News

May 2008 Finance

Prepare for take off

Finance Broking Bill 2007

Submissions have closed in relation to the exposure draft of the *Finance Broking Bill* 2007.

When enacted, the Bill will provide a national regulatory framework for finance brokers.

Following consideration of the submissions, we expect there will be some amendments to the Bill.

At this stage, the key features of the Bill are as follows:

What transactions will be affected

The Bill when enacted will apply to persons carrying on a business where a finance broking service is provided. The main component of the business need not be finance broking and can include business where the arranging of a loan is incidental to its core business.

The Bill applies to broking transactions for all types of loans not just loans regulated by the Uniform Consumer Credit Code. Exceptions to this include:

- where the credit is for business purposes and the amount of the credit is more than $2 million or the number of people employed in the business exceeds 20 or 100 if the business is a manufacturing business; and
- broking for leases or hire purchase. However the legislation will apply to equipment finance loans.

The purchase of a single dwelling for investment purposes is not regarded as a business purpose so broking for such a transaction would be regulated.

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All brokers to be licensed

Under the Bill, a person cannot undertake finance broking or advertise that they provide broking services unless the person holds a broking licence or is authorised by a licensed broker to engage in finance broking.

Each applicant for a licence will be required to undertake probity checks and to hold membership of an approved external dispute resolution scheme and to have certain prescribed educational qualifications or skills.

The licence will be wide enough to allow brokers to trade in all States and Territories within Australia.

The mandatory educational requirements will be contained in the Regulations to the legislation. The required level will not be below Certificate IV in financial services (Finance/Mortgage Broking) and may include additional requirements for competencies in those aspects of broking not currently included in this Certificate.

Experience in the industry will not result in automatic qualification for a licence and each person applying for a licence will need to show that they have the required skill to provide broking services.

Professional indemnity insurance

Brokers must hold professional indemnity insurance to a required level.

Operational restrictions

A broker is not permitted to submit a credit application unless:

- the broker has determined that the applicant has the capacity to repay the credit; and
- the credit is suitable for the applicant's requirements.

The broker is required to enter into a written agreement with the applicant and is not entitled to submit a credit application until this has been done. The broker cannot submit an agreement to the applicant for signing until the broker has confirmed that the applicant has the capacity to repay credit of the amount and on the terms set out in the agreement.

In order for the broker to be able to charge a fee, the credit obtained must be substantially the same as the credit set out in the finance broking agreement and the credit must in fact be obtained.

The broker must also set out the credit options available to an applicant in writing in a consistent form to facilitate easy comparison. The information that must be contained in this document includes the amount, term, interest rate and repayment arrangements relating to the credit. In addition, the broker needs to disclose any commission to be received by the broker, any commission being received by any other person in the broking chain (by amount or calculation method), interests or relationships the broker has that could influence the recommendation, fees payable to the broker, fees and charges payable to the credit provider and the amount of credit available after fees are paid.

The broker is not entitled to submit a credit proposal that an applicant does not have the capacity to repay or that does not meet the applicant's requirements.

A broker must notify an applicant of any change in interest rates that occurs before the consumer enters into a credit contract.

Reverse mortgages

There are additional disclosures required for reverse mortgages. Brokers are required to give applicants estimates showing the applicant's future debt in relation to a range of time periods and in relation to the future value of the mortgaged land.

Also if on inquiry it becomes apparent to the broker that an applicant may need aged care accommodation in the future, the estimates must include a calculation to show at what point the applicant's equity in the property (which is required to fund aged care accommodation) will be less than the amount required to fund the aged care accommodation.

There are to be regulations prescribed setting out assumptions to take into account when making such estimates.

Refinances

When dealing with credit applications for refinances or credit restructures, the finance broker must include a comparison of the credit offered with the applicant's current credit facilities and a list of the following fees:

- exit fees on current facilities; and
- set up fees for the new credit facility.

A broker is prohibited from making a credit proposal that the applicant does not have a better capacity to repay and is not more suitable than the applicant's current credit facility.

