PITFALLS FOR LENDERS

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Mr Gray has concentrated upon duties to which lenders become subject in various circumstances of recovery and enforcement. In doing so, he recognises that, both at that stage and at the point of loan establishment, duty is the concomitant of right and therefore the raw material of pitfall. Traditional classifications of legal duties are prompted by or reflected in the notions of unconscionability upon which Mr Gray erects his central thesis: that a protection afforded by the legislature, by common law rules or by principles of equity is triggered by reliance upon faulty adherence to a standard of fairness to which the object of the protection is entitled. There is, in other words, resort ultimately to some system of values inherent in society.

In noting the move towards "reliance based" liability - as he does in his discussion of waiver, estoppel and other areas - Mr Gray highlights the prevailing preoccupation with inequality of power, knowledge and opportunity as a motivating factor. That factor plays a significant part in both the development of judge made principle and the formulation of statutory rules given to the courts to interpret and implement. At the end of the day, much is left to the kind of judicial sensitivity not at all concealed by Knight Bruce LJ more than a century ago in **Slim v Croucher** ((1860) 1 DeG F & J 518): "A country whose administration of justice did not afford redress in a case of the present description would not be in a state of civilisation". In contract, in tort and in equity this kind of sensitivity, influenced by the prevailing values of society, plays its part in the process of development.

The doctrine of the implied term enunciated in **The Moorcock** ((1889) 14 PD 64) has come to pay attention to the judgment of the fair and reasonable man. "And the spokesman for the fair and reasonable man, who represents after all no more than the anthropomorphic conception of justice, is and must be the court itself": **Davis Contractors Ltd v Fareham UDC** ([1956] AC 696) per Lord Radcliffe. Australian courts, however, remain concerned with the quest for a legal norm: see, for example, **Moorgate Tobacco Co Ltd v Philip Morris Ltd** ((1984) 59 ALJR 77); **Con-Stan Industries Pty Ltd v Norwich Winterthur Insurance (Australia) Ltd** ((1986) 60 ALJR 294).

Similar processes are evident in the development of the duty of care in negligence. Lord Atkin's neighbour principle - the result of his search in **Donoghue v Stevenson** ([1932] AC 562) for "some general conception of relations giving rise to a duty of care" - is easily seen for what it is. "In previous cases when faced with a new problem, the judges have not openly asked themselves the question: what is the best policy for the law to adopt? But the question has always been there in the background. It has been concealed behind such questions as: was the defendant under any duty to the plaintiff? ...": **Dutton v Bognor Regis UDC** ([1972] 1 QB 373) per Lord Denning MR. The Australian

approach again seeks to hold to a legal norm. "Yet legal rules are required to determine whether a duty of care exists in a particular case. By a legal rule I mean a rule that prescribes an issue of fact on which a legal consequence depends": **San Sebastian Pty Ltd v Minister** ((1986) 61 ALJR 41) per Brennan J.

Taking but one example from equity, the development of the constructive trust as an instrument for remedying unconscionable conduct or redressing unjust enrichment has been ascribed in England to the court's willingness to adopt that classification "whenever justice and good conscience require it": **Hussey v Palmer** ([1972] 1 WLR 1286) per Lord Denning MR. This makes the constructive trust, as developed in England, "a device whereby a judge may impose a proprietary trust on a person's property for no other reason except that, in the instant circumstances, his instinct makes him feel that it is fair": R P Meagher QC, "Future Directions in Equity", 1985. The High Court, while acknowledging the flexibility of the constructive trust (eg, in **Baumgartner v Baumgartner** (1987) 62 ALJR 29), shrinks from this overtly instinctive approach and continues to restrict it to "any case where some principle of the law of equity calls for [its] imposition ...": **Muschinski v Dodds** ((1985) 160 CLR 583), per Deane J.

In the statutory context too there is increasing resort to value judgments of this kind. The Corporate Law Reform Bill 1992, for example, proposes new provisions concerning redress at the suit of a liquidator in case of "voidable transactions". The relevant criteria are expressed by means of words such as "unfair", "uncommercial" and "extortionate", with references to the postulated actions of "a reasonable person in the company's circumstances". The avowed legislative purpose, as expressed in the explanatory memorandum, is to give the court "very wide powers to make appropriate orders in respect of voidable transactions to fit the particular circumstances". This jurisdiction, if it is created, may well prompt courts to say that, although it is far-reaching and remedial, it is also non- discretionary and involves the same kind of conceptual application of legal rules as a finding of negligence. Certain comments in **Beneficial Finance Corporation Ltd v Karavas** ([1991] ASC 56-754) as to the statutory provisions on "unjust" contracts proceed on that basis. We may nevertheless expect that courts will, as intended, continue to resort to a case by case review of merit in which concepts of reliance and inequality will play an essential part.

