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Précis Paper

The banker-customer relationship

A discussion about the recent decision of *Gooley v NSW Rural Assistance Authority* [2020] NSWCA 156

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The banker-customer relationship

In this edition of BenchTV, Justin Bates (Partner, Dentons Australia, Sydney) and Timothy Castle (Barrister, 6 St James Hall, Sydney) discuss the recent decision of *Gooley v NSW Rural Assistance Authority* [2020] NSWCA 156

Overview

1. The case examined all aspects of what happens in a banker-customer relationship, essentially from inception when the borrowers refinanced from their prior bank through a series of variations, through to expiry of the loan and ultimately to litigation
2. The bank was ultimately successful both before the trial judge, Justice Parker and in the Court of Appeal.

The 2008 variation to the contract

3. In terms of the contract, the bank refinanced and offered their customer a 15-year loan facility with the first five years being interest only and the last ten years being interest and principle repayments.
4. In or around 2008, there was a flood at the farm and the customers required some disaster relief funding. The funding was forthcoming however it required a second mortgage.
5. As part of receiving consent of the bank for the second mortgage, the bank shortened the loan term to five years. This was done by way of a letter of variation, which was signed by the customers however the witness section was missing. There were also subsequent letters of variation which confirmed the loan term was five years
6. The customers seized upon the fact that the execution on the variation letter was not done in accordance with normal practice. This opened the door for them to make allegations which they claimed that they had signed different documents to the ones that the bank was presenting.
7. The bank was in a position of having to establish that the loan term had been varied back to the five years. This became significant as when the bank indicated that the loan term had expired at the five-year mark, the allegation made by the customer was that the loan had not expired and that there remained an unexpired ten-year principle and interest period
8. The critical question was what was the true status of the contract between the bank and the customer at the end of the five-year mark?

Legal Principles

9. The primary legal question in this matter was what does a variation of contract really mean as a matter of law?
10. There is an authority in a decision called *Hillam v Iacullo* [2015] NSWCA 196 that says where there is a subsequent document that varies an earlier document, one must analyse what that subsequent document does; whether it replaces the earlier document so there is a recission of the earlier agreement or whether the earlier agreement continues to have some significance and both documents are to be taken together.
11. In the present case, the language in the bank's document used the specific word that the terms of the facility agreement replace all other prior agreements.
12. There was also a question about consideration. The argument was put by the borrower that they received no consideration for the variation of the loan term. However, the decision in *Cellarit Pty Ltd v Cawarrah Holdings Pty Ltd* [2018] NSWCA 213 says that consideration can be found in mutual promises in a variation agreement. More than that, in this case the variation of the term from 15 years to 5 years was something that could have benefited either the bank or the borrower at the time the loan was entered into.
13. The bank proposed that the benefit to the borrowers was when the five-year mark came up it may give the borrowers an opportunity to enter into another five-year interest only period rather than straight to principle and interest. The borrowers argued that there was some certainty in having a 15-year loan.
14. Both Justice Parker and the Court of Appeal took the view that because the situation at the end of the five-year mark was uncertain as to who it would benefit, consideration had been provided.
15. Once one can establish that there was an agreement, there is no onus on the bank to prove offer, acceptance, consideration as per objective theory of contract in *Taylor v Johnson* (1983) 151 CLR 422.

<u>Negligent lending claim</u>

16. There was a proposal from the bank's customers to acquire further property. At that time, the customers were carrying on a cattle business and had certain forecasts which they were putting to the bank.
17. The bank was being asked to fund the acquisition of a property which was partly owned by one of the two customers and it was one of the transactions that that decision to lend which was challenged in this case.
18. The allegation here concerned the banking code of practice, clause 25.1 which was in effect a negligent lending claim. The relevant provision in the banking code requires the bank to exercise due skill and care in two respects.
19. The cases of *National Australia Bank Ltd v Rose* [2016] VSCA 169, *Sam Management Services v BankWest* [2009] NSWCA 320, *Marsden v DCL Developments Pty Ltd* (No. 3) NSWSC 1795

and *Doggett v Commonwealth Bank of Australia* [2015] VSCA 351 all look at the negligent lending term in the contract.