Fees

- No upfront fees can be charged until credit has been obtained.
- Fees cannot be charged unless the credit obtained is substantially the same as set out in the finance broking agreement.
- Fees set out in the finance broking agreement must be adhered to. The broker cannot charge a fee higher than that set out in the broking agreement.
- A broker cannot charge a mark-up on fees paid to third parties for securing credit.
- If the applicant declines credit (subject to certain requirements), the broker can charge a fee for securing the credit.
- Brokers are prohibited from listing consumers with a credit reference agency for non-payment of fees and from lodging a caveat or claiming that they intend to lodge a caveat over an applicant's property in relation to outstanding fees.

Exclusive arrangements

Brokers who undertake broking activities under exclusive arrangements are exempt from the requirements of the Bill on the basis that the broker only deals with one credit provider and offers only one type of credit. To be exempt the broker would not charge a broking fee and would not suggest that they are able to access any other credit than the brand that they promote.

There are also exemptions available in relation to first choice arrangements.

Penalties

The Bill prescribes a range of penalties for failure to comply including:

- disciplinary action;
- reprimands or cautions;
- repayment of fees (with interest);
- payment of compensation;
- imposition of a fine;
- suspension or cancellation of licence; and
- disqualification (temporarily or permanently from holding a licence).

The Bill also provides for the establishment of a compensation fund to cover claims against brokers. This will be funded from levies paid by finance broking licence holders. ■ *Nancy Bramley-Moore is a partner of Makinson & d'Apice Lawyers.*

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Powers of attorney – are they safe for lenders to rely on?

Lenders are often asked to accept documents executed under powers of attorney. Often one of the parties to the loan is overseas and unable to sign loan documents within the time frame required for settlement of a transaction.

There have been two recent decisions of the Supreme Court of New South Wales in recent months where powers of attorney have been relied upon. The judgments offer some helpful reminders as to the issues that can cause problems for lenders.

Sweeney v Howard and Kaygen Pty Ltd and Sintan Pty Ltd and anor [2007] NSWSC 852 (8 August 2007)

The first case is the decision of the Supreme Court of New South Wales on 8 August 2007 of *Sweeney v Howard*.

The facts

In this case, the plaintiff, "*various members of the Sweeney family* (Cynthia Sweeney, David Sweeney and Rhonda Collison (nee Sweeney)", owned a property known as Scenic Hills at Denham Court. They used this to conduct a horse riding and agistment business and a function centre. They gave a power of attorney to Greg Sweeney who was a co-owner of the property. It was in the standard form prescribed at that time and included authority to allow Greg to execute documents which conferred a benefit on him.

It was subject to a limitation to act in relation to "*(a) the property known as Lot 1 Campbelltown Road, Denham Court in the State of New South Wales including but not limited to the sale and mortgaging of the property and (b) all loans and guarantees and indemnities*".

David, Rhonda and Cynthia Sweeney all executed a power of attorney in the above form.

The facts of this matter are lengthy and detailed and involve a number of mortgages and transactions entered into by Greg under power of attorney over time. We have confined this article to the facts relating to the transactions in issue in so far as the powers of attorney are concerned.

A mortgage in favour of Sintan Pty Limited over the property was authorised by Greg to secure a principal sum of $9,910,000. The plaintiffs claimed that two of the amounts included in the total of the principal sum namely $2 million and $600,000 were not secured by the mortgage and not due by them to the mortgagee because those sums were borrowed for and applied to the benefit of Sean Howard and and/or Mr Howard's company Kaygen Pty Limited.

An escrow deed between Cynthia, David and Greg Sweeney and Rhonda Collison (nee Sweeney) and Sintan Pty Limited was executed by Greg pursuant to the powers of attorney. This is the document that created the initial indebtedness on the part of the Sweeneys to the mortgagee.

The amount of the debt was initially $6.6 million which was ultimately applied as follows:

- $4.6 million to pay out an existing mortgage on the Denham Court property to Statewide Secured Investments Limited and other pressing debts of the Sweeney family; and
- $2 million to finance the deposit for the purchase of a property in Shellcove Road, Neutral Bay from Kaygen Pty Ltd by interests associated with Kaygen Pty Limited which was a company controlled by Sean Howard in respect of which Greg believed he had a joint venture interest.

