# RESPONSE TO CASE STUDY

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## 1. DID BRUCE OR LENDSAFE BANK ("LENDSAFE") TAKE ADVANTAGE OF ALBERTO OR PROSCIUTTO PACKAGING ("PP") PTY LTD?

Bruce and Alberto have run a packaging business in partnership since 1982. Alberto has very little knowledge of financial matters and relies on Bruce to run the business and read any relevant documents. Bruce is experienced in the packaging industry and is predominately responsible for managing the business' finances.

Against this background, it is important to consider whether Bruce's dealings with Alberto are tainted with duress, undue influence or unconscionable conduct.

### AUSTRALIA

### (a) Duress

There is no suggestion that the dealings between the partners were induced by actual or threatened violence to Alberto or actual or threatened deprivation of his liberty.[1] Nor is there any indication of duress applied to members of his family.[2] And there is no evidence of duress to goods in the form of actual or threatened seizure or destruction of Alberto's goods.[3] Finally, Bruce's dealings with Alberto do not appear to be affected by economic duress in the form of illegitimate commercial pressure.[4] There is no suggestion

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1 See *Barton v Armstrong* [1976] AC 104; *Williams v Bayley* (1866) LR 1 HL 200.

2 See *Mutual Finance Ltd v John Wetton & Sons Ltd* [1937] 2 KB 389.

3 Despite earlier doubts, it appears that an agreement infected with duress of goods can be set aside. See JW Carter & DJ Harland, *Contract Law in Australia* (3rd ed, 1996), para 1309 and *Hawker Pacific Pty Ltd v Helicopter Charter Pty Ltd* (1991) 22 NSWLR 298; *Skeate v Beale* (1841) 11 Ad & E 983; 113 ER 688; P Hall, *Unconscionable Contracts and Economic Duress* (1985).

4 See *Crescendo Management Pty Ltd v Westpac Banking Corp* (1988) 19 NSWLR 40 at 46; *Wardley Australia Ltd v McPharlin* (1984) 3 BPR 9500.

that Bruce was threatening to exercise his rights in a way not authorized by his existing partnership arrangements with Alberto.[5]

Consequently, there are no grounds for setting aside the loan facilities relating to the initial $100,000 unsecured overdraft or the further loan of $1 million on the basis of duress in Bruce's dealings with Alberto.

It might be argued that Lendsafe applied economic duress to Bruce and Alberto by threatening to withdraw the overdraft facility at a crucial stage in the development of the business, leaving the partners with no real alternative but to enter into the new loan facility and cause PP to provide collateral securities for the existing overdraft and the new loan facility. However, a plea of economic duress is unlikely to succeed in the present case.[6] While it is true that in some circumstances commercial pressure may constitute duress,[7] overwhelming pressure, not amounting to unconscionable or unlawful conduct, will not necessarily constitute economic duress.[8] It is neither unconscionable nor unlawful for a bank to insist on security for an existing overdraft and a new substantial loan facility.[9] Moreover, the borrowers chose not to explore their other options. In any event, they decided to enter into the new loan agreement, not because of any economic duress applied by Lendsafe, but rather because of their interest in expanding their

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5 See *North Ocean Shipping Co Ltd v Hyundai Construction Co Ltd* [1979] 1 QB 705; *Atlas Express Ltd v Kafco (Importers and Distributors) Ltd* [1989] QB 833; *B & S Contracts & Design Ltd v Victor Green Publications Ltd* [1984] ICR 419.

6 See *Parras Holdings Pty Ltd v Commonwealth Bank of Australia* [1999] FCA 391. Pleas of economic duress are rarely successful. See eg. *Belgravia Investments Pty Ltd v Evans* BC 9800836 (unreported decision of Smith J of the Supreme Court of Victoria, 13 March 1998); *Cox v Esanda Finance Corp Ltd* [2000] NSWSC 502; *Commonwealth Bank of Australia v Davridge* BC 9501760 (unreported, Supreme Court of NSW, Giles CJ, 9 November 1995).

7 *Pau On v Lau Yiu Long* [1980] AC 614.

8 *Crescendo Management Pty Ltd v Westpac Banking Corp* (1998) 19 NSWLR 40 at 46.

9 *Parras Holdings Pty Ltd v Commonwealth Bank of Australia* [1999] FCA 391. See also *Cox v Esanda Finance Corp Ltd* [2000] NSWSC 502.

business.[10] The subsequent destruction of their business can be attributed to their inability to meet the bank's demands for payment, not any alleged economic duress before they entered into the loan facility agreement.[11]

It is even less likely that the collateral securities provided by PP are tainted with economic duress. On policy grounds, it is not advisable to find that any economic duress applied to an individual director automatically affects his company. Persons who choose to conduct their businesses in corporate form should not generally be allowed to cause their companies to invoke defences which are normally restricted to individuals.[12]

### (b) Undue Influence

Undue influence connotes "the improper use of the ascendancy acquired by one person over another for the benefit of himself or someone else, so that the acts of the person influenced are not, in the fullest sense of the word, his free voluntary acts".[13] The cardinal question is whether the influenced party entered into the agreement as the result of an independent will. Unlike duress, undue influence may not be characterized by any specific act, but it does invoke "some unfair and improper conduct, some coercion from outside, some overreaching, some form of cheating, and generally though not always, some personal advantage" by the party exerting the influence.[14]

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10 The economic duress must be one cause of the party entering into agreement: *Crescendo Management Pty Ltd v Westpac Banking Corp* (1998) 19 NSWLR 40 at 46; *Belgravia Investments Pty Ltd v Evans* BC 9800836 (unreported, Supreme Court of Victoria, Smith J, 13 March 1998).

11 *Parras Holdings Pty Ltd v Commonwealth Bank of Australia* [1999] FCA 391.

12 *Commonwealth Bank of Australia v Rideout Nominees Pty Ltd* [2000] WASC 37.

13 *Union Bank of Australia Ltd v Whitelaw* [1906] VLR 711 at 720 per Hodges J; *Allcard v Skinner* (1887) 36 ChD 145.

14 *Allcard v Skinner* (1887) 36 ChD 145 at 181; *Robertson v Robertson* [1930] QWN 41.

A presumption of undue influence can arise from a particular class of relationship (such as parent and child)[15] or a special relationship of influence, ascendancy or trust.[16]

In the present case the partnership between Bruce and Alberto does not fall within the established categories of relationship where undue influence is presumed. On the other hand, it is clear that Alberto placed trust and confidence in Bruce in handling the financial affairs of the partnership. It appears that he signed business documents on Bruce's advice or guidance. Moreover, Bruce stood to gain a personal benefit from the loan transactions. It could be argued that a presumption of undue influence arose because of Bruce's special relationship with Alberto. But Bruce could, no doubt, rebut the presumption of undue influence by showing that he did not, in fact, exert any undue influence over Alberto and that Alberto entered into the loan contract as a result of a free exercise of his will.[17] As Wheeler J pointed out in *Commonwealth Bank of Australia v Ridout Nominees Pty Ltd*,[18] the trust and confidence reposed in a person may be justified.

Strictly speaking, it is unnecessary to consider the state of Lendsafe's knowledge in relation to the alleged undue influence because there is no evidence that Bruce abused his position, but we shall address this issue for the sake of completeness.

Lendsafe's enforcement of the loan agreement or the collateral securities will only be affected: where it has itself exercised undue influence against either Alberto or Bruce; where it has notice of undue influence exercised by Bruce on Alberto; or where it has

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15 *Phillips v Hutchinson* [1946] VLR 270; *Powell v Powell* [1900] I Ch 243; *Archer v Hudson* (1844) 7 Beav 551; 49 ER 1180.