Against this background, it is instructive to examine briefly some of the instances in which reliance based liability and its attendant attention to inequality have demonstrated themselves in the lending context.

We may begin with the foreign currency loan cases. The high water mark of liability in this area is found in **Ferneyhough v Westpac Banking Corporation** (Federal Court, No G105 of 1989, 18 November 1991). The borrower's claim for damages against the bank in respect of losses flowing from a foreign currency loan were based upon implied term, duty of care in tort and statutory misconduct on the bank's part.

The claim in contract relied upon three implied terms binding upon the bank: first, that it would provide sufficient and accurate advice with respect to borrowing in a foreign currency; secondly, that it would give such advice as was required for the duration of the loan to permit the borrowers to make informed decisions on what, if any, action should be taken to protect their position having regard to their obligations to the bank under such a loan facility; and, thirdly, that it would exercise reasonable care and skill in performing these contractual duties.

Lee J held that all three terms should be implied. As to the first, he merely said that, in the context of the banker customer relationship and the actual dealings at the time of the loan, it was "reasonable" to imply the term. Resort to reliance based liability was more

evident in the way in which he found the second term to be implied: "... the facts of this case show the nature of the risks involved in such a facility extending over a period of five years and the inexperience of the Ferneyhoughs in that field made it a term necessarily to be implied in the contractual arrangements between Westpac and the Ferneyhoughs". In other words, the borrowers were inexperienced and vulnerable and that was the basis for finding the existence of an unspoken contractual promise by the lender.

A similar rationale was expressed in relation to the implying of the third term: "In the particular circumstances of this case, where the bank is offering to its customer a new facility in respect of which, to the bank's knowledge, the customer is entirely inexperienced and unfamiliar and which involves unusual risks, the nature and control of which require arcane commercial knowledge and sophisticated management, it would appear to be equally appropriate and necessary to imply a term in the banker and customer contract to the effect that Westpac undertook to exercise reasonable care and skill in providing the advice discussed above".

Upon what basis of principle did Lee J reach these conclusions? He began by observing that the criteria for deciding whether a term should be implied into a wholly written contract may not be apt for cases where the contractual relationship is based in part upon conduct and oral exchanges or is formed against a background of commercial custom and usage. He then quoted the statement of Deane J in **Hawkins v Clayton** ((1988) 164 CLR 539) that, in such cases, "a court should imply a term by reference to the imputed intention of the parties if, but only if, it can be seen that the implication of the particular term is necessary for a reasonable or effective operation of a contract of that nature in the circumstances of the case". As foreshadowed by Lord Radcliffe's formulation in **Davis Contractors** (*ante*), the determination of what was "necessary" or "reasonable" was made by the court itself; and consistently with the postulated notion of reliance based liability, the plaintiff's lack of experience and skill - as against the bank's supposed "arcane commercial knowledge" - became the touchstone of liability, presumably because of the "necessary" implication it created.

Turning to the claim in negligence, Lee J said that the facts he had already related "set the ground for the existence of a duty on the part of Westpac to exercise reasonable care and skill in providing advice and information to Mr Ferneyhough in the circumstances described". He went on: "Having regard to the relative position of the parties and the knowledge reposed in Westpac and lack of it held by Mr Ferneyhough, the duty was not confined to some limited aspect of the advice or information provided". A criterion of inequality of information thus played a central role in the existence and formulation of the duty of care in tort.

The same thinking underlies the brief analysis of duty in tort in the similar case of **Thannhauser v Westpac Banking Corporation** (Federal Court, No QG29 of 1989, 9 December 1991). Pincus J said: "Counsel for both sides referred me to discussions of the extent of the bank's duty in cases of this sort, to be found in a number of reported and unreported decisions. It appears difficult to generalise in this field ... Here, there was a long-standing customer who, on inquiring about an offshore loan, was sent to Mr Look to discuss it with him and obtain information and advice about the subject. Mr Look himself says that his function was to warn people about the risks of such loans and, although I do not believe that, there is no reason to doubt that he was, to the knowledge of the bank, purporting as part of his ordinary function to tell prospective foreign currency borrowers the merits and demerits of the course they proposed. I therefore do not see that any legal obstacle stands in the path of the applicant, once past the hurdle of showing that the advice she was given was negligently wrong, and misleading".

