

**PRACTICAL ADVICE ON
RAISING FINANCE**

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Practical Advice on Raising Finance

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1. Introduction

Banking is a necessary part of Australian commercial life. Farmers and members of rural communities often complain about the absence of specialist rural finance providers such as the Commonwealth Development Bank, the Agricultural Bank and the Queensland Industry Development Corporation which provided low interest, long term finance, catering for the vagaries of farming operations. Rural borrowers very often have to negotiate loans on the basis of criteria that are set down for city based borrowers, such as equity ratios and the like.

Like all general statements I am aware that this is not universally true. I have had experience of banks conducting very meaningful conversations with farming clients that were designed to deal with difficult seasons and how those difficulties can be best survived both for the farming family and the bank.

The Reserve Bank specifies that there is currently some \$31 billion dollars in rural loans. This indicates the enormity and value of primary production to the Australian economy and highlights the need to find better ways of conducting finance in the rural sector.

The comments in this paper reflect fifteen years of working with borrowers negotiating financial facilities with lending institutions.

The burden to ensure that the fund raising goes smoothly rests both with the lender and the borrower.

The key has always seemed to me to be not only understanding the documentation, but the intention of the parties.

Included in the documentation that must be clearly understood, are the terms of the Code of Banking Practice since the provisions of the Code are now terms in the contract between the customer and the bank.

2. Early and Clear Communication

In recent years the banks have made considerable effort to ensure that their documentation is in plain language and can be understood by the careful reader. While this as a general statement is correct, it is not always the case as will be seen in the next section of this paper.

In the context of rural lending, the writer is aware of at least one bank being willing to discuss with the borrower the possible problems with the weather and seasonal difficulties. These issues are not reduced to writing but are generally in the form of conversations to the effect that if there is a difficulty at the end of the coming year, the farmer should feel free to talk to the bank and the position will be reviewed. Fortunately for the farmer involved, the position has always been reviewed favourably, even though there have been some difficult years. The problem is that there is a degree of inconsistency because some of the banks, including this very bank, on many occasions rely on asset bank lending alone. This situation sometimes leads to later confrontation and the running of cases claiming estoppel or contract variation since the promises are almost always in conflict with the written agreements.

Before reviewing documentation, the parties to the transaction must be clear between themselves as to what their expectations are from the bargain and whether those expectations can be met.

A few years ago, acting for a borrower, I assisted at an eight day mediation to finalise the documentation for a loan transaction. It was certainly true that the documents were well understood by the end of the process. Sadly, the relationship still broke down after approximately eighteen months because the borrower complained that a Relationship Manager had not been appointed in a timely fashion as, it was alleged, had been promised.

Not only is it necessary to understand the documentation, the parameters of the bargain must be understood and a view taken as to whether or not the bargain is realistically achievable. By this I do not necessarily mean enforceable. Having a workable transaction, it seems to me is better than one that does not survive the test of time even if the rights are enforceable.

3. Consequences of Failure to Have Clear Early Discussions

A good illustration of the consequences of failure in the early negotiations can be seen in the facts of *Perpetual Nominees Ltd v Parist Holdings Pty Ltd* [2005] NSW SC1345. The borrower, Parist Holdings, had defaulted in loan transactions and orders were sought for the possession of land and recovery of money.

An issue arose as to whether or not part of the provision to determine interest was void.

Perpetual sought possession of the land on the basis that there had been a default in the payment of principal.

Critically important was the definition of the rate of interest that applied. The rate was defined to mean the aggregate of the Benchmark Rate and the margin. The margin was defined to mean 3% per annum, and clause 1.1 of the Memorandum defined the Benchmark Rate to mean:

‘the rate as determined by the lender on 1 December 2004 and then as redetermined by the lender quarterly on or about the first business days of January, April, July and October in each year. The lender will (but without having any obligation to do so) when determining and redetermining the Benchmark Rate refer to the level at which ninety day bank bill products have been trading by the major Australian trading banks rounded up to the nearest five basis points.’

