Update on Case Law Developments

Hon Justice Mark O'Regan
High Court of New Zealand

I have selected a number of recent cases from the United Kingdom and New Zealand which I think may be of some interest to banking lawyers. Chief Justice de Jersey will be dealing with Australian cases. I acknowledge the assistance of Mariette Van Ryn in identifying the cases referred to in this paper. I will deal with the New Zealand cases first.

NEW ZEALAND

Edgewater Motel Ltd & Ors v Commissioner Inland Revenue & Ors (High Court, Auckland, CP 432-IM01, 28 May 2002, Baragwanath J)

This case involved a mortgagee sale of a property which was subject to two mortgages. The sale price did not cover both mortgages and there was a dispute between the Commissioner and the second mortgagee as to who had priority in respect of the GST which was paid on the sale price. As the sale price was $940,000 plus GST, the GST was a considerable sum: $117,500.

The Commissioner argued that the GST on the sale was payable to the Commissioner under s 17 of the Goods & Services Tax Act 1985 which says that where goods are sold under a power of enforcement, the person undertaking the sale is required to file a GST return and pay the GST charged on the sale. On a literal interpretation this seems to require the mortgagee to pay GST to the Commissioner in priority to the claim of any mortgagee.

The second mortgagee's case was based on s 104 of the Land Transfer Act 1952 which requires that the sale proceeds from a mortgagee sale, after payment of the cost of sale and the money owing to the mortgagee, must be applied in payment of any subsequent registered mortgage.

The Judge held that, on a strictly literal interpretation of s 17 of the GST legislation the Commissioner should succeed. But he took a broader view in the light of the statutory context, in particular, he considered the fact that s104 was settled law for a long period and s17 was repugnant to it. He said that he preferred to adopt a "strained construction" leading to a finding for the second mortgagee.

His reasons were:

- The outcome would then be consistent with the outcome in respect of a sale of secured property by a liquidator under the Companies Act 1993 and by a receiver under the Receiverships Act 1993;
- It would also be consistent with the situation where the mortgagor itself sells the property with the consent of the mortgagee;
- It gave effect to settled public policy that mortgagees are entitled to first priority over the proceeds of sale of the secured property;
- The Commissioner's position, while it would involve a literal construction of s 17, made no practical sense. Section 17 is largely a machinery provision which should not override s 104 which states substantive rights.

Bryers v Harts Contributory Mortgages Nominee Company Ltd (CA 5/02, 13 May 2002) (Court of Appeal).

This was an appeal from a grant of summary judgment against a guarantor for the shortfall arising after the sale of mortgaged properties, where the guarantor had guaranteed the obligations of the mortgagors.

The first issue was whether a default notice given to one of the mortgagors was invalid because it failed to comply with s 92 of the Property Law Act 1952. The alleged invalidity arose because of the mistaken reference to defaults occurring on 2 March 1999 when they had in fact occurred on 2 March 2000. The Court found that the notice did comply with s 92, despite this clerical error. It rejected the arguments that s 92 required literal accuracy in the statement of a date, and that there could be no compliance even where there was a clerical error which was as obvious as the one in this case. The Court was satisfied that a reasonable recipient would have understood what date was intended and found this adequately informed the mortgagor of the time by which it was required to remedy the default.

The second issue involved s 103A of the Property Law Act 1952, which says that a mortgagee owes a duty to the mortgagor to take reasonable care to obtain the best price reasonably obtainable at the time of the sale. Mr Bryers alleged that the mortgagee had breached these duties. The Court found that the mortgagee does not owe the s 103A duty to a guarantor of the mortgagor because the duty applies only to a "mortgagor", which is defined as including any person entitled to redeem a mortgage according to his estate, interest or right in the mortgage property. As a guarantor has no estate, interest or right in the mortgaged property, the guarantor is not a mortgagor as defined.

In any event, the Court found that the terms of the guarantee prevented Mr Bryers from raising questions concerning a breach of s 103A until he had paid the gross amount of the remaining mortgage indebtedness. Once he has done so he would be free to exercise his right of subrogation and call upon the mortgagors to bring on his behalf a claim for loss, which may have been suffered because of the way in which the mortgagee sale proceeded. The appeal was therefore dismissed.

Mason and Mason v National Australia Bank Ltd (CA 178/01, 18 April 2002) (Court of Appeal).

