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# AML legislation: implications for lawyers

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## Main points

- The *Anti-Money Laundering and Counter-Terrorism Financing Act 2006* (Cth) expressly preserves legal professional privilege, but not a lawyer's duty of confidentiality.
- When the second tranche of reforms promised by government brings the legal profession directly within the scope of the Act, lawyers will potentially be placed in an impossible position of conflict and the trust which can be placed in them will be undermined

The *Anti-Money Laundering and Counter-Terrorism Financing Act 2006* (Cth) (the AML Act) received Royal Assent on 12 December 2006 and its provisions will be phased in over a two-year transition period to coincide with the phasing out of corresponding provisions of the *Financial Transaction Reports Act 1988* (Cth) (the FTRA). In its current form, the AML Act, like the FTRA, applies to the financial services sector, bullion dealers and providers of gambling services. Among other things, it imposes a range of customer identification obligations and obligations to report transactions and other matters to the Australian Transaction Reports and Analysis Centre (AUSTRAC). Currently, the AML Act does not have an equivalent of the FTRA's obligation imposed on solicitors to report significant cash transactions (greater than $10,000).

It is intended that under a second tranche of reforms, the AML Act will directly regulate the services of real estate agents, jewellers and professions such as accountants and lawyers.

Under the AML Act as it now stands, lawyers could be regulated if they provide a financial service that is a designated service. For example, lawyers could potentially be taken to provide the following types of designated services:

- designated remittance services in respect of trust account receipts and payments;
- custodial or depository services; and
- safe deposit box facilities.

Note that the AML Act provides for Rules to be made which would exempt certain legal practitioner services in relation to custodial or depository services and safe deposit box facilities.

Obligations under the AML Act operate subject to legal professional privilege which is expressly preserved.[1]

Draft Q&A guidance from the Attorney General's Department for legal practitioners posed the question 'Would reporting obligations conflict with legal practitioners' professional obligations?' The answer given was that a legal practitioner would not be required to make reports based on information that is subject to legal professional privilege.

However, this answer fails to recognise that not all confidential communications between a lawyer and client will attract legal professional privilege. There is a clear distinction between a legal practitioner's professional confidentiality obligations and a client's legal professional privilege.

Lawyers, accountants and certain other professionals were identified in the Recommendations of the Financial Action Task Force as needing to be subject to suspicious matter reporting obligations. However, those recommendations expressly exempt lawyers from these obligations where the obligations would conflict with 'professional secrecy obligations' *or* 'legal professional privilege'. However, Australia's AML Act does not respond to the recommendation to preserve professional secrecy obligations except to the extent that those obligations may coincide with a client's reliance on legal professional privilege.

This issue is not unique to Australia. In 2002, law societies across the Canadian provinces sought injunctive relief from the effect of the *Proceeds of Crime*

*(Money Laundering) and Terrorist Financing Act*, SC 2000 cl 17. In each case, the relief sought was founded on constitutional grounds, with the Act said to be in violation of the protected right of an independent bar, the *Constitution Acts 1867* and *1982* and the *Canadian Charter of Rights and Freedoms*.

The law societies initiated a series of court challenges across the 12 provinces. In the first, the Law Society of British Columbia argued that an exemption for information subject to legal professional privilege was of little comfort to members of the Canadian legal profession for several reasons, one of which was that it did not apply to solicitor–client confidentiality.

In granting an interim injunction against the application of the statute to the legal profession, the court noted that:

> … the legislation places all lawyers in a profound conflict of interest between their duty of solicitor–client confidentiality owed to a client and their duty to report that client to the government … The solicitor–client relationship is a unique one, not comparable to the other professions and entities covered by the Act. The principles of fundamental justice that are said to be threatened by this legislation include the independence of the bar, solicitor/client confidentiality, and the duty of loyalty owed by lawyers to their clients.[2]

By consent, the Federation of Law Societies of Canada and the Attorney-General agreed that the court's decision would receive national recognition until a test case of the constitutionality of the relevant provisions of the Act could be run in the Supreme Court of British Columbia. Ultimately, however, the government repealed the controversial sections of the Act before this could happen.[3]

So, is this really an issue in Australia? To what extent could a communication or document be confidential and not privileged?