16 See eg: *Bank of Credit & Commerce International SA v Aboody* [1989] 2 WLR 759 and *Lloyds Bank Ltd v Bundy* [1975] QB 326. Actual and presumed undue influence should be seen as alternatives: *Bank of Scotland v Bennett* (1999) 4 Lloyd's Rep Bank 145.

17 *Allcard v Skinner* (1887) 36 ChD 145.

18 [2000] WASC 37, para 77.

entrusted Bruce to obtain Alberto's signature and Bruce abused his position of influence.[19]

There is no evidence of actual undue influence by Lendsafe in the present case but the bank had notice of Bruce's dominant position within the partnership and Alberto's reliance on him in relation to documents and financial matters. Indeed, Alberto confided to Lawrence, the bank officer: "*I don't really know why we need all of these documents, you'd be better off getting Bruce to sort it out*". It is also clear that the bank entrusted Bruce to obtain Alberto's signature in accordance with their usual practice in relation to this partnership. This would be sufficient to give the bank knowledge of any undue influence exercised by Bruce.

Lendsafe can rebut the presumption of undue influence by adducing evidence that Bruce did not in fact exercise any undue influence over Alberto[20] or by showing that Alberto was given independent advice from an impartial person, usually but not necessarily a lawyer.[21] In the present case Lawrence's request that Alberto and Bruce read over the documents would clearly not qualify as independent advice.[22]

Apart from any undue influence exercised by Bruce, there may have been actual or presumed undue influence exerted by Lendsafe in its dealings with Bruce and Alberto. However, for the reasons outlined earlier in relation to duress, it is unlikely that a plea of actual undue influence would succeed against the bank.[23]

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19 See O'Donovan & Phillips, *The Modern Contract of Guarantee* (3rd ed, 1996), pp 195-199.

20 *Allcard v Skinner* (1887) 36 ChD 145 at 171.

21 *Re Brockhurst (deceased)* [1978] Ch 14; *Inche Noriah v Shaik Allie Bin Omar* [1929] AC 127 at 135-136; *Union Fidelity Trustee Co of Australia Ltd v Gibson* [1971] VR 573 at 577-588.

22 While in some cases independent advice may entail providing an opportunity to read the document in "less overawing" surroundings than a bank or a solicitor's office, this is no substitute for comprehensive independent advice. Compare *Bester v Perpetual Trustee Co Ltd* [1970] 3 NSWR 30 at 33.

23 See O'Donovan and Phillips, *The Modern Contract of Guarantee* (3rd ed, 1996), p 175. In *Thermo-Flo Corp Ltd v Kuryluk* (1978) 84 DLR (3d) 529 the court

Alberto may stand a better chance of success relying on a presumption on undue influence arising from a special relationship of trust and confidence between himself and the bank over a long period during which he relied on the bank for advice and assistance. Yet even this plea appears to be doomed because the case is not as strong as *Lloyd's Bank Ltd v Bundy*,[24] where an elderly man placed his residence at stake in a transaction because he trusted the bank officer to protect his interests.

### (c) Unconscionable Conduct under the General Law

Lendsafe will have more difficulty rebutting a plea of unconscionable conduct. Given the bank's knowledge of Alberto's ignorance of financial matters and his admission that he does not understand why all the documents are necessary, it could be argued that he was in a position of special disadvantage which seriously affected his ability to make a judgment as to his own best interests.[25] In *Blomley v Ryan*[26] two of the personal characteristics which Fullagar J mentioned in describing a position of special disadvantage were a lack of education and a lack of assistance or explanation where assistance or explanation is necessary. Moreover, it is accepted that a lack of knowledge or business acumen are important factors in determining whether a person is in a position of special disadvantage.[27] Other significant factors in the present case are the length of the relationship between the bank and the partnership, the misrepresentation by Lawrence that the

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rejected a plea of actual undue influence where the execution of a guarantee was induced by threats of no further credit.

24 [1975] QB 326.

25 *Commercial Bank of Australia Ltd v Amadio* (1983) 151 CLR 447 at 462 per Mason J (as he then was).

26 (1956) 99 CLR 362 at 405.

27 *National Australia Bank Ltd v Nobile* (1988) ATPR 40-856 at 49, 240 per Davies J; *Household Financial Services Ltd v Price* (unreported, SA Supreme Court, Burley J, 14 November 1994); *National Australia Bank Ltd v Le Mastre* (unreported, NSW Supreme Court, 25 March 1988); *Nolan v Westpac Banking Corp* (1989) ASC 55-930 at 58, 515.

proposed expansion is viable, the risk of default, the relative bargaining positions of the parties and the purpose of the loan.[28]

In the present case Alberto's special disadvantage is "sufficiently evident" to Lendsafe to make it unconscientious for the bank to accept his consent to the loan transaction.[29] It could be argued, therefore, that the loan transaction should be set aside as an unconscionable bargain.[30]

Lendsafe could have protected its position by ensuring that Alberto was given a proper explanation or independent legal advice. Lawrence's request that Bruce and Alberto "read over" the documents would not suffice.

However, the Court will not necessarily set aside the loan documents just because of Alberto's special disadvantage. If the bank can show that the transaction is "fair, just and reasonable" it will not be set aside unless the bank has taken advantage of its superior position.[31] On the face of it, there is nothing unfair, unjust or unreasonable about the loan documents themselves. But the circumstances surrounding the execution of the documents and the collateral securities provide compelling evidence that Lendsafe Bank exploited the vulnerability of at least one of its customers. On this basis, the loan documents could be set aside under the general law, at least so far as Alberto is concerned. This may well have a consequential effect on the collateral securities provided by PP because PP has assumed the position of a third party mortgagor and it might be discharged if the principal loan contract is set aside.

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[28] See O'Donovan & Phillips, *The Modern Contract of Guarantee* (3rd ed, 1996), p 178.

[29] See *Commonwealth Bank of Australia v Rideout Nominees Pty Ltd* [2000] WASC 37, para 201. The bank must be "aware of facts that would raise the possibility in the mind of any reasonable person that the other party occupies a position of special advantage"; *Commercial Bank of Australia Ltd v Amadio* (1983) 151 CLR 447 at 467. See also *Tzefrios v Polites* (1994) ANZ Conv R 32.

[30] However, there is little evidence of unconscionability in the present case. Contrast *Asia Pacific International v Dalrymple* (2000) 2 QdR 229.

[31] *Commercial Bank of Australia Ltd v Amadio* (1983) 151 CLR 447 at 474 per Dixon J; *Blomley v Ryan* (1956) 99 CLR 362 at 428-429 per Kitto J.

Much depends upon the terms of the collateral securities. They might contain provisions preserving PP's liability in the event that the principal loan contract is set aside.

Alberto's position of special disadvantage will not necessarily be imputed to PP. In *Commonwealth Bank of Australia v Ridout Nominees Pty Ltd*[32] Wheeler J was prepared to assume an *Amadio* type defence would be available to a corporation in certain circumstances, but not just because the lender was aware of the special disability of one director of the company, especially where it was clear that all the significant corporate decisions were made by another director.

With the injection of equity capital from the partners as a result of the loan facility, PP purchased the factory and equipment. It cannot be said, therefore, that it derived no benefit from the transaction. It was not entitled to be informed that the collateral securities extended to an existing overdraft.[33] In any event, this knowledge could be imputed to it through its directors, Bruce and Alberto.[34] Moreover, it may be taken to be aware of the policy of the selective dishonouring of business cheques because of the knowledge of its directors. For this reason, it is not in the same position as the guarantors and third party mortgagors in *Commercial Bank of Australia v Amadio*.[35] It is unlikely, therefore, that PP could successfully plead unconscionable conduct against Lendsafe.