At the heart of the matter is unequal bargaining power or, as it was put by Einfeld J in **Quade v Commonwealth Bank** ((1991) 99 ALR 567), "unequal knowledge and understanding of the facts and problems". Circumstances of that kind were seen by Einfeld J as marking the dividing line between justified non-disclosure and "dishonesty or even sharp practice" involving breach of duty as discussed by Gleeson CJ in **Lam v Ausintel Investments Aust Pty Ltd** ((1990) ATPR 40-990). Even then, known reliance is a necessary component of a duty in tort. In **David Securities Pty Ltd v Commonwealth Bank** ((1990) 93 ALR 271), the Full Federal Court applied the observation of Deane J in **Hawkins v Clayton** (*ante*) that "... where the plaintiff's claim is for pure economic loss ... the categories of case in which the requisite relationship of proximity is to be found are properly to be seen as special in that they will be characterised by some additional element or elements which will commonly (but not necessarily) consist of known reliance (or dependence) or the assumption of responsibility or a combination of the two ..." And in **Quade's** case (*ante*), one member of the Full Court was content to note that "a sufficient duty for the present case is established by virtue of Morling J's finding that the respondent assumed responsibility to advise and knew of the applicants' reliance on whatever it said".

These formulations are concerned with the situation where an advisory function is undertaken by the bank. If, on the other hand, the bank makes it clear that it does not intend to assume an advisory role, no duty in tort will arise (**David Securities**, *ante*) unless it can be said that there is a positive duty to warn. The existence of such a duty at common law was postulated by Rogers J in **Mehta v Commonwealth Bank** (Supreme Court of New South Wales No 50023 of 1989, 27 June 1990) in accordance with approaches he had foreshadowed to this conference two years ago (see (1990) 1 *JBFLP* 201). His thesis, as then explained, was that "a bank's knowledge of the enormity of the risk and its knowledge that the borrower did not realise it, coupled with the refusal to manage the risk, imposed a duty to speak". In the result, however, this supposed duty at common law did not form the basis for the bank's liability at first instance in **Mehta**. The liability arose under s52 of the Trade Practices Act. This led Samuels JA, upon appeal ((1991) 1 ATPR 41-103), to observe that "it is reasonable to give his reference to a duty to speak a meaning directly material to that head of statutory liability." The general law duty to warn was also implicitly rejected by Meagher JA: a banker "is liable if, and only if, the advice which he tenders is deceptive or misleading" (or, as he afterwards put it in the **Karavas** case, "there is no duty on a financier to provide either a borrower or a third-party guarantor with any commercial advice"). Meagher JA also disapproved the notion that a foreign currency loan is an inherently dangerous thing, thus reinforcing the rejection in **David Securities** (*ante*) of the idea that a duty to warn arises at general law in the same way as in relation to poisons, explosives and the like (cf **Adelaide Chemical & Fertiliser Co Ltd v Carlyle** (1940) 64 CLR 514).

A distinct head of liability not yet visited upon banks in the foreign currency loan context is that arising from fiduciary duty. The possibility was adverted to in the paper presented to this conference by Mr Justice Rogers in 1990 and in **Quade's** case by Einfeld J who pointed to the fact that bank managers sometimes become "family advisers and father confessors to their clients", sharing "personal friendships and joint social, philanthropic, communal, church or sporting pursuits with their clients, during and by reason of which the client becomes even more susceptible to trust and rely upon the bank and its advice". The relationship of trust and confidence is thus foreshadowed. It is based, in the case of a bank manager, upon the "combination of status, goodwill and knowledge" which the position can sometimes entail: **Lloyds Bank v Bundy** ([1975] 1 QB 326).

The possibility that a bank explaining a loan transaction to a borrower may yet be found to owe fiduciary duties to that borrower nevertheless remains. While the banker-customer relationship of itself cannot be the source of such a duty (**James v ANZ Bank**

(1986) 64 ALR 347), assumption by a bank of the functions of what Brennan J has called "an investment adviser" (**Daly v Sydney Stock Exchange** (1986) 160 CLR 371) may so change the nature of the relationship as to give it a fiduciary character.

