no mechanism in section 87, nor in the Act generally which would enable the Court to make orders for contribution or indemnity against other contravenors of the Act or persons involved in the primary contravention.'[29]

Furthermore in **Munchies Management Pty Ltd v Belperio**[30] the Full Bench quoted from a passage in the judgment of French J in **Pavich v Bobra Nominees**[31] 4 August, 1988 where French J said:

'The primacy of the causation principle in section 82 would seem to exclude reliance upon such concepts as mitigation or contributory negligence, unless it can be shown that the applicant's own carelessness or disregard for his or her interest is the cause of all or some part of the claimed loss. It may still be in such a case that the misleading or deceptive conduct complained of may be identified as a sine qua non of the loss claimed. There may come a point, however, where the applicant's own conduct is so dominant in the causal chain as to constitute a novus actus interveniens. It is perhaps simply putting it another way to say that in such a case a selection principle of the kind adverted to [in the ***Elna Australia*** *case, supra] comes into operation to exclude liability. The criteria for such selection may import concepts analogous to remoteness, mitigation or contributory negligence.'*

The approach was echoed by Hill J in **Argy v Blunts.**[32]

In the articles referred to, Campbell has argued that liability to pay damages for a contravention of section 52 ought to be regarded as a tort within the meaning of section 5(1)(c) of the *Law Reform (Miscellaneous Provisions) Act* 1946 (NSW). The argument runs that the liability to pay damages for breach of section 52 comes within the ordinary definitions of a tort, or can be regarded as a breach of statutory duty - and thus a tort, or as an innominate tort. Campbell also argued that there is a right of contribution in equity.

One possible result, therefore, in the situation posed in the variant of the facts in the **AWA** case stated above, is that the second bank, which was not negligent, is made liable for its breach of section 52, for all the loss suffered by the plaintiff. The plaintiff, whose negligence contributed to its own loss, recovers the full amount of damages suffered. And the first bank, which was also negligent, escapes making any contribution to that damage.

In relation to actions heard in Victoria, the provisions of Parts IV and V of the *Wrongs Act* 1958 in relation to contribution and contributory negligence are, I believe, unique among Australian jurisdictions in that they do not limit the entitlement of a defendant to claim contribution to cases where damage is suffered as a result of a tort. In relation to contributory negligence, the relevant *'fault'* on the part of a plaintiff is expressly defined to include *'breach of statutory duty'*. A defendant in Victoria will therefore whether the action is brought in a State or a Federal Court, be in a much better position to argue that the plaintiff's damages should be reduced by the extent appropriate to the plaintiff's responsibility for such damage. Defendant banks in other Australia jurisdictions have bigger hurdles to clear before apportionment of loss and damage can be achieved.

NEW ZEALAND

Like problems arise in New Zealand, where the legislation comparable to section 52 is section 9 of the *Fair Trading Act* 1986. It is well established that section 9 is not limited to dealings with consumers, but also applies between rival traders. However in a recent case, **Jagwar Holdings Limited v Julian,**[33] where the plaintiffs claimed in negligence, as well as for breach of section 9, Thorp J, having found the plaintiffs guilty of contributory negligence, reduced the amount of damages awarded under section 9 by a similar discount on the ground that:

'Liability clearly arises if the offending conduct is a material factor in the plaintiff's decision, even if only a relatively minor factor. To conclude in the latter situation that the whole of the loss is caused by the defendant's action seems to me to introduce a punitive element into the assessment which is not required either by logic or by the language of the statute.'

CONCLUSIONS

If the worst case scenario arising from the foregoing is made out by future judicial decisions, bankers and their lawyers have good reason for dissatisfaction with the present state of the law, in particular section 52 and its consequences. The conclusions the banking community might wish to pursue, include the following:

1. Section 52 should be amended to limit the section's application to conduct occurring in transactions directly affecting consumers.

2. Alternatively section 52 should be amended:

    (a) so as to exclude banks from its operation (by analogy with the US legislation); or

    (b) so as to exclude banks, save in dealings with consumers.

3. Alternatively banks should be permitted, save in dealings with consumers, to contract out of the operation of section 52.

4. If regulation of interbank transactions is thought necessary, the Reserve Bank could play a role comparable to that played by the OCC in issuing Banking Circular 181.

5. The Federal Parliament should legislate to ensure that contributory negligence and contribution are clearly available in section 52 proceedings.

6. Interbank agreements, such as syndicate management agreements, require urgent re-examination, particularly in relation to limitation and exculpatory clauses, in the light of their apparent vulnerability where section 52 is concerned.

7. It may be necessary to review the costing of interbank arrangements and any insurance involved, in the light of the change in perceived risk.

8. It must be recognised that levels of communication within most banks are almost certainly inadequate, having regard to the fact that the actions of one department may lead to a duty being imposed on a different department to volunteer information in particular circumstances.

    One of the most disconcerting features of the present situation is the possibility that a bank may be in breach of section 52, without having any reasonable means of knowing that fact.

FOOTNOTES

1. Heydon, *Trade Practices Law*, Vol 2, 5511, 5513.

2. (1981) 53 FLR 340 at 348.

3. (1988) 79 ALR 83 at 93.

4. (1986) 64 ALR 347 at 372.

5. (1977) 29 FLR 270.

6. (1987) 71 ALR 367 at 371.

7. Tadgell J (unreported, judgment delivered 10 August 1990). Judgments of Appeal Division (Fullagar, Brooking and Beach JJ), unreported, delivered September 1992.

8. 57 CLR 215 especially per Wilson J at 236.

9. (1988) 79 ALR 83 at 95.

10. (1983) 66 FLR 14.

11. (1977) 137 CLR 545 at 561.

12. (1985) 7 FCR 325 at 332.

13. (1990) 169 CLR 594 at 601-2.

14. *Supra.*

15. Sheppard, Foster and Hill JJ, unreported, judgment delivered 17 December 1992.

16. (1988) 79 ALR 83 at 99.

17. National banks are commercial banks whose charters are approved by the US Comptroller of the Currency rather than a state banking department. National banks are required to be members of the Federal Reserve System and to purchase stock in the Federal Reserve Bank in their district. They must also belong to the Federal Deposit Insurance Corporation.

18. The Comptroller of the Currency is the federal official, appointed by the President and confirmed by the Senate, who is responsible for chartering, examining, supervising and liquidating all national banks. In response to the Comptroller's call, national banks are required to submit all reports of their financial activities at least four times a year and to publish them in local newspapers. National banks can be declared insolvent only by the Comptroller of the Currency.

19. CCH (US) *Federal Banking Law Reporter*, page 38,858, footnote 1.

20. *Id.*

21. Note 19, *supra.*

22. 808 P 2d 804 (Wyo 1991).

23. 808 P 2d 804, 806-807 (Wyo 1991).

24. 768 F Supp 943 (DRI 1991).

25. 768 F Supp 943, 949 (DRI 1991).

26. **Northern Trust Company v Federal Deposit Insurance Corporation** 619 F Supp 1340 (WA Okla 1985).

27. Vol 67 *ALJ* Part 2, 87 and Part 3, 177.

28. (1991) ATPR 41-139.

29. At 52,999.

30. (1988) 84 ALR 700.

31. Unreported on this point, although noted at (1988) ATPR 46-039.

32. (1990) 94 ALR 719 at 743, 744.

33. (1992) 6 NZCLC Case 96-562, 68,040, especially at 68,097-8.