## Legal professional privilege

Legal professional privilege is essentially a general law concept relevant to court or other legal proceedings at which evidence is adduced. A client's privilege is respected by courts and other bodies conducting legal proceedings.[4] Privilege also exists under statute in ss 117–126 of the *Evidence Act 1995* (Cth) as a 'client legal privilege', preventing evidence from being adduced in legal proceedings if it would disclose a confidential communication or document prepared for the dominant purpose of providing legal advice (s 118) or legal services relating to a legal proceeding (s 119).[5]

The current test for legal professional privilege is laid down by the High Court in *Esso Australia Resources Ltd v Federal Commissioner of Taxation* (1999) 201 CLR 49. At common law, a confidential communication or document would be privileged if made or prepared for the dominant purpose of:

- obtaining or giving legal advice or assistance; or
- use in legal proceedings.[6]

Privilege does not extend to all that passes between lawyer and client within the bounds of the lawyer's retainer, and stops short of commercial advice.[7]

But the duty of a lawyer to maintain confidentiality is not so limited. A communication which does not meet the high standard of a dominant purpose may nonetheless be confidential.

The concern for lawyers and their clients arising from the AML Act is that there are situations where communications between them will clearly be confidential even though they may not be protected by legal professional privilege.

Many lawyer–client relationships are such that clients may routinely brief their lawyers on wide ranging concerns simply to promote greater awareness of their business or circumstances. Such communications, while inherently confidential, may occur in the absence of any legal proceedings or any instructions to provide legal advice or assistance. As a consequence, the communications will not be privileged and may be subject to reporting obligations binding on solicitors under the second tranche of reforms.

Solicitors representation letters are also cause for concern. Recently in the case of *Westpac Banking Corp v 789TEN Pty Ltd* (2005) 55 ACSR 519; [2005] NSWCA 321; BC200507412, the NSW Court of Appeal held that an ordinary solicitor's representation letter to a client's external auditor was not prepared for the 'dominant purpose' of providing legal advice to the client or pending litigation. As a result, the letter did not attract privilege.

Communications with inhouse counsel are another example of confidential information which may not be privileged. The fact that 'an in-house lawyer is able to claim privilege on behalf of his or her employer is now well established' both at common law and under the *Evidence Act*.[8] However, it is common for in-house counsel to have a commercial function (for example, company secretary/compliance officer) as a component of his or her duties. In this instance, privilege will only attach to communications with sufficiently independent counsel where the dominant purpose of that communication is the provision of legal advice. This may be of particular concern if the second tranche of reforms extends to all lawyers with practising certificates (including corporate practising certificates).

Yet another relevant circumstance arises where there has been waiver of privilege. Privilege, like confidentiality, is readily capable of being waived. This may occur through a deliberate or inadvertent disclosure of privileged information by the client or the client's lawyer. At general law, such disclosure must be 'inconsistent with the confidentiality which the privilege serves to protect'.[9] Waiver need not be expressed, but may be implied from conduct.[10] The general law approach to waiver is modified by s 122 of the *Evidence Act* (and corresponding provisions in the *Uniform Civil Procedure Rules*) which relevantly asks whether the client has 'knowingly and voluntarily disclosed to another person the substance of the evidence'.

Each of the above scenarios represents circumstances where a lawyer may be subject to obligations of confidentiality, but yet legal professional privilege will not attach to a document or communication. It follows that under the second tranche of reforms, a lawyer may technically be obliged to report such information to AUSTRAC where the information triggers a reporting obligation under

the AML Act, such as the obligation to report suspicious matters.

## Duty of confidentiality

In many ways, despite their differences in focus, privilege and confidentiality are coextensive. Legal professional privilege is only extended to communications made in confidence. However, as described above, their coverage is not identical, a fact made explicit by *Professional Conduct and Practice Rules 2002* (NSW), r 2,[11] which states that confidentiality is not limited to information which may be the subject of legal professional privilege.

The duty of secrecy owed by lawyers to their clients, commonly described as lawyer-client confidentiality, is founded on an amalgamation of the following contractual, equitable and statutory grounds.

### *Implied or express contractual term*

It is likely there is an express, but at any rate an implied, term in every contract of retainer between lawyers and their clients that confidentiality will be maintained in respect of communications between them. The duty of confidentiality also stems from the fiduciary relationship between lawyers and their clients, a duty which also derives from the retainer.

