RECENT DEVELOPMENTS

QUESTIONS AND ANSWERS

Question - Robert McDougall QC (Barrister, New South Wales Bar):

I am speaking about a New South Wales problem. I would like Lee's comments. It really seems to me that under the *Contracts Review Act* the parties in a real sense get only one chance. There are two elements involved in a dispute under the *Contracts Review Act*. The first is the consideration of whether the contract is unjust in the circumstances etc, and the second, if that question is answered "yes", is, what do you do? Now the Court of Appeal has held, and I think it is still the case, that the first question is a question of fact and that the second question is a question of discretion. If that analysis is correct, then the chances of upsetting a finding on appeal are of course circumscribed by first of all, the very well known limitations on challenging findings of fact, and secondly, the even greater limitations on challenging exercises of discretion. The lesson seems to me to be, but I would be grateful for your comments Lee, how with that in mind you prepare your case. Do you think it is right that you get only one chance?

Response - Lee Aitken (Speaker):

I think that is right, but that really illustrates the reason or a very good reason why one ought to start in the Federal Court with a scatter-gun approach. Assuming that the jurisdiction is available there, and I think it probably is, it is probably wiser to start there and seek general relief under section 87 of the Act which gives the court a very wide power to mould an order or to alter an order in the court's discretion, rather than get caught in a situation where you have probably got, as you have said, an adverse finding against you at first instance. I think though, from the point of view of judicial economy - and what I said this morning was trying to illustrate it - frankly acting for the borrower all of the time you are really trying to buy time and some sort of accommodation. And provided that the borrower is able to stymie the bank initially, then it may well be that you will get some sort of accommodation - provided you do not go too far of course and develop what I call the "vendetta mentality" which may result in them getting possession of everything - your house, your car, your underpants - and then bankrupt the poor chap. That can happen as well. So you have got to always keep a bit of a balance. But I think at first instance at least the courts are conscious of the overload in the Court of Appeal now and that is maybe one of the reasons why they have developed these rules - which is to say that you have had a run before Mr Justice X, who is very kind-hearted, but you have had your lot as they say in the classics. I cannot really think of too many *Contracts Review* cases on appeal - I suppose *Baltic* went on appeal - but not too many of them. Very few get past first base because some accommodation is then reached. Very few successful appeals.

Question - Ian Davidson (Barrister, New South Wales Bar):

I have a question for Lee also.

If *Smith v Elders Rural Finance* is not overturned, whether there could be a *Contracts Review Act* problem for a bank of being able to say that really there is nothing wrong that the bank did, no misconduct, or conduct that can be really criticised, but the circumstances are that it was just a transaction that should not have been entered into and therefore it will be set aside. So that if that was so, the obligation of the bank to investigate would be very high. And one might say that a bank should investigate, because they should not be lending money if it does not seem objectively that it can be repaid. But that just seems to me a very significant impact of that case.

Response - Lee Aitken (Speaker):

Well I think it is. That is the real problem. I did not quote the full part of the judgment, but I was not being rude to Justice Bryson. If you turn to page two at the top you see his Honour talks about it not being possible to articulate the elements with rigorous completeness. I think what he means there is that this one does not feel good, so I am going to put them down. He cannot actually state precisely what paragraphs of section 9 he is relying on in terms of the *Contracts Review* defence. But as I said, the real problem is, it is very hard to see why, whenever you go into a bank, the bank should not make a detailed personal inquiry into your understanding of the transaction to know how sophisticated you are, with a view to not lending you the money if your understanding is inadequate.

And that of course runs directly across all those other authorities I have not quoted which say that if you turn up and want to borrow, then the bank is there to lend on its own criteria. It is not there to protect you. So *Smith v Elders Rural Finance* is a dangerous case. Just last week I got a matter coming through where this *Smith v Elders* defence had been pleaded in detail. The people are saying they are unsophisticated borrowers, the bank should not have lent, and obviously in the wider hinterland it is having an effect.

It is also interestingly having an effect on banks themselves because when this case was expedited (I didn't mention this), the appeal was expedited and is being heard on a very short-term basis. The reason it was expedited was because the appellant put in a large number of statements from various other banks saying that the effect of *Smith* was having a stymieing effect on rural lending. In other words, people who ordinarily lend to customers in a rural environment were not lending because they were afraid they were going to be hit by a *Smith* operation or a *Smith* defence put on when the money was advanced. And that was the main reason I think that the court granted expedition. And that is something that I think people tend to forget when looking at the effect of all of these decisions.

In *O'Brien's Case* Lord Browne-Wilkinson makes the obvious point that if there are too many defences available, no one will be able to borrow. And certainly *Smith's Case* represents that because it survived a blanket defence that you appear simplistic or you do not understand what you are doing. I think that is right and that is why I think *Smith* probably will not survive, sadly, this Court of Appeal.

Question - David Clifford (Allen Allen & Hemsley, Sydney):

I just want to ask a question about a case or a line of authority which was not referred to in either of the papers but it seems to me is very much on point. The line of authority coming from *Fiberi* and similar cases about questions of internal management and banks looking at authority to enter into transactions. Some of the recent cases after *Fiberi* seem to suggest that there is very little difference between the *Corporations Law* section 164 and the old rules about internal management - which seems to me to be a very strange result.

I know in *Fiberi* they said that, whilst section 164 of the *Corporations Law* about assumptions you can make about authority might be satisfactory in many instances, in the sort of suspicious circumstances case which was not really enumerated there, that it was a case where a wife and a husband were interested in a company and a mortgage was given to secure a loan for the benefit of the husband. They said that section 164 did not get the bank out of gaol and the bank really should have looked into the question of authority in a way which would have meant that they would have spent a week with the company's internal documents. This seems to me to be a strange result, and as I say, the disentitling grounds for the bank to be able to rely on the assumptions according to recent cases in obiter has been said to be no different from the due inquiry rule in the earlier internal management cases - the *Turquand* case for example. Perhaps I could have a comment from the speakers.