### (d) Section 51AC of the Trade Practices Act 1974

The doctrine of unconscionable conduct has its statutory counterpart in s51AC of the *Trade Practices Act* 1974. That section provides that a corporation must not, in trade or commerce, engage in conduct that is, in all the circumstances, unconscionable in

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32 [2000] WASC 37.

33 *Westminster Bank Ltd v Cond* (1940) 46 Can Cas 60.

34 Compare *Wren v Emmett Contractors Pty Ltd* (1969) 43 ALJR 213 and *Winstone Ltd v Bourne* [1978] 1 NZLR 94.

35 (1983) 151 CLR 447.

connection with the supply or possible supply of services to another person or corporation where the price of the service is up to $3 million. The price of a service comprising or including a loan facility is taken to include the capital value of the loan or loan facility. The price is not, therefore, confined to the lender's fees and interest charges.

In determining whether the supplier of financial services has engaged in unconscionable conduct in its dealings with a business consumer, the Court can take into account a wide variety of factors catalogued in s51AC(3). In the present case, the following factors appear to be relevant:

(i) the relative strengths of the bargaining positions of the supplier and the business consumer;

(ii) whether the business consumer was able to understand any documents relating to the supply of the services;

(iii) whether any undue influence or pressure was exerted on, or any unfair tactics were used against, the business consumer or a person acting on behalf of the business consumer, by the supplier, or a person acting on behalf of the supplier, in relation to the supply of services;

(iv) the extent to which the supplier's conduct towards the business consumer was consistent with the supplier's conduct in similar transactions between the supplier and other like business consumers;

(v) the extent to which the supplier and the business consumer acted in good faith.

The statutory concept of unconscionable conduct is broader than its equitable counterpart, but it is unlikely that the Court will find that Lendsafe was guilty of unconscionable conduct under s51AC of the

*Trade Practices Act 1974*. It is true that the collateral securities taken by Lendsafe were intended to shore up its position in relation to past indebtedness but they were not extracted under duress, undue influence or unconscionable conduct. However if the loan facility and collateral securities are successfully challenged under s51AC of the *Trade Practices Act 1974*(Cth), the Court may award damages under s82 or a remedial order under s87.

## NEW ZEALAND

### (a) Duress

Duress was traditionally confined to actual violence or threats of violence. It later expanded to other forms of pressure short of duress to the person. Subsequently, duress has expanded to include elements of economic pressure (Burrows, Finn & Todd, *Law of Contract in New Zealand*, second edition, Wellington, 2002, para 12.2.1, p368).

There are two elements of duress: compulsion of the will of the victim and the illegitimacy of the pressure. The legitimacy of the pressure must be considered from two aspects: the nature of the pressure and secondly, the nature of the demand which the pressure is applied to support (*Universe Tankships Inc of Monrovia v International Transport Workers Federation* [1983] 1 AC 366, 400-401, per Lord Scarman).

Economic duress is unlikely to succeed in circumstances where there is an existing contract and a party induces a new agreement simply by threatening to enforce it (Burrows, Finn & Todd, para 12.2.1, p369). It is difficult to imagine the circumstances in which a bona fide demand, together with a threat of lawful action, will be treated as duress (Burrows, Finn & Todd, para 12.2.1, p372).

There is nothing to suggest that there is any element of duress in Bruce and Alberto's relationship.

As between Lendsafe and the partners, it is unlikely that there is any basis for a finding of duress. On the known facts, the threat to terminate the overdraft facility is unlikely to be illegitimate (still less unlawful), nor can the demand that the partners clear the overdraft be seen as illegitimate. If Lendsafe was entitled to call up the overdraft then there is unlikely to be any duress.

If there has been an affirmation of a contract, a party may lose the right to plead economic duress, although that only applies if the victim is no longer under the undue pressure of the other party (*Haines v Carter* [2001] 2 NZLR 167). If the victim has subsequently taken steps to implement the contract, the victim can be treated as having affirmed its terms. The partners' efforts to reduce the overdraft probably do not amount to an affirmation, as the threat to call up the overdraft continued to hang over their heads.

There is no suggestion of duress by the Bank in entering into the new loan agreement, and as the securities were collateral to the new loan agreement, notwithstanding that the securities were granted by PP, it is unlikely they could be described as being the product of duress.

**(b) Undue Influence**

The law of undue influence in New Zealand has not yet taken full account of the House of Lords' decision of *Royal Bank of Scotland Plc v Etridge (No. 2)* [2002] 2 AC 773 [2001] 4 All ER 449, [2001] 3 WLR 1021. It is understood that there is to be an appeal to the Court of Appeal in *Lee v Damesh Holdings Limited* (unreported, High Court of New Zealand, Christchurch Registry, CP75/03, Chisholm J, 31/3/03), to be heard on 30 September 2003, where the application of *Etridge* in New Zealand may be addressed squarely.

Undue influence was argued in the Court of Appeal *Attorney-General for England and Wales v R* [2002] 2 NZLR 91, which involved the application of English law by New Zealand Courts. *Etridge* was decided in October 2001, after the Court of Appeal hearing in *Attorney-General for England and Wales v R* in May 2001, but before the decision in November 2001. The Court of Appeal referred to *Etridge*, (114-115 paras 72-75) but dealt with the case on the pre-*Etridge* law, and found no undue influence.

In the Privy Council decision in *Attorney-General for England and Wales v R* (Privy Council Appeal No. 61 of 2002, 17/3/03), the Board also referred to *Etridge*. The majority opinion was that while R's superior officers may have exercised influence over him, the agreement he was required to sign was a reasonable condition to his remaining with the SAS; as such, the nature of the transaction was not such that it gave rise to an inference that it was obtained by an unfair exploitation of the relationship (*Attorney-General for England and Wales v R*, para 24).

On the facts in the current case, neither the relationship between Bruce and Alberto, nor the relationship between Lendsafe and the partners is a relationship of presumed undue influence, although the parties can prove such a relationship.

There is no suggestion that Alberto took any steps as a result of Alberto's reliance, trust and confidence or dependence on Bruce. Therefore the resulting agreements were the result of Alberto's free will, so there is no actual undue influence.

If there was undue influence by Bruce over Alberto, the loan agreement with Lendsafe and the collateral securities will only be affected as a result if the Bank has actual or constructive notice of the undue influence, or if Bruce was the Bank's agent for the purposes of obtaining Alberto's signature. The view seems to be that there will rarely be a case where agency can properly be asserted, and the more relevant question is whether the Bank was

on notice of the undue influence (Burrows, Finn & Todd, para 12.3.8(a), p372).

It is unlikely that where the relationship is commercial (as between partners or common shareholders), and the loan is made to the partnership or the company (and they benefit from the transaction) the Bank would be unlikely to be on notice of any undue influence; the transaction is not one that cannot be explained by the relationship (*Attorney-General for England and Wales v R*, para 22). As lending by a bank to commercial organisations can be explained, a party alleging undue influence will have to establish it. Whether there actually was undue influence is a matter of fact, as is whether what Alberto said to Lawrence was sufficient to put the Bank on notice of undue influence is also a question of fact.