The facts were that the appellants had borrowed from National Australia Bank in order to buy six residential units on the Gold Coast of Queensland. The bank took security over the residential units and when the appellants defaulted the bank sold them, leaving a large shortfall. In the High Court, the Master gave summary judgment for that amount plus interest and costs.

The appellants believed they were the victims of a disreputable maretking practice which, apparently, was relatively common in Queensland at the time. This practice involved promoting real estate at inflated prices to people who were unfamiliar with the market because they normally resided remote from it. This practice had been the subject of a report by the Queensland Office of Fair Trading in 1999.

The appellants alleged that there was a sufficient link between the unlawful conduct by (or on behalf of) the people who sold the residential units to the appellants and the bank so as to make it wrong to enter summary judgment in favour of the bank. The bank's response was that the appellants could not escape their obligation to repay money they had borrowed from the bank by reference to the conduct of a third party or parties, for whom the bank was not responsible.

The Court found that the appellants' claims failed because of the manifest inadequacy of evidence linking the bank to unlawful conduct by anyone. In relation to the individual arguments the Court found that:

- The Fair Trading Act 1986 did not apply either for limitation reasons or for jurisdictional reasons, given that the loan contracts were entered into in Queensland;
- An argument based on contractual mistake (as to the value of the units in question), failed because the mistake had nothing to do with the bank, the bank did not know of the mistake and if there had been a mistake it had not resulted in a substantially unequal exchange of values between the appellants and the bank;

- An argument based on the Contractual Remedies Act 1979 depended on the feasibility of an assertion that, in agreeing to advance the loan, the bank was representing that the price the appellants were paying for the residential units was a realistic price, for which there was no evidence;
- An unconscionability argument depended on an argument that the appellants were unsophisticated and relied on the bank, which required a finding that the bank was, or ought to have been, aware, not only that the appellants were unsophisticated but also that they were victims of an unconscionable transaction. Again, there was no evidence of this;
- An argument based on an implied term that the bank would not act unreasonably failed because there was no complicity by the bank in the unlawful scheme and no evidence that its actions were unreasonable;
- An argument under the Credit Contracts Act 1981 that the contracts for the loans were oppressive and should be re-opened failed because there was no basis for imputing oppressive conduct in respect of the loan agreement to the bank and, in any event, the Credit Contracts Act did not apply to contracts governed by the law of a country other than New Zealand;
- An argument that the bank had failed to mitigate its loss failed because the bank was not suing for damages but rather for recovery of a debt;
- An argument that the appellants had a set off right because of negligence by the bank required a finding that the bank had a duty of care to warn the appellants of the existence of the disreputable marketing practices. There was no basis for imposing such a duty of care to tender such unsolicited advice to customers of the bank;
- An argument that the Court should have declined summary judgment in its residual discretion, based on the fact that summary judgment would lead to bankruptcy and therefore pre-empt the appellant's counterclaim against the bank, was found to be unpersuasive.

Allen's Enterprises Ltd v Bank of New Zealand (2001) 7 NZBLC 103,251. (High Court, Fisher J)

This case involved an argument over only $3000, but required consideration of the contractual regime applying in relation to the use of credit cards.

Allens was an antique dealer which sold antiques to individual purchasers throughout the world. In 1998 Allens decided to offer customers the option of paying for their purchase by credit card and entered into a written agreement (known as a "merchant agreement") with BNZ.

The background to the agreement between Allens and BNZ consisted of local and international systems for the payment of merchants from the bank accounts of purchasers, using credit card vouchers issued or authorised by the purchasers. This system rested upon three contractual relationships, namely:

- The contract between the cardholder and the cardholder's bank;
- The set of contracts linking the various banks and the credit card operator (in this case, Visa);
- The merchant agreement.