It was contended by the borrower that this provision was void for uncertainty. The Court set out the relevant principles to determine when a contract provision is void... ‘the first is that if parties to a contract do not agree on a fundamental term, there will be no contract at all...the second is that there is no contract if its effect is that one party is left to choose whether or not it will perform it...the third is that there can be no concluded bargain if a vital matter has been left to the determination of one of the parties.’

In this case the provision was void by reason of the third matter.

The other provisions in the determining of the interest were not declared to be void. However after calculating the interest owing, there was found to be no default. Unfortunately for the

borrower, there had been a non monetary default, albeit of a most technical nature, and the possession was allowed.

The point is that a careful reading of the transaction documents would have thrown up this issue and it may have been that expensive litigation could have been avoided.

It sometimes occurs that the borrower will allege that the Bank Manager had indicated that he gave a promise that he would look after them. Such promises often lead to cases claiming estoppel. Had the early communication been clearer there would be no necessity to make this claim.

A good example of the principles in this type of case were before the court *PA Wright & Sons Pty Limited v Australia and New Zealand Banking Group*, judgment delivered by Mr Justice Hunter on 25 June 1999. In this case, the Wright family, in June 1989, embarked on a 10 year plan that had been put to the bank. The evidence of the members of the Wright family was that they relied on the representations and assurances made by the bank officers as to the Bank's support of the plan. In reliance on the assumptions the Wright family embarked on a course of conduct that proved to be detrimental when in 1991 the ANZ Bank withdrew its support and required the Wright family and its group of companies to begin repayment of the funds owed to the Bank. It was claimed that the Bank knew that PA Wright & Sons Pty Limited would be relying on the promises and continued to make the promises knowing that P A Wright & Sons Pty Limited was investing heavily in reliance on the promises. In these circumstances it was unconscionable of the Bank to claim its legal rights under the loan and security documents to require repayment. The court was asked to give effect to the estoppel by ordering the Bank to pay compensation for the detriment suffered by the Wright family as a result of their reliance on the Bank's promises.

His Honour found in the Wright case that the promises were not sufficiently clear or certain to establish the claim in estoppel. The bank could not be held to such an uncertain or vague promise.

One answer to the problem faced by P A Wright & Sons Pty Limited is the proposition that the courts are moving away from a requirement of a clear or certain promise. Several of the

important cases in the area base the claim in estoppel on implications from silence or by a close examination of the course of conduct (*Waltons Stores Interstate Limited v Maher* (1988) 164CLR and *S & E Promotions Pty Limited v Tobin Bros Pty Ltd* (1994) 122ALR). The emphasis of the courts now is on whether or not the reliance was reasonable in all of the circumstances of the case.

Some of the judgments say that to establish the claim it is not sufficient to simply believe that the Bank would support a plan or scheme that is put to it. It must be believed that the Bank is legally bound to support the scheme. The commentators however suggest that this cannot be correct. In the case of Mr Verwayen, for example, there was an assumption by him that the Commonwealth would not plead the Defence of the six years. He certainly did not think that the Commonwealth was legally obliged not to file such a Defence.

It of course sometimes occurs that borrowers succeed in estoppel cases. One such is the interlocutory decision of *Spalla v St George Wholesale Pty Ltd* of 4 March 1999.

The applicant in the Federal Court proceedings conducted a car dealership by arrangement with Mitsubishi. The bank was a number of companies associated with the St George Bank Group (St George).

The applicant had a floor plan or bailment plan with St George and was not only in default but was effectively using St George funds to keep afloat. This had been going on since at least 1994.

Eventually in late 1998 St George appointed a receiver. The Court proceedings arose because the applicant applied to the Federal Court to prevent the receiver selling the business because it was claimed that the receiver was invalidly appointed. It was said by the applicant that circumstances existed that lead the applicant to believe that St George accepted the default position that the applicant was in and would not appoint a receiver. The applicant claimed that he believed that St George would not require him to abide by the strict terms of the bailment agreement and the deferred payment agreement without reasonable notice. This accepted the principle in estoppel cases that the person who makes the promise is entitled to resile from the promise provided reasonable notice is given.