The Bank can rebut any allegation of being on notice of Bruce's undue influence, by showing that there was no undue influence or that the Bank had taken steps to protect Alberto from the potential wrongdoing of which it had notice (*Wilkinson v ASB Bank Ltd* [1998] 1 NZLR 674, 695 per Tipping J). It could do this by ensuring that Alberto understood the nature and effect of the transaction, for instance by ensuring that he had taken independent legal advice.

It is also unlikely on the facts that either of the partners can assert a claim that there has been actual undue influence by the Bank over either of them nor that the relationship was such that a presumption has arisen that it is a special relationship of trust and confidence.

### (c) Unconscionable Conduct under the General Law

The jurisdictions in respect of undue influence and unconscionable bargains to a certain extent overlap. In the case of unconscionable bargains, a party alleging it must prove serious disadvantage on the weaker party's part, known to the other party and the exploitation of that disadvantage by the stronger party. Often associated with this will be some procedural impropriety and substantial inadequacy of

consideration (*Attorney General for England and Wales v R* [2002] 2 NZLR 91, 118-119, para 89 per Tipping J). (While this case involved the application of English law, His Honour suggested that the leading New Zealand case, *O'Connor v Hart* [1985] 1 NZLR 159, a Privy Council decision, was important as the opinion in that case did not suggest that English and New Zealand law on unconscionable bargain were different (117 & 119, paras 85 & 89)).

It is of interest that Lord Hoffmann, speaking for the majority in the Privy Council in that case, having found that there was no undue influence, dealt with the entire aspect of unconscionable bargain in one sentence, as follows:

> "*If the transaction was not such as to give rise to an inference that it had been unfairly obtained by a party in a position to influence the other, it must follow that the transaction cannot be independently attached as unconscionable.*" (Privy Council Appeal No. 61 of 2002, 17/3/03, para 29.)

While Lord Scott delivered a dissenting opinion on the issue of undue influence, he said nothing further on unconscionable bargain.

While unconscionable bargain cases are fact dependent, it is not clear that Alberto's position is such that he was at a "*serious disadvantage*". If Alberto were at a "*serious disadvantage*", it may be that this would affect his relationship with respect to Bruce, it may not necessarily be sufficient to affect the relationship with the Bank.

Even if it were, the facts do not suggest exploitation and even if there was procedural impropriety, there is no substantial inadequacy of consideration.

The issue of corporate unconscionable bargain does not appear to be discussed at any length in New Zealand, but PP would struggle to say that it derived no benefit from the transaction.

### (d) Credit Contracts Act 1981

A similar jurisdiction to that provided by s51AC exists in s10 of the Credit Contracts Act 1981. This provides that the Court can reopen "*oppressive*" contracts, and grant a wide range of relief under s14. The Court can do so if the credit contract is oppressive, if a party intends to exercise its contractual rights in an oppressive way, or if it induced another party's entry into the contract oppressively. Section 9 defines "*oppressive*" as meaning "*oppressive, harsh, unjustly burdensome, unconscionable, or contravention of reasonable standards of commercial practice*".

The leading decision on s9 is *Italia Holdings (Properties) Limited v Lonsdale Holdings (Auckland) Limited* (HC) where it was held that:

> "*The word "oppressive" clearly connotes that some real detriment or hardship is involved ... Injustice must be shown to exist as well... It would be difficult to argue that an applicant under the Credit Contracts Act could succeed in having a credit contract set aside by setting up facts which would have been insufficient to enable a person in an unequal bargaining situation to have a contract entered into by him set aside on equitable grounds.*" [1984] 2 NZLR 1, 15-16.

In relation to terminating the overdraft facility, financial hardship is insufficient; the Courts usually require something more, such as an ulterior motive, or a disproportionate response to a breach by the borrower (which is likely to be difficult to establish when dealing with an overdraft facility).

It is also unlikely in the circumstances of this case that the loan contract could be reopened.

## 2. DOES THE CODE OF BANKING PRACTICE APPLY?

### AUSTRALIA

Lendsafe agreed to provide the loan facility to Bruce and Alberto jointly as co-debtors but this "banking service" was not "wholly or exclusively" for their "private or domestic use" so they are not "Customers" within clause 1.1 of the Code of Banking Practice. Consequently, the provisions of the Code dealing with disclosure of terms, conditions and charges (clauses 2.1, and 3-6), variations of terms and conditions (clause 9) and misleading advertising (clause 18) do not apply in this present case.

The New Code of Banking Practice is expected to come into operation in August 2003.[36] It applies to small business customers as well as individual customers and PP would fall within the definition of a small business customer.[37] When a small business customer encounters difficulties in servicing its debts to a bank, the New Code requires the bank to help the customer to overcome these difficulties, if the customer agrees.[38]

Moreover, the New Code requires banks to act fairly and reasonably towards customers in a consistent and ethical manner.[39] This obligation is similar to the obligation imposed on financial services licensees to do all things necessary to ensure that the financial services covered by the licence are provided efficiently, honestly and fairly.[40] It remains to be seen how these obligations will affect a bank that effects a unilateral variation of a loan contract or collateral securities.

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[36] See generally R Grady & Mie-lin Loh, "New Code of Banking Practice" (2002) 18(3) *Australian Banking and Finance Law Bulletin* 37.

[37] See clause 1.1 and the definition of "you" and "your" in clause 40 of the New Code.

[38] Clause 25.2 of the New Code.

[39] Clause 2.2 of the New Code.

[40] See *Corporations Act* 2001(Cth), s912A and *Story v National Companies and Securities Commission* (1988) 13 NSWLR 661.

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The Code of Banking Practice is the Code of the New Zealand Bankers' Association, and it became effective 1 March 1992. The Code does not impose any additional basis for liability.

The Code does not, on its own, "*impose a duty of care which alter the equitable principles*" which existed before its adoption (*Clarke v Westpac Banking Corporation* (1996) 7 TCLR 436, 449). Likewise it is "*a voluntary ethical code. It is not a statutory duty. It is not a common law duty*" (*Dungey v ANZ Banking Group (New Zealand) Limited* (unreported) High Court of New Zealand, Blenheim Registry, CP 12/96, Doogue J, 18/2/97, p14).

## 3. DOES THE UNIFORM CONSUMER CREDIT CODE APPLY?

### AUSTRALIA

The Uniform Consumer Credit Code has no application to the loan facility or the security documents. In the present case Lendsafe did not provide the credit through the loan facility wholly or predominately for personal, domestic or household purposes.[41] The loan was made available for investment purposes so it is not regulated by the Code.

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The Credit Contracts Act 1981 applies to the loan facility irrespective of whether the credit has been provided for personal or business purposes. The disclosure provisions in that Act are subject to a threshold of $250,000, however, the provisions for the reopening of "*oppressive*" contracts apply irrespective of the amount of credit involved.

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41 *Consumer Credit Code*, s6.

It is difficult to see a factual basis for reopening the contract in this instance. There appears to be nothing overtly unfair about the terms of the contract as presented (although Alberto's lack of commercial acumen may assist to some degree). Neither does the decision to call up the loan appear oppressive. It has been held that insistence by a creditor upon a contractual right of repayment is not oppressive. (*Dennis Hedley Limited v Freefit Mufflers Limited* (1982) 1 BCR 394.) It also seems unlikely that Alberto and Bruce could succeed with an argument that they had been induced to enter into the contract by oppressive means. (See for example, *Italia Holdings (Properties) Limited v Lonsdale Holdings (Auckland) Limited* [1984] 2 NZLR 1 and *Jenkins v NZI Finance Limited*, Court of Appeal, CA 214/88, 9 November 1989).

