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Hostage to the Vibe - The Future of Statutory Unconscionability In Banking Transactions

Rt. Hon Peter Blanchard
A Judge of the Supreme Court of New Zealand
Wellington

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I became very nervous when I read in Professor Horrigan's excellent paper about the difficulty of assigning a meaning to unconscionability or unconscionable conduct in its Australian statutory guise or guises. As Professor Charles Rickett has observed, those terms have rapidly become prominent but largely incoherent features of the legal landscape. This is the warning that Rickett has given:[1]

> That there is no generally accepted meaning for unconscionability should immediately warn us off its use. It is not good enough to trumpet the rule of law, and then to apply the rule of men's hearts. The rule of law requires juridically applicable principles. To tell a cricket umpire to adjudicate on the basis of fairness would be to deny the game the right to be taken seriously; those who wanted to carry on playing the game would need to play elsewhere. To tell a judge to adjudicate on the basis of unconscionability would be to deny the law the right to be taken seriously; those who wanted to carry on living under the law would need to live elsewhere.

Perhaps that is why I choose to live in New Zealand!

The Judge-made law on unconscionable bargains over the Tasman is in much the same condition as it is here. It remains a "narrow principle", to adopt Spigelman CJ's description of it in equitable doctrine,[2] as quoted by Professor Horrigan in his paper.

The rationale is the relief of the weak in appropriate cases from bargains entered into as a result of their weakness. The crucial elements are:

1. The weaker party is under a significant disability.

2. The stronger party knows or ought to know of that disability.

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1 "Unconscionability and Commercial Law" (2005) 24 UQLJ 73 at p 87.
2 *Attorney-General (NSW) v World Best Holdings Ltd* [2005] NSWCA 261 at para [120].

3. The stronger party has victimised the weaker in the sense of taking advantage of the weaker's disability, either by active extortion of the bargain or passive acceptance of it in circumstances where it is contrary to conscience that the bargain should be accepted.

Those elements are crucial. Normally there will also have been a marked inadequacy of consideration and the stronger party either knew or ought to have known that to be so. As Deane J said in *Amadio*,[3] inadequacy of consideration is not mandatory but will almost always be present.

Often, too, there will have been some procedural impropriety but that is not a mandatory feature. Absence of independent advice to the weaker party is a frequent feature of unconscionable bargain cases. Where the weaker party did receive adequate independent advice it will be much harder for a successful allegation of unconscionable bargain to be made. I draw this summary of the way in which unconscionable bargain has been approached by New Zealand Courts from the judgment of Tipping J in *Bowkett v Action Finance Ltd.*[4]

You will appreciate that all this is very similar to the approach taken by the High Court of Australia in cases like *Amadio*,[5] *Blomley v Ryan*[6] and *Louth v Diprose*.[7]

On the subject of Judge-made law, I should add that we have not in New Zealand ever suffered from the limitations of *Yerkey v Jones*,[8] which we have never followed, or even of *Garcia*,[9] should there prove to be any such limitations. The leading undue influence case of *Wilkinson v ASB Bank Ltd*[10] applies quite broadly and expressly covers all family members and those in de facto relationships. I have no doubt that it would extend to gay relationships. Any differences between *Wilkinson* and the House

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3 *Commercial Bank of Australia Ltd v Amadio* (1983) 151 CLR 447.
4 [1992] 1 NZLR 449 (HC).
5 (1983) 151 CLR 447.
6 (1956) 99 CLR 362.
7 (1992) 175 CLR 621.
8 (1939) 63 CLR 649.
9 *Garcia v National Australia Bank Ltd* (1998) 194 CLR 395.
10 [1998] 1 NZLR 674 (CA).

of Lords' subsequent decision in *Etridge*[11] about recommended banking practice when obtaining a covenant from someone who may be acting under the influence of a principal borrower or may be otherwise disadvantaged are unlikely to be of much significance. The almost complete absence of cases arising in the decade since *Wilkinson* suggests that adherence by banks and other financiers to the recommendations in *Wilkinson* has largely eliminated the kind of problem that was often seen before that judgment was delivered.

But our subject today is *statutory* unconscionability and here Australian law is, depending upon how you look at it, much more developed or much more troubled. Today's paper may suggest the latter.

New Zealand did copy large parts of the Trade Practices Act in our Fair Trading Act 1986 and it has proved to be a useful and often salutary transplant. However, for reasons unknown to me, and critics might say no doubt more due to good luck than good judgment, we have never copied s 51AA or its derivatives. Nor have we endeavoured to create our own version.

And, so far, we do not have unfair contract terms legislation either, although the Ministry of Consumer Affairs has in a Discussion Paper[12] suggested that we might consider it.[13] That same Ministry, a little organisation with not much political clout, has suggested that if this is done it would not propose to recommend any amendment to the Fair Trading Act to make provision for prohibiting unconscionable conduct.[14] That was in May 2006 and I have not heard of any movement towards unfair terms legislation. It is certainly not beyond the bounds of possibility, however, that case law emerging from the current financial turmoil will produce a reaction from the Government and we may see legislation. To date no significant judgments have been delivered concerning the consequences of what Professor Horrigan calls the GFC, although I think we may have some quite soon.