In the decision handed down on 4 March 1999, His Honour found that the applicant had made out a sufficient case to allow the injunction to be granted until the final hearing. After His Honour had looked at all of the evidence in detail and heard several days of evidence he found that the conduct of St George amounted to no more than acts of indulgence and that type of conduct could not constitute a promise or assurance that late payment would forever be indulged or would be indulged until notice to the contrary was given so as to found an estoppel. His Honour put the case of the applicants in the following way:

“The applicants found their argument on estoppel on two broad propositions. First, it is said that by representations and conduct the St George Companies lead Irlmond and APS to believe, and they did believe, that no reliance would be placed on any of the grounds that I have found would justify the appointment of a receiver.”

The second basis was enunciated by senior counsel in the following language:

“What St George was in effect saying to the dealer was “We will continue to provide ongoing floor plan finance and otherwise support you financially to the extent necessary to get you in a position to sell or re-finance.”

As I have said above, at the end of the day His Honour found against the applicant. Circumstances may exist where such an applicant might be successful.

The real point to be made here is that the very expensive litigation that occurs in cases where the client believes enforceable promises are made, can and perhaps should be avoided by better, earlier communication.

Very often borrowers are not sufficiently aware of non monetary defaults. Such defaults are often regarded as trivial or of no consequence. Sadly, such defaults have time and time again been held to be breaches that entitle the financier to exercise their enforcement rights. In the case of Parist Holdings Ltd, the default ultimately relied on was a breach of an undertaking to provide evidence of the payment of rates to the bank. In the case of Parist there was no issue that the rates had been paid. The most often quoted case on trivial defaults is *Canberra Advance Bank Ltd v Benny* (115 ALR 207). This was a case where the bank had appointed a receiver. The loan document provided that the bank was entitled to appoint a receiver if there was any “event of default” by the borrower. The bank relied on the fact that the borrower had

failed to supply quarterly accounts to the bank, and that this was a sufficient default to justify the appointment of the receiver. The borrower argued that this was no more than a “technical” breach which did not give the bank the power to appoint a receiver. The court did not accept this argument and held that the appointment of the receiver was valid.

Although the borrower’s argument in that case was not accepted, all hope is not lost. Consider the following statement from Sir Anthony Mason, the former Chief Justice of the High Court:

“There may be ... situations in which the breach of a term expressed to be an essential condition is so trivial and insignificant that an attempt to take advantage of it for the purpose of terminating the contract would violate the dictates of fair dealing or would amount to unconscionable or unequitable conduct and give rise to a case for relief”. (*Sunbird Plaza Pty Ltd v Maloney* (1986) 166 CLR 245 at 263.)

It therefore may still be possible for borrowers to argue that a “trivial” breach will not give the bank rights to enforce the loan.

Fortunately, at the moment I think there is very little lending to drunken borrowers as in *Blomley v Ryan*, or non English speaking borrowers or guarantors such as in the case of Mr and Mrs Amadio. This I think can be taken as evidence that there is better and stronger communication that prevents these sorts of issues arising.

This does not mean of course that they never arise.

Perhaps the dependency cases may have been avoided if there had been better early communication.

After Mrs Garcia’s case, there has been further development in this area of the law.

On 9 March 2001 Mr Justice Levine delivered judgment in the matter *State Bank of NSW v Layoun*.

This case concerned a family that had migrated from Syria. The parties to the proceedings were the parents and two sons. A third son Joseph Layoun borrowed money for his business, Castle Hill Ceramics Pty Limited (Ceramics). Joseph's business failed and the Bank then demanded that the family members make the payment because they have given a guarantee. The guarantee was supported by a mortgage over a home that they owned together.

His Honour accepted that the eldest son Joseph, as the first-born, enjoyed a special position of responsibility in a cultural context in his family. His Honour accepted that Joseph was in effect in charge of family affairs and that the family relied upon him in respect of such affairs. His Honour found that Joseph provided modest material needs to his parents but said that this did not remove them from the category of volunteers in the sense of them obtaining a benefit from Joseph's transaction for his company.

