FINANCING TRANSACTIONS AND THE RELENTLESS INTRUSION OF STATUTORY REGULATION

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Part A Introduction

The impact of statute on commercial transactions is so pervasive today that it barely calls for comment. In a survey conducted in 2008, the Institute of Public Affairs noted that the average number of pages in Commonwealth legislation had increased from less than 2000 thousand pages in the 1970s to over 6000 pages in 2006.[1] The increase in the statutory regulation of financing transactions is but one example of this phenomenon. Although it would be fair to say that statute has always had some part to play in regulating financing transactions and in their documentation, the extent of statutory intervention has increased significantly over the last 40 years, and in many areas statute is now the main factor in determining the manner in which risk is allocated between a financier and a borrower.

This paper provides a brief survey of this phenomenon since the 1970's,[2] by reference to some of the main legal considerations which financiers need to address for the purposes of ensuring the enforceability of contractual rights in a financing transaction. In order to provide a context for these legislative changes and a framework for assessing their significance, there will be a brief discussion in Part B of the legal considerations arising at general law including equity. Examples of statutory intervention will be then be considered in Part C.

The historical analysis reveals a trend of increasing layers of statutory intervention. Whilst some of the interventions may have been in response to perceived gaps in the law, others may have been unnecessary. It will be argued that the law, as it stood prior to the legislative change, may have already adequately addressed part of the mischief sought to be further regulated. In some instances, the law was amended with scant attention to the existing regulatory regime. Because of the sheer bulk of the statutory changes, the survey is selective and focuses on the more significant developments.[3] The law regulating financial transactions is now a complex overlapping web of the common law, contract and statute and presents significant challenges for even the most experienced legal practitioner specialising in the area. Apart from compliance costs[4], the law also poses significant operational risks for any financier who fails in any attempt to comply in good faith with its provisions. Part D of the paper

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1 Chris Berg, 'The Growth of Australia's Regulatory State Ideology, Accountability and the Mega-regulators', Institute of Public Affairs, 2008 at 9.

2 This date has been selected to enable identification of potential claims prior to the introduction of the *Trade Practices Act 1974* (Cth) and in particular s52 of that Act enabling claims to be made in respect of conduct that is misleading or deceptive or is likely to mislead or deceive.

3 Reference will not be made to mirror provisions in the Australian State and Territory fair trading legislation. As at 2011 and notwithstanding the introduction of the *Australian Consumer Law*, the State and Territory legislation is still not identical. This paper will not address the regulation of credit card transactions nor licensing requirements and only brief reference will be made to the *Contracts Review Act 1980* (NSW).

4 In implementing the *Consumer Credit Code* in 1994, financiers incurred a one-off implementation cost of $200 million with an ongoing recurring cost of $50 million. See 'Rethinking Regulation Report of the Taskforce on Reducing Regulatory Burdens on Business' at page ii quoting from a submission of the Australian Bankers Association.

considers briefly the policy implications arising from increased statutory intervention and suggests that the law in this area needs to be simplified and rationalised.

Part B General Law risk considerations for financiers

(a) **Common law claims**

Even prior to the 1970's and leaving aside any statutory rights, a financier seeking to recover a loan still had to contend with a significant array of possible cross claims by a borrower, the effect of which, if successful, was to either reduce the borrower's liability to the financier or to relieve the borrower from that liability in its entirety. A bank seeking to recover a loan in this period may have found itself subject to a cross claim for breach of an implied term in the banker/customer contract where, for example, the bank offered a new risky product to an inexperienced customer without providing proper warning or advice as to the risks involved. More recently, these claims could also have been based on a breach of the Code of Banking Practice which is incorporated as a matter of contract into loan agreements between a bank and its customer, which for these purposes would also include a small business[5]. Alternatively, the financier may have been exposed to a cross claim in tort on the basis of fraudulent[6] or negligent advice.

In *Woods v Martins Bank Ltd*[7], for example, a young man of no business experience sued the bank for negligent advice associated with his investments in a company whose account with the bank at the relevant time was overdrawn in circumstances where the financier was pressing the company to reduce its indebtedness. The young man lost £16,000 and sued the bank for fraud and negligence. Although fraud was not established, it was found that the bank manager had been grossly negligent. After considering the advertising material and booklets produced by the bank, the court rejected the defence that the advice given by the bank manager was outside the scope of the financier's business. The court awarded damages based on negligence. However, in what has been described as a "shabby subterfuge to overcome the authorities which in 1959 appeared clearly to mean that there was no duty of care in those circumstances",[8] the Court found that there was a fiduciary relationship between the bank and the plaintiff.

In *Hedley Byrne & Co Ltd v Heller & Partners Ltd*,[9] it was held that a bank may be liable for negligent misstatement associated with credit enquiries that demonstrated reliance on the bank's skill or judgment. If the bank provided such advice without a clear disclaimer of responsibility (which was found to be effective in the instant case), it accepted a legal duty to

5 Code of Banking Practice clause 40 (definition of 'you' and 'your' when read with the definition of 'small business' defined to mean a manufacturing business having less than 100 full time people or in any other case less than 20 full time people).

6 *Deery v Peek* (1889) 14 Ap Cas 337. In practice fraud was difficult to establish because of a need to prove an actual intent to deceive or reckless indifference as to the truth or falsity of any statement.

7 [1959] 1 QB 55.

8 Meagher Gummow and Lehane's, *Equity Doctrines and Remedies* (4th ed) at [2-280]. One such authority was *Banbury v Bank of Montreal* [1918] AC 626 where a financier was found not liable for investment advice, because it was outside the scope of its business. Salmon J was forced to distinguish this case in his judgment. See *Woods v Martins Bank Ltd* [1959] 1 QB 55 70.

9 [1964] AC 465.

exercise proper care, even if it was not under any contractual or fiduciary duty to the enquirer.[10]

Defaults under foreign currency loans extended by banks largely to farmers in the second half of the 1980's presented the courts with an opportunity to explore further the application of principles relating to negligent misstatement in the context of financing transactions. In response to demands by banks for loan repayments, borrowers would often plead negligent misstatement by way of cross claim (where the bank had provided advice to the borrower in connection with the taking out of the loan).[11] To establish a claim, it was necessary for borrowers to establish evidence of forseeability and evidence of reliance or assumption of responsibility or both[12] and that the loss was caused by the breach. Some of these claims succeeded[13] whilst others failed[14].

(b) **Breach of fiduciary duty**

A financier is not within one of the traditional categories of fiduciary relationship, such as principal and agent or solicitor and client. A fiduciary relationship will only arise between a financier and a customer where the financier:

(i) has an obligation to act for or on behalf or in the interests of the customer in exercising a power or discretion which will affect the interest of the customer in a legal or practical sense;

(ii) is given a special opportunity by the customer to exercise a power which may operate to the detriment to the customer; or

(iii) acts in a representative capacity in exercising responsibilities.[15]

However, one finds in the law reports a reluctance to treat the banker/customer relationship as fiduciary in nature.[16] This attitude may be seen in *Lloyds Bank v Bundy*[17] where an old farmer

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10 See also *Box v Midland Bank Ltd* [1979] 2 Lloyd's Rep 391 on app [1981] 1 Lloyd's Rep 434. The financier was found liable for statement that obtaining of finance was a mere formality where finance rejected. Compare *Mutual Life and Citizens Assurance v Evatt* [1971] AC 793, holding that the principle in *Hedley Byrne* did not extend to negligent advice given by one whose business did not include the giving of advice and had not held himself out as an expert.