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[11] *Royal Bank of Scotland plc v Etridge (No 2)* [2002] 2 AC 773 (HL).
[12] Ministry of Consumer Affairs, *Review of the Redress and Enforcement Provisions of Consumer Protection Law: International Comparison Discussion Paper* (May 2006).
[13] At pp 24 – 27.
[14] At pp 49 – 50.

What we do have already on the New Zealand statute book is something called the Credit Contracts and Consumer Finance Act 2003. As its name suggests, that Act is mostly about consumer contracts. It contains rules for them and also for consumer leases, credit-related insurance and buy-back transactions of land.[15] It prescribes remedies and enforcement procedures for those kinds of transactions only.[16] But then, in Part 5,[17] when it turns to provisions enabling the reopening of oppressive credit contracts, that Part is expressed to apply to "every credit contract (whether or not it is a consumer credit contract)".[18] A "credit contract" is defined[19] so as to include within its reach an arrangement that in substance or effect is a contract under which credit is or may be provided.

Section 120 is the central provision:

> **120 Reopening of credit contracts, consumer leases, and buy-back transactions**
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> The Court may reopen a credit contract, a consumer lease, or a buy-back transaction if, in any proceedings (whether or not brought under this Act), it considers that—
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> (a) the contract, lease, or transaction is oppressive; or
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> (b) a party has exercised, or intends to exercise, a right or power conferred by the contract, lease, or transaction in an oppressive manner; or
>
> (c) a party has induced another party to enter into the contract, lease, or transaction by oppressive means.

I want to come back to the meaning of "oppressive" but before I do I should mention that there is a section which treats a refusal on the part of a financier to agree to early termination variation or waiver of a credit contract as the exercise of right or power under the contract.[20]

Section 124 directs the Court in considering a reopening to have regard to "all of the circumstances relating to the making of the contract … or the exercise of any right or

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[15] Sections 60 – 83.
[16] Sections 84 – 116.
[17] Sections 117 – 131.
[18] Section 117(a).
[19] Section 7.
[20] Section 121.

power … or the inducement to enter the contract"[21] and particularly whether the amount payable by the debtor, or the time given to the debtor to remedy a default,[22] or a refusal by the creditor to release part of the security, is oppressive.[23] The matter of relevance to today's subject is the definition of "oppressive", in s 118, as:

> oppressive, harsh, unjustly burdensome, unconscionable, or in breach of reasonable standards of commercial practice.

This definition, and the other provisions about reopening of credit contracts, have actually been brought forward from legislation first enacted in 1981.[24] This suggests that Parliament must have been content when it passed the new Act in 2003 with the relatively limited scope of judicial intervention under the 1981 Act. However, under the new Act an application can now be made by a regulator, the Commerce Commission, as well as by someone claiming to be a victim of oppressive conduct.

Because unconscionability is only one possible aspect of oppressive conduct under this Act, it seems fairly clear that in this statutory context it does not have to be restricted as it is in equity. For example, in equity it is necessary to show that the defendant was aware, or at least should have been aware, of the plaintiff's significant disability. But under the statute it may well be enough, to show oppression in the form of unconscionability, that there was such a disability and that the bargain was unfair. I do not mean to suggest, however, that a mere showing of unfairness is going to amount to oppression. It is plain from the case law that is not the position.

The first case on the 1981 provisions, *Italia Holdings*,[25] is the one most frequently cited, albeit it was at first instance. It involved the making of a loan to a property developer on condition that the borrower should purchase two properties from the finance company. The Court found this was not oppressive – nothing more than the ordinary give and take and bargaining inherent in commercial transactions generally. The borrow/developer had expertise and had access to independent legal advice. The Judge said that there had to be some real detriment or hardship involved before there

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21 Section 124(a).
22 Section 124(b)(i).
23 Section 124(b)(iv).
24 Credit Contracts Act 1981.
25 *Italia Holdings (Properties) Ltd v Lonsdale Holdings (Auckland) Ltd* [1984] 2 NZLR 1 (HC)

could be said to have been oppression. The fact that the performance of the contract created difficulty for the plaintiff was insufficient. Injustice had to be shown to exist as well.

A case which went the other way was *Elia v Commercial & Mortgage Nominees Ltd*.[26] It involved a middle-aged Cook Islander with limited English and little or no business experience who was persuaded to render himself responsible for loans made so that his new de facto partner could acquire a business, which ultimately failed. He mortgaged his house to provide part of the security. He did get half the shares in the new business but it was never viable. The Court found that Elia had not understood the commitments he was making and had not received independent advice because the solicitor assigned to act for him was also the solicitor for the financiers. They had taken advantage of him. Gault J found that unconscionability was proved so that it would be inequitable to allow the securities to be enforced against Elia. And, if need be, he would also have found statutory oppressiveness justifying re-opening of the loan contracts. They were set aside.