### *Equity*

The test for breach of confidence is set out in the oft-quoted judgment of Megarry J in *Coco v AN Clark (Engineers) Ltd* (1968) 1A IPR 587; [1969] RPC 41 at 47–48, a judgment which remains the definitive statement of the position of the equitable duty of confidence. The duty arises where:

- the information is confidential in nature; and
- it is communicated in circumstances importing an obligation of confidence.

Where there is an unauthorised use of the information which has caused detriment to the party to whom the duty is owed, an equitable remedy may be available.

### *Statute*

The duty of confidentiality owed by lawyers is one of the fundamental professional duties within r 2 of the *Solicitors' Rules 2002* (NSW). However, the regulatory requirement of confidentiality expressly carves out disclosure of information by a lawyer if '*permitted* or compelled by law' or 'in circumstances in which the law would *probably* compel its disclosure, despite a client's claim of legal professional privilege, and for the sole purpose of avoiding the *probable* commission or concealment of a felony'.[12] These are substantial exceptions to the duty of confidentiality.

## Conclusion

Inherent in the lawyer–client relationship is a duty to maintain the confidences of clients. While the government has yet to release details of the proposed second tranche of reforms under the AML Act, it is presently anticipated that, subject only to a client's legal professional privilege, lawyers will be obliged to report suspicious matters to AUSTRAC without being permitted to advise their clients that such a report is made or is even contemplated. Without express preservation of a lawyer's duty of confidentiality, the second tranche of reforms will place lawyers in an untenable position of conflict and will discourage full and frank communications with clients, thereby undermining confidence in legal representation and the legal system. ●

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## Endnotes

1. AML Act, s 242.

2. *The Law Society of British Columbia v Attorney-General of Canada* [2001] BCSC 1593 at [76]–[77].

3. Federation of Law Societies of Canada *Money Laundering Chronology of Events* May 2005 <www.flsc.ca/en/pdf/ml_chronology.pdf>.

4. It is also important to note that legal professional privilege is a rule of substantive law, rather than a mere rule of evidence, and may therefore be used to resist producing documents in all situations, and not just during the processes connected with litigation: *Daniels Corporation International Pty Ltd v ACCC* (2002) 213 CLR 543 at 552 (Gleeson CJ, Gaudron, Gummow and Hayne JJ).

5. The Commonwealth *Evidence Act 1995* also applies in the ACT and is replicated in NSW and Tasmania.

6. *Esso* at [2]; the test incorporates that used in ss 118 and 119 of the *Evidence Act 1995*.

7. Although Allsop J specifically acknowledges the difficulty in practice of disentangling commercial advice from advice relating to an 'overall legal framework': *DSE (Holdings) Pty Ltd v Intertan Inc* (2003) 135 FCR 151; 203 ALR 348; [2003] FCA 1191; BC200306380.

8. *Sydney Airports Corporation Ltd v Singapore Airlines* [2005] NSWCA 47; BC200501073 at [18] (Spigelman CJ).

9. *Mann v Carnell* (1999) 201 CLR 1 at [34] (Gleeson CJ, Gaudron, Gummow & Callinan JJ); *Ashfield Municipal Council v Roads and Traffic Authority of NSW* [2004] NSWSC 917; BC200406542 (Barrett J).

10. See, for example, *Benecke v National Australia Bank* (1993) 35 NSWLR 110; BC9301918 where providing evidence of instructions to a barrister meant that the plaintiff could not prevent the barrister from giving evidence of his understanding of those instructions in related proceedings.

11. There are professional rules to the same effect in each jurisdiction: Law Council of Australia's *Model Rules of Professional Conduct and Practice,* r 3.1; *Professional Conduct Rules* (ACT) (amended as at September 2003), r 2.1; *Rules of Professional Conduct and Practice* (NT) (January 2002), r 2.1; *Solicitors' Handbook* (Qld), para 4.02.1; *Rules of Professional Conduct and Practice* (SA) (effective 1 March 2003), r 3.1; *Rules of Practice 1994* (Tas), r 11(1); *Professional Conduct and Practice Rules 2005 (Vic),* r 3.1; *Professional Conduct Rules* (WA) (amended as at December 2003), r 6.3.