11 See, eg, *Commonwealth Bank of Australia v Smith* (1991) 42 FCR 390. (Bank liable for investment advice given by financier manager relating to the purchase of a hotel in a small country town from another customer of the financier. Business performed poorly and customer sought and obtained relief against the financier.)

12 *David Securities Pty Ltd v Commonwealth Bank of Australia* (1990) 93 ALR 271 (reversed on other grounds in *David Securities v Commonwealth Bank of Australia* (1992) 175 CLR 353). These principles have developed further in the context of expert reports and whether the author of the report is liable to third parties who relied on them. See eg *Esanda Finance Corp Ltd v Peat Marwick Hungerfords* (1997) 188 CLR 241 and *Ingot Capital Investments v Macquarie Equity Capital Markets (No 6)* (2007) 63 ACSR 1. Currently, the principles are being further tested in actions commenced by local councils against rating agencies for ratings associated with products marketed in Australia by a member of the Lehmann group of companies.

13 See eg *Foti v Banque Nationale de Paris (No 1)* (1989) 54 SASR 354.

14 See eg *Copping v ANZ McCaughan Ltd* (1997) 67 SASR 525.

15 *Hospital Products v United States Surgical Corporation* (1984) 156 CLR 41.

provided a guarantee and charge to support his son's indebtedness to the bank. Following the son's bankruptcy and the bank's attempt to enforce the guarantee and charge, the Court set them aside. Lord Denning based his judgment on both an inequality of bargaining power between the bank and Mr Bundy and undue influence. In contrast, Lord Justice Sachs based his decision on undue influence and the "confidentiality" which is an essential ingredient of the special relationship upon which undue influence is grounded. In substance Sachs LJ found that a fiduciary relationship existed. In contrast, Cairns LJ said that he had doubts as to the existence of a fiduciary duty in the case "but in the end … for the reasons given by Sir Eric Sachs … I have reached the conclusion that in the very unusual circumstances of the case there was such a duty".[18] Even today, the Courts are wary of finding fiduciary relationships in commercial dealings.[19]

(c) **Unconscionability and Undue Influence in Equity**

The equitable principles associated with relief from transactions on the basis of unconscionability have an impeccable pedigree dating back at least as far as the seminal decision in *Earl of Chesterfield v Janssen*.[20] In modern parlance, the case may be seen as an example of a debt restructuring which was set aside on the basis of unconscionability.

In *Chesterfield*, an heir borrowed money secured over an expectancy from his grandmother's estate. Variations were made to the loan contract the ultimate effect of which was that the principal sum doubled in size if the borrower failed to repay the debt on the new repayment date. The borrower failed to repay the debt on the amended repayment date with the result that the outstanding principal doubled in size. The borrower's estate (the borrower had died in the meantime) was granted relief on the basis that the loan arrangements constituted a 'catching' bargain involving an heir "against which relief always extended".

The jurisdiction is engaged "whenever one party to a transaction is at a special disadvantage in dealing with the other party because of illness, ignorance, inexperience, impaired faculties, financial need or other circumstances affect his ability to conserve his own interests and the other party unconscientiously takes advantage of the opportunity thus placed in his hands".[21] A transaction may also be set aside because of other factors such as age, sex, lack of proper explanation and lack of education.

Although these principles have been applied in a wide variety of circumstances, and not just where a financier attempted to recover a loan, they have been relied upon from time to time by

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16 In this respect, the comments of Salmon J in *Woods v Martins Bank Ltd* [1959] 1 QB 55 constitute a notable exception.

17 [1975] QB 326.

18 Ibid, 340.

19 See eg the dismissal by Eintein J of a fiduciary claim by investors in the Great Southern managed investment schemes in *Bendigo and Adelaide Bank in Bendigo and Adelaide Bank Limited v Cairncross* [2011] NSWSC 610 (22 June 2011).

20 (1751) 2 Ves Sen 125; 28 ER 82. In this case Lord Hardwicke outlined the various categories of equitable fraud of which unconscionability is one manifestation and which are still applicable today.

21 *Blomley v Ryan* (1956) 99 CLR 362 415.

borrowers in response to a demand by a financier for repayment of financial indebtedness.[22] Financiers were reminded of the extent of this equitable jurisdiction in the 1986 decision in *Commercial Bank of Australia Ltd v Amadio*,[23] where an elderly lowly educated migrant couple with poor English signed guarantees and mortgages over their home to support an overdraft facility provided by the financier to their son, a builder. At the relevant time, the son's building business was in financial difficulties. On the evidence, the parents did not fully understand the extent of the liability covered by their guarantee and mortgage. In addition, Mr and Mrs Amadio were given no opportunity to obtain independent advice in respect of their liabilities. Not surprisingly, they were relieved from the obligations under the documentation.

In addition or in the alternative, a borrower or security provider was also able to set aside its obligations on the grounds of undue influence. [24]

Part C - Statute law risk considerations for financiers

The above overview illustrates that in many cases, the general law was able to provide a remedy where financiers had acted improperly. However, even prior to the 1970's, the legislature recognised the need for at least some form of statutory regulation in relation to certain types of loans. For example, up until 1981, the provisions of the *Money Lenders and Infants Loans Act* 1941 (NSW) required moneylenders to be licensed and permitted the court to re-open loan contracts which were harsh or unconscionable.[25] However the Act did not apply to banks and only applied to a certain category of loans above a designated interest rate.

Many of the more recent statutory innovations discussed below relating specifically to financing transactions were introduced to make up for what were perceived to be deficiencies in the existing law (often with little or no analysis of the existing law) and were in response to particular problems or abuses experienced by individual borrowers. However, other statutory changes were more generic in nature and applied to commercial transactions generally, including financing transactions, even though financing transactions may have been already subject to a specific existing regulatory regime. As a consequence, financing transactions became subject to ever increasing layers of statutory regulation, much of which was directed at the same type of conduct.

(a) **Misleading and Deceptive Conduct (section 12 DA of the *Australian Securities and Investments Commission Act 2001*)**

Section 12DA of the *Australian Securities and Investments Commission Act 2001* ('*ASIC Act*') states that a 'person must not, in trade or commerce, engage in conduct in relation to financial services that it misleading or deceptive or is likely to mislead or deceive'. This

[22] See for example *Harrison v National Bank of Australasia Limited* (1928) 23 Tax LR 1.