The same was said of one of Joseph's brothers Louis, who was a party to the proceedings, who had worked for Ceramics as a sub contractor. His Honour found that Joseph did not explain the document to any of the family members.

In this case His Honour set aside the guarantee and the mortgage on the same principle that is set out in the case of *Gacia*. The case of Layoun is important because it extends the category of person who is entitled to seek relief beyond the wife. Mr Justice Levine in the Layoun case referred to the four factors that should be identified which make it unconscionable for a bank to enforce security of the kind held by the bank in the Layoun case. The four factors are as follows (quoting from the *Gacia* decision):

- “
- (a) In fact the surety did not understand the purport and effect of the transaction;
 - (b) The transaction was voluntary (in the sense that the surety obtained no gain from the contract the performance of which was guaranteed);
 - (c) The lender is to be taken to have understood that, as a wife, the surety may repose trust and confidence in her husband in matters of business and therefore to have understood that the husband may not fully and accurately explain the purport and effect of the transaction to his wife; and yet
 - (d) The lender did not itself take steps to explain the transaction to the wife or find out that a stranger had explained it to her.”

The last example of cases where early communication may avoid later trouble relates to corporate special disability. In the case of *Parras Holdings Pty Ltd v Commonwealth Bank of Australia* [1997] 1107 FCA (24 October 1997), the bank became concerned that the expenditure on the property development blew out beyond what had been projected and was concerned also that the value of the development when completed, may not be as high as had been estimated. Acting on these concerns, the bank began to dishonour cheques and insisted on further security. The Court held that the bank had taken unfair advantage of the borrower's vulnerable position.

It is tempting to suggest that had the early communications been clearer, this problem could have been avoided.

4. Code of Banking Practice

Because the terms of the Code of Banking Practice are incorporated in the contract between the customer and the bank (provided the bank has adopted the Code), no practical guide to raising finance can omit a brief discussion of the Code. Even in cases where the institution has not adopted the Code, its existence sets a benchmark for behaviour that cannot be ignored. On the 3 November 1993 the Code of Banking Practice was adopted by the Banks, however, the Code did not become fully operational until November 1996. A review of this Code was started on the 12 May 2000. The Code is now reviewed at least every three years and will ensure adequate regard to the views of interested parties.

The Code of Banking Practice seeks to promote and encourage good relationships between the Bank and its customer. The main objectives of the Code are to improve the standards of practice and service which the Banks offer to the Customer, to provide relevant and useful information to the Customer in relation to Banking Services, and to require the Banks to have dispute resolution procedures to follow in the event of a dispute between the bank and its Customer.

The Code incorporates principles of fairness and imposes serious obligations on the Banks. The incorporation of these provisions commits the Banks to act fairly and reasonably with their dealings with Customers.

The term “Banking Service” is defined to mean any service provided by the Bank to its Customers. The Code makes it sufficiently clear that the Bank is held responsible for any of its products or banking services that are offered to its customers either directly or by way of an intermediary.

The definition of a customer is extended to mean an individual or a small business.

A small business is defined to mean a business employing less than 100 people if the business is or includes the manufacture of goods, or in any other case less than 20 people. The Code could be applied equally to a small business as to any other customer, despite minor modifications such as confidentiality and privacy.

Subscribers to the Code are required to ensure that their staff are trained and competent to perform their duties efficiently. Also Code members, their staff and agents will be required to have a sufficient amount of knowledge of the Code and its provisions.

The Code embodies an independent and sufficient process for monitoring Banks compliance with the Code. A committee, the Code Compliance Monitoring Committee is to be set up within the Australian Banking Industry Ombudsman scheme with the capacity to impose obligations and sanctions when the Code is breached. The Code entitles consumers, consumer advocates and regulatory agencies to make complaints about non-compliance with the Code. The Code requires its members to supply on request copies of contracts, account statements, notices and other relevant documents to customers, guarantors and persons acting for them subject to the usual confidentiality and privacy requirements being satisfied.

Subscribers to the Code will be required to exercise due care and diligence in assessing a customer’s ability to repay a credit facility before the bank agrees to provide it to them. The Code also commits banks to assisting their customers experiencing financial difficulties.