12. Emphasis added.

# AML update: final AML/CTF Rules

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The Rules relating to the provisions of the *Anti-Money Laundering and Counter-Terrorism Financing Act 2006* (Cth) [AML/CTF] (the AML/CTF Act) due to come into effect on 12 June 2007 and 12 December 2007 have been finalised by AUSTRAC and released on 30 March 2007.

The final AML/CTF Rules incorporate amendments made in the Version 3 Draft AML/CTF Rules released 20 March 2007, amendments outlined in the Version 4 Draft AML/CTF Rules, released 27 March 2007, the Anti-Money Laundering and Counter-Terrorism Financing Rules in Respect of Correspondent Banking released 18 January 2007 and the Draft Anti-Money Laundering and Counter-Terrorism Financing Rules in respect of the definition of 'designated business group' released 15 January 2007.

The Rules include the requirements for customer identification and verification procedures, and anti-money laundering and counter-terrorism financing (AML/CTF) programs.

The Rules are divided into chapters. Chapters 1, 2 and 3 relate to:

- key terms and concepts;
- designated business groups; and
- correspondent banking due diligence.

The Rules in these chapters relate to provisions in the AML/CTF Act that are due to commence on 12 June 2007.

Chapters 4, 5, 6, 7, 8, 9 and 10 of the Rules relate to:

- Part B of a standard AML/CTF program and Part B of a joint AML/CTF program;
- special AML/CTF programs;
- customer identity verification;
- applicable customer identity verification deemed to have been carried out by a reporting entity;
- Part A of a standard AML/CTF program and Part A of a Joint AML/CTF program; and
- casinos

The Rules in these chapters relate to provisions in the AML/CTF Act that are due to commence on 12 December 2007.

AUSTRAC announced that the Rules were registered on 13 April 2007. This will add to the current Rules for movements of bearer negotiable instruments; register of providers of designated remittance services; movements of physical currency into or out of Australia; and receipts of physical currency from outside Australia that were registered in December 2006 by AUSTRAC. AUSTRAC CEO, Neil Jensen, has given an undertaking that all remaining Rules will be finalised before the implementation dates for each relevant section of the AML/CTF Act.

## General

### *Privacy*

The Rules refer to the fact that:

- activities carried out in order to comply with the Rules are subject to the provisions of the *Privacy Act 1988* (Cth) even if a reporting entity would be otherwise exempt from the provisions of the *Privacy Act*;
- a reporting entity should consider its obligations under the *Privacy Act* when deciding on what information to collect as part of its identification procedures; and
- a reporting entity should take note of the Privacy Commissioner's information sheet with respect to the handling of employee information.

## Chapter 1

### *Key terms and concepts*

#### *Certified copy*

The list of persons authorised to certify document copies under the AML/CTF Act is increased to include members of the Institute of Chartered Accountants, CPA Australia and the National Institute of Accountants.

The term of membership for all authorised certifying entities has been lowered from five years to two years.

#### *Correspondent banking relationship*

The definition of a 'correspondent banking relationship' in s 5 of the AML/CTF Act allows for exclusion of banking services as specified in the Rules.

A new Rule provides that the exclusion from the definition of 'correspondent banking relationship' applies to all banking services that do not involve Nostro or Vostro accounts. This Rule came into effect on 14 April 2007.

This exclusion will mean that only those services that involve Nostro and Vostro accounts will be regarded as correspondent banking for the purposes of the AML/CTF Act.

The AML/CTF Act and Rules do not provide a definition of Nostro and Vostro accounts. However, an AUSTRAC definition for these terms in AUSTRAC Guideline No 1, *Financial Transaction Reports Act 1988* (Cth), Suspect Transaction Reporting issued in October 1989 provides the following definitions:

- Nostro Accounts — Australian financial institutions' foreign currency accounts conducted with international correspondent banks to settle foreign currency transactions initiated by either the Australian Financial Institution or international correspondent banks; and
- Vostro Accounts — international correspondent banks' Australian currency accounts conducted with Australian financial institutions to settle Australian currency transactions initiated by either the Australian financial institution or international correspondent banks.

