Banking Code Has Legal Weight - Do Not Let Bankers Water It Down

Summary:
Judge lashes National Australia Bank (NAB) for breaching the Code of Banking Practice. The code has contractual force and does give protection to victims of bank misconduct.

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Failing to comply with Banking Code of Practice costs NAB $6 million

The Banking Code of Practice has contractual force. Where applicable, a bank must comply with the Code. Failure to comply can expose the bank to a claim for damages.

In National Australia Bank Limited v Rice [2015] VSC 10, a guarantor, Mr Rose, successfully avoided liability under five guarantees, where National Australia Bank (NAB) claimed $6,184,593.48 plus interest and costs.

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Background

Mr Rice and Mr Rose entered into a joint venture arrangement for the acquisition and sale of real estate on a 50/50 basis. When a property was purchased, a new company was incorporated for the acquisition of the property and finance was obtained from NAB. Rice and Rose were directors of the company.

Before the joint venture arrangement, Rice had an existing relationship with NAB. Rose had no previous business relationship with NAB.

Rice had most of the dealings with NAB's representative, Mr D'Angelo, regarding the obtaining of finance.

Although Rose had been successful in business, he had never invested in real estate for commercial gain and had only limited experience in general business affairs.

Rose personally contributed $4.8 million towards the purchase price of the initial properties. Rice had no funds of his own to invest.

Rose signed guarantees that made him liable for all of the obligations of the borrowers. Rose thought that, in signing the guarantees, he was only liable for 'interest on the loans or something like that'.

The guarantees were signed by Rose when they were given to him by D'Angelo as part of the bundles of loan documentation for execution.

At no time were the guarantee documents in Rose's possession before signing, other than as part of the execution process.

The guarantees signed by Rose contained a warning statement on the front page of the guarantee that he should seek independent legal and financial advice on the effect of the guarantee before signing the guarantee.

One of the documents signed by Rose was a certificate stating he had read and understood the guarantee documents.
The signature page for each guarantee also contained warnings, however they were not immediately adjacent to the place for the required signature.

D'Angelo was aware that Rose did not read any of the warnings or the documents before signing the guarantees.
NAB's guarantees also contained the usual clauses found in bank documentation where Rose waived any right as a guarantor that might be inconsistent with the provisions of the guarantee, or that would restrict NAB's rights or remedies under the guarantees.

The guarantees contained a provision that the Code applied to the guarantees.

The Code

Clause 31.4(a) (previously clause 28.4(a)) provides that before the bank takes a guarantee, the bank is required to give the proposed guarantor a prominent notice that:

- they should seek independent legal advice and financial advice on the effect of the guarantees;
- they can refuse to enter into the guarantees;
- there are financial risks involved;
- they have a right to limit their liability in accordance with the Code and as allowed by law; and
- they can request information about the transaction or facility to be guaranteed including any facility that is being refinanced.

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Clause 31.5 (previously clause 28.5) provides that the bank will not ask you to sign a guarantee, or accept it, unless the bank has:

- provided the proposed guarantor with the information described in clause 31.4 to the extent that the Code requires that information to be given; and
- allowed the proposed guarantor until the next day to consider that information.

The bank is not required to allow the proposed guarantor until the next day to consider the information if the proposed guarantor has obtained independent legal advice after receiving the information required by clause 31.4.

Execution of the guarantees

The Court found that D'Angelo:

- was unclear as to the precise explanations and warnings that he had given Rose when the guarantees were signed;
- did not discuss any page of the guarantee in any detail; and
- relied on his standard practice as to what he did and what he said to Rose at the time of the execution of the guarantees.

There was a large discrepancy between what D'Angelo was purported to have said based on his standard practice and what Rose purported to recall not being told by D'Angelo.

It was not part of D'Angelo's standard practice to refer to the warnings on any page. After the guarantees were signed, D'Angelo returned to his office and completed a record of interview or checklist as to what occurred when the guarantees were signed.