The Code provides that where a primary cardholder advises the bank to cancel a subsidiary card and takes reasonable steps to have the card returned, the primary cardholder will not be held liable for continuing use of the card.

Under the Code banks should not sign up a party as a joint borrower, where the bank knows that the party will receive no direct benefit under the contract. The Code also requires banks take reasonable steps to ensure that both co-borrowers are well informed about their liability under contracts which they enter into. Furthermore, banks are required to stop further advances on a joint credit facility at the request of one of the joint account holders.

The Code requires that banks have an internal process for handling complaints with its customers. This process will be available to all customers free of charge and must be consistent with any industry dispute resolution standard or guidelines which ASIC declares to apply.

The Code also requires that banks have an external and impartial process of handling disputes available to its customers. This process will also be free of charge and will be consistent with the regulatory guidelines for the approval of external complaints resolution schemes.

The Code requires that a guarantor should be provided with a copy of the contract of guarantee and any such relevant information before it enters into it. Furthermore, relevant information about the debtor and the facility to be guaranteed should be made available to a prospective guarantor. The Code requires that the bank recommend the guarantor to obtain independent financial advice.

In the event of closing down a branch, the Code provides that banks should give 3 months notice to customers and relevant community organisations of their intention to do so. Banks are required by the Code to waive any fees or penalties incurred in respect of early repayment of loans or closing of accounts.

The New Code of Banking Practice was introduced in August 2003 and a copy of the Code should be made available at all branches of the Bank. The Code requires that for those Bank's who do not have branches should make a copy of the Code available electronically (i.e. websites).

5. Farm Debt Mediation Act

I do not propose to discuss the Farm Debt Mediation Act in detail in this presentation since that Act on the whole, is designed to assist farmers who are in default of a farm mortgage. The Act provides, as I am sure everyone knows, that the financier must invite the farmer to participate in a mediation before commencing enforcement proceedings.

A borrower when raising finance, may well have an interest in knowing that this right exists.

More importantly, in the context of this paper, is section 9(1A). This section provides that even a farmer who is not in default can request mediation concerning a farm debt.

It seems to me that this provision and other sections of this Act may well be important considerations to a farmer during the fund raising exercise.

The only issue of course is what constitutes a mediation. The Court of Appeal in *Gain v Commonwealth Bank of Australia* (1997) 42 NSW LR 252, said that in their view a satisfactory mediation is a mediation which has proceeded as far as it can.

As we all know, this may not be very far.

6. The Future

The key to the future can be seen in the report of the House of Representatives Standing Committee on Finance and Public Administration of November 1991. Sadly, although much has been done in the intervening years, there are still gaps in awareness and product range that are causing grief to many farming families.

The Committee recognised that the rural sector is affected by many outside influences. Some of those influences being cyclical, others a one off. The difficulties with seasons, although well understood by the farming community, are rarely taken into account by lenders. It seems widely recognised that there is a five year cycle of weather patterns. The one off factors include adverse trading conditions affecting commodity prices.

The Committee recognised that there was a wide range of products that could meet the needs of the farming community but there was a lack of widespread awareness of the availability of these products. Although the banks have made efforts to publicise specialised products, there are many farmers who are not aware of the range of banking products that could be of assistance to them.

Often there is a resistance to obtaining advice from solicitors, accountants, rural counsellors or other relevant professionals in relation to rural financing. This has begun to change as well but there is probably much to be done. In large part the change has been driven by the need the banks have to, quite rightly, comply with principles that have arisen out of cases such as *Garcia*.

Farmers' banks are not uncommon around the world. In France, the Credit Agricole grew to be one of the largest banks in the world having started as an institution for wine makers. In South Korea, there are a number of farmer co-operatives that are particular to different farming sectors. In the Netherlands, the co-operative nature of Rabo Bank is well known. Less well known is the considered and sensitive way in which farmers are dealt with if a default occurs; a committee of farmers will assist the defaulting farmer with restructure and only if that fails, will the farmer be asked to vacate the property.

Let's hope that in Australia, products and ways of banking are developed that will be more sensitive to the rural borrower.

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