If this definition is intended to apply, it may limit the definition of correspondent banking relationships to the situations where those accounts are established for the purpose of settling foreign currency and Australian currency transactions.

*KYC information*

The defined know your customer (KYC) information for unincorporated associations no longer includes:

- state, territory or country of incorporation; or
- date of incorporation.

*ML/TF Risk*

The definition of ML/TF risk is no longer limited to the 'designated services' provided 'at or through a permanent establishment of the reporting entity in Australia'. Presumably reporting entities should therefore also consider the risks involved in providing designated services in foreign jurisdictions.

## Online gambling service

The definition of online gambling service includes gambling services provided by the means referred to in s 5(1)(b) of the *Interactive Gambling Act 2001* (Cth) which includes any of the following:

- an internet carriage service;
- any other listed carriage service;
- a broadcasting service;
- any other content service; or
- a datacasting service.

However, the definition excludes:

- a 'telephone betting service' as defined in the *Interactive Gambling Act* to mean a gambling service provided on the basis that dealings with customers are wholly by way of voice calls made using a standard telephone service;

and includes:

- services that are 'excluded wagering services' for the purposes of the *Interactive Gambling Act*, being online gambling services for betting on:
  - — a horse race;
  - — a harness race;
  - — a greyhound race;
  - — a sporting event;
  - — an event;
  - — a series of events; or
  - — a contingency.

### *Primary non-photographic identification document*

A citizenship certificate issued by a foreign government is now included as a document that is a primary non-photographic identification document for the purposes of identification of individuals.

### *Primary photographic identification document*

One of the documents that is a primary photographic identification document and was previously identified as a 'card issued under a law of a State or Territory for the purpose of *identification*' is now identified as 'a card issued under a law of a State or Territory for the purpose of *proving a person's age*'. This will include the various state issued 'proof of age cards'.

### *Registered foreign company*

A definition is now included for a registered foreign company. The definition refers to those companies that are registered under Div 2 of Pt 5B.2 of the *Corporations Act 2001* (Cth).

### *Secondary identification document*

The documentary notice introduced as a Secondary Identification Document in the Rules of 20 March 2007 where the notice is issued by a school principal and contains the name and residential address of the minor and the period of time over which the minor attended the school is stated to apply only for the purposes of identification of a person under the age of 18.

### *Transaction history*

The definition of transaction history that was introduced in the 20 March 2007 Draft Rules has been removed. The reference to a 'transaction history' as part of the 'safe harbour' electronic identification procedure is not defined. There may be some clarification of the term in the guidelines to be issued by AUSTRAC and in the absence of clarification transaction history must presumably refer to history held provided by a third party because the Rules refer to the use of 'reliable and independent' electronic or documentary data for the purposes of verification.

### *Totalisator agency board*

The definition of a totalisator agency board now includes a corporate entity holding a licence for operating a betting service and clearly includes Tabcorp.

## Chapter 2

### *Definition of a 'designated business group'*

Chapter 2 of the Rules now provides for the election requirements referred to in para (b) of the definition of designated business group in the AML/CTF Act.

To make a valid election to be a designated business group the election must be on the AUSTRAC form provided in the Rules and must be provided by the Nominated Contact Officer.

Forms are also included for the:

- withdrawal of a member from the designated business group;
- election of a new member; and
- termination of the business group.

All forms must be lodged by the Nominated Contact Officer within 14 business days of any of the changes taking effect.

The Chapter also includes the conditions referred to in para (d) of the definition in the AML Act that must be satisfied for a member to be a member of the group. It provides that each member must either be:

- a related body corporate of each other member of the group within the meaning of s 50 of the *Corporations Act* and either
  - — a reporting entity; or
  - — a company in a foreign country which if it were resident in Australia would be a reporting entity; or
- providing a designated service pursuant to a joint venture agreement, to which each member of the group is a party.

### *Nominated contact officer*

Is defined to mean an officer or an AML/CTF Compliance Officer — a member of the designated business group — who is appointed as the Nominated Contact Officer by the designated business group.

## Chapter 3

### *Correspondent banking due diligence*

Chapter 3 replaces the former Ch 7 of the Draft AML/CTF Rules relating to correspondent banking. The Rules have not changed since the Draft Rules released by AUSTRAC 18 January 2007.

