CBA/BankWest unconscionability and the courts

By Evan Jones - posted Thursday, 18 July 2013

Rory O'Brien is one of hundreds of BankWest small business customers (mostly developers or hoteliers) foreclosed after the Commonwealth Bank of Australia bought BankWest from the failing HBOS in December 2008.

Public hearings in August 2012 during a Senate Economics Committee Inquiry brought statements from bank representatives and selected foreclosed customers, exposing the dissembling of the former and the extent of the suffering experienced by the latter.

The media have universally declined to probe the extent and character of the takedown – save for an ABC 4 Corners program on 9 April 2012.

The Senate Inquiry, initiated by National Party Senator John Williams following BankWest victims' pressure (and whose Terms of Reference was subsequently diluted), produced a hollow report in November 2012 that would have bank executives clinking their champagne glasses. Indeed, CBA Chief Counsel David Cohen is brandishing the Report as legitimising the bank's position.

Thus the foreclosed customers face litigation in the court system, a system long prejudiced against bank victims. Against this backdrop, BankWest took developer Rory O'Brien to court on 2 May 2012, seeking a summary judgement to reclaim a debt contracted at $176 million.

O'Brien had built a luxury resort development at Whisper Bay, Airlie Beach in Queensland, with its BankWest valuation at one stage conservatively placed at $250 million. The resort was close to completion, with over $100 million presales contracted, when BankWest declined to turn over the debt in January 2009. O'Brien was foreclosed in April 2009. KordaMentha was given the receivership (Mark Mentha fronted for the banks on the 4 Corners program).

KordaMentha sold the resort in August 2010 to bottom feeder David Marriner for a mere $56 million. The pre-arranged sales were discarded. In January 2011 BankWest sought payment from the guarantors of the residual debt, spawningthe bank-driven litigation of May 2012.

The judgement of McDougall J is dense with tortured minutiae on the law of contract. But the essence can be found buried in the dross.

The brutal contract that O'Brien signed in October 2006 includes the clause: 'All money payable by the Borrower under this document must be paid in cleared funds without set-off or counter-claim and free of all deductions as and where the Lender directs …'. For the benefit of us legal outsiders, the provision is termed a 'suspension' clause. Such are accompanied by 'preservation' clauses that preserve bank claims regardless of what other actions the bank takes.

McDougall had before him some counter claims, including:

> *(2) that the bank had made various representations to the borrower and the guarantors, the effect of which was that the bank would roll the debt over after 15 January 2009, on which representations the borrower and the guarantors relied, to their detriment, by not seeking alternative sources of funding*

McDougall decided for the bank, with an extempore judgement. McDougall claimed that the suspension clause is a rock solid principle – citing himself as precedent. O'Brien's claims that 'the bank engaged in misleading or deceptive conduct, acted unconscionably … and acted in breach of contract' were thus irrelevant.

McDougall is saying to O'Brien and his partners – pay back the contracted loan debt and pursue a counter claim later. Of course, O'Brien doesn't have a spare couple of hundred million because the bank has relieved him of his key asset and sold it under value. Moreover, there would be no counter claim by O'Brien because he would bankrupted by the bank post haste.

McDougall also claimed that most of what has come before him is irrelevant. The contract stipulates that the loan is due on 15 January 2009. That date passed, and the loan becomes due. End of story.

The McDougall judgement is a shocker – high farce in one act. Ironically, the hearing and judgement took place within the Equity Division of the NSW civil court system – a linguistic joke understood only by the legal profession.

O'Brien appealed, and his case came before Beazley, Macfarlan and Ward JJ on 31 January 2013. The judgement came down on 11 April. Lo and behold, the Appeal Judges decided for O'Brien.

This is a miracle. Generally judges decide for the bank as a matter of course. On my estimation, only two cases have been decided for the bank customer since four foreign currency loan cases were decided for the customer in 1990-91 (Quade v CBA; Chiarabaglio, Spice & Ferneyhough v Westpac). Not counted are 'disability' unconscionability cases (guarantor is non-English speaking or uninformed wife) – Garcia (1998), Petit-Breuilh (1999), Ashton (2001), all against the NAB – for which there is unshakeable legal precedent. And the two victorious cases were either partial (Kay v NAB, 2010) or ephemeral (NAB v McCall, 2011). That is 22 years of Buckley's chance for a bank victim seeking justice in the courts.

But here we have a unanimous decision against the bank, with costs. Some salient quotations from the judgement:

> *3(c) Powers to summarily terminate proceedings must be exercised with exceptional caution. …*
>
> *68 The issue, therefore, in the present case is whether … there is an underlying defence that has a real (or more than a fanciful) prospect of success. If so, then summary judgment should not have been given in favour of the Bank.*
>
> *38 The Guarantors contend that representations were made both to the borrower and to them (and both before and after 15 January 2009) that the Bank would roll-over the facility and would advance further funding to the borrower to allow the completion of the development. They contend that (to the Bank's knowledge) they (and the borrower) had relied to their detriment on those representations by not making arrangements to secure alternative funding. The Guarantors further allege unconscionable conduct on the part of the Bank, in taking the steps that it did in relation to the non-payment of moneys payable under the facility agreement, by reference to both equitable and statutory concepts of unconscionability …*
>
> *112 In Bitannia Pty Ltd v Parkline Constructions Pty Ltd (2006) 67 NSWLR 9; [2006] NSWCA 238, Hodgson JA, at [8] noted that s 52 of the Trade Practices Act (Cth) disclosed a legislative intention that persons should have a remedy to protect them from (or to recover compensation for) damage from the misleading conduct of a corporation and it would not be in accordance with that intention to permit a corporation to obtain judgment on a cause of action one essential element of which had been created by the corporation's misleading conduct. …*

The bench agrees with the victim appellants. There is the claimed promise of rollover, which must be tested. And there is the claimed unconscionability, which must be tested independently. The supposedly sacrosanct suspension/preservation clauses are overturned. More, the judges' authority is drawn from precedent and from the ASIC Act, an Act that ASIC itself declines to administer.

Yet all this weighty deliberation takes place in the abstract – the judgement is made on technicalities. But what do we have here?

> *122 … the Bank [is claimed to be] in breach of express or implied terms of the facility agreement precluding the Bank from exercising its powers contrary to good faith or for a collateral purpose. The allegation by the Guarantors is that the Bank took these steps at the direction of a third party (in order that there might be a reduction in the price to be paid for the acquisition of the Bank).*

The judges acknowledge that something unusual might be afoot. The 'third party' is the CBA itself, the instigator of the takedown of the borrowers, via its placing of its man Jon Sutton to oversee the process at its subsidiary BankWest.

On 7 May, the law firm acting for the CBA, Ashurst Australia, issued a document titled 'The rise and fall of suspension clauses'. Notes the Ashurst Partners:

> *Summary judgments or 'strike outs' refer to judgments which are given purely upon the pleadings which have been filed by the parties and before either party has had the opportunity to test the evidence which has been filed in the proceedings. From a financier's perspective, a summary judgment (in appropriate circumstances) can be a very effective tool for obtaining judgment quickly and efficiently against a customer or a guarantor for an outstanding loan.*

Excellent – we can win the day with no evidence being heard. Ashurt concludes its missive:

> *The judgment given in O'Brien has important consequences for financiers and the way in which debts can be recovered from borrowers and guarantors. … we anticipate that borrowers and guarantors will now ensure that they plead defences which seek to challenge and attack the underlying debt said to be owing to the financier.*

There is something rather hysterical about the Ashurst document. Ashurst can't grasp that unconscionable conduct might exist or be relevant in a court proceedings brought by a bank against its hapless customer.

O'Brien's legal team intends to sue the bank for breach of contract and to seek document discovery regarding the possible existence of a 'claw back' arrangement – any deal that linked the purchase price of BankWest to the quantum of bad debt loans that CBA subsequently 'found' on BankWest books.

It is evident that there will be no one-liner smoking gun. A document submitted to the Senate Estimates Committee on 4 June analyses the fragmentary information publically available from financial reports of the CBA, BankWest and HBOS. The paper estimates (from the HBOS reported loss of £845 million) that the book value of BankWest at time of acquisition was $4.25 billion. The CBA reports BankWest's 'provisional fair value' in its 2009 report as $3.7 billion. The agreed price was $2.428 billion and the price paid $2.1 billion (the residual remained unpaid). The paper estimates that the CBA planned for $2.15 billion in loan impairments, of which $1.28 billion were designated as pre-acquisition impairments, and $867 million in post-acquisition impairments (i.e. between 19 December 2008 and 30 June 2010). Impairment totals were deducted from BankWest's profits, generating a reduced tax bill, even though the impairments had contributed to the discounted price.

In essence, the so-called 'clawback' had already been achieved in the heavily discounted purchase price, with an insignificant (publicised) post-purchase adjustment. The massive impairments were manufactured to legitimise the purchase price, and perhaps to keep the bank's capital adequacy ratio (capital to risk weighted assets) under the regulatory radar.

More, the CBA gouged revenue by manufacturing debt in the form of penalty interest rates, from fraudulently appropriating customer assets that secured bank debt, from corruptly appropriating customers' other financial assets, from illegitimately claiming tax deductions on manufactured impairments, and by suing guarantors. In the long run it is not improbable that the CBA will have acquired BankWest for effectively close to nothing.

Disclosure of the bank's procedures would impale CBA Head Office, and clear the way for restitution and compensation for the estimated 1000 victims, but O'Brien's case doesn't depend on the bank's motives in this case. The unconscionability is transparent.

The CBA is refusing to pay O'Brien's costs, dictated by the Appeal judgement. The CBA evidently sees itself as above the law, a reasonable presumption to date.

The CBA is currently embroiled in a scandal over pervasive corruption in its financial advisory subsidiary CFPL. The Storm Financial scandal, with the CBA at its centre, retains a bad odour. It is long overdue that the CBA's Board and major shareholders paid attention to the dysfunctional culture that prevails amongst the bank's senior management. What happened to the People's Bank?

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