The Credit Contracts Act 1981 is to be repealed by further Consumer Credit legislation currently before Parliament. The Consumer Credit bill was introduced on 17 September 2002 and had its first reading on 18 February 2003. It is currently before the Commerce Select committee which is due to report back to the House on 17 August 2003. The "*oppression*" provisions in the Credit Contracts Act 1981 are substantially carried forward in the bill and will continue to apply to all credit contracts (whether or not they are consumer credit contracts as defined in the bill).

## 4. IS LENDSAFE BANK LIABLE FOR MISLEADING ADVERTISING?

### AUSTRALIA

Lendsafe's advertisement in relation to its new "Biz Boost Loan" could offend s12DA of the *Australian Securities and Investments Commission Act 1989* because it is misleading or deceptive. In its Information Circulars, the Trade Practices Commission (as it then was) has advised that a statement to the effect that "low interest finance [is] readily available" in an advertisement directed at lower income home buyers would be misleading if average persons responding to the advertisement could not qualify for the low interest finance and were consistently persuaded to sign up for loans at

a higher interest rate.[42] Even the addition of the words "to approved purchasers" would not correct the deception in the advertisement.[43]

By similar reasoning, it could be argued that Lendsafe's advertisement is deceptive because it states that a low interest rate of 3% is "readily available" to "approved customers" but the bank consistently signs up borrowers to a higher interest rate because they do not meet the bank's creditworthiness requirements and because the minimum loan at the lower rate of interest is $2 million. It would be still be necessary, however, for Bruce and Alberto to prove that they were "worse off" as a result of Lendsafe's misleading or deceptive conduct.[44] It would be necessary, therefore, for them to adduce evidence that they could have obtained a comparable loan at a lower rate than 4% variable interest elsewhere in the marketplace. If they are unable to do this, they will not be able to recover damages against Lendsafe.

There would appear to be a breach of s12DG of the *Australian Securities and Investments Commission Act 1989* in the present case. In essence, this section prohibits bait advertising. It provides that a

"*corporation must not, in trade or commerce advertise financial services for supply at a specified price, if there are reasonable grounds, of which the corporation is aware or ought reasonably to be aware for believing that the corporation will not be able to offer for supply those services at that price:*

*(a) for a period that is; and*

*(b) in quantities that are reasonable*

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42 TPC Information Circular, No 18 *Real Estate Advertising Guidelines* (1976) para 4.1.

43 TPC Information Circular, No 10 *Advertising Guidelines* (1975) para 5.9(c), citing *CRW Pty Ltd v Sneddon* [1972] AR NSW 17 at 33.

44 *Marks v GIO Australia Holdings Ltd* (1998) 196 CLR 494. See also *Gates v City Mutual Life Assurance Society Ltd* (1986) 160 CLR 1.

*having regard to the nature of the market in which the corporation carries business and the nature of the advertisement."*

This obligation may prove to be particularly significant in the present case if Bruce and Alberto are unable to prove that they are worse off as a result of agreeing to a business loan at the higher rate of interest as in *Marks v GIO Australia Holdings Ltd.*[45] At least they would be able to argue under s12DG and s12GM that the interest rate should be reduced to the lower rate of 3%.

**NEW ZEALAND**

Section 9 of the Fair Trading Act 1986 ("FTA") prohibits generally, in trade, conduct that is misleading or deceptive or is likely to mislead or deceive.

Section 11 specifically prohibits conduct that is likely to mislead the public as to the nature, characteristics, suitability for a purpose, or quantity, of services. "*Services*" includes a contract between a bank and its customer and contracts for or in relation to the lending of money or granting of credit.

Section 19 prohibits bait advertising. It provides that no person shall, in trade, advertise for supply at a specified price goods or services which that person –

**does not intend to offer for supply; or**

**does not have reasonable grounds for believing can be supplied by that person –**

at that price for a period that is, and in quantities that are, reasonable having regard to the nature of the market in which the person carries on business and the nature of the advertisement.

Sections 9, 11 and 19 of the FTA are interlinked, in that a breach of one may be a breach of the others. Lendsafe may face liability under sections 9, 11

and 19 if, on the facts, it can be shown that: 3% loans were not available at all, 3% loans were not "*readily available*" (i.e., almost no-one could qualify) and/or that a $2m minimum would in fact exclude most small businesses.

Civil remedies for breach of s9, 11 and 19 of the FTA are provided for in s43 of the FTA. If a Court finds that a person has suffered loss or damage as a result of conduct in contravention of those sections, the Court can order that a contract between the person contravening the Act and the person suffering the loss is void, or vary the terms of that contract or direct that a refund or other compensation be paid or provided for. This may provide a means for Alberto and Bruce to have the contract with Lendsafe avoided, or to obtain orders that the loan terms be varied such as to reduce the interest rate to 3%. However, it may be difficult (even assuming they can show liability), for Alberto and Bruce to show that the advertising caused them loss or damage such as would entitle them to such remedial orders, in circumstances where they were under no obligation to take the 4% loan, (and 4% may well be a competitive rate in the circumstances).

If Lendsafe has breached s11 or 19 of the FTA, it could also be liable for a fine (up to $100,000) pursuant to s40 of the FTA.

## 5. IS LENDSAFE LIABLE FOR LAWRENCE'S STATEMENT ABOUT INTEREST RATES?

### AUSTRALIA

Lendsafe can be vicariously liable for Lawrence's statement under s12GH of the *Australian Securities and Investment Commission Act 1989* because he is an employee of the bank acting within the scope of his actual or apparent authority.[46] Moreover, because Lawrence made a statement about a future event or expressed an opinion, Lendsafe will be deemed to be guilty of misleading or deceptive conduct unless it can prove that there were reasonable grounds for making the statement or expressing the opinion at

[45] (1998) 196 CLR 494.

the time it was made or expressed. In effect, this reverses the usual onus of proof and confers an important tactical advantage on Bruce, Alberto and PP.

**NEW ZEALAND**

Under s45(2) of the FTA any conduct on behalf of the body corporate by a director, servant or agent of the body corporate, acting within the scope of that person's actual or apparent authority, is deemed to have been the conduct of that body corporate.

## 6. IS LENDSAFE LIABLE FOR LAWRENCE'S STATEMENT THAT HE THINKS "THE EXPANSION IS VIABLE"?

**AUSTRALIA**

This statement is a statement of opinion and it appears that there were no reasonable grounds for expressing the opinion at the time. Indeed, Lawrence recently declined a similar meat processing venture because he was concerned that there was insufficient demand for packaged meat. If Alberto (or Bruce) relied on this statement, then he may be able to obtain damages under s12GF or a remedial order under s12GM of the *Australian Securities and Investments Commission Act 1989*.

**NEW ZEALAND**

Lendsafe can be liable for Lawrence's opinions regarding the expansion under the usual doctrines of vicarious liability for employees.

Liability is likely to arise in New Zealand under s9 of the FTA (and s45 makes Lendsafe liable for any breaches of the Act by its employees); Lendsafe could also be liable for Lawrence's opinions if they amounted to a

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[46] See generally *Ardour Holdings Pty Ltd (in liq) v Commonwealth Bank of Australia* [1991] ATPR 41-147 at 57, 143 and O'Donovan, *Lender Liability* para [6.125].

negligent mis-statement (following proof of duty of care, breach of duty, causation and damage).