The Rules with respect to correspondent banking establish:

- the due diligence assessment that must be undertaken pursuant to s 97(2) of the AML/CTF Act before entering into a 'correspondent banking relationship';
- the matters to be considered by a senior officer before approving a correspondent banking relationship referred to in s 99(1) of the AML/CTF Act;
- the matters referred to in s 98(2)(a) of the AML/CTF Act to be assessed regularly as part of ongoing due diligence of the correspondent banking relationship;
- the matters referred to in s 98(5) for determining the period between each reassessment of the correspondent banking relationship.

reporting entity in a foreign country' has been removed from the factors which a reporting entity must consider when identifying ML/TF Risk.

### *Documentation based and electronic based safe harbour procedure where ML/TF Risk is medium or lower*

The safe harbour procedures relate to medium to low risk customer identification where the customer is an individual. The Rules clarify that a reporting entity is not bound to use the safe harbour procedures for identification of individual customers who are medium to low risk. A reporting entity may choose to adopt another method of identification and verification of medium-to-low risk customers and can do so if it otherwise complies with the obligations in Ch 4 of the Rules.

### *Existence of the trust — collection and verification of information*

The verification and collection procedure requirements have been amended to apply to trustees that are individuals in addition to trustees that are companies and the reference to a trust being licensed has been amended to a reference to a trust being registered. AUSTRAC has undertaken to issue guidance on the meaning of 'reliable and independent documents relating to the trust'.

The Rules clarify that a reporting entity is not bound to use the safe harbour procedures for identification of individual customers who are medium-to-low risk.

## Chapter 4

Chapter 4 sets out Rules referred to in ss 84(3)(b) and 85(3)(b) of the AML/CTF Act for Part B of a reporting entity's standard or joint 'AML/CTF Program' to comply with AUSTRAC's requirements.

The previous reference to 'risk based procedures' now refers to 'risk based systems and controls' and is consistent with other references in the AML/CTF Act and Rules.

The reference to the risk posed by 'the provision of *designated services* by any permanent establishments of the

## Chapter 6

### *Verification of the identity of customers for the purposes of ss 29(2) and 31(2)*

The Rules clarify that where a 'reporting entity' has previously carried out the 'applicable customer

identification procedure' it is not required to carry out the identification again when a suspicious matter arises.

## Chapter 7

### *Applicable customer identification procedures deemed to have been carried out by a reporting entity*

The Draft Rules of 20 March 2007 provided for an exemption from obtaining the identification records from a Licensed Financial Adviser on whom a reporting entity seeks to rely for identification of a customer, prior to the provision of the designated service. The exemption arises if there was an agreement between the Financial Adviser and the reporting entity for the management of records and the reporting entity has access under that agreement to those records.

This exemption now applies to members of the same designated business group relying on identification undertaken by another member of the designated business group. If the parties have an agreement in place for the management of records, and the reporting entity seeking to rely on identification by another member who is a reporting entity has access under that agreement to those records, it is not necessary to obtain the records prior to the provision of the designated service.

The wording has also clarified that access must be to the records made by the reporting entity that has undertaken the identification.

## Chapter 8

### *Independent review*

The results of any independent review were previously required to be provided to senior management. The Rules now provide that the governing board must also receive the results.

## Chapter 9

### *Permanent establishments in a foreign country*

The Rules have been clarified to provide that implementation of an AML/CTF program for provision of designated services at or through a permanent establishment in a foreign country are minimal where that foreign country's AML and CTF regulation is comparable to Australia's.

## Chapter 10

### *Casinos*

The limitation applying in the Draft Rules to customer ongoing due diligence by casino operators has been deleted. Casino operators are therefore subject to the ongoing customer due diligence obligations in s 36 of the AML/CTF Act.