20. *Doggett v Commonwealth Bank of Australia* [2015] VSCA 351 was a case in which a bank officer made an error in the information that he had taken into account in assessing whether or not to lend money. His customers were making a transaction to acquire a motel on the Gold Coast in QLD and that hotel was being operated by an owner-manager. The bank's customers were going to appoint their own manager to the business and remain and reside in Melbourne. The bank and the customers did not realise that because there was going to be a manager appointed to the business, there was going to be an additional layer of expense. This additional layer of expense changed the business in terms that it was no longer sufficiently profitable to be able to repay the loan. This was enough for the judge to find that the bank had not properly discharged its obligations under the code of banking practice when assessing the loan.
21. The question was whether by reason of the error, money was advanced when, if the error had not been made, there would have been no loan.
22. In *Haynes v St George Bank a Division of Westpac Banking Corporation; Haynes v Westpac Banking Corporation* [2018] SASCFC 51, the Full Court noted that this serviceability criteria in the banking code does not require the bank to form a view that there will be no default. That is, the bank by lending money is not guaranteeing that the customer will be able to repay it in all circumstances. Although questions of default and the likelihood of default will be a relevant consideration.
23. In the present case there were two issues to take into account for credit officers; the first is the borrower's 'ability to repay'. The argument was that there was no possibility that the customers could repay the whole of that loan on the expiry date of two years.
24. The Court said that that was not the correct approach and the correct approach is to look at what can be done on repayment date, for example, is refinancing an option for the borrowers?

<u>Notional 15-year term</u>

25. The notional 15-year term was the way in which the bank went about assessing whether or not there was sufficient capacity to repay. Internally, as part of its assessment process, the bank forecast over a 15-year period, even though it was notional as the loan was set to expire in two years
26. The bank looked at based on the customer's forecast of profit from cattle farming whether there was enough income to repay the loan over the 15 years. This was subject to some criticism by the customer as they only applied for a two-year loan.
27. What was explained in the evidence was that the 15-year notional term was a rule of thumb.

28. This shows that it is important for credit officers to explain what they have done and why they have done it. It also shows that it is important to have these things set out in appropriate documentation that will back up the credit officer.

Asset lending

29. There was also an allegation of asset lending in relation to that same two-year loan. That was an allegation that the customers could not afford to repay the loan. The Court dealt with that allegation fairly briefly. The law is relatively clear in regard to pure asset lending as described in *Perpetual Trustee Company v Khoshaba* [2006] NSWCA 41. Pure asset lending is in effect where there is no realistic prospect of the loan being repaid other than from the sale of the asset and is generally argued as unconscionability
30. This was argued as an unconscionable conduct claim however the customers had a business and a business plan; the information provided to the bank showed the ability to service the loan, there was the prospect that in the second year of the business there would be significant free cash available. It was not a case that conformed to pure asset lending criteria.

Customer's return to the bank

31. In 2011, there was a sharp fall in the price of cattle and the customer returned to the bank to lend more money for working capital purposes. The customers requested further funding. As part of that process, they showed their accounts and revealed that they had a large outstanding debt to one particular company that was providing them with finance so that they could assist with purchasing their capital.
32. Around mid-2012, the bank decided to refer the file to Sydney for a closer examination of the state of play relating to the customer's performance and ultimately the customer's request for finance failed. This caused the client to complain and make a claim that it was unconscionable on behalf of the bank to withhold such finance.
33. The legal allegation concerned two other provisions in the code of banking practice;
    a. Clause 2.2 says that the bank will act fairly and reasonably towards the customer in a consistent and ethical manner and in doing so will consider the customer's conduct, their conduct and the contract between them
    b. Clause 25.2 says with the customer's agreement they will try to help them overcome financial difficulties with any credit facility they have with them

What does the banking code do?

34. The banking code does not require the bank to lend money to bail out the customer or to help the customer who is in financial difficulty.