The Full Federal Court recently considered circumstances in which a bank occupied such a position in relation to a customer. In **Commonwealth Bank v Smith** ((1991) 102 ALR 453), a country manager had brought together the seller and buyer of a hotel business, at the same time advising the buyer (a customer of many years' standing unfamiliar with the hotel industry) on the merits of the proposed purchase and its advantages over other options the purchaser had been canvassing. The purchaser, the court said, "evinced complete faith" in the manager. The seller was also a customer of the same branch and the manager had confidential knowledge of its financial affairs. Important to the finding of fiduciary duty toward the buyer was the bank's connection with both buyer and seller. Their conflicting interests and the bank's "conflicting engagements" produced "the crucial incident of the fiduciary relationship" as in the two Canadian cases upon which particular reliance was placed: **McBean v Bank of Nova Scotia** ((1981) 15 BLR 296); **Hayward v Bank of Nova Scotia** ((1984) 45 OR (2d) 542). This element is, of course, absent from the loan situation, although **Daly v Sydney Stock Exchange** (*ante*) shows that there may be circumstances in which a deposit taking institution's advisory role causes it to owe fiduciary duties.

From there, we may pursue Mr Gray's notions of reliance based liability into the field of guarantees. The general law duty of a creditor taking a guarantee is to bring to the prospective guarantor's attention anything in the debtor-creditor relationship which the guarantor would not expect to exist. "But if there be nothing which might not naturally take place between these parties, then, if the surety would guard against particular perils, he must put the question and he must gain the information which he requires": **Hamilton v Watson** ((1845) 12 Cl & F 109) per Lord Campbell. That duty, however, arises from the mere relationship between principal creditor and surety. It is supplemented by duties which arise as concomitants of both equity's ability to grant relief on the basis of unconscionable conduct and statutory jurisdiction to deal with unjust contracts and misleading conduct.

The equitable principle draws upon principles of undue influence discussed in **Blomley v Ryan** ((1956) 99 CLR 362) and was stated in these abstract terms by Mason J in **Commercial Bank of Australia v Amadio** ((1983) 57 ALJR 358, 366): "... if A having actual knowledge that B occupies a situation of special advantage in relation to an intended transaction, so that B cannot make a judgment as to what is in his own interests, takes unfair advantage of his (A's) superior bargaining power or position by entering into that transaction, his conduct in doing so is unconscionable. And if, instead of having actual knowledge of that situation, A is aware of the possibility that that situation may exist or is aware of facts that would raise that possibility in the mind of a reasonable person, the result will be the same". Such a principle allowed the unsophisticated and commercially inexperienced guarantors in that case to escape liability. Their "weakness" - a combination of age, limited grasp of English and lack of business judgment - brought the equitable principles into play. It provided a basis for the operation of "the fundamental principle according to which equity acts, namely that a party having a legal right shall not be permitted to exercise it in such a way that the exercise amounts to unconscionable conduct": **Legione v Hateley** ((1983) 152 CLR 406). The **Amadio** principles have been frequently applied in later cases. In **National Australia Bank v Nobile** ((1988) 100 ALR 227), for example, relief was again granted to elderly guarantors whose command of English was poor and who had little knowledge of business matters. In language carrying heavy fiduciary overtones, Davies J said that "it was unconscionable that [the principal debtor's bank manager], who in this

transaction was not acting as their bank manager but had a conflict of interest, should not have explained to Mr and Mrs Martelli that they should seek independent advice".

The same notions spill over into the statutory jurisdiction to set aside unjust contracts. In **Westpac Banking Corporation v Clemesha** (Supreme Court of New South Wales No 18226 of 1987, 29 July 1988), for example, Cole J found that a relationship of "trust and confidence" existed between the guarantor and the principal debtors and that the guarantor was so overborne in her decision to give the guarantee that undue influence came into play. He also found that the bank was aware of both the principal debtors' poor financial position ("such that it was almost inevitable that the guarantee would be called upon") and "the special disability between" the principal debtors and the guarantor. It did not recommend or require independent advice and the elements of unconscionability according to **Amadio** principles were made out. Although disposing of the matter on those grounds, the judge added that the circumstances would also have attracted the operation of the Contracts Review Act 1980 (NSW).