Having entered into its merchant agreement with the BNZ, Allens started selling pottery by auction on the internet, using the internet auction house, eBAY. In January 2000 Allens sold an antique pottery horse through eBay to a Mr Tang of the United States, for $NZ4,845. Mr Tang authorised Allens to charge the purchase price to his Visa card and provided the necessary particulars for that purpose. Operating under the relevant agreements, Allens made a Visa claim to its bank, BNZ, for the purchase price. BNZ presented that claim to Mr Tang's bank, Citibank, through the Visa system and Citibank remitted the necessary funds to the BNZ. Allens sent off the horse to Mr Tang, but two months later Mr Tang decided the horse was a fake and returned it, demanding a full refund. When the horse arrived back, Allens took steps to confirm its authenticity, and having confirmed that it was authentic, offered Mr Tang the option of returning the horse to him at his cost, or reselling it and forwarding him the proceeds. Having received no response from him it did the latter, but the net proceeds were only $1,819, which was credited to Mr Tang's Visa account through the Visa system.

Citibank subsequently claimed a refund from BNZ for the full purchase price and despite Allen's explanation as to why a full refund had not been given, BNZ accepted Citibank's argument that a full refund was due, made the full refund and debited Allen's account for that purpose. The Judge said he found it difficult to see why BNZ agreed to this, when on the face of it Mr Tang had no right to rescind his contract.

Allens then sought reimbursement from BNZ for the amount debited to its account on the basis that BNZ had breached the merchant agreement. This involved an interpretation of the merchant agreement. The Judge found that there was no basis for saying that Allens was ever a party to the contractual arrangements between the various banks and/or the credit card operator, Visa, in this case, nor was it a party to any contractual arrangements between Citibank as the cardholder's bank and Mr Tang as the cardholder. The BNZ could not impute to Allens' knowledge of the systems and practices within the banking world, which would be unknown to customers such as Allens.

On a proper interpretation of the merchant agreement, the BNZ had no right to debit Allens' account – the only basis on which it could do this would be where a transaction was not valid, but there was nothing

about this transaction which made it not valid as defined in the merchant agreement. The Judge rejected the contention that the merchant agreement should be interpreted so that it does not leave the bank in a position where it may be obliged to make a refund without recourse to the merchant, on the basis that there was no reason to believe that this was the likely outcome if the bank operated in accordance with the merchant agreement.

NMFM Mortgages Ltd v McGaveston & Ors (High Court Wellington, CP97/01, 18 December 2001, Master Thompson)

This case concerned the interpretation of an all-moneys mortgage document in circumstances where the mortgagee had assigned the mortgage and the mortgagor had pre-existing obligations to the assignee.

The facts were somewhat convoluted. NMFM held a first ranking debenture over the assets of the second defendant, First Investments Ltd (FIL). The debenture gave NMFM a first charge over all FIL's real estate. Subsequently FIL became the registered proprietor of a property in Auckland (the property) and granted a first mortgage over the property to Elders. FIL then entered into an agreement with Sage, a company owned by McGaveston to sell the property. Later McGaveston acquired the Elders' mortgage over the property and then exercised his power of sale under that mortgage. The sale price was $260,000 greater than the purchase price provided for in the Sage/FIL agreement which could no longer be performed. McGaveston retained all the proceeds from the mortgagee sale. NMFM claimed about $280,000, being the surplus remaining after payment of all amounts owing under the Elders mortgage and costs of enforcement. McGaveston said that the mortgagee sale meant that FIL could not sell the property to Sage, which caused loss to Sage, and that this amount could also be secured under the mortgage. (McGaveston also claimed FIL owed him money personally which the Master did not accept. In the circumstances of the case, and for the purposes of argument, the Master accepted that the amount owing to Sage was effectively owed to McGaveston.)

The issue was therefore whether the ex-Elders mortgage could secure an amount owing to McGaveston by way of damages from FIL in respect of which FIL was already contingently liable to McGaveston prior to McGaveston purchasing the mortgage from Elders. The Master had no difficulty in answering that question "No". He found that under s 104 of the Land Transfer Act 1952, McGaveston as first mortgagee had to pay to NMFM as a subsequent mortgagee (by virtue of the debenture) the surplus from the mortgagee sale because:

- The Elders mortgage secured only indebtedness owing in respect of financial services, which did not include a pre-existing damages claim;

- The definition of "moneys hereby secured" referred to moneys which are now or hereafter owing, and that also meant that a pre-existing debt to an assignee of the mortgagee was not included;
- The general rule is that unless a mortgage document expressly contemplates a mortgagor's pre-existing obligations to an assignee of the mortgagee being brought within the amount secured by the mortgage, a mortgage will not secure that sum;
- The proposed sale of the property to Sage would have required the consent of NMFM as a chargeholder pursuant to its debenture and this had not been sought. Accordingly, NMFM's entitlement to the proceeds of sale of the property could not be prejudiced by a proposed sale to Sage, to which it had not consented.