35. The case of *Marsden v DCL Developments Pty Ltd (No. 3)* [2016] NSWSC 1795 highlights some of the pitfalls in this area. This case involved a farming enterprise and the farmer was after further funding to keep the business going. The case highlights the decision that the bank has to make at that point; whether they keep lending to the customer to try to support them through the period of financial difficulty or whether they stop lending and look to possibly making an external appointment.
36. If the courts are going to be critical to banks who lend to distressed customers, then it is likely that there will be more formal appointments made and the banks will be too nervous to lend when the capacity to repay is not as clear as they would otherwise like.
37. One of the issues that was raised in this case was the lack of documentation of the steps that were being taken. As such, it is important for banks to have a clear document trail.

The Credit Code

38. Section 77 of the National Credit Code provides a remedy which the borrowers were asking for in this case. The remedy, they claimed allowed them to have a fairly wide ranging opening up of the credit contract. The precondition to that is a hardship notice. There was a question whether there was an actual hardship notice here.
39. The fundamental question however in regard to any case is whether the credit code applies.
40. There is some authority about when the credit code applies. Section 5 of the National Credit Code dictates that it applies to all credit unless it is for a purpose other than domestic, personal and household and there is an objective threshold test.
41. In this case, one of the issues that came up was that there was no business purpose declaration that was available other than in respect of the last of the variations.
42. The case of *Haynes v St George Bank a Division of Westpac Banking Corporation; Haynes v Westpac Banking Corporation* [2018] SASCFC 51 represented a case where there is a mixed use. In that case, there was a gentleman who purchased a daffodil farm and a residence and the question was whether it was a retirement project at his home or was it a hobby farm and the housing on it was incidental to the business purpose. The South Australian Full Court noted that one has to look at all the evidence. In that case, the critical evidence was that the gentleman had claimed tax deductions for many things to do with the farm which led the court to find that as a matter of fact, it was business credit not consumer credit. This case shows the importance of getting declarations signed.

Farm Debt Mediation Act 1994 (NSW)

43. In this case the bank had made a demand to be repaid before it went through the Farm Debt Mediation process and it had also tried to enter into a forbearance type arrangement.

After it did this, it decided to issue the formal notice which triggered the Farm Debt Mediation process.

44. Based on this case, where one is simply crystallising their rights with a claim in debt either by a letter of demand or a statement of claim to recover the debt, rather than taking action in respect of the mortgage, it will not be considered to be enforcement action.
45. The High Court in *Waller v Hargraves* (2012) 245 CLR 311; [2012] HCA 4 made some comments in relation to this however they still remain to be tested in an appropriate case. As such one must be careful about the potential reach of the *Farm Debt Mediation Act* 1994 (NSW).
46. One of the arguments that was put is that if the *Farm Debt Mediation* Act 1994 (NSW) is given too broad a reach and includes enforcement action, it captures not only actions that could touch the property but also actions in respect of the debt, it may have the unintended consequence of bringing Farm Debt mediations too early in the process.

BIOGRAPHY

Justin Bates

Partner, Dentons Australia, Sydney

Over the last 25 years, he has acted predominately for secured lenders, banks and receivers. He has also acted for liquidators, trustees in bankruptcy, security trustees and company administrators in a wide range of matters concerning external administrations and distressed debt. He has conducted cases involving questions of banking practice, company law, professional indemnity insurance, misrepresentation, fraud and property law. Very often Justin's cases are conducted in the NSW Supreme, NSW Court of Appeal and the Federal Court of Australia.

Timothy Castle

Barrister, 6 St James Hall, Sydney

From 1992-2007, Tim was a barrister at Seven Wentworth Chambers for over 15 years and appeared in a number of leading corporate disputes including the Superleague case, *Hungry Jacks v Burger King*, and the C7 Dispute for Telstra. Prior to that, Tim was a commercial litigation solicitor at Mallesons Stephen Jaques, now King & Wood Mallesons.

Prior to returning to the Bar in 2013, Tim practiced as a partner at specialist corporate law firm Atanaskovic Hartnell, was a Senior Executive Leader in Financial Special Deterrence at ASIC, in-house Counsel at Competitive Foods Australia Pty Ltd, one of the largest restaurant franchisees in Australia, and had a range of other roles whilst acting as a solicitor in his own practice.

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