[23] (1983) 151 CLR 447. The New Zealand case of *Archer v Cutler* [1980] 1 NZLR 386 in some respects anticipated the reasoning in *Amadio*. Compare the position in England where reliance on undue influence is the norm.

[24] See eg *Bank of NSW v Rogers* (1941) 65 CLR 42. In England, the related equitable doctrine permitting transactions to be set aside on the basis of undue influence is preferred. See eg *National Westminster Bank plc v Morgan* [1985] AC 685.

[25] *Money Lenders and Infants Loans Act 1941* (NSW), s30.

provision is the mirror provision of section 18 of the *Australian Consumer Law (‘ACL’)* which relates to conduct other than financial services.[26] Each of these provisions is derived from section 52 of the *Trade Practices Act 1974 (Cth).* However, in their latest manifestation they have been expanded by deleting the reference to ‘corporation’ and inserting the word ‘person’ in its place.

The Explanatory Memorandum to the *Trade Practices Bill 1974* (Cth) merely described the provision[27] and lacked any real analysis of the deficiencies in the then existing general law as a justification for introduction of the new provision. Indeed, as seen above, the general law continues to have relevance. It was simply asserted that:

The untrained consumer is no match for the businessman who attempts to persuade the consumer to buy goods or services on terms and conditions suitable to the vendor. The consumer needs protection by the law and the Bill will provide such protection’.[28]

At the time, there was some appreciation of the impact of the new law on existing State legislation[29] but no appreciation of its ultimate reach.

A breach of section 12DA of the *ASIC Act* occurs where there is misleading or deceptive conduct or conduct that is likely to mislead or deceive where the recipient of such conduct relies on such representation and as a consequence suffers loss.[30] The conduct alleged to be misleading or deceptive need not be the sole *cause* of the loss but must be a *cause* as determined by the court. Although section 12DA does not give rise to a general duty of disclosure, in some instances silence may, on the particular facts, constitute misleading or deceptive conduct.[31] In determining the second element namely reliance, the court may take into account the skill of the party making the claim to test whether reliance had in fact occurred.[32] In financing transactions, the issue usually arises where the financier’s representative proffers deficient advice prior to the borrower entering into the transaction. In many instances, this claim is pleaded in addition or as an alternative to a claim for negligent misstatement to address conduct which may have been misleading or deceptive but not negligent.

In *Westpac Banking Corporation v Spice*,[33] a bank manager advised a Mr Spice in relation to a foreign currency loan that “there is no catch” and that the taking out of the loan “… is very much the thing to do”. Although the manager advised Mr Spice that “the exchange risk is

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26 *Competition and Consumer Act 2010* (Cth) s131A.

27 Explanatory Memorandum, Trade Practices Bill 1974 (Cth) paragraph 60.

28 Commonwealth, *Parliamentary Debates*, House of Representatives, 16 July 1974, 226 (Kep Enderby, Minister for Manufacturing Industries).

29 Ibid 573 (Robert Ellicott QC).

30 Requirements pertaining to *Trade Practices Act 1974* (Cth*)* s52 as outlined in *Gould v Vaggelas* (1985) 157 CLR 215. These principles are equally applicable in construing section 12DA of the *ASIC Act* and the mirror provisions in s18 of the *ACL*.

31 *Henjo Investments Pty Ltd v Collins Marrickville Pty Ltd (No 1)* (1988) 39 FCR 546 commenting on the equivalent provision in the *Trade Practices Act 1974* (Cth).

32 *Lam v Austotel Investments Australia Pty Ltd* [1990] ATPR 50, 866.

33 [1990] ATPR 51386.

yours", there was no further explanation or disclosure as to the particular type of risk or its magnitude. The Full Federal Court confirmed the findings of the trial judge that the conduct of the financier induced Mr Spice to enter into the foreign currency loan and consequently suffer loss.[34] The current edition of the leading Australian text which considers these provisions[35] identifies 9 reported cases where financiers and financial advisers have been found liable for misleading or deceptive conduct, including 2 further foreign currency loan cases where the financier was found to have been liable.[36]

(b) **Unconscionability under statute - (sections 12CB and 12CC of the *ASIC Act*)[37]**

Section 12CB of the ASIC Act states that a 'person must not, in trade or commerce, in connection with the supply or possible supply of financial services to a person, engage in conduct that is, in all the circumstances, unconscionable'.

The provision was originally enacted in 1986 as section 51AB of the *Trade Practices Act* 1974 (Cth) following a recommendation of the Swanson Committee in 1976. According to the Explanatory Memorandum accompanying the amendment, its aim was to provide a 'greater ability to deal with the general disparity of bargaining power between buyers and sellers.'[38] The provision "introduce[d], in effect, a general duty to trade fairly in relation to consumers by establishing a norm of conduct prohibiting unconscionable conduct in connection with the supply of goods or services".[39] The provision only applied to goods and services of a kind ordinarily acquired for personal, domestic or household use or consumption and which were not goods supplied for the purposes of resupply or for the purposes of transforming them in trade or commerce.[40] Again, it is notable that the Explanatory Memorandum contains little analysis of the existing law or its deficiencies as a justification for the changes.

For the first time, the legislature introduced a series of factors to be weighed by the court in determining whether the provision had been breached.[41] The reference to the strength of the

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34 Compare the decision in *David Securities Pty Ltd v Commonwealth Bank of Australia* (1990) 93 ALR 271 where the full court of the Federal Court upheld the decision at trial that there had been no reliance by the borrower on any statement made by the financier officer. In that case, the court held that there was nothing inherently dangerous about a foreign borrowing "merely because opportunities for profit, or loss may exist" [at 34].

35 *Miller's Australian Competition and Consumer Law* annotated (33rd edition 2011) (Thomson Reuters) at page 1579

36 *Chiarabaglio v Westpac Banking Corporation* (1989) ATPR 40-971 and *Commonwealth Bank of Australia v Mehta* (1991) 23 NSWLR 84. *Compare Kullack v ANZ Banking Corporation Ltd* (1988) ATPR 40-853. (Bank found not found to have engaged in misleading or deceptive conduct).

37 The mirror provisions are found in ss 21 and 22 of the *ACL*.

38 Explanatory Memorandum, *Trade Practices Revision Bill 1986* (Cth) paragraph 79.

39 *Miller* above, footnote 35 at 1660.

40 *Trade Practices Act* 1974 (Cth) s51AB(5) and (6).