McGaveston therefore had to pay the surplus to NMFM. The decision followed two Australian decisions to the same effect, namely *Katsikalis v Deutschebank (Asia) AG* [1988] 2 Qd R 641 and *Re Modular Design Group Pty Ltd* (1994) 35 NSWLR 96.

UNITED KINGDOM

AIB Group (UK Plc) v Martin & Anor [2002] 1 All ER 353 (House of Lords)

This case involved the interpretation of a standard clause in mortgages, dealing with joint and several liability. The mortgage had a standard covenant saying that the mortgagor covenanted to pay all sums of money advanced to the mortgagor by the bank. This was amplified by a clause dealing with the situation where "the mortgagor" consisted of more than one person. That clause said that the term mortgagor "shall be construed as referring to all and/or any one of those persons and the obligations of such persons hereunder shall be joint and several".

In this case the mortgagor did consist of two people, Mr Martin and Mr Gold. They had together borrowed money for a business enterprise, and had granted a mortgage over their jointly owned property. In addition, each of them had individual obligations to the bank secured by individual mortgages over their individually owned property.

The bank argued that Mr Gold was liable not only for the sums which had been advanced to him alone and those which had been advanced to him and Mr Martin jointly, but also for sums that had been advanced solely to Mr Martin. The House of Lords accepted that the Bank's interpretation was correct, based on the plain meaning of the relevant provisions.

Counsel for Mr Gold argued for a distributive construction so that the reference to "the mortgagor" would be construed as referring not to all of the people constituting the mortgagor but only the particular

mortgagor who owed the money. This would mean Mr Gold would be responsible for money owed to Mr Gold; Mr Martin would be responsible for money owed to Mr Martin, and both Mr Gold and Mr Martin would be responsible for the money lent to them jointly. This distributive interpretation found some favour with Lord Millett, but not with the other Law Lords. In the face of unanimous opposition from his colleagues, Lord Millett said he was not prepared to dissent from the majority view and reluctantly concurred with it.

Accordingly, the interpretation contended for by the bank was adopted and Mr Gold was found to be liable for amounts which had been lent by the bank to Mr Martin alone.

Paragon Finance PLC v Staunton [2001] 2 All ER (Comm) 1025 (Court of Appeal)

Paragon was enforcing mortgages from two of its customers. A variable interest rate was specified in the mortgage, and the mortgage documents said interest would be charged at the rate which Paragon from time to time applied to the category of business to which it considered the mortgage belonged, and may therefore be increased or decreased at any time.

The defendants resisted enforcement on a number of bases, some of which related to the particular characteristics of English legislation. The point of interest for us is the finding by the Court of Appeal that the power given to Paragon to set interest rates was not unfettered. The Court found there was an implied term that the discretion to vary interest rates would not be exercised dishonestly, for an improper purpose, capriciously or arbitrarily, and that such a term would be implied into the mortgage agreement in order to give effect to the reasonable expectations of the parties. The fact that there was some regulatory control through the Director General of Fair Trading, and that the defendants were free to redeem their mortgage and seek finance elsewhere, did not displace the need for such an implied term.

The Court said that "unreasonable" was to be assessed in a sense analogous to *Wednesbury* unreasonableness in the administrative law context: *Associated Provincial Picture Houses Ltd v Wednesbury Corp* [1948] 1 KB 223. The Court said this was quite different from a term that the lender would not impose an unreasonable rate of interest. The fact that Paragon's rates were higher than its competitors by some margin, may have meant they were unreasonable rates, but it did not mean they were set unreasonably, given that Paragon's own financial difficulties made it commercially necessary to charge such rates.

Bank of Ireland v AMCD (Property Holdings) Ltd [2001] 2 All ER (Comm) 894 (High Court, Chancery Division)

This case involved a financing facility provided by the Bank of Ireland. The facility agreement recorded that the facility was to finance the development of 19 residential flats on the defendant's property. The facility agreement said that repayment was to be made "on demand", but then went on to say "in the expected ordinary course of events, the facility will be repaid from the sale of the development within 12 months. The bank will receive the full net proceeds of the properties to be sold until the facility is repaid in full." There was a subsequent clause dealing with material adverse changes which said that if there was a breach or change in circumstances which materially adversely affected the defendant's ability to meet its commitments, which was not rectified within 14 days of notice from the bank, then the bank was entitled to make demand for immediate repayment. There were also a number of conditions precedent, two of which were receipt of a valuation and the provision of the necessary security.