### *On-course bookmakers and totalisator agency boards*

#### *Record keeping*

On-course bookmakers and totalisator agency boards are not required to retain records of designated services or transaction records relating to the provision of a designated service. If the designated service is either:

- receiving or accepting a bet;
- placing or making a bet on behalf of a person; or
- accepting a person's entry into a game of chance or mixed chance and skill, where the game is played for money and not played on a *gaming machine* at an eligible *gaming machine* venue. ●

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Bank FIN DEVELOPMENTS

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# Hardship and the Consumer Credit Code

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## Main points

- The New South Wales Supreme Court held that there is no express time limit for a hardship application under s 68 of the *Consumer Credit Code* (Code). An application can be made notwithstanding the expiry of a Notice of Default at any time until judgment of the court.
- The phrase 'other reasonable cause' under s 66 of the Code is to be read widely. The court needs to consider what was the cause for a borrower being unable to meet his or her obligations and then to determine on the facts of the particular case whether that cause was reasonable.

On 16 March 2007, the NSW Supreme Court delivered judgment in *Permanent Custodians Ltd v Upston* [2007] NSWSC 223; BC200701913, regarding a hardship application made by the defaulting borrower pursuant to s 68 of the Consumer Credit Code (the Code) that may have potential impacts on all lenders and borrowers.

## Facts

Carolyn Joy Upston (the borrower) entered into a loan agreement with Permanent Custodians Ltd (the lender) for total credit of $264,000, split into two loan amounts of $180,000 and $84,000 respectively. The borrower used the loan to refinance a residential property with the first loan amount and to purchase a takeaway business with the second loan amount.

The borrower resigned from her employment to manage the takeaway business when it was apparent that it had operational difficulties. During her time overseeing the business, the borrower defaulted on her loan from December 2005 to February 2006 but made all payments due since March 2006 after selling the business and regaining employment.

The lender subsequently commenced proceedings in the Supreme Court for possession of the residential property.

## Issues

First, the lender submitted that the loan agreement should not be regulated by the Code as it was not predominantly for personal, domestic or household purposes (at [8]).

In her defence, the borrower submitted that she did not receive the Notice of Default from the lender pursuant to s 80 of the Code (at [6]).

The borrower then cross-claimed for hardship relief under s 68 of the Code notwithstanding the expiry of the Notice of Default (at [7]). The timing of the application for hardship relief and whether the cause of her default was reasonable were the key issues considered by Cooper AJ.

## Cooper AJ's decision

### *Is the loan regulated by the Code?*

Cooper AJ declared the loan to be regulated by the Code as it satisfied the requirement of s 6 that the credit be predominantly for personal, domestic or household purposes. The lender alleged that the credit was provided for business purposes because the only reason for the borrower to go to considerable expense for early discharge of a previous mortgage and entering into the new mortgage with the lender was to obtain additional funds, namely the second loan amount of $84,000, to purchase the takeaway business (at [29]).

Cooper AJ rejected this argument for two reasons.

- Although the loan agreement contained a statement describing it as a 'Business Loan', it did not contain the required business purpose declaration as stipulated under ss 10 and 11 of the Code.
- The substance of the transaction must be considered in the context of its performance (referring to *Jonsson v Arkway Pty Ltd* [2003] 58 NSWLR 451 at 456). Since the substance of the loan as intended and executed was for $180,000 to refinance the residential property, a personal use, and $84,000 for acquiring the business (*Permanent Custodians Ltd* at [32]), the total credit was provided predominantly for personal, domestic or household purposes under s 6 of the Code.

### *Did the borrower receive the Notice of Default?*

Cooper AJ was satisfied on the probabilities of the evidence before the court that the borrower did receive the Notice of Default. Therefore, there was no breach of s 80 of the Code by the lender and the defence to the action failed (at [68)].

### *Can a hardship application under s 68 be made after expiry of the Notice of Default?*

#### *Rights in rem or rights in personam*

The lender submitted that no claim for relief can be made under s 68 of the Code as the Notice of Default had expired, resulting in the whole of the balance immediately due and payable under the acceleration clause of the mortgage (at [71]).

The Notice of Default was also issued in pursuant to s 57(2) of the *Real Property Act 1900* (NSW); therefore, ss 58 and 60 of that Act regarding the mortgagee's power to sell and bring proceedings for possession were relevant (at [75]). The lender submitted that the expiry of the Notice of Default and the

acceleration clause coming into effect created rights *in rem* in favour of the plaintiff. Since the provisions of the *Real Property Act* were enlivened, the lender argued that the Code no longer applied, as it cannot be a brake or fetter upon the lender's rights to the land under that Act (at [78]).