The Statewide mortgage was paid out and Sintan Pty Limited took a transfer of it.

Subsequently, the Sweeneys other than Greg were asked to sign an acknowledgement of the mortgage which confirmed their consent to the mortgage to Sintan Pty Ltd but did not state the amount of the indebtedness or the method of application of the funds.

The Sweeneys had legal advice in relation to this document but deny being told the amount of the principal sum or how the funds were to be applied.

On the same day, Koffels, solicitors, who acted for the Sweeneys authorised the mortgage to be amended to increase the principal sum to $6,910,000 ostensibly at the authority of Greg. Later, additional loans were obtained including the sum of $600,000. Again pursuant to documents signed by Greg as attorney for the other family members. The $600,000 was applied towards payment of legal costs owed to Koffels by Glenn Freeman who was involved in the purchase of the Shellcove Road, Neutral Bay property and also in a proposal with the Sweeney family to develop the Denham Court property.

In relation to the sum of $2 million which was applied towards the deposit of the Neutral Bay property and the payment of $600,000 which was applied towards Glenn Freeman's legal fees, the Sweeneys claimed, amongst

other things, that the powers of attorney did not authorise the transactions.

The evidence of the Sweeneys was that they had no knowledge of the escrow document or the manner in which the funds were to be applied. This was accepted by Justice Windeyer in his judgment.

The Court's findings

The judge found that under the power of attorney Greg had the power to execute the mortgage over the Denham Court property but that the question in issue was whether or not Greg also had the power to direct the payment of $2 million of the amount secured by the mortgage towards the deposit on the Shellcove Road property and $600,000 towards the payment of Freeman's legal fees.

The judge found that Greg's powers did not extend to the direction to the mortgagee apply the $2 million towards the deposit for the Shellcove Road property and that the mortgagee had notice that Greg was acting in his own interests because he had some interest in the property at Shellcove Road. This took the payment outside the terms of the authority in the power of attorney.

The claim in relation to the $600,000 failed and this is because the mortgagee had no way of knowing or suspecting that the Sweeneys would not get the benefit of the $600,000.

Therefore in this case whilst there was clear authority for Greg Sweeney to execute mortgage documents in respect of the Denham Court property and loan documents, the power of attorney did not allow Greg to direct the funds to be applied to his benefit and the mortgagee was aware of the purpose of the application of the funds.

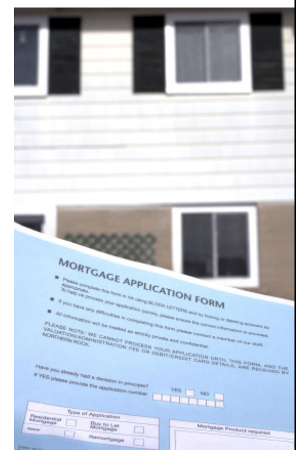
Spina v Conran Associates Pty Ltd; Spina v M&V Endurance Pty Ltd (2008) NSWSC 326 (14 April 2008)

On 14 April 2008, Justice Austin gave judgment in two cases. These were *Spina v Conran Associates Pty Limited* and *Spina v M&V Endurance Pty Limited*. The two proceedings related to common fact situations and were consolidated.

The facts

The plaintiff was Angelina Spina who was a 91 year old widow living in a nursing home. She had very limited understanding of written and spoken English.

Angeline Spina was the registered proprietor of a property at Cherrybrook which until 2003 was unencumbered.



In February 2003, she gave a power of attorney to her son Michael Spina.

The power of attorney was unlimited in nature and included authority to Michael to execute documents which conferred a benefit on himself.

Michael operated a business known as Action Fruit Supply which was a wholesale seller of tropical fruits with a stand at Flemington Markets. Action Fruit Supply was in financial difficulties and had loans from Conran Associates Pty Limited secured by the home of Michael and his wife Sarina at Dundas.

