Précis Paper

Banking Guarantees – the Ankar Principle

Bank loans, bank guarantees, enforceability and the Ankar principle. A useful discussion lead by Philip Clifford who is well experienced.

<u>Discussion Includes</u>

- What do bank guarantees typically provide regarding further loans and variations?
- What is the general law regarding a surety being bound by variations between the lender and principal debtor?
- What is the Ankar principle?
- What questions of burden of proof arise under the Ankar principle?
- What lessons should banks draw from this case?

Précis Paper

Banking Guarantees – the Ankar Principle

1. In this edition of BenchTV, Philip Clifford (Barrister) and Ian Benson (Solicitor) discuss the recent decision of the Western Australian Court of Appeal (McLure P; Buss & Murphy JJA) in *Australia and New Zealand Banking Group Ltd v Manasseh* [2016] WASCA 41. The case considered the enforceability of a guarantee where a replacement for the underlying agreement is entered into without the guarantor's consent. Mr Clifford appeared for the successful respondent in the Court of Appeal.

<u>Background</u>

2. The case was a fairly standard set of facts in the banking and finance, and property development industries. A corporate entity wanted to develop land for living units, a shopping complex and a hotel. The corporate entity approached ANZ which provided $10m for the acquisition of the property, the construction of the units and the sale or lease of the units/shops. When the project commenced, it had been given a valuation for return on investment purposes of $20m to support the borrowing of $10m. The acquisition price for the land was $5m.

3. As is usually the case, the bank asked for guarantees from the directors of the corporate borrower. The directors gave the guarantees. Mrs Manasseh was a director and the wife of another director. It was not her principal income to be a property developer. The bank took the guarantees and as security for that guarantee the bank took a mortgage over the matrimonial home of Mr and Mrs Manasseh. Significantly for the proceedings which later ensued, the terms of the guarantee did not extend to "any new or replacement arrangements" unless the guarantor had given consent.

4. The complicating factor in this commercial relationship, as well as countless others, was the onset of the Global Financial Crisis, which made the project non-commercial. The value that had been given to the land, units, shops and trading was reduced to a point where the bank felt that the original purpose of the loan would not be achieved. It also became clear that the project would not be completed on time.

5. As a result, the bank took steps to alter the basis upon which the loan was given. This included adjustments to the terms of the loan agreements with confirmation being sought from the guarantors for the changes. This first set of changes was approved by the guarantors, which included increasing the monies made available to the corporate entity by $401,000 and extending the time for repayment by 6 months. Rather than seeking a new

guarantee for this second loan agreement, the bank sought an approval for the change. Mrs Manasseh along with the other guarantors gave their approval.

6. Six months after the approval of the second agreement it became clearer that the project would not be profitable. The bank and the borrower entered into further negotiations to increase the size of the loan by $200,000-$300,000 and sought to extend the time for repayments of the loans. Over 9 months, there were 5 or 6 proposed amended loan agreements, none of which were accepted by the corporate borrower and none of which Mrs Manasseh responded to. Thereafter, there was an agreement between the corporate borrower and the bank to enter into a third loan agreement. The bank then wrote expressly to Mrs Manasseh as guarantor and asked her to consent to guarantee the “new” arrangement. The word “new” appeared in the covering letter but did not appear in the agreement itself. Mrs Manasseh wrote back to the bank and refused to consent to guaranteeing the third agreement, giving reasons. The bank, notwithstanding the express refusal from Mrs Manasseh, ‘completed’ the third agreement by lending the additional money.

7. Ultimately, the bank moved upon the corporate borrower by appointing liquidators. Pursuant to its security, the bank sold the development property, leaving a shortfall on the loan agreement of $7.5m (although on one argument it was alleged to be as high as $11m). Mrs Manasseh wrote to the bank and expressed her view that her guarantee did not apply to the final loan agreement because it was ‘new’ within the meaning of the guarantee. Alternatively, by reason of the Ankar principle (see more below), Mrs Manasseh argued that the guarantees had been discharged as a matter of law. She then asked the bank to remove the securities that the bank had over her matrimonial home. The bank refused and negotiations ensued for 14 months, without an agreement being reached.

8. Mrs Manasseh then sued the bank and made 3 allegations. The first two were as above. First, she alleged that the terms of the initial guarantee required her to consent to guarantee any ‘new’ agreement, which she did not provide in relation to the third agreement. Second, if she was wrong on the construction of the guarantee, the guarantee should nevertheless be discharged by applying the Ankar principle. Third, if wrong about both, Mrs Manasseh sought relief under the Australian Consumer Law, alleging that the bank had engaged in misleading and deceptive conduct. This claim was based on the fact that the loan agreement stipulated a ‘termination date’ (that had already been reached), which she felt represented to a reasonable person that the guarantor’s obligations ceased where that date was reached and no claims had been brought. The misleading and deceptive conduct claim will not be the focus of discussion in what follows.

The Ankar Principle

9. The general law regarding whether a surety is bound by a variation agreed between the principal debtor and lender is determined by the Ankar principle from *Ankar Pty Ltd v National Westminster Finance (Australia) Ltd* (1987) 162 CLR 549.

10. Under the Ankar principle, where the underlying liability guaranteed is altered or varied without consent, the guarantor is discharged from the guarantee unless the change is unsubstantial and not prejudicial or the guarantee expressly permitted the variation. Significantly, to rely on the guarantee the bank has the burden of proof of establishing that the change to the underlying liability was unsubstantial and was not prejudicial. Moreover, guarantees are construed strictly in favour of the guarantor as distinct from all other contracts.