The statutory jurisdiction is nevertheless independent. In **Beneficial Finance Corporation Ltd v Karavas** (*ante*), an **Amadio** defence raised by the guarantor failed. The court found that the lender had in no sense sought to take advantage of a superior bargaining position. A defence based on the Contracts Review Act was, however, successful. The rationale was that, to the lender's knowledge, the guarantors, although generally aware of the possibility that their properties might be lost if the principal debtor did not pay, gained no adequate concept of the risks surrounding the business enterprise to which the borrowed money was to be devoted. The importance of the respective strengths and states of awareness of the contracting parties was emphasised by Kirby P: "The appellant [lender] is in a position to make informed business assessments about the risks involved in the extension of finance to particular borrowers. It can cover its position handsomely by taking mortgages such as were secured in this case. It then runs comparatively little risk of ultimate loss. But where the borrowers, or their guarantors and mortgagors, are ill-educated, inexperienced in business, related to those principally involved by blood or affection and involved in the purchase of a business with some apparent risks, the lesson of this case may indeed be that the financier will be well advised to ensure that the guarantors receive effective, independent financial advice on the risks they are running."

In New Zealand, there has been an attempt to impose upon a creditor a duty in tort towards a prospective guarantor. In **Shotter v Westpac Banking Corporation** ([1987] BCL 352), Wylie J described the supposed duty thus: "A duty of explanation, warning or recommendation of separate advice arises when a bank should reasonably suspect that its customer may not fully understand the meaning of the guarantee and the extent of the liability undertaken thereby or that there is some special circumstance known to the bank which it should reasonably suspect might not be known to the prospective guarantor and which might be likely to affect that person's decision to enter into the guarantee".

This development of a duty in tort was checked by Hardie Boys J in **Westpac Banking Corporation v McCreanor** ([1988] BCL 234): "I have difficulty in accepting that by invoking a tortious duty of care the court should negate the very clear line of authority based on equitable principles that a bank is under no duty to explain except in the circumstances described in **Hamilton v Watson** and the authorities that have followed it ... Thus with great respect I cannot agree with the conclusion reached by Wylie J in the **Shotter** case."

Various forces are thus at work in an attempt to keep liability in negligence under control and to prevent its assuming the proportions of a cure-all. One is the finding, already

noted (and relevant to the **Shotter** approach), that there is not as yet any affirmative duty in tort for one party to a commercial contract to warn another of the hazards it might present: **David Securities** (*ante*), **Mehta** (*ante*). Another is what appears to be a re-alignment by English judges of their approach to the duties owed by mortgagees in exercising their power of sale.

It will be recalled that as a result of **Cuckmere Brick Co Ltd v Mutual Finance Ltd** ([1971] Ch 949), the duties owed to a mortgagor by a mortgagee exercising power of sale tended to be characterised in England in terms of negligence and as involving liability for damages. This approach did not find favour in Australia (cf **Forsyth v Blundell** (1973) 129 CLR 477; **ANZ Bank v Bangadilly Pastoral Co Ltd** (1978) 139 CLR 195) but was followed in England (eg **Standard Chartered Bank v Walker** [1982] 1 WLR 1410). The English courts have now acknowledged what Australian commentators have long regarded as error (Meagher Gummow & Lehane, "Equity-Doctrines and Remedies", 2nd ed, para 230). In **Parker-Tweedale v Dunbar Bank** ([1991] Ch 12), the Court of Appeal said that it was both unnecessary and confusing for the duty owed by a mortgagee to be expressed in terms of the tort of negligence. It arises out of the mortgagor - mortgagee relationship and the equitable environment in which that and attendant relationships exist. This was also the approach taken by the Privy Council in **China & South Sea Bank v Tan Soon Gin** ([1990] 1 AC 536) where the tort of negligence was put into its proper context: it "has not yet subsumed all torts and does not supplant the principles of equity or contradict contractual promises or complement the remedy of judicial review or supplement statutory rights".

In summary, we may say that reliance based liability remains a concern to lenders. Despite attempts in some judicial quarters to create in this field "a general principle which replaces all that went before" (Meagher, Gummow & Lehane, *op cit*, par 1530 commenting on **Lloyds Bank v Bundy**), reliance based liability continues to be regulated by established patterns of right and duty. Attempts to expand the duty of care in negligence have met with a measured response founded upon principle. The same is generally true of fiduciary duty. It remains to be seen whether resort to the implied contractual term in the somewhat imprecise way which commended itself to Lee J in **Ferneyhough's** case will gain further support. One thing at least is clear: that statutory intervention and clarification will continue. One need only look to the current draft of the Corporate Law Reform Bill to see, in its re-definition of the duties of a receiver (or other administrator) selling company property and its provisions on voidable transactions, new examples of the kind of protective legislation exemplified by the general statutes such as the Trade Practices Act and the Contracts Review Act.