Response - Bill Gough (Speaker):

I am not sure that I can add much to David's comment. I suppose it is reflected in the old rule that the more things change the more things remain the same.

Response - Lee Aitken (Speaker):

I think also some of those cases illustrate the basic principle when we actually go into court which is where do the merits lie? If you have got the merits where the wife appears to have been completely subordinate or a cat's paw to the husband, then the court will find any reason to read the operation of the rules down. And I think that is probably what *Fiberi* and those other cases represent. Strictly what you said is absolutely right. And in terms of compliance costs, it would throw a huge burden on the bank to have to investigate every conceivable matter - I suppose you would need to look at every minute, or every company document. But from what I remember of that case, it was a particularly harsh case in terms of the wife being duped and it may simply be a reflection of that. It is a rationalisation, but that is often accurate. In other words, the court does not always operate strictly "legally". I should not say that, but we all know it is true.

Question - Michael Daniel (Dunhill Madden Butler, Sydney):

A question for Lee. You mentioned that you thought that there may be a tactical advantage of appointing a receiver even if the security is from an individual. If that security is over somebody's home, what do you see to be the tactical advantage of appointing the receiver, leaving aside any publicity problems?

Response - Lee Aitken (Speaker):

Well I think I added a caveat about that, but I think there are very big publicity problems. I put it really in the negative. I said that that is an option which is available, but which people tend not to think about because the usual route for taking possession is by means of a writ of possession in the common law division, having served all sorts of notices. Now as soon as you get into the notice area, you start generating your own problems, of course, because of the risk there will be some mix up in the notices. Appointing the receiver is a much more effective way of operating, because you immediately get possession of the property, you are in possession, but the bank would never do that because the publicity is just too bad. It always sells under a notice as far as I am aware. I am not aware of any position where a bank has taken possession relying on the covenant to appoint the receiver rather than go by the usual route of requiring the money to be repaid and then selling under the power of sale. That is the usual way they do it. I would be interested if anyone has ever seen a lender do the peremptory thing as it were. I do not think they would, for reasons that you advanced.

Question - Michael Daniel (Dunhill Madden Butler, Sydney):

I really meant that, leaving aside the question of the publicity, are you saying that there would be problems in appointing a receiver to take possession without a court order, so that you do not really need to even give notice.

Response - Lee Aitken (Speaker):

That is right - you do not. You are in a very strong legal position. And that is why of course if you are ever acting for anyone lending, you must always resist the arrival of the receiver. It is a very interesting legal position or question, why the receiver is entitled to come in without any court order relying on a security document and simply dismiss all the staff and seize the place and the inventory and whatever, and change the locks. We all know it happens all the time and the usual reason when you seek an injunction is that damages against lender "X" will be an adequate remedy. But if you think about the strict legalities of it, you are being put out of possession on the basis of some contract you have signed. And if you dispute the contract, I do not see why you should not be able to argue about it.

I had a case not so long ago about a nightclub where in fact we had our own security and we were able to retake possession from the receiver. I think about ten minutes after a phone call 15 men of South Sea Island appearance arrived and retook possession. It was only when the police arrived that we were prevented from taking our own safe out of the back of the premises. But unfortunately it is unusual that you are able to do that, because you normally do not have enough men on the ground to resist the receiver, and people are normally so shell-shocked in a business sense that they are just overwhelmed. But if you think about it legally, it is very difficult to see why the damages are an adequate remedy, whereas if some other right is being interfered with the court will give you an immediate injunction. Say there is a lease agreement, for example. Someone comes and seizes your computers, then of course if there is a breach of some lease you are out of business. The court will order the machines to be returned to you. In the converse situation, the court will normally uphold the sanctity of the security document. I suppose it has to, because otherwise business would stop. But it is an interesting question in legal terms why there is that difference. There is no theoretical difference, no matter how you sell it to the court.

Question - From the floor:

About the desirability of automatic crystallisation of floating charges.

Response - Bill Gough (Speaker):

This is really linked to the issue of the outcome of the Law Reform Commission's Report on Personal Property Security. There is a proposal in there to restrict the grounds of crystallisation by requiring that crystallisation would not be effective until the filing of a notice - the equivalent of filing a notice of appointment of a receiver. My personal view on this subject is that that would be a retrograde step. In my talk this morning I only attempted to address the issue of the law as it is rather than the law as it ought to be, and this is a rather large subject. Although, oddly enough, the rather dramatic events of the case law over the last few years make an interesting comparison as to which is developing faster - the formal proposals for law reform or case law developments. But personally I have never seen the express crystallisation as the sort of mischief or the evil that many have. I think that the express crystallisation is there for a purpose, to preserve priority. To require a formal act obviously nullifies the security priority purpose. It may be that with these modified convertible forms of charge that this is an issue that is becoming yesterday's issue anyway because developments may be more for this convertible form of charge rather than the argument we have had over express crystallisation over the last few years anyway.

Comment - David Allan (Chairman):

Yes, I can just confirm that the Law Reform Commission did propose that crystallisation should be dependent upon some act such as the filing of a notice. But I agree that would be a retrograde step, and I think that is the general view that is taken.

As there are no more questions or comments from the floor, could I on behalf of everybody thank both Bill and Lee for what I am sure you will agree has been a most stimulating and valuable session, and also to thank those who have contributed from the floor. Thank you.