41 The factors included:

- the relative strengths of the bargaining positions of the parties;
- whether the consumer is required to comply with conditions not reasonably necessary for the protection of the legitimate interests of the supplier;
- the ability of the consumer to understand the documentation;
- whether any undue influence had been exercised or unfair tactics used;

bargaining positions of the parties[42] is reminiscent of the reference to Lord Denning's allusion to inequality of bargaining power in *Lloyds Bank v Bundy*.[43] The references to the inability of the consumer to understand the documentation, to the exercise of undue influence or pressure and to unfair tactics raise factors similar to those which an equity court considers in deciding whether or not to set aside a transaction on the basis of undue influence or unconscionability, as illustrated by the *Amadio* decision. However, the statutory provision introduced two innovations. First, the provision applied without the court having to find a recognised category of disadvantage. Secondly, and in contrast to the position in equity, the court was now also able to consider an additional range of factors.[44]

In the period between 1990 and 2010, there were three further significant developments. First, the norm of unconscionability was widened to incorporate "conduct that is unconscionable within the meaning of the unwritten law …".[45] Secondly, the specific statutory norms of unconscionable conduct were extended to business transactions involving unlisted corporations.[46] For these purposes, the Court was directed to consider a set of factors similar but not identical to those applicable when determining whether dealings with individuals were unconscionable, including any industry code which for these purposes would include the Code of Banking Practice in so far as it applied to small business. Thirdly, the responsibility for administering the unconscionability provisions of the statute, in so far as they related to financial products and financial services was vested in the Australian Securities and Investments Commission.[47]

Of these changes, the extension of statutory unconscionability to business transactions was perhaps the most significant development. In relation to financial products and services, this provision is currently found in section 12CC of the *ASIC Act*. Financiers and their advisers tend to confine considerations concerning unconscionability and its statutory manifestations to dealings with individuals; they are apt to overlook the significance of the extension of these principles to unlisted businesses. The matters which a court is asked to consider in relation to a claim on the basis of unconscionability when made by an individual, are also relevant in the context of a an claim of unconscionability in a business transaction.

Some of these matters (for example, scope for negotiation, the right to unilateral variation and good faith) are also factors for determining whether the statutory provisions discussed below relating to unfair contract terms are engaged. They constitute a good example of overlapping regulation.

- consideration for equivalent or identical services.

42 See now *ASIC Act* s 12CB (1)(a) and 12CC (1)(a).

43 [1975] 1QB 326.

44 See now *ASIC Act* s 12CB (2)(a) s12CC (2)(b) and s 12CC (3)(b).

45 *Trade Practices Act* 1974 (Cth) s51AA. The applicable provision is now to be found in section 20(1) of the *ACL* and s12CA of the *ASIC Act*.

46 *Trade Practices Act* 1974 (Cth) s51AC. The provision is now to be found in s22 of the *ACL* and s12CC of the *ASIC Act*.

47 Pursuant to s131A of the *Competition and Consumer Act* 2010 (Cth), the *ACL* contained in schedule 2 of that Act does not apply to "the supply, or possible supply, of services that are financial services, or of financial products".

Examples where such claims have been made include the following:

- the calling up of performance bonds and letters of credit;[48]
- the demand for the provision of security where a company gets into financial difficulties;[49]
- margin calls under margin loans;[50]
- ambiguous loan approvals subject to valuation where the loan amount is later reduced due to an unsatisfactory valuation;[51]

To date, most of the claims based on unconscionability have been unsuccessful, but financiers are likely to see more of these claims in the future.

Further important changes in the law relating to statutory unconscionability will be made by the *Competition and Consumer Legislation Bill 2011* which, at the time of writing, is before the Commonwealth Parliament. Section 12CB and section 12CC of the *ASIC Act* will be repealed. New section 12CB of the *ASIC Act* will apply the same unconscionabilty test for both consumer transactions and to transactions with entities which are not listed public companies[52]. For the purpose of determining whether conduct is unconscionable, new section 12CC lists a set of common factors which the Court is required to consider in relation to dealings involving both consumers and unlisted public companies. More significantly, a court will now also be able to consider the actual terms of the contract and the 'manner in which and the extent to which the contract is carried out'.[53] Accordingly, even though the unfair contract terms provisions discussed below apply only to consumer contracts, it is conceivable that in the future an unlisted public company may be able to challenge a term in a non-consumer contract on the basis of unconscionability.

(c) Unfair Terms in Consumer Contracts

With effect from 1 July 2010, a term of a standard form consumer contract relating to a financial service or a financial product is void if it is unfair where the contract is a standard form contract.

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48 *Clough Engineering Ltd v Oil & Natural Gas Corporation Ltd* [2008] FCA 191; *Clough Engineering Ltd v Oil & Natural Gas Corporation Ltd [No 2]* [2007] FCA 927 and *Clough Engineering Ltd v Oil & Natural Gas Corporation Ltd* [2007] FCA 881.

49 *Bell Corporation Ltd (in liq) v Westpac Banking Corporation* [2008] WASC 239.

50 *Imobilari Pty Ltd v Opes Prime Stockbroking Ltd* [2008] FCA 1920; *Storm Financial v CBA* [2008] FCA 191.

51 *Ines v CBA* (2008) FCA 1608.

52 The relevant definition is found in *Income Tax Assessment Act 1997* s 995-1 which defines a listed public company as 'a company shares in which…are listed for quotation in the official list of an approved stock exchange'. However, a company is not a listed public company if, amongst other matters, a person controls or is able to control or up to 20 persons between them control, 75% of the voting power of the company.

53 S 12CB(4)(c) of the *ASIC Act* and s 21(4)(c) of the *ACL* after amendment by the *Competition and Consumer Legislation Amendment Bill 2011*. Similar amendments will also be made to the mirror provisions in the *ACL*.

For these purposes, a consumer contract exists when the supply of the product or service is "wholly or predominantly … for personal, domestic or household use or consumption". In contrast to the other provisions applicable to consumers, where the test for consumers is objective[54], the test refers to the subjective intention of the person acquiring the product or service[55]. The provisions do not apply to loans to corporations and may not apply to loans to individuals to fund a personal investment.

A contract is presumed to be standard form unless the other party to the proceedings proves to the contrary[56]. For these purposes, the court is to consider such matters as it thinks fit. As was said in *Director of Consumer Affairs Victoria v Craig Langley Pty Ltd & Matrix Pilates and Yoga Pty Ltd (Civil Claims)* in relation to similar provisions in Part 2B of the *Fair Trading Act 1999* (Vic):

> *"[T]erms of a consumer contract which have been the subject of genuine negotiation should not be lightly declared unfair. This legislation is designed to protect consumers from unfair contracts, not to allow a party to contract who has genuinely reflected on its terms and negotiated them, to be released from a contract term from which he or she later wishes to resile."*[57]

The unfair contract terms provisions are inapplicable to the terms referable to the main subject matter of the contract, the upfront price or any terms expressly permitted by Commonwealth, State or Territory law[58].

The main subject matter of the contract refers to both terms relating to the subject matter (material conditions) and such terms which give effect to the main subject matter terms and would include delivery or payment conditions (that is, all terms ancillary to the supply or grant of the main subject matter of the contract). The upfront price refers to a price payable which was disclosed before the contract was entered into. For financial products and financial services, the upfront price includes the principal amount borrowed together with interest payable. The upfront price would also include fees disclosed at the time of contracting but not include contingent fees such as default fees.[59]

All other contractual terms, except for those expressly permitted by Commonwealth, State and Territory law, are subject to the test of unfairness. For these purposes the court is directed to consider the following factors:

- *Significant Imbalance* **-** that is whether a term of the consumer contract causes a significant imbalance in the parties' rights and obligations *under* the contract.