Cooper AJ rejected this submission. The lender had relied on s 60(c) of the *Real Property Act* to bring the proceedings for possession. Cooper AJ declared that this was a right *in personam* for the mortgagee to bring proceedings and that it was the judgment of the court which creates rights *in rem*. Therefore, the borrower was not precluded in this instance from making a hardship application under s 68 of the Code (at [85]).

Cooper AJ did note that if the lender had exercised the power to sell the residential property and passed on good title to the purchaser under s 58 of that Act then this would have precluded the borrower from making a hardship application under the Code as that would be contrary to the vesting of title in the purchaser (at [82]).

### *No express time limit for making application for hardship*

The Code provides that a borrower may make a hardship application to the court under s 68 to vary the loan contract. In particular, s 68(3) provides that the court may stay any enforcement proceedings under the loan until the application has been determined (at [90]).

It was noted that enforcement proceedings cannot be commenced until the expiry of a Notice of Default pursuant to s 80 of the Code. Therefore, Cooper AJ declared that the construction of s 68(3) allowed the borrower to make an application for hardship relief notwithstanding expiry of the Notice of Default (at [91]).

Further, Cooper AJ declared that a borrower can make a hardship application under the Code at any time until judgment by the court (at [97]).

### *The test for hardship*

The test for hardship is given under s 66 of the Code. It states that a borrower may apply for relief if the borrower is unable reasonably, because of illness, unemployment or other reasonable cause, to meet the obligations under the loan and that the borrower reasonably expects to be able to discharge the obligations if the terms of the loan were varied.

The phrase considered in depth was 'other reasonable cause'. Cooper AJ declared this phrase was to be read widely in accordance with its ordinary meaning. That is, there is no genus in the preceding words of 'illness' and 'unemployment' to limit the reading of the phrase (at [155]).

Therefore, Cooper AJ declared that in applying the phrase 'other reasonable cause', the court was to consider what was the cause for a borrower being unable to meet his or her obligations and then to determine on the facts of the particular case whether that cause was reasonable (at [156]).

In light of this wide application, the cause of the borrower here being unable to reasonably meet her obligations to the lender from December 2005 to February 2006 was because of her leaving employment in an attempt to revive the take-away business. Cooper AJ was satisfied that this cause was reasonable (at [157]).

Further, the borrower's regaining employment and good employment history demonstrated that she reasonably expected to be able to discharge her obligations if the loan was varied (at [161]).

Consequently, Cooper AJ allowed the application for hardship relief and ordered the 30-year loan term recommence with the arrears to be capitalised (at [183]).

## Conclusion

This is a significant case because Cooper AJ declared that an application for relief under s 68 of the Code is allowed notwithstanding the expiry of a Notice of Default and the time when an application may be made ends only when the application has been decided by the court. Further, the wide application of the test for hardship may provide greater recourse to s 68 relief for borrowers under the Code than was previously thought to be available. ●

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# in BRIEF

**Anthony Lo Surdo** and **David Richardson**

## GEOFFREY WILLIAM VINES v AUSTRALIAN SECURITIES & INVESTMENTS COMMISSION

***[2007] NSWCA 75; BC200702341 (4 April 2007)***

### Main point

Two of the issues raised for determination in these proceedings were:

- the standard of care owed by a director under s 232(4) of the *Corporations Law* (the Law); and
- whether that duty is owed solely to the company or whether it extends to creditors and contributories.

Section 232(4) of the Law required officers of a corporation to exercise care and diligence in the performance of their duties. The Appellant, a chartered accountant and former auditor, was the Chief Financial Officer of the GIO Group, but not a director, when a hostile takeover bid for GIO was launched by AMP Ltd in 1998. The Appellant had general responsibility for the financial affairs of the GIO Group and undertook specific responsibilities with respect to GIO's response to the takeover including co-ordinating the work of the Due Diligence Committee.

The Australian Securities and Investments Commission (ASIC) alleged that the Appellant breached his duty in relation to the calculation of, and communication concerning, a profit forecast for the year 1998/99, which included a profit forecast for the reinsurance division of GIO Insurance Ltd, GIO Re. GIO Re was exposed to significant claims as a result of Hurricane Georges, which struck North and Central America a month after the takeover bid was announced. At issue was the inclusion of an $80 million profit forecