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Restructuring & Insolvency Alert

The rise and fall of suspension clauses

When can a financier rely on a "pay now, litigate later" provision in its loan documents or guarantees

WHAT YOU NEED TO KNOW

- Suspension clauses in loan documents and guarantees are no longer capable of overcoming a defence which seeks to challenge whether a customer's loan is due and payable to a financier.
- Suspension clauses can only work in circumstances where a customer or a guarantor concedes that their loan is owing to a financier but seeks to reduce their liability by asserting their own independent claim against the financier.
- Suspension clauses in loan documents and guarantees are not capable of defeating an unconscionable conduct or a misleading and deceptive conduct claim made by a customer or a guarantor against a bank under the *Australian Competition and Consumer Act 2010* (Cth) and its related legislation.

WHAT YOU NEED TO DO

- Reconsider the effectiveness of suspension clauses in light of the judgment given by the NSW Court of Appeal in *O'Brien v Bank of Western Australia Ltd* [2013] NSWCA 71.

Overview

The recent decision by the New South Wales Court of Appeal in *O'Brien v Bank of Western Australia Limited* [2013] NSWCA 71 (*O'Brien*) is one of the most important decisions made to date as to the proper scope and effect of "suspension clauses".

This is an important decision as it will have a significant impact upon the ability of financiers to seek recovery of debts from customers and guarantors.

Suspension clauses

Suspension clauses are commonly found in loan documents as well as leasing and other commercial transactions.

Suspension clauses are typically used in loan documents in one of the two following ways:

- Loan agreements and guarantees will usually place an obligation upon a customer and their guarantors to repay a loan in full without "set-off, cross-claim or deduction" on the date specified in the loan agreement.
- A customer and their guarantor will agree that until a loan is repaid, they will not raise any "set-off, counter-claim or deduction" to reduce the debt they owe to a bank.

Such clauses are therefore referred to as suspension clauses, as they provide for a borrower's and a guarantor's rights to be suspended until their loan has been repaid in full. Colloquially, they are also known as "pay now, litigate later" clauses, because that is their intended effect.

Summary judgment

Suspension clauses are important in circumstances in which financiers seek recovery of outstanding loans from borrowers and/or guarantors in contested proceedings.

If used appropriately, suspension clauses can provide a means to overcome and defeat defences

raised by borrowers or guarantors, including on a summary basis.

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.

Factual background to *O'Brien*

Between December 2006 and January 2009, Bank of Western Australia Limited (BankWest) lent FOB Airlie Beach Pty Ltd (Borrower) approximately $170,000,000 to complete construction of a development located at Airlie Beach in the Whitsundays, Queensland (Loan).

In support of the Loan, BankWest obtained a number of securities from the Borrower and a personal guarantee from the Borrower's director, Rory O'Brien (O'Brien), and its sole shareholder, Bakota Holdings Pty Ltd (Bakota).

Under the terms of the loan agreement (as varied from time to time), the Loan was scheduled to be repaid on or before 15 January 2009.

On 15 January 2009, the Loan was not repaid and in April 2009 BankWest appointed receivers and managers over the development. Once appointed the receivers proceeded to realise the development for the benefit of BankWest.

When the sale of the development by the receivers proved unable to repay the bank in full, BankWest commenced proceedings in the Supreme Court of New South Wales against O'Brien and Bakota to obtain judgment under their guarantees for the shortfall owing on the Loan.

Defence

During the course of the proceedings, both O'Brien and Bakota filed defences in which they alleged that they were not liable to repay the Loan to the bank as obligated under their guarantees.

Amongst other things, O'Brien and Bakota asserted that they ought to be relieved from their liabilities under their guarantees, because of alleged representations to them and the Borrower that the bank would not insist upon repayment of the Loan on 15 January 2009 and would provide the Borrower with an extension of time and additional funding to pursue a turnaround plan proposed by O'Brien.

O'Brien and Bakota sought to rely on these alleged representations to assert that the bank was either:

- estopped from asserting that the Loan became due and payable on 15 January 2009; or
- O'Brien and Bakota ought to be relieved from their liability to repay the Loan under section 12GM of the *Australian Securities and Investments Commission Act 2001* (Cth)(ASIC Act). Section 12GM of the ASIC Act, like section 87 of the *Australian Competition and Consumer Act 2010* (Cth), enables a court to make orders varying the terms of, or relieving a party from obligations assumed under a contract which has been vitiated or affected by misleading and deceptive representations or unconscionable conduct.