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54 *ASIC Act* s12BC.

55 *ASIC Act* s12BF(3).

56 *ASIC Act* s12BK.

57 [2008] VCAT 482 at 66 per Harbison J.

58 *ASIC Act* s12BI.

59 *ASIC Act* s12BI(2). However, an upfront price could include future payments or a series of future payments, provided such payments are disclosed in a way that is transparent, before the contract was entered into.

- *Whether reasonably necessary* **-** that is whether a term is reasonably necessary to reflect what was freely negotiated between the contracting parties. The party advantaged by the term must provide evidence to the court to demonstrate why it is necessary for the contract to include the term.

- *Detriment* -whether a term would cause detriment to a party if it were to be applied or relied upon[60].

The court must also consider:

(a) the extent to which the term is transparent; and

(b) the contract as a whole.[61]

A term is transparent if it is:

(a) expressed in reasonably plain language;

(b) legible;

(c) presented clearly; and

(d) readily available to any party affected by the term.

Section 12BH of the *ASIC Act* contains illustrations of unfair terms[62]. The provisions tend to be classed into 3 categories: anti-unilateral provisions without relevant disclosure and transparency to the consumer, anti-assignment provisions where the rights of the consumer are adversely affected and anti-enforcement provisions whereby businesses try to restrict the enforcement measures of the consumers. Some of these factors (for example, the bargaining power of the parties and whether or not the terms of the contract were negotiable) overlap with the matters which a court may consider when determining whether a party has engaged in statutory unconscionability. The impetus is on equalising the bargaining power between the parties.

Although intended to operate in relation to consumer contracts generally, such as standard form gym contracts, the provisions have added another layer of compliance and complexity for banking and financial institutions. Similar legislation has been in force for some years in Victoria and England[63] and case law in those jurisdictions[64] will assist in construing the new

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60 *ASIC Act* s12BG(1).

61 *ASIC Act* s12BG(2)(b), s12BG(2)(c) and s12BG(3).

62 Examples include: terms permitting one party to avoid or limit performance; unilateral clauses regulating termination, variation and the contractual renewal; unilateral clauses limiting liability or clauses imposing an evidential burden on a party (for example a clause in an agreement stating that a certificate from a financier is prima facie evidence of the amount owing by the borrower). Penal clauses are also captured.

63 For England see the *Unfair Terms in Consumer Contracts Regulations 1999* (UK); for Victoria see Part 2B of the *Fair Trading Act 1999* (Vic).

64 For England, see *Director-General of Fair Trading v First National Bank plc* [2002] 1 AC 481;*The Office of Fair Trading v Foxtons* [2009] EWHC1681; for Victoria, see *Director of Consumer Affairs Victoria v Craig Langley Pty Ltd & Matrix Pilates and Yoga Pty Ltd* [2008] VCAT 482.

Commonwealth provisions. When combined with the provisions of the *National Consumer Credit Protection Act 2009* (Cth) and *National Credit Code*, which do regulate the main subject matter of the contract and its enforcement (as to which, see further below), significant parts of financing contracts relating to consumer loans are now regulated by statute and very little is left unregulated.

In the Explanatory Memorandum accompanying the Bill[65] which originally introduced the unfair contracts terms provisions into the *Trade Practices Act 1974* (Cth), it was stated that there was 'limited evidence'[66] that unfair contract terms were causing detriment to consumers. It appears that the more significant driver for the introduction of these provisions was to render national law consistent with the unfair contracts provisions in Victoria and to avoid differences in consumer legislation throughout Australia.

(d) **Responsible Lending**

The collapse of share prices following the Global Financial Crisis occasioned significant social and financial difficulties for individuals who had entered into margin lending facilities through investment advisers such as Storm Finance Limited. It was argued that such facilities were regulated inadequately under Australian law[67]. The *Green Paper on Consumer Credit and Financial Services Reform* identified the absence of specific regulation of margin lending as a significant gap in the regulation in Australia of financial services.[68] The gaps included inadequate pre-contractual disclosures, absence of any licensing requirement, inconsistent application of Chapter 7 of the *Corporations Act* and the absence of any requirements to give notification of margin calls.[69] As a matter of contract, clause 25.1 of the Code of Banking Practice already required banks to 'exercise the care and skill of a diligent and prudent banker in selecting and applying [the bank's] credit assessment methods and in forming [its] opinion on the [borrower's] ability to repay it'. However, the Code did not apply to non-bank financial institutions.

Following the passing of the *Corporations Legislation Amendment (Financial Services Modernisation) Act 2009*[70], a margin lending facility is now included in the definition of financial product under section 764A(1)(l) of the *Corporations Act* and as a consequence is regulated by Chapter 7 of that Act. These provisions do not apply to margin lending

65 *Trade Practices Amendment (Australia Consumer Law) Bill No2 2010* (Cth).

66 Ibid, 110.

67 Many retirees entered into such transactions without necessarily appreciating the implications. Many borrowers were unable to meet margin calls and in many cases lost their homes.

68 The current litigation instituted by the Australian Securities and Investments Commission against Storm Finance Limited and associated financiers will test this conclusion. According to the ASIC website (accessed July 7 2011), the action against the financiers is based upon breach of contract (presumably, amongst other matters, on the basis of a breach of the prudent banker obligation in clause 25.1 of the Code of Banking Practice), unconscionable conduct and liability as a linked credit provider under s73 of the *Trade Practices Act 1974* (Cth). Relief is also being sought on grounds that the arrangements between the borrowers, the financiers and Storm Finance Limited constituted an unregistered managed investment scheme.

69 Explanatory Memorandum, *Corporations Legislation Amendment (Financial Services Modernisation) Bill* 2009 *(Cth)* 15.

70 Act No 108 of 2009.

facilities[71] provided to individuals in amounts equal to or greater than $500,000.[72] For these purposes, a margin lending facility may be either a standard margin lending facility (where the securities are mortgaged or charged to the financier)[73] or a non standard margin lending facility (where the securities are transferred absolutely to the financier).[74] The provisions applied to some lenders from July 2010 and applied to all lenders from January 1 2011.

If a financier wishes to provide a margin lending facility to a retail client or increase that facility, section 985E of the *Corporations Act* triggers two obligations. First, prior to providing the facility the financier must:

(a) make reasonable inquiries as to the retail client's financial situation;[75]and

(b) take reasonable steps to verify the retail client's financial situation.

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71 By way of exception, the provisions do not apply to limited recourse margin lending facilities. See *Corporations Regulations* 7.8.08B.

72 That is the provisions only apply in dealings with 'retail clients'. See *Corporations Act* s761G(7)(a) when read with *Corporations Act* s761G(10) and Regulation 7.1.19 of the *Corporations Regulations*. A borrower will not subsequently become a retail client if its loan amount falls below $500,000. See *Corporations Regulations* 7.1.27.