11. It should also be noted that there are generally two types of guarantees. The first type of guarantee involves a guarantee that the borrower will perform according to the terms of the loan agreement, which requires close attention being paid to the loan agreement and the guarantee. The second type of guarantee involves a guarantee of the repayment of all monies owing by the borrower to the lender with no consideration of its origin, source or purpose. Where the guarantee is an all-monies guarantee, the Ankar principle may or may not apply and according to *Commonwealth Bank of Australia v McArthur* [2003] VSC 31 the bank tends to be in a stronger position than the borrower. In *Manasseh*, it was determined that the guarantee was of the first type although an argument was made that it was an all-monies type.

Legal Issues in the Proceedings

12. Aside from the misleading and deceptive conduct claim, the questions for the court were whether the final agreement was in fact 'new' for the construction argument or whether despite being a variation or alteration it was prejudicial or substantial per the Ankar principle, and thus the bank could not rely upon the guarantee.

13. It was noted by the presenters that the resolution of these questions required a consideration of the surrounding circumstances of the contract in light of the decision in *Codelfa Constructions Pty Ltd v State Rail Authority of NSW* (1982) 149 CLR 337.

The Trial

14. At first instance, McKechnie J in *Australia and New Zealand Banking Group Ltd v Manasseh* [2015] WASC 34 determined on the construction point that the new or replacement

agreement was separate and distinct from the original agreement. This finding was largely based on his Honour placing emphasis on the covering letter from the bank noting that 'attached was a new agreement'. As the final agreement was 'new' and because Mrs Manasseh had not consented, the guarantee did not apply and it was found that the mortgages should therefore be discharged.

15. McKechnie J also found that there had been changes to the original agreement that Mrs Manasseh had guaranteed and that those changes were not unsubstantial or were prejudicial. By reason of that, the Ankar principle also applied to discharge the guarantee.

16. On the other hand, his Honour dismissed the misleading and deceptive conduct claim on the basis that it would have made the guarantee unworkable if it expired on the termination date of the loan agreement. Mr Clifford considered that the trial judge had approached this claim from the perspective of a lawyer and not from the perspective of a reasonable person, as was required per *Forrest v Australian Securities and Investments Commission* [2012] HCA 39.

On Appeal

17. Both the questions regarding the upholding of the guarantee and those relating to the misleading and deceptive conduct claim were taken to the Court of Appeal.

18. The appeal court determined that it was a new loan agreement, not by reference to the accompanying letter but by reference to the substance of the terms of the final agreement. A close consideration of the substance of both agreements was also necessary to decide whether the changes were not unsubstantial or not prejudicial for the Ankar point. The Court ultimately decided that the subsequent agreement was both 'new' and involved prejudicial or not unsubstantial changes by taking into account the following considerations:

   a. First, the <u>extension of time for repayment</u> was not unsubstantial.
   b. Second, an <u>increase of the amount of the loan agreement</u> when compared to the original amount (i.e. the increase of $300,000-500,000 in $11m) was not unsubstantial.
   c. Third, the <u>terms</u> of the underlying loan agreement had been altered. The interest payable under the original loan was capitalized to be repaid at the end of the venture from sales. Under the final agreement, the interest was payable on an interim basis and the amount of the interest was increased. Accordingly, if the interest was not paid on the interim basis the loan agreement would more quickly fall into default and would be for a greater amount and the bank had not shown that to be not unsubstantial and not prejudicial.

d. Finally, the purpose of the loan changed not unsubstantially. Originally, the purpose was to acquire the land, build the structure and sell the units but the final agreement was for the purpose expressly of giving breathing space to the company to sell the project, land or the venture without building on it.

19. Mr Clifford argues that these considerations of alterations to the time for repayment, the size of the loan, the payment of interest and the purpose of the loan are relevant indicia in other cases for determining whether an alteration creates a 'new' agreement or whether the Ankar principle applies.

20. Although it was strictly unnecessary for the Court of Appeal to determine the misleading and deceptive conduct issue, the judges expressed a view in support of the trial judge's ruling dismissing the claim. Mr Clifford again argues that this result conflicts with the decision in *Forrest*.

Implications

21. Banks should be very careful about paperwork and resources by virtue of the special legal status that guarantees have regarding the construal of ambiguities being in favour of the guarantor. The care that the bank should take is largely internal to the bank. That is, if it wants the guarantees to apply, regardless of the type, the paperwork must be consented to and perhaps a new guarantee should be sought in respect of every alteration to an agreement.

22. Furthermore, when a bank is going to vary or change an underlying agreement, the bank should strictly check the express terms of guarantees to ensure this does not result in their discharge.

BIOGRAPHY

Philip Clifford

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Philip Clifford practised as a lawyer in WA and NSW before he joined the WA Bar in 1995. His areas of practice include building and construction law, commercial law, coronial inquiries, equity, insolvency, mining law and trade practices.

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Focus Case

Australia and New Zealand Banking Group Ltd v Manasseh [2016] WASCA 41

Benchmark Link

https://benchmarkinc.com.au/benchmark/composite/benchmark_14-03-2016_insurance_banking_construction_government.pdf

Judgment Link

http://decisions.justice.wa.gov.au/supreme/supdcsn.nsf/PDFJudgments-WebVw/2016WASCA0041/%24FILE/2016WASCA0041.pdf

Cases

Ankar Pty Ltd v National Westminster Finance (Australia) Ltd (1987) 162 CLR 549
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Legislation

Competition and Consumer Act (Schedule 2 – Australian Consumer Law) 2010 (Cth)