## 7. ARE THE COLLATERAL SECURITIES VALID?

### AUSTRALIA

Uncommercial Transactions

> The collateral securities may well run foul of s588FB of the *Corporations Act 2001*(Cth) as uncommercial transactions because a reasonable person in the position of PP might not have entered into the transaction having regard to the detriment suffered by PP and the benefits derived by Lendsafe and Bruce and Alberto.[47]

Constructive Trust

> Moreover, by inducing the directors of PP to grant these securities the bank may have become involved in a breach of fiduciary duties by the directors. If the bank dishonestly induced or facilitated this breach of fiduciary duties it could be liable as a constructive trustee and its securities could be set aside.[48] But in the present case there does not appear to be sufficient evidence of dishonesty by the bank to hold it liable as a constructive trustee.

Prohibited Financial Assistance

> PP provided financial assistance to Bruce and Alberto in their acquisition of shares in the company by providing Lendsafe with

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47 See generally *Rivarolo Holdings Ltd v Casa Tua (Sales) Pty Ltd* (1997) 24 ACSR 105; Morrison and Anderson, "Uncommercial Transactions – Developments in the New Regime" (1999) 7 ILJ 184 and McPherson, *The Law of Company Liquidation* (4th ed by Professor AR Keay), pp 449-465.

48 See *Royal Brunei Airlines Sdn Bhd v Tan* [1995] 2 AC 378; *Twinsectra Ltd v Yardley* [2002] 2 AC 164 and *Rolled Steel Products (Holdings) v British Steel Corporation* [1985] 2 WLR 908.

collateral security for the loan facility. This financial assistance may be prohibited by s260A of the *Corporations Act 2001* because it could prejudice PP's ability to pay its creditors. On the other hand, it could be argued that the transaction assisted PP to acquire the factory and equipment. This would confer a substantial benefit on the company but it does not disguise the fact that the collateral securities also cover an existing overdraft which provides no benefit to the company or its creditors.

The prohibited financial assistance and any connected contract, including in this case the collateral securities, are not invalidated simply because the section is contravened but the persons involved in the contravention may be liable under the section or for a breach of directors' duties under ss.180-183. This is a far cry from the old regime under which a bank was ordered to repay $4.3 million paid in breach of a predecessor of s260A, not just the amount of its profit from the transaction.[49]

## NEW ZEALAND

### (a) Uncommercial Transactions

While historically companies could not conduct transactions outside of the company's commercial interests, that position in New Zealand has been reversed by s17(3) of the Companies Act 1993, which provides that:

> "*The fact that an act is not, or would not be, in the best interests of a company does not affect the capacity of the company to do the act.*"

Any challenge to the transaction will have to be on other grounds.

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[49] See *Hunters Products Group Ltd v Kindley Products Pty Ltd* (1996) 14 ACLC 826.

**(b) Constructive Trust**

If the directors have been guilty of a breach of fiduciary duty (as they do owe such a duty to PP), and Lendsafe has knowingly assisted this breach or knowingly received securities as a result, it is possible that it could be held liable as a constructive trustee. However, such an action is only likely to be brought by the liquidator of PP. It may well be that a liquidator relies upon one of the statutory provisions in respect of voidable securities (discussed below), which could well provide easier to establish, rather than attempting to rely upon the equitable jurisdiction.

The relevant provisions governing transactions and voidable securities are sections 292-294 and 297 of the Companies Act 1993. In summary, these provisions give a liquidator the ability to challenge transactions which have had a preferential effect, the granting security which lead to one creditor being preferred over another, and transactions at an undervalue.

These sections focus on the economic effect of the transaction first; if the transaction does not meet the relevant economic criteria, then the transaction is potentially voidable, unless the transactions took place in good faith (although the tests are differently expressed in each section). It is likely that any challenge to the securities will be made under one of these sections.

**(c) Prohibited Financial Assistance**

Under New Zealand law financial assistance may be given to a person for the purpose of, or in connection with, the purchase of a share issued or to be issued by the company, or by its holding company **only** if approved in accordance with the procedures in the Companies Act 1993. While contravention of the Act will not invalidate the transaction if Lendsafe received the security given by PP in the knowledge that the provisions of the Act relating to the

provision of financial assistance had not been complied with, it could be a constructive trustee in relation to that security.

Section 62 of the Companies Act 1955 (the predecessor of the current section) referred to financial assistance for the purpose of or in connection with a purchase or subscription for shares. The current provision however refers only to "*the purchase of a share*". The position therefore appears to be that the provisions of this Act relating to the giving of financial assistance do not apply to the initial subscription for shares in a company. Accordingly, the giving of security by PP to Lendsafe would not infringe the rules in the Companies Act 1993 relating to the giving of financial assistance.

## 8. DE FACTO AND SHADOW DIRECTORS

### AUSTRALIA

When Bruce and Alberto consistently exceeded their overdraft Lawrence adopted a policy of selectively dishonouring cheques in order to pay essential creditors and protect the bank's position.[50] This practice could render the bank liable as a de facto or shadow director under the extended definition of "director" in s9 of the *Corporations Act 2001*. On this basis, the bank could be liable for breaches of directors' duties under ss180-183 and insolvent trading under s588G.[51]

### NEW ZEALAND

A de facto director is one who is held out by the company or purports to act as a director, notwithstanding for example, an invalidity in the appointment, or something else which means that they are not legally a director. The definition of director in s126(1)(a) of the Companies Act 1993 appears to include de facto directors, so directors' duties can be visited on such

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50 *Re Tasbian Ltd* (No3) [1991] BCC 436.

51 For a detailed account of the potential liabilities of banks as shadow and de facto directors, see O'Donovan, *Lender Liability* (2000), Ch 11.

persons. But the definition is unlikely to encompass the Bank because the Bank is not purporting to act as a director, nor is the Company holding the Bank out as a director.

In relation to shadow directors, s126(1)(b) of the Companies Act 1993 imposes a number of (but not all) directors' duties on those persons who direct or have the power to direct an appointed director or appointed directors. The issue of who is a shadow director is whether such a person directs or controls the board or any individual on it. It is unlikely that exercising a discretionary contractual right to dishonour cheques will be sufficient to create shadow directorship, but a more active approach in management could raise the prospect of liability for Lendsafe.

## 9. UNILATERAL VARIATIONS

### AUSTRALIA

In *Paragon Finance Plc v Nash*[52] the English Court of Appeal declared that the power of a mortgagee to vary interest rates periodically was not completely unfettered. In order to give effect to the reasonable expectations of the parties it was an implied term of every mortgage that the discretion to vary interest rates should not be exercised dishonestly, for an improper purpose, capriciously, arbitrarily or in a way which no reasonable mortgagee acting reasonably would do.

This principle is consistent with Australian authorities to the effect that there is an implied term that each party to a contract agrees "to do all such things as are necessary on his part to enable the other party to have the benefit of the contract".[53]

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52 [2002] 1 WLR 685. See also *Burger King v Hungry Jack's Pty Ltd* [2001] NSWCA 187.

53 *Butt v McDonald* (1896) 7 QLJ 68 at 70-71 per Griffith CJ, approved in *Secured Income Real Estate (Australia) Ltd v St Martins Investments Pty Ltd* (1979) 144 CLR 596 at 607.

It follows that the parties to a contract are subject to an implied duty to do all that is reasonably necessary to secure performance of the contract.[54] Neither party may do anything to impede performance of the agreement or to injure the right of the other party to receive the proposed benefit.[55]

However, it is not necessary to imply a term relating to good faith performance into a loan contract in order to give it business efficacy;[56] nor should such a term be implied as a matter of law as a legal incident of an ordinary contract between a lender and a borrower.[57]

Indeed, even in *Paragon Finance Plc v Nash*[58] the English Court of Appeal accepted that it was not a breach of the alleged implied term not to vary interest rates if the mortgagee, as a commercial organization, raised interest rates in order to overcome financial difficulties it had encountered. If the decision to widen the gap between the rate charged by the mortgagee and the standard market rates was motivated by purely commercial considerations there were no grounds for alleging a breach of the implied term.