73 *Corporations Act* ss761EA(2)(a)-(e) and 761EA(4). A standard margin lending facility has the following elements:

(a) the provision of credit to a natural person;

(b) provision of credit for the purpose either of the acquisition of a financial product (for example a share or a unit in a managed investment scheme) or to refinance a prior acquisition of such a product;

(c) the credit is secured over property consisting of marketable securities; and

(d) the facility is subject to a term requiring compliance with a loan to value ratio computed by reference to the amount of the debt owing by the client and the value of the secured property in circumstances where upon non compliance with the LVR ratio the borrower (the client) or the provider become required or entitled respectively to initiate action.

74 *Corporations Act* section 761EA(5). The Act defines a non standard margin facility to include the following elements:

(a) the *transfer* by a natural person of marketable securities to the provider of the facility;

(b) the transfer by the provider of the facility of property to the client;

(c) the transferred property is to be applied wholly or partly to acquire a financial product;

(d) the vesting in the client of a right to receive in the future marketable securities equivalent but not identical to the securities originally transferred by the client to the provider; and

(e) the incorporation as a term of the facility of a loan to value ratio computed by reference to the value of any property transferred by the provider to the client, and any other amount owing by the client to the provider and the value of the securities originally transferred by the client to the provider, non-compliance with which requires the client to take action or the provider being entitled to take action.[emphasis added]

75 Regulation 7.8.09 of the *Corporations Regulations* imposes the following additional inquiries:

(a) whether the client has taken out a loan to fund the secured property or transferred securities contributed by the client for establishing the margin lending facility;

(b) if an existing loan has been made to fund the secured property or transferred securities whether that loan extends to the client's primary residential property;

(c) if there is a guarantor reasonable inquiries as to whether the guarantor has been warned of the risks associated with the provision of a guarantee;

(d) reasonable inquiries as to the amount of any other debt incurred by the client;

(e) any other matter specified by ASIC in a legislative instrument.

Secondly, the financier must assess "whether the margin lending facility will be unsuitable for the retail client if the facility is issued or the limit is increased".[76] A facility is regarded as unsuitable if the retail client:

(i) would be unable to comply with the retail client's financial obligations under the terms of the facility; or

(ii) could only comply with substantial hardship.

In order to determine suitability, a financier is required to make wide ranging inquiries with respect to the potential borrower's financial circumstances. The complexity of the decision is increased by the need also to take into account significant movements in markets and the consequential operation of any loan to value ratio. A financier is required to form a positive opinion that it is unlikely either of the above consequences will occur. A conservative loan to value ratio will assist a financier in reaching this conclusion.

The provisions prompt certain questions. What other factors go into the determination of likelihood in these circumstances? Is the enquiry at large or may it be confined just to the personal circumstances of the retail client? To what extent must the financier take into account external macro-economic factors beyond the control of the borrower? How far ahead is the financier meant to look? The Australian Securities and Investments Commission ('ASIC') has indicated that it will not issue any guidance notes as to the nature of reasonable inquiries which are to be made in the context of margin lending facilities. However, ASIC has issued guidance notes for the mirror responsible lending provisions in relation to consumer loans subject to the *National Consumer Protection Act 2009* (Cth) which will be of assistance in applying the same requirement for margin loans.[77]

A financier would breach the provisions if it:

- provides or increases the limit of a margin lending facility without making an assessment[78];
- fails to assess a margin lending facility is unsuitable[79];
- issues or increases the limit of a margin lending facility if it forms a view that margin lending is unsuitable for the client,

(e) **Consumer Credit legislation**

Any survey addressing the increasing trend of statutory intervention into financial transactions would be incomplete if reference were not made to consumer credit regulation. Historically, the money lending legislation of the States and Territories permitted the court to open unjust

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76 *Corporations Act* s985F.

77 Compare the extensive "scalable" inquiry requirements outlined in ASIC Guidance Note No. 209 (March 2011) in relation to consumer lending.

78 *Corporations Act* s985E(1).

79 S985H(1).

loan contracts.[80] In the 1980's[81], each State and Territory of Australia enacted new legislation regulating consumer credit, the current version of which is found in the *National Consumer Credit Protection Act 2009* (Cth) and the *National Credit Code* which is schedule 1 to that Act. The *National Credit Code* applies to credit contracts with natural persons or strata corporations for personal, domestic or household purposes.[82] It also applies to credit contracts for the purchase of investment properties or for their renovation or improvement.[83] However, the Code does not apply to margin loans.[84] The statutory intrusion into regulated credit contract is now all pervasive. Some key aspects are summarised below.

(i) changes to credit contracts on the basis of hardship and unjust transactions

Section 72 of the *National Credit Code* enables a debtor to request an alteration to their credit contract where the debtor "is unable reasonably, because of illness, unemployment or other reasonable cause, to meet the debtor's obligations under a credit contract …"[85] and where the debtor would otherwise be able to discharge that obligation if the contract were changed in the manner requested. This provision does not apply if the amount of credit exceeds $500,000. If the credit provider does not make a change following the debtor's application so to do, the debtor may apply to the court which on hearing the applications from the respective parties, "may, if it thinks it appropriate … stay any enforcement proceedings under the credit contract and make such other orders as it thinks fit …".[86]

(ii) *Reopening Unjust Transactions*

Section 76(1) of the *National Credit Code* enables the court, on application of a debtor, mortgagor or guarantor, to reopen a credit contract if the Court concludes that the contract was 'unjust' as at the time of its creation. Similar wording may be found in the *Contracts Review Act 1980* (NSW). Before forming a view that the contract is unjust, the court is required to consider a list of factors which is similar but not identical to those which a court is directed to consider for the purposes of determining whether conduct is unconscionable or whether a contract contains an unjust contractual term.[87]

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80 See eg s30 of the *Money-Lenders and Infants Loans Act 1941* (NSW).

81 See eg *Credit Act 1984* (NSW).

82 National Credit Code s5(1).

83 Ibid s5(1)(b)(ii).

84 Ibid s6(12).

85 Ibid, s72(1).

86 Ibid, s74.(2).

87 *National Credit Code* s 76(2). The list is similar but not identical to the list of factors which a court may consider under s12BH, s12CB and s12CC of the *ASIC Act* when determining whether a term of a contract is unfair or whether conduct is unconscionable. However, the list in the *National Credit Code* contains significant differences. For example, s76(2)(l) enables the court to consider whether or not at the time of entering into the relevant contract, "the credit provider knew, or could have ascertained by reasonable enquiry at the time that the debtor could not pay in accordance with this terms or not without substantial hardship". The latter provision appears to overlap with the responsible lending provisions in the *National Consumer Credit Protection Act 2009* (Cth*).*

(iii) *Unconscionable interest and other charges*

By separate provision, the court is also authorised to review and make orders in respect of any interest charge which it perceives to be unconscionable. In determining unconscionability for these purposes, the court considers whether the credit fee or charge "is equal to the credit provider's reasonable costs of administering an application for credit and the administrative cost of providing credit or is equal to the credit provider's average reasonable costs of those things in respect of that class of contract".[88] In this respect, the provision goes beyond the protection given by the unfair contract terms provisions where an interest is part of the main subject matter and not susceptible to review.[89]

(iv) *Responsible lending*

In relation to credit contracts subject to the *National Credit Code*, the *National Consumer Credit Protection Act 2009* (Cth) also imposes responsible lending obligations on credit providers, credit assisters such as investment advisers and brokers as well as lessors. These provisions applied to some institutions with effect from July 1 2010; they applied to all other financial institutions, including authorised deposit taking institutions, from January 1 2011. The substance of the provisions are largely the same as those applicable to lenders providing margin loans to retail clients regulated by the *Corporations Act*.