There were gaps and errors in the bank's internal records as to what D'Angelo did and what he said to Rose at the time the guarantees were signed. As a result, the Court placed little reliance upon the bank's contemporaneous documentation purporting to record what occurred.

The Court preferred the evidence of Rose, who:

- said that he did not have any of the guarantees properly explained to him and that he simply signed where he was told to sign by D'Angelo;
- was emphatic that D'Angelo never told him that he should obtain independent legal advice; and
- said that, if he had been told to obtain independent legal advice, he would have done so.

NAB's contention regarding the warnings

NAB argued that it was not necessary to give the warnings orally. The Court accepted this but said that to comply with the Code, NAB was required to give Rose 'a prominent notice' of such matters. Simply 'looking' at the front page and giving the inadequate summary that D'Angelo said formed part of his standard practice, and not inviting Rose to read any of its contents, did not give prominent notice of the required warnings.

There was no attempt by D'Angelo to give Rose the opportunity to consider the information contained in the bank documentation, or to give him until the next day to sign the guarantees. On either version of what occurred, nothing that was said by Rose could amount to a waiver of the benefit of the provisions under the Code. Signing the guarantees did not amount to such a waiver.

Consequences of breaching the Code

Rose's unequivocal evidence was that if he had been told by D'Angelo that he should obtain independent legal advice before signing any of the guarantees, he would have done so.

The Court held that such legal advice would most likely have informed Rose of the true extent of his potential liability under the guarantees. The Court accepted Rose's evidence that if he had known that he would become potentially liable for all of the debts, he would not have signed any of the guarantees.

The Court commented that in some cases, asking a potential guarantor whether they wanted to get legal advice, as opposed to telling the potential guarantor that legal advice should be obtained, would be unlikely to have any effect on the attitude of the guarantor. However, in this case the Court said the distinction was critical. If D'Angelo had told Rose he should get legal advice, that would have rung alarm bells and Rose would have sought the suggested legal advice.

Entitlement to damages

The Court held:

NAB's failure to comply with the requirements of the Code constituted a breach of warranty entitling Rose to claim damages;
the clauses in the guarantees did not prevent Rose from claiming damages;
Rose's damages equated to at least his liability under the guarantees; and
if NAB had not breached the Code, Rose would not have signed any of the guarantees and he would not have had any liability to NAB.

During the course of the joint venture, Rose had received $1.1 million from the sale proceeds of a property that was financed by NAB. NAB argued that the profit should be taken into account.

The Court said that in the absence of the NAB finance, the purchases would not have proceeded and Rose would not have invested approximately $5 million of his own funds in the joint venture. In those circumstances, the receipt of the $1.1 million did not result in any real profit to Rose.

Rose suffered loss far beyond his exposure under the guarantees because of his joint venture with Rice. This remained the position even after taking into account the $1.1 million sale proceeds that Rose received.

Claims for consequential loss

The Court did not consider whether Rose's $5 million loss of funds were too remote to be claimed against NAB.

This was because Rose did not make any claim for consequential loss. If he had made a claim for damages in relation to consequential loss, the $1.1 million he received would have to be taken into account. However, Rose had simply sought to set off the amounts payable under the guarantees, and as a result, the Court said it would be incorrect to reduce that amount by the sale proceeds that Rose received.

Comments

The decision highlights the danger of bank representatives witnessing the execution of guarantees and having loose procedures regarding the explanations and warnings to be given to a proposed guarantor to comply with the Code.

A court may not place any reliance on a bank's internal documents such as a record of interview or checklist if there are gaps or errors in the document or if they are inconsistent with what actually

occurred.

If you would like more information about these issues, please contact Graham Roberts on +61 7 3231 2404 or Miranda Bird on +61 7 3231 2998.

Graham Roberts has been recommended in Doyle's Guide in its 2015 list of leading Queensland insolvency lawyers.

Websites For More Information: Court rules NAB unable to recover Gold Coast millions due to breach of banking code
http://www.smh.com.au/business/court-rules-nab-unable-to-recover-gold-coast-millions-due-to-breach-of-banking-code-20150507-ggwjp6

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