These loans and the loans which are the subject of the proceedings were arranged by Rodney Shields and Mr McVittie, a lawyer of Shields Lawyers. Mr McVittie prepared the mortgage documentation for the loans.

The Conran Associates loan was $110,000 for a term of six months. The interest rate was 2.5% per month reducing to 2% per month for payment on time. This was to be secured by a registered second mortgage and lodgement of a caveat over the Cherrybrook property. Spywing Pty Limited was to be a guarantor of the loan. The purpose of the loan was said to be assist with seasonal working capital for the benefit of a wholesale fruit business at Flemington Markets.

The mortgage was signed by Michael Spina under the power of attorney. In addition all other documentation in the name of Angelina Spina was signed by Michael under power of attorney including a statutory declaration in her name.

The loan was received from Conran Associates and paid into the trust account of Shields Lawyers and subsequently after payment of expenses the balance in the sum of $99,404 was paid out by cheque in favour of Action Fruit Supply.

The second loan from M&V Endurance Pty Limited was for the sum of $60,000 and was secured by a third mortgage over the Cherrybrook property which was unregistered and protected by a caveat. The term of the loan was four months and the interest was to be 4% per month reducing to 3% per month for payment within seven days of the due date. The security included a guarantee by Michael and a fixed and floating charge over Spywing Pty Limited. The purpose of the loan was said to be to assist with seasonal purchase of bulk fruit for the wholesale fruit business at Flemington Markets. Repayment was to be from sales of wholesale fruit.

Again the mortgage was signed by Michael under the power of attorney as were the other loan documents in Angelina Spina's name.

Loan funds from M&V Endurance Pty Limited were paid into the trust account of Shields Lawyers and the net amount of the loan after payment of costs in the sum of

$56,586 was paid out of the trust account to Action Fruit Supply.

As with the Conran Associates loan, the benefit of the loan flowed to Action Fruit Supply and Michael Spina to the detriment of Angelina Spina.

There was no evidence to indicate whether Angelina Spina was aware of the transactions at any time up to completion.

There was nothing in the mortgage documentation to suggest any irregularity and the mortgage was properly executed by Michael Spina as attorney under a registered power of attorney. However, the other documentation prepared made it clear that the loan money was to go to Action Fruit Supply and that the purpose of the loan was for the Action Fruit Supply business and not for the benefit of the registered proprietor of the Cherrybrook property Angelina Spina.

Angelina Spina sought orders declaring that the two mortgages should be set aside and claimed that she was not indebted under the mortgages.

Amongst the submissions made for and on behalf of Angelina Spina were submissions that:

- Michael's entry into the two mortgages was beyond the powers conferred on him by the power of attorney; and
- the agreements should be set aside on equitable grounds relating to undue influence or unconscionability.

There was no suggestion that there was anything improper about the manner in which the power of attorney was granted.

The power of attorney conferred on Michael the authority to do on Angelina Spina's behalf anything she may lawfully authorise an attorney to do and clause 2 of the power of attorney authorised the doing of an act whereby a benefit was conferred on Michael as attorney.

The Court's findings

The judge stated that the power of attorney did not confer on the attorney the power to do anything that Mrs Spina could lawfully authorise ***another person*** to do. It only gave the attorney authority to act to do things that Mrs Spina could lawfully authorise an ***attorney*** to do. In the judge's opinion these words made it plain that the person to whom the authority is given is limited to act within an agency capacity and the use of a general power of attorney for execution of the mortgage over the grantor's land to secure borrowing solely for the benefit of the attorney could not be regarded as something that an ***attorney*** might be

lawfully authorised to do. Therefore the general authority conferred in the power of attorney cannot extend to actions that result in a benefit for the attorney unless the authority to do so is expressly conferred by the instrument. The fact that Mr McVittie as representative for the lender was expressly aware that the purpose of each loan was to support the Action Fruit Supply business in which Michael but not Mrs Spina was interested was a key issue.