In response to these defences, BankWest applied for summary judgment to be entered against O'Brien and Bakota for the full amount owing under their guarantees. In support of its application, BankWest sought to rely upon the suspension clauses which had been included in the loan agreement entered into by BankWest with the Borrower and the guarantees which had been provided by O'Brien and Bakota.

BankWest argued that O'Brien and Bakota did not have an arguable defence because the Borrower had agreed that the Loan was payable on 15 January 2009 in full without counter-claim, set-off or deduction and both O'Brien and Bakota had agreed that until the Loan was repaid in full they would not seek to rely on a "cross-claim, set-off or deduction" to reduce their liability for the Loan.

Supreme Court

At first instance, BankWest's application for summary judgment was heard in the Supreme Court of New South Wales before Justice McDougall in the Commercial List.

After hearing extensive argument from both parties, Justice McDougall entered judgment in favour of

BankWest against O'Brien and Bakota in the sum of $158,661,356: see *Bank of Western Australia Limited v O'Brien* [2012] NSWSC 456.

O'Brien and Bakota subsequently appealed against this judgment.

Appeal

On 31 January 2013, the New South Wales Court of Appeal (consisting of President Beazley and Justices MacFarlan and Ward) heard the appeal.

On 11 April 2013, judgment was given in favour of O'Brien and Bakota and their appeal was allowed: see *O'Brien v Bank of Western Australia Ltd* [2013] NSWCA 71.

In allowing the appeal, the NSW Court of Appeal made the following comments in respect of the scope and effect of the suspension clauses:

- **Defences which assert that the debt is not due and owing** - Suspension clauses in loan documents and guarantees are not capable of overcoming a defence which asserts that the underlying loan did not become due and payable because of an alleged estoppel or a misleading and deceptive conduct claim. According to the Court, suspension clauses are built upon an implied foundation that the debt said to be owing to the bank is due and payable. If a borrower or a guarantor asserts (because of an alleged estoppel) that no debt is payable, then the financier's entitlement to its debt ought to be tested at trial and the financier cannot rely upon a suspension clause to obtain summary judgment for the debt.

  As explained by Justice Ward at paragraph [94] of the Court's reasons:

  "Whether or not the reference to set-off or counterclaim in the suspension clauses extend beyond monetary cross-demands, to claims based on estoppel/misleading and deceptive or unconscionable conduct, the suspension clauses are predicated on an amount being (due and) unpaid and if there was an arguable defence that (by reason or circumstances before or after the date on which under the facility agreement the sum was to be due) there was no sum due and payable at the date demand was made of the borrower, then there is no right/liability upon which the suspension clause can operate."

- **Defences which accept that the debt is due and owing but assert a cross-claim** - Suspension clauses can work in circumstances where a customer or a guarantor concedes that the guaranteed money is due and owing but seeks to set-off or reduce its liability to a financier by asserting its own independent claim against the financier or a third party.

- **Misleading and deceptive conduct** - Suspension clauses are not capable of preventing a customer or a guarantor from relying upon a misleading and deceptive conduct defence under the *Australian Competition and Consumer Act 2010* (Cth) (or its related legislation) because under that legislation they may seek orders that the loan agreement or the guarantee be declared void or that they should be retrospectively relieved from the obligations they had agreed to accept under those agreements.

On this reasoning, the Court held that Justice McDougall erred in entering summary judgment in favour of the bank. In its view, the Court cannot make a judgment on whether the suspension clauses are effective until it has decided whether:

- BankWest was estopped from asserting that the Loan became due and payable on 15 January 2009; and
- O'Brien and Bakota are entitled to the relief they are seeking retrospectively under section 12GM of the ASIC Act.

O'Brien has been referred back to the Supreme Court of New South Wales for hearing on these and other issues in the proceedings.

Consequences

The judgment given in *O'Brien* has important consequences for financiers and the way in which debts can be recovered from borrowers and guarantors.

Although summary judgments and strike outs may still be available in a narrow range of circumstances, in general, 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.

In these circumstances, financiers will have no other choice but to respond to such defences at a final hearing and through the filing of applicable evidence in reply.

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