Where there is no express provision in a loan contract dealing with variations in the interest rate it may well be that the mere sending of a notice to the borrowers informing them of an increase in the interest rate does not render the borrowers liable at the higher rate. But where the customers

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54 *Service Station Association Ltd v Berg Bennett & Associates Pty Ltd* (1993) 45 FCR 84.

55 *Shepherd v Felt and Textiles of Australia Ltd* (1931) 45 CLR 359 at 378 per Dixon J; *United States Surgical Corp v Hospital Products International Pty Ltd* [1982] 2 NSWLR 766 at 800 per McLelland J; *Supergrasse Pty Ltd v Macquarie Bank* (unreported, Supreme Court NSW, Bryson J, 27 November 1990).

56 See *BP Refinery (Westernport) Pty Ltd v Hastings City Council* (1977) 180 CLR 266; *Codelfa Construction Pty Ltd v State Rail Authority of New South Wales* (1982) 149 CLR 337; *Hospital Products International Ltd v United States Surgical Corp* (1984) 156 CLR 41.

57 See *Castlemaine Tooheys Ltd Carlton & United Breweries Ltd* (1987) 10 NSWLR 468 at 486; *Hughes Aircraft Systems International v Airservices Australia* (1997) 76 FCR 151.

58 [2002] 1 WLR 685.

borrow more money from the bank after receiving such notice, the bank is justified in charging the higher rate.[59]

While the lender may be free to effect a unilateral variation in interest rates so far as the borrowers are concerned, the impact on guarantors and third party mortgages needs to be considered. If the guarantee or third party mortgage is collateral to a principal loan contract that does not contemplate variations in terms, then the guarantors and third party mortgagors will be discharged if the variation in the interest rates might prejudice them.[60] Clearly an increase in interest rates cannot benefit guarantors and third party mortgagors so they will be discharged by even a marginal increase in the interest rate on the principal loan. For this reason, it is imperative for lenders to ensure that there are express provisions in the loan contract contemplating variation in the terms. Otherwise it will be necessary to obtain the fully informed binding consent of the guarantors or third party mortgagors.[61] Usually, guarantees and third party mortgages contain express provisions purporting to preserve the liability of the guarantor and mortgagor if the principal contract is varied. Such provisions are effective.[62]

**NEW ZEALAND**

The contract allowed Lendsafe to vary the interest rate by publishing a notice in *The Australian*. However rather than simply vary the interest rate it appears that Lendsafe has substituted another means of calculating the

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59 See *Gaddar Mal v Tata Industrial Bank Ltd Bombay* (1927) 1 LR 49 All 674 (Ind).

60 See *Gordon v Hebblewhite* [1927] 1 DLR 817; *National Westminster Bank v Riley* [1986] FCR 213.

61 See *Farrow Mortgage Services v Williams* (unreported, Supreme Court of NSW, 5 April 1993); *Invercargill Savings Bank v Genge* [1929] NZLR 375; *Sabemo Pty Ltd v De Groot* (1991) 8 BCL 132; *Tasman Finance Pty Ltd v Edwards* (unreported, Supreme Court of NSW, 8 December 1992) and O'Donovan & Phillips, *The Modern Contract of Guarantee* (3rd ed 1996), pp 346-347. The lender's agreement to keep the borrower's account open is not sufficient consideration for a binding agreement to remain liable as a guarantor notwithstanding a variation in the principal loan contract. See *Royal Bank of Canada v Salvatori* [1928] 3 WWR 501. Cf. *Royal Bank of Canada v Mills* [1932] 4 DLR 574.

62 See O'Donovan & Phillips, *The Modern Contract of Guarantee* (3rd ed 1996), pp 349-353.

interest rate. We do not know whether the contract contains other provision for the variation of its terms. In the absence of a contractual right for Lendsafe to unilaterally vary the terms, a unilateral variation by Lendsafe of the terms of the contract will not be binding upon Alberto and Bruce unless their consent was obtained. Whether their subsequent conduct is sufficient to imply consent will depend upon the terms of the contract and whether agreement in writing is required.

The position of Lendsafe as guarantor should also be considered. Most will be familiar with the provisions of the guarantee preserving a guarantor's liability even if a change has been made to the loan terms (including express waivers, principle debtor clauses and indemnities). In the absence of such provisions or a separate consent to the changes being obtained then there is a risk of the guarantor's obligations being discharged.

## 10. IS LENDSAFE LIABLE FOR A BREACH OF FIDUCIARY DUTY?

### AUSTRALIA

The short answer to this question is that it is unlikely that Lendsafe would be subject to a fiduciary duty in the present case. The key factors of trust, confidence, reliance and vulnerability are not as clearly evident as in *Commonwealth Bank of Australia v Smith*,[63] even though Bruce and Alberto have been customers of the bank for many years. Alberto's statement that the bank has "been helping" the partners for many years would not, in itself, be sufficient to establish a fiduciary duty but there is no doubt that this allegation would be raised against Lendsafe if only to avoid an *Anshun* estoppel being raised by the plaintiffs.[64]

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63 (1991) 102 ALR 453. Contrast *Pavlovic v Commonwealth Bank of Australia* (unreported, Supreme Court of SA, Legoe ACJ, 28 May 1993); *James v Australia and New Zealand Banking Group Ltd* (1986) 64 ALR 347; *Golby v Commonwealth Bank of Australia* (1996) 72 FCR 134; *Truebit Pty Ltd v Westpac Banking Corp* (unreported, Federal Court of Australia, 27 November 1997). See generally O'Donovan, *Lender Liability* (2000), para [4.160].

64 See *Port of Melbourne Authority v Anshun Pty Ltd* (1981) 147 CLR 589. An Anshun estoppel was successfully raised against a guarantor in *Parras Holdings Pty Ltd v Commonwealth Bank of Australia* [1999] FCA 391, para 91.

**NEW ZEALAND**

> *"The essence of a fiduciary relationship is an inequality of bargaining power brought about by the trust or confidence reposed in, and accepted by, the fiduciary to perform some functions for another's benefit in circumstances where the beneficiary lacks the power adequately to control or supervise the exercise of that function."* (Laws of New Zealand, Equity, Charles Rickett, Wellington, Lexisnexis, 2003, para 97)

It is highly unlikely that a fiduciary relationship can be established between Lendsafe and Alberto and Bruce. The relationship is not assumed to be fiduciary, and something more than the normal banking arrangements must be established (Rickett, para 117), which does not appear on the facts.

## 11. WAS ROGER VALIDLY APPOINTED AS RECEIVER?

**AUSTRALIA**

In the absence of an estoppel[65] or a contractual restriction upon termination of the loan facility, Lendsafe would be entitled to enforce its collateral securities even if that would destroy the business.[66]

At the time of Roger's appointment, the mortgage and fixed and floating charge were valid and enforceable so his appointment should be valid. However, if the securities are successfully attacked in the subsequent liquidation of PP as uncommercial transactions under s588FB of the *Corporations Act 2001* or on the basis of a constructive trust, the securities could be set aside and the receiver could be removed.

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[65] As to estoppel, see O'Donovan, *Company Receivers and Administrators*, para [3.90].

