SECRET COMMISSIONS

QUESTIONS AND ANSWERS

Question - John O'Sullivan (Freehill Hollingdale & Page, Sydney):

It frequently happens in syndicated lending that a borrower will pay an agent bank fees for services which are never fully described but probably include putting the syndicate together and subsequent administration of the loan. Those fees, in my experience, or the size of those fees, are never disclosed by the agent to the members of the syndicate. Frequently the documentation discloses that the agent is getting a fee, but not how big it is. Alternatively, sometimes the agent makes no disclosure at all, simply relying on the fact that it is common custom and all the banks know that the agent is getting a fee.

I would be interested in Mr Fitzgerald's view as to whether or not disclosure of the amount of the fee is required to avoid the secret commissions legislation?

Response - Tony Fitzgerald QC:

The reference to the custom has already been covered in what I have said. There seems to be a general policy that the existence of a custom is no defence if an offence would otherwise have been committed. May I ask in those circumstances is the agent to whom you have referred the agent of the lenders or the agent of the borrower?

Comment - John O'Sullivan (Freehill Hollingdale & Page, Sydney):

It is generally thought that his roles change before the loan is documented. When the borrower has asked the agent to put together a syndicate to raise funds for him, at that point the agent of the bank is usually thought to be the agent of the borrower. Once the loan is in place and the loan document is signed, the agent bank then becomes responsible for administering the loan, he is usually thought to be the agent of the syndicate.

Response - Tony Fitzgerald QC:

The importance of that it seems to me is in identifying the purpose for which the fees are paid and whether or not the payment is made by the principal, that is to say the borrower, to its agent for services rendered to the borrower or whether the payment is made in relation to the lenders' agent. And if it is a payment made to the lenders' agent then it seems plain enough

that there must be disclosure to the lenders, and the only question is as to the adequacy of the disclosure.

For myself I would have thought that it would be sufficient to disclose the fact of the payment without its amount, but I don't know of any authority which conclusively answers that question. It seems to me that that is an adequate disclosure and certainly places the principal, which I am assuming at this point is the lender, in a position of making an election as to whether or not to approve or disapprove of what is taking place.

Question - Rob Turner (National Australia Bank, Melbourne):

Mr Fitzgerald, the width of the secret commissions legislation and the fact that you have indicated that the implied consent and so on and standard practice are not necessarily defences, it seems to me there are at least two industries, if not more, in our community which seem to thrive and have their very being out of secret commissions. The two predominant ones at the moment probably would be the travel agent industry where commissions are paid on sale of tickets, and the financial advisory industry where commissions are paid on the inducement to bring people in to either buy shares or invest in a particular trust fund or whatever it might be. And I would be interested in your comments on those two areas.

Response - Tony Fitzgerald QC:

Well, I suppose there is a third one - or there used to be a third one - and that was the way insurance brokers carried on business, but since they are generally regarded as I understand it as the agents of the insured, not the insurers.

My understanding is that many of the financial advisers these days do disclose the fact that they are receiving benefits from the companies or institutions with which the investments are placed. And so far as the travel agents are concerned, I am not aware of the technical position as to whether or not they are agents of the customer or agents of the airline. It seems to me if they are agents of the airline or hotel or travel company - whatever it is - that the problem does not exist.

Question - John Walter (Clayton Utz, Melbourne):

Rob Turner has mentioned the prevalence of secret commissions in certain industries. At a certain level of the banking industry, the finance industry, does indeed itself give rise to a significant level of commissions of various degrees of secrecy. One of the most prevalent is, I would suggest, the question of the payment of commission in the context of the reference of so-called consumer finance paper to financial institutions. The *Credit Act*, I think I am right in saying, simply requires disclosure of the fact of payment of a commission. It is not, I think, unusual for the level of the commission to be referable to two matters - referable to the volume of paper submitted over the

course of a period of time, but also referable to the level of credit charge which is able to be recouped by the particular referrer of paper to the finance house. And I suppose my question is this - absent the provision in the credit legislation or indeed notwithstanding its presence, but the question is this: The issue of appropriate disclosure which you said might perhaps in the example given be satisfied by a statement of a fact as opposed to the level of the payment of commission, where you have a situation where the level of commission is referable to some act which may not be apparent to the customer as in this instance, does that circumstance affect your response to the nature of the disclosure which may be required so that the commission no longer answers the description of secret? Just to repeat, what happens is that the level of payment of commission is increased by reference to the increased level of interest charge which may be documented as part of the credit document.

Response - Tony Fitzgerald QC:

It is possible, it seems to me, that there may be different answers in the civil law and in the criminal law in relation to that matter. The civil law seems to require that the principal be armed with sufficient information to allow him or her to make an informed election. It may be that some or other of those circumstances would provide a context in which a truly informed election could not take place and one might therefore have an outcome in favour of the principal against the donor and the recipient of the secret commission.

But the criminal law poses all sorts of additional complications. For example, the actions taken under mistake and ignorance and so forth, it seems to me that realistically in the criminal law, although I know you are asking for the technical position rather than what a jury might do, it seems to me to be most unlikely to secure a conviction in those circumstances, and without having thought at length on the specific matter I think it would be necessary to look at the exact terms of each of the different pieces of legislation in the different jurisdictions in order to answer it. I am finding it difficult myself to separate out what I regard as the practical outcome from the technical outcome.

The Commonwealth, for example, does have specific provisions dealing with what the principal must know. The States don't have that but most of the States require that the payment be made corruptly. Just what "corruptly" means has been a matter of considerable dispute which is only recently started to become clear with the two Victorian decisions - one of the *Gallagher* and the other one *Anderson* I think - I can't remember but they are in the 80's. And even so it is quite clear that there is no precise meaning able to be accorded to corruptly. It is almost ambivalent to be determined by reference to all the circumstances. What is the reason for the payment, what are the circumstances surrounding it? It seems to me that if there has been a disclosure which the principal treated as sufficient it would be most unlikely that it would be regarded as a corrupt payment.

Question - Martin Kriewaldt (Feez Ruthning, Brisbane):

Turning to a point which you raised about the solicitor going along to a bank and saying "if I bring my trust account here, can I have a nice couple of percent off my mortgage or my overdraft?" If I an a very small depositor into that trust account, can I then go along to the bank and say "well look, calculate for me the whole of the benefit which you have given to the entire solicitors firm over all of their overdraft facilities and so on and pay the lot to me, even though the amount which I have in the trust account is quite minuscule", and if that is so, does that mean that I can then having received my large cheque suggest that to my friend who also had a small amount there and they can go and do it again, and so on ad infinitum?

Response - Tony Fitzgerald QC:

I am sure that no solicitor would dream of doing that but I will answer it anyway. It seems to me that the answer is no, that the culpability is related to the subject transaction. And the subject transaction would be the payment in of the moneys referable to the particular client. Indeed I think there is specific authority to say that other untainted transactions are not in any way caught up with the tainted transaction.

Comment - Peter Everett (Chairman):

Ladies and gentlemen, on your behalf may I thank Mr Tony Fitzgerald for this closing session of the Banking Law Conference. Would you join me in expressing your appreciation.