Conclusion

The cases of *Sweeney* and *Spina* concern powers of attorney where there is express authority for the attorney to enter into transactions which confer a benefit on the attorney. In both cases some or all of the funds were applied towards purposes which did not benefit the grantors of the powers of attorney with the knowledge of the lender.

Although both cases are not entirely on all fours, the ultimate result was the grantor of the power of attorney was not liable to pay the indebtedness that was not for the grantor's benefit when the lender was aware of the ultimate purpose of the loan.

Powers of attorney can be useful tools in situations where a party is not available to execute documentation. However, as these cases make clear, there can be issues with relying on them notwithstanding the fact that they appear on their face to authorise the attorney to execute mortgage and loan documentation. The purpose of the loan and whether or not a benefit is to be received by the grantor of the power of attorney are critical issues.

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Some relief for lenders on the subject of asset lending

Two recent decisions of the NSW Supreme Court found that borrowers who obtain a loan upon the security of their home and apply the funds to a failed investment needed to take responsibility for their own actions and could not rely on arguments that the lender has engaged in asset lending or unconscionable conduct in having the loan set aside like the borrowers in the *Khoshaba* decision referred to below.

The relevant cases are as follows:

Riz v Perpetual Trustee Australia Ltd & Ors [2007] NSWSC 1153

The facts

Mr and Mrs Riz borrowed the sum of $275,000 from Perpetual Trustee Australia Ltd (**Perpetual**) on the security of their home. They applied part of the loan funds to discharge an existing home loan and $150,000 towards an investment in Karl Suleman Enterprises.

Arabic was the Riz's first language and it was alleged that their English was poor. With the assistance of their solicitor and mortgage broker, the borrowers gave Perpetual declarations that they earned just over $36,000 per annum. Their loan application was accompanied by certain tax returns and financial statements for a purported partnership. The tax returns were unsigned by the borrowers but apparently signed by a tax agent. In the return for the 2000 tax year, the borrowers' names were not referred to in the statement of distribution to partners. The information in the tax returns contradicted the borrowers' personal income statements which was accepted by the Court as being indicative of fraud.

The Karl Suleman investment failed and the borrowers could not meet their repayments. They defaulted under their loan and sought relief against Perpetual and certain other parties, including their solicitors. Their main argument was that Perpetual should not have relied upon the tax returns to verify the borrowers' income and ought to have known that the borrowers did not have the capacity to repay the loan. The borrowers maintained that Perpetual engaged in asset lending and that the loan contract was unjust in the circumstances and should be set aside.

The Court's findings

Justice Brereton was satisfied that from the documents supporting the loan application, Perpetual believed that the loan was serviceable and as such did not engage in asset lending. He said that "*Although asset lending is not necessarily unjust, such contracts have the potential for injustice*".

His Honour also found that Perpetual was not indifferent to the purpose of the loan. Perpetual was not in any way involved in the Karl Suleman investment and was aware that the loan was in part to refinance an existing loan and in part for further investment. It did not proceed with the loan on the basis of the security alone, but assessed the loan for serviceability which appeared to be satisfactory. These are distinguishing features to the decision in *Perpetual Trustee Company Limited v Khoshaba* [2006] NSWCA 41 where the Court found that a loan agreement was unjust, in part due to the fact that the lender did not have adequate regard to the ability of the borrower to make the loan payments and failed to obtain information regarding the purpose of the loan.

Interestingly, the Court noted that a lender is not an "*auditor*" and cannot be expected to scrutinise tax returns to determine whether

the borrower or its representative engaged in some fraud.

His Honour found that Perpetual did not engage in conduct which deprived the borrowers of a "*real or informed choice*" to enter into the loan contract and the Court was not prepared to find that the contract was unjust simply because it was not in the interests of the borrowers to enter into the contract. There was therefore no "*unconscionable dealing*" on the part of Perpetual and the borrowers' claims against Perpetual failed.

Justice Brereton did however rule that the borrowers had grounds for relief against their solicitor, for breach of fiduciary duty in failing to warn them of the risk associated with the Karl Suleman investment. The borrowers' solicitor also had a conflict of interest as their firm was involved in advising Mr Suleman. Justice Brereton was critical of the borrowers' solicitor in not properly advising the borrowers who believed their investment would generate income of $10,000 per fortnight.