First, a credit provider regulated by the *National Consumer Credit Protection Act 2003* (Cth) is required to make reasonable enquiries concerning the consumer's objectives and requirements.

Secondly, the credit provider must ascertain the financial circumstances of the proposed borrower. In particular, enquiries are to be made as to the borrower's ability to meet all repayments and other liabilities under the proposed borrowing and whether or not these can all be met from income or other assets of the borrower or consumer.

Thirdly, the credit provider must verify the consumer's financial circumstances by, amongst other things, undertaking the enquiries ordinarily taken by a prudent lender in these circumstances. For these purposes, the lender should obtain information from other sources such as accountants.

Finally, the credit provider must determine whether the proposed contract is unsuitable. Relevantly, if it is likely that the consumer will be unable to repay the proposed loan as at its repayment date or will only be able do so with substantial hardship, then the loan will be regarded as being unsuitable. Substantial hardship is presumed to occur if the borrower is only able to meet the obligation by selling his

[88] Ibid, s78(3).

[89] See *ASIC Act*, s12BL.

principal place of residence.[90] Otherwise, the matter is left for resolution by the general law and is likely to be given a wide interpretation.[91]

In addition, unsuitability would also be established if the proposed loan contract does not meet the consumer's requirements or objectives. The latter requirement is not contained in the provisions in the *Corporations Act* regulating margin lending. However, its absence may not be significant in practice given the nature of the enquiries which a prudent financier would ordinarily make in any event in deciding whether or not to provide that type of facility to a borrower. ASIC has published guidelines indicating the nature of enquiries which are to be made by credit providers regulated by the *National Consumer Credit Protection Act 2009* (Cth) and notes that such enquiries are scalable, that is, adjustable having regard to the personal circumstances of the particular borrower.[92]

The responsible lending provisions are not uniquely Australian. Statutory provisions in England and the United States also impose obligations on lenders to assess the borrower's ability to pay.[93]

(iv) *Recent and Proposed Regulatory Changes for Consumer Loans*

Some commentators and politicians are of the view that the current statutory provisions are still inadequate. For any loans secured over residential property entered into after July 1 2011, credit providers are now prohibited from charging a credit fee or charge such as a break fee or a discharge fee[94]. Why, it may be asked, were the unfair contracts term provisions inadequate in addressing this issue? As with the other changes discussed in this paper, there appears to have been little analysis as to why the existing statutory provisions failed to regulate this conduct adequately.

Finally, reference should also be made to the amendments contained in the *Consumer Credit Protection Amendment (Fees) Bill 2011* (Cth). As currently drafted, this Bill will require that credit providers must only charge a reasonable credit fee or charge[95]. If this provision is breached, ASIC may apply to the Court to annul or vary the fee. There is also a consequential amendment to the *Banking Act 1959* (Cth) which prohibits an authorised deposit taking institution having a market share of more than 10 % from imposing an early termination fee for any loan agreement or mortgage contract entered into after the commencement of the

[90] *National Consumer Credit Protection Act 1999 (Cth)* ss118(3), 119(3), 131(3), 141(3), 142(3), 146(3).

[91] Compare cases on hardship under the Uniform Credit Code. See eg *Permanent Custodians Ltd v Upton* [2007] NSWSC 223 at [155], [156].

[92] See Credit licensing: Responsible lending conduct, ASIC Regulatory Guide 209 (March 2011).

[93] *Consumer Credit Act* 1974 (UK), section 25(2B); *Consumer Credit Code Act* 1974 (UK), s55B; *FSA MCOB* 11.3.1; 11.3.2R; *Truth in Lending Act* 1968 USA, s129B including amendments made by the Dodd-Frank Wall Street Reform and Consumer Protection Act 2010, s1411.

[94] *National Consumer Credit Protection Amendment Regulations 2011 (No2)* (Cth) and *National Consumer Credit Protection Amendment Regulations 2011 (No3)* (Cth).

[95] The change will be made by the insertion of a new s30B into the *National Credit Code.*

section.[96] Again, in what respect is the current legislation deficient in regulating excessive credit fees or charges? On what basis will the criterion of 'reasonableness' be assessed? Will it require an inquiry into a financier's own funding arrangements? How will the cost of those funding arrangements be applied to a specific loan agreement? Anyone who has attempted to enforce an increased costs clause in a loan agreement will appreciate the practical limitations in administering the proposed provisions.

Part D Assessment

A financier considering providing a loan facility to a corporate or individual borrower is now subject to a vast array of potential risks prior to the execution of the loan contract and during its administration and enforcement. These risks are associated with the potential application of the common law principles and the potential application of the statutory provisions relating to misleading or deceptive conduct and unconscionability. If the borrower is an individual, additional risks may arise because of the potential application of unfair contracts terms legislation and responsible lending obligations. If the facility is a consumer loan, the *National Consumer Credit Protection Act 1999* (Cth) imposes yet another layer of risk. When dealing with an individual potential borrower, a financier's freedom to require certain terms to be inserted into a loan contract is now significantly constrained. Many of the statutory changes outlined above were made without any serious consideration having been given to the impact of this change on the existing law and the extent to which the existing law already dealt adequately with the problem sought to be further regulated. The result is a complex cumulative matrix of overlapping statutory provisions.

In December 2005, the Business Council of Australia[97] noted that documentation totalling some 227 pages was required before a customer was able to open a cheque account with an overdraft limit with an accompanying home loan, approximately 5 times the amount of documentation required in 1985. Some recognition that statutory provisions requiring such prolix documentation are not achieving their purpose may be seen in yet another amendment to the *National Consumer Credit Protection Act 1999* (Cth) to be made by the *National Consumer Credit Protection Amendment (Home Loans and Credit Cards) Bill 2011* (Cth) requiring financiers of home loans to make available by website and on request a Key Facts Sheet.

In contrast to New Zealand, Australian policy makers appear to have little appreciation of the compliance costs[98] associated with increased statutory regulation. of financing transactions. As the Task Force On Reducing Regulatory Burdens on Business wrote in 2006:

> *"Regulation has come to be seen as a panacea for many of society's ills and as a means of protecting people from inherent risks of daily life. Any adverse event - especially where it involves loss of life, possessions immunity or money - is laid at the government's door for a*

[96] The Bill will insert new s9AF into the *Banking Act 1959* (Cth). Compliance with these provision will also be made a condition of the authority of held by the ADI.

[97] Business Council of Australia, submission to the Task Force on Reducing the Regulatory Burden on Business.

[98] In an address to the Israel Chamber of Commerce on July 5 2011, Sir Ralph Norris, CEO of the Commonwealth Bank of Australia, stated that the new banking regulations were costing the CBA $100 million a year 'with the financial sector as a whole facing a $500 million bill'. Quoted in Mark Ludlow, 'Norris Warns About Regulation', *The Australian Financial Review* (Sydney), July 6 2011.

regulatory fix. The pressure on government to 'do something' is heightened by intense, if short lived media attention … in responding to such pressures, governments themselves are often attracted to regulatory solutions, both as a tangible demonstration of government concern and because the costs are typically 'off budget' diffuse and hard to measure …

In this climate, a 'regulate first, ask questions later' culture appears to have developed. Even where regulatory action is clearly justified, options and design principle which could lessen compliance costs or side-effects appear to be given little consideration."[99]

In relation to the regulation of financing transactions, these comments apply equally today if not more so. It is not suggested that all statutory controls should be removed. Indeed, there are many instances where regulation is justified and reasonable of which the regulation of margin loans is a good example. However, it is also likely finance will cease to be available to many potential borrower and costs for existing borrowers will increase. In relation to the new responsible lending requirements, a mortgage broker has described those who are now missing out on finance as :

… older borrowers aged 40 and upwards who were taking out loans that would need to be repaid after retirement and couples moving to a single income due to circumstances such as maternity leave.[100]

It is legitimate to now ask whether the correct balance has been struck between lenders and borrowers and whether this vast array of statutory regulation is really achieving its stated purpose.

Furthermore, little attention appears to have been given to another important issue, namely the extent to which the various statutory changes have added an additional layer to the operational risks faced by financiers, and if they are authorised deposit taking institutions, whether additional capital should be set aside to meet these risks. Many of the statutory changes are potentially fertile grounds for the emergence of such risks, especially when combined with the obligation imposed on financiers to remit disputes with borrowers to external dispute resolution[101]. It also prompts the question whether the practical difficulties in complying with this raft of statutory regulation is setting banks and other financial institutions up for failure.

In relation to responsible lending, the same mortgage broker made the following observations:

Smart solicitors will just claim under the responsible lending obligations [as there is no clear guidance of what this constitutes] and there is no question there will be opportunistic claims …[102]

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99 Rethinking regulation report of the Task Force on Reducing Regulatory Burdens on Business, January 2006 at I-II.

100 Quoted in Jane Searle, 'Credit Code Creates Confusion', *The Australian Financial Review (*Sydney), July 4 2011.

101 The obligation is sourced in clause 36 of the Code of Banking Conduct; the *National Consumer Credit Protection Act 2009 (Cth)* ss 47(1)(h) and (i) and s64(4) and (5) (as licence conditions). For margin loans to retail clients, the obligation is sourced in s912A(1)(g) and s912A(2) of the *Corporations Act.* ASIC has also issued a Regulatory Guide (RIG 139) on external dispute resolution schemes.

102 Ibid.

The extent of the operational risk is illustrated by the summary of the available remedies in schedules 1 and 2 of this paper if a financier breaches the provisions regulating misleading or deceptive conduct, unconscionability, unfair contract terms in the *ASIC Act*, or responsible lending provisions for margin loans in the *Corporations Act*. For example, a finding that a term used by a financier in a standard form agreement with a consumer is unfair, would mean that a bank would henceforth be unable to rely upon such a term in similar contracts with other parties and thereby arguably decrease the book value of that type of facility. More significantly, if a financier was found to have breached a provision, any remedial monetary orders made by a court may generate set-offs or cross claims by borrowers against financiers and thereby reduce the amount ultimately recoverable by the financier from the borrower. The potential diminution in the value of a loan book arising from these provisions poses challenges not only for the financier but also for the regulators.

This discussion of the more significant, but by no means complete, statutory provisions impacting on a financing transactions also raises the question as to whether the statutory intrusion is justified by the mischief that the statutory response was intended to address. In times past, case law would have provided a response even if such a response may have been selective and slow to emerge given the delays and expense associated with litigation. The writer is not suggesting a return to the past. Over the last 40 years, there have been many instances of financiers "behaving badly". In some instances, this behaviour was the result of deliberate deceit, self-interest and greed accompanied by a free-wheeling attitude with respect to the provision of financial accommodation. On many occasions, the principal concern of a financier was the adequacy of the security. A loan would often be provided so long as the security was adequate, even if such a devil may care attitude may result in the loss of a borrower's family home. As against that, a case can be made that the balance may have tipped too far in favour of borrowers who appear to require a risk free environment. Even if it felt that the correct balance has now been struck between lender and borrower, the law in this area is now too prescriptive and made excessively complex by overlapping and cumulative layers of regulation. At the very least, the law should be shortened and rationalised.

SCHEDULE 1

Remedies

If there is a breach of the misleading or deceptive conduct provisions of the *ASIC Act* or the unconscionability provisions, the following remedies are available:

- fine - *ASIC Act* s 12GB;
- pecuniary penalties - up to $1.1 million for breaches by companies and $220,000 for breaches by individuals. *ASIC Act* s12GBA. (Note that this provision does not apply however with respect to misleading or deceptive conduct under s 12DA);
- injunctive relief - *ASIC Act* s12GD;
- damages for persons suffering loss - *ASIC Act* s12GF;
- non punitive orders such as community service orders or probation orders -*ASIC Act* s 12GLA;
- punitive orders including adverse publicity orders - *ASIC Act* s12GLB;
- public warning notices - *ASIC Act* s12GLC;
- disqualification from managing a corporation - *ASIC Act* s12GLD;
- such other orders as the court thinks fit - *ASIC Act* s12GM;
- redress orders for losses suffered by non party consumers - *ASIC Act* s12GNB and s12GNC;
- declaratory relief- ASIC Act s 12GND
- infringement notices - ss 12GX-12GXG;
- substantiation notices - *ASIC Act* ss12GY-12GYB.

SCHEDULE 2

Remedies for breach of unfair contract terms provisions

A party to a consumer contract or ASIC may seek a declaration that a term in a standard form consumer contract is unfair- *ASIC Act* section 12GND.

It is then a breach for the other party to the contract to rely upon or purport to rely upon the unfair contract term - *ASIC Act* section 12GM(10). If a party does purport to rely upon such a term in breach of the Act then the following remedies would be available:

- injunction - *ASIC Act* s12GD;
- such other orders as the court thinks fit including specific performance or damages - *ASIC Act* s12GM.;
- orders prohibiting the payment or transfer of money - *ASIC Act* s12GN;
- orders requiring redress to be paid to non party consumers (other than an award of damages) as the court considers appropriate - *ASIC Act* s12GNB and s12GNC;