**NEW ZEALAND**

The decision by Lendsafe to exercise in a valid manner a power of appointment of a receiver cannot be challenged unless it is exercised in bad faith *(Shamji v Johnson Matthey Bankers Ltd* [1986] BCLC 278*)*. The manner in which a receiver is to be appointed is prescribed by the general security agreement and must be strictly followed *(Wrights Hardware Pty Ltd (Prov Liq APPTD) v Evans* (1988) 13 ACLR 631). This includes the appointment being in writing which in New Zealand it is now a statutory requirement (Receiverships Act 1993 s6(2)). This also includes ensuring that demand is made where the General Security Agreement requires this to occur. Given that a default has occurred and assuming the requirements of the General Security Agreement have been complied with the appointment of Roger appears valid.

If the appointment is invalid and Lendsafe is not estopped from asserting that invalidity (*Bank of Beroda v Panessar* [1986] 3 All ER 751), Roger as receiver would be a trespasser against the property of PP of which he has taken possession even though he may have acted in good faith. Roger may be liable to pay substantial damages and be deprived of fees (*ANZ Banking Group (NZ) Ltd v Gibson* [1986] 1 NZLR 556].

## 12. IS ROGER LIABLE FOR A BREACH OF HIS DUTIES?

**AUSTRALIA**

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66 *Re Potters Oils Ltd* (No2) [1986] 1 All ER 890; *Shamji v Johnson Matthey Bankers Ltd* [1986] FTLR 329. Cf. *Terry Clark & Associates v Carez Nominees Pty Ltd* (1993) 13 ACSR 314.

A receiver does not necessarily breach his duties by selling backlogged stock at discount prices.[67] But in the present case it appears that Roger has not taken all reasonable care to sell PP's stock for its market value or the best price reasonably obtainable in the circumstances.[68] It is difficult to defend his discount sales because he did not ascertain the value of the stock.[69]

The sale of a business by a receiver and manager as a going concern is GST-free. In order to qualify for this concession, the receiver and manager must ensure that the following conditions are satisfied:

(a) the sale must be for consideration

(b) the purchaser must be registered or required to be registered for GST purposes; and

(c) the company in receivership and the purchaser must have agreed in writing that the sale of the business is a sale of going concern.[70]

If the GST exemption does not apply to the sale, the company in receivership and its receiver will be liable for the payment of the GST even if the receiver believed the sale was GST-free. No doubt, the receiver would seek to recover this amount under the indemnity usually provided by his appointor.

In the present case Roger and Lendsafe have made a conscious decision not to sell the business as a going concern. Would this involve a breach of the receiver's duty to take all reasonable care to sell the company property

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67 *Expo International Pty Ltd v Chant* [1979] 2 NSWLR 820 at 834.

68 See generally O'Donovan, *Company Receivers and Administrators*, para [11.2130].

69 *Kyuss Express Pty Ltd v Sellers* (2001) 37 ACSR 62. See also *Jeogla Pty Ltd v ANZ Banking Group Ltd* (1999) 150 FLR 359, where a receiver was held liable for a breach of his statutory duty because he failed to identify the correct "market" for the sale of the company's pedigree cattle. Confirmed on appeal: *Skinner v Jeogla Pty Ltd* (2001) 37 ACSR 106.

for its market value? The sale may be for full market value but the return to the secured creditor and the company may be reduced by the amount of the GST. It is interesting to speculate whether this would render the receiver liable under s420A or the general law. Even if there is no such liability (as seems likely), receivers should consider this issue carefully in selling secured assets in order to maximize the return to their appointors.

**NEW ZEALAND**

The general duties of receivers and their duty when selling property are respectively now found in s18 and 19 of the Receiverships Act 1993. Essentially, a receiver must exercise his or her powers in good faith and for a proper purpose. A receiver also has a duty to obtain *"the best price reasonably obtainable as at the time of the sale"* (s19). As with the case of the stock, Roger's refusal in accepting a generous offer for PP's forklifting computer systems, could well give rise to a breach of Roger's duties of care to not only PP but any sureties and indeed Lendsafe. (*R A Price Security Ltd v Henderson* [1989] 2 NZLR 257)

## 13. WHAT IS THE EFFECT OF LIQUIDATION?

**AUSTRALIA**

When PP went into liquidation, Roger could no longer purport to exercise his full range of powers as agent of the company.[71] Nevertheless, he retained his power of sale and remained subject to his statutory duty under s420A of the *Corporations Act 2001*.

Accordingly he could well be liable for his failure to accept a generous offer to purchase PP's forklift and computer systems.[72] Lendsafe Bank will not

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[70] See generally O'Donovan, *Company Receivers and Administrators*, para [11.2410].

[71] The receiver's agency survives so far as it is consistent with the statutory scheme for winding up the company: *Graeme Webb Investments Pty Ltd v St George Partnership Banking Ltd* (2001) 38 ACSR 282 at 297.

[72] See the cases cited at n.69 above.

however be vicariously liable for Roger's acts or omissions unless it issued him with directions or instructions to forgo the offer.[73]

In relation to the proposed sale of the factory, Roger is not purporting to act as a receiver but rather as agent of Lendsafe as a mortgagee in possession. It follows that Lendsafe will be subject to the duty imposed on controllers by s420A in relation to the exercise of its power of sale.[74]

### NEW ZEALAND

As in Australia, Roger ceases to be agent of PP although he is not automatically agent of Lendsafe (s31(3) Receiverships Act 1993). Under s31 a receiver is entitled to exercise all the powers that a receiver has in respective property notwithstanding the appointment of a liquidator. Under 131(2) the receiver can act as agent of the company either with the approval of the Court or the express written consent of the liquidator.

Assuming Roger has been instructed to take possession of the PP's factory by Lendsafe as mortgagee, he will be construed as an agent of Lendsafe as mortgagee. Under s103A Property Law Act 1952 (as amended), a mortgagee who exercises a power of sale of land or other mortgaged property owes a duty to the mortgagor to take reasonable care to obtain the best price reasonably obtainable as at the time of sale.

## 14. REMEDIES

### AUSTRALIA

If PP wishes to challenge an exercise of Lendsafe's power of sale it may seek injunctive relief. Payment into Court will usually be required for the grant of such relief where the mode of the exercise of the power of sale is

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73 *American Express International Banking Corp v Hurley* [1985] 3 WLR 564.

74 See generally O'Donovan, *Company Receivers and Administrators*, Vol 1, [APX 3.270].

challenged[75] but not where the validity of the mortgage or charge itself is in dispute.[76] No doubt PP will bear this in mind when it challenges Lendsafe's collateral securities and its enforcement strategies.

**NEW ZEALAND**

In addition under s35 of the Receivership Act 1993 the Court has the power on application of PP or indeed Fred Ferret to apply to the Court for an order that Roger cease to act as receiver. Further, pursuant to s301 of the Companies Act 1993 the Court may on application of the liquidator or Lendsafe or Albert and Bruce enquire into the conduct of the receiver and order the receiver to repay or restore money or property or to contribute a sum by way of compensation where the receiver has been guilty of negligence, default or breach of duty in relation to PP. Apart from the statutory jurisdiction, the Court has an inherent jurisdiction to remove Roger where it is proved that he is exercising of proposing to exercise powers dishonestly or recklessly and thereby abusing the powers conferred upon him (*Re Neon Signs Ltd (Australasia)* [1965] VR 125

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[75] See *Harvey v McWatters* (1948) 49 SR (NSW) 173.

[76] *Inglis v Commonwealth Trading Bank of Australia* (1972) 126 CLR 161.