The bank made an advance of £75,000 prior to the satisfaction of the two conditions precedent referred to above. Problems then arose and it was not possible to give the bank the required security (the prior mortgagee did not agree to yield priority). The bank then demanded repayment of the £75,000 advance and also payment of the arrangement fee.

The defendants argued that the requirement to repay advances under the facility "on demand" did not mean "on demand", but instead should be construed against the background that sums owing under the facility were to be made available for the specific purpose of allowing the development work to commence and therefore to allow the bank to demand repayment would be repugnant to the purpose of the advance.

This was rejected by the Court. While it was true that the facility envisaged a 12 month drawdown period and provided for repayment after 14 days notice in the case of certain defaults and changes, that did not mean it was not an on-demand facility. Those provisions were not repugnant to, and did not over-ride, the clear statement in the facility agreement that repayment was to be made on demand. On the true construction of the facility agreement it simply meant that amounts advanced would be repayable on demand, but if all went well the bank would expect to receive repayment from the sale of the development. Since all had not gone well, the bank was entitled to enforce the requirement for repayment on demand. Summary judgment was entered for the bank.

Royal Bank of Scotland v Etridge (No.2) & Other Appeals [2001] 2 All ER (Comm) 1061 (House of Lords)

This case considered a number of appeals relating to situations where a wife has guaranteed obligations of her husband (or vice versa), or the obligations of a company belonging to the husband. The House of Lords enunciated a number of principles for this situation, namely:

1. A bank is put on inquiry whenever a wife offers to stand surety for her husband's debts (or vice versa). The same arises where the wife becomes surety for the debts of a company whose shares are held by her and her husband, even when she is a director or secretary of the company;
2. When a bank is put on inquiry, it needs to do no more than take reasonable steps to satisfy itself that the practical implications of the proposed transactions have been brought home to the wife, in a meaningful way, so that she enters into the transaction with her eyes open. That can be done by relying on confirmation from a solicitor acting for the wife that the solicitor has advised her appropriately, so long as the bank is not aware that the solicitor has not duly advised the wife or the bank knows facts from which it ought to have realised that she has not received appropriate advice.
3. The solicitor acting for the wife needs to explain to her why the solicitor is involved, the fact that bank will rely on that involvement to counter suggestions of undue influence, and obtain confirmation from the wife that she wants the solicitor act.
4. The advice needs to explain the nature of the documents, the practical consequences for the wife if she signs them, point out the seriousness of the risks involved, include an explanation of the purpose of the facility and its terms, inform her of her liability under the guarantee, discuss with her her financial means and ability to repay and those of the husband, inform the wife she has a clear choice and that the decision is hers and hers alone which will involve some discussion of the present financial position of the wife and the husband.
5. The solicitor then needs to check with the wife that she wants to proceed and obtain her permission to write to the bank confirming that the solicitor has explained matters to her, or whether she wants the solicitor to negotiate with the bank on the terms of the transaction. Confirmation should not be given to the bank without the wife's specific authorisation.
6. The solicitor's role is not to veto the transaction if the wife wishes to proceed with a financially unwise transaction. However, there may be exceptional circumstances where it is glaringly obvious that the wife is being grievously wronged and in those cases the solicitor should decline to act further.
7. The solicitor may also act for the husband, or the bank, so long as the solicitor is satisfied it is in the wife's best interest and will not give rise to conflicts of duty or interest.

8. The House of Lords set out a detailed procedure which should be followed by banks when they are in this situation, in order to protect themselves against defences based on undue influence.
9. The House of Lords also said that banks should regulate their affairs in the future on the basis that they are put on inquiry in every case where the relationship between the surety and the debtor is a non-commercial one, this being a "modest burden for banks and other lenders, being no more than is reasonably to be expected of a creditor who is taking a guarantee from an individual". Failure to take these steps will mean the bank is deemed to have notice of any claim the guarantor may have that the transaction was procured by undue influence or misrepresentation on the part of the debtor.