In one of the few cases in which the Court of Appeal has considered what is oppressive, *Greenbank New Zealand Ltd v Haas*,[27] Tipping J said this for the Court:

> The various words which together form the definition of the term "oppressive" all contain different shades of meaning but they all contain the underlying idea that the transaction or some term of it is in contravention of reasonable standards of commercial practice. In a sense that phrase gives the underlying commercial rationale for the earlier words or phrases. Something which is, for example, unjustly burdensome must necessarily be regarded as being in contravention of reasonable standards of commercial practice; similarly with something harsh. To determine whether a contract or term is oppressive within any of the words or phrases in the definition, it is necessary to have some basis of comparison. In the context the comparator can only be what would be expected or acceptable in terms of reasonable standards of commercial practice. Something which is in accordance with such reasonable standards could hardly be held to be oppressive. Conversely something which is not in accordance with (i.e in contravention of) such standards is, by definition, oppressive.

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[26] (1988) 2 NZBLC 103,296 (HC).
[27] [2000] 3 NZLR 341 (CA).

Greenbank v Haas concerned a very short-term unsecured loan to fund a 10% deposit on a land purchase by a company called Transworld for over $1 million which promised to be very lucrative for the purchaser. It would miss out on the opportunity if it could not fund the deposit. The loan contract provided for a rate of interest which was not abnormal, but there was also a finance fee of $45,000 and, when this was added in, the overall cost of finance for Transworld was 217.3% pa! Nonetheless, the Court found that oppression was not proved. It recognised that the venture had elements of profit-sharing, with the financier putting up a vital sum of money to pay the deposit and Transworld getting the advantage of the profit which it expected to derive from the resale of the land. There was no suggestion that the financier had taken advantage of difficulties Transworld was already in, save for its inability to finance a venture which it saw as profitable. There was no basis in the evidence for saying that the financier was not entitled to some premium by way of fee to reflect the nature of the transaction and the risks it was taking as an unsecured lender.

In a later case, *Raptorial Holdings Ltd v Elders Pastoral Holdings Ltd*,[28] the Court stressed that standards of commercial practice must be reasonable and, if they are not, they may be rejected as a valid basis for determining whether the transaction in issue is oppressive.[29]

Turning to statutory unconscionability in Australia, I confess I feel rather inhibited in commenting as the provisions are new to me and it is apparent that even those with years of experience with them are struggling somewhat to see where the courts are going or even where the legislators may have intended them to go.

I was intrigued to learn that your present Chief Justice has in an earlier life flirted with the notion that a special disadvantage could possibly arise just from circumstances, without the party who claimed to be suffering from a disadvantage being able to point to any personal characteristic like limited intellectual ability or education. If that approach came to be followed, it could mean that there would be great uncertainty

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[28] [2001] 1 NZLR 178 (CA).
[29] At para [56].

whenever a banker or other financier was asked to fund someone already in financial trouble. Could it later be claimed that particular securities or guarantees were only given at that time because of a special *situational* disadvantage making the taking of them unconscionable? Similarly, it would be very tricky advising a financier on calling up an advance or on enforcement of a security because of a situational disadvantage arising from insolvency of the borrower, regardless of whether there was some contributing infirmity or special weakness.

Merely to state this problem is perhaps to demonstrate how unworkable the concept of situational special disadvantage could be. I might have some difficulty in accepting, if I were a Judge in Australia, that legislators enacting the Australian statutory unconscionability provisions ever intended them to apply so broadly – so far beyond the metes and bounds of equitable unconscionability.

I suspect I would be in the camp of Gleeson CJ when in *ACCC v CG Berbatis Holdings Pty Ltd*,[30] as Professor Horrigan points out, the former Chief Justice warned against allowing situational disadvantage to take on a life of its own that might go too far beyond what existing equitable doctrines allow. Surely the concern to which the statutory provisions are broadly addressed is the protection of those who are vulnerable because of their personal weaknesses, not those who have chosen to fight a commercial battle and take commercial risks with their eyes open and ended up on the losing side. The consequences of losing may be hard, but such is the nature of capitalism. There will be winners and there will be losers. Any attempt by sympathetic Judges to mitigate the consequences for the losers, particularly at the expense of those whose role is merely to provide funding, might be productive of great mischief. Misplaced sympathy may have its own unintended consequences which I do not need to spell out to an audience of banking lawyers.

For these reasons, I would be supportive of what Professor Horrigan has called the "very clear conventional line" between, on the one hand, relief based on a disability which has the effect that someone cannot make a decision in their own interests and, on the other, a disability which affects only their power to act in their own interests

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[30] (2003) 214 CLR 51.

because of some commercial constraint. A disability arising from impecuniosity may straddle this line, however, and there perhaps interesting case law may emerge.