The judgment shows that courts will not always set aside loans on the basis of asset lending.

Perpetual Trustees Victoria Ltd v Ford [2008] NSWSC 29

The facts

Mr Ford borrowed $200,000 from Perpetual Trustees Victoria Ltd (**Perpetual**) secured by his home in Wollongong. He was almost 58 years of age at the

date of the loan transaction, suffered from a congenital intellectual impairment and was illiterate. At the time of entering into the loan, he was in receipt of a disability pension and had no capacity from his income or other resources to service the payment of interest on a loan of $200,000.

The loan was arranged by Mr Ford's son in order for the son to purchase a cleaning business for the sum of $180,000. The business was purchased in the name of Mr Ford although he did not have the ability to manage or conduct the business.

Mr Ford as borrower signed the loan documentation, including declarations as to the purpose of the loan and that he understood his obligations under the loan in the presence of a mortgage broker. The majority of the loan funds were used to purchase the cleaning business for the Mr Ford's son and the remainder of the funds of approximately $25,000 were credited to Mr Ford's account.

Within 12 months of the date of the loan agreement, Mr Ford defaulted and Perpetual commenced

proceedings to seek recovery of amounts outstanding under the loan agreement and possession of the security property. Mr Ford's defence raised issues directly and indirectly related to his literacy and capacity to enter into the transaction with Perpetual or to understand it.

Mr Ford relied on a number of defences including the defence of *non est factum* which is in essence an argument that "*the mind of the person who signs did not go with his or her pen*" and therefore that person's belief is radically different to the effect of the document. The evidence of a clinical psychologist was submitted and in the psychologist's opinion, the borrower was not capable of entering into a contract and his "*intellectual functioning was comparable to an individual suffering from Down's Syndrome. He could not read the word 'contract' and could not spell it. He certainly could not define it.*"

The Court's findings

Justice Harrison held that the defence of *non est factum* was made out and therefore ruled that both the loan agreement and mortgage were void. He was satisfied that no explanation of the documents would have been adequate to provide the borrower with an understanding of their true meaning or effect. Justice Harrison made this decision notwithstanding the fact that Perpetual in his opinion, did not engage in unconscionable conduct as it had no direct dealings with the borrower and was unaware of the borrower's illiteracy and intellectual capacity.

There was also no evidence that Perpetual had notice of any undue influence on the part of the borrower's son who was said to be continuously present at the borrower's side, including when he signed the documents in the presence of the broker, who incidentally the Court found was the agent of the borrower.

The Court also made some interesting comments about asset lending and said "*Some may argue that a financial institution that is prepared to lend relying only upon a conservative debt to asset ratio, without any … regard to the resources of the borrower … to make repayments … ought to be treated as constructively on notice of any relevant disabilities of the borrower that might potentially render the contract unjust if actual notice of them existed. However asset lending is not illegal, and not always or necessarily unfair to the borrower. There is no evidence in the present case that the plaintiff was aware of the defendant's disabilities, nor any basis for concluding that it should have been.*"

The most interesting aspect of the decision is that although Perpetual had no ability to enforce the void loan agreement, the Court found that Perpetual was entitled to restitution of the amounts outstanding under the loan, including interest and costs, on the basis that the borrower had been unjustly enriched.

Although the cleaning business was purchased in his name, it is difficult to see how the funds applied towards the purchase of the business were directly for his benefit however, Justice Brereton said that "*The same*

could not be said of the sum of $24,857, which the defendant clearly received".

The decision is difficult to rationalise particularly as the end result appears inconsistent with the underlying basis upon which the borrower was able to avoid the contract. Perhaps the decision would have been different and ultimately favoured the borrower if the cleaning business were purchased in the borrower's son's name. ■ *Rosemary Carreras is an associate of Makinson & d'Apice Lawyers.*

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If we are able to assist you in any of these areas, or other banking and finance matters, please contact one of our Banking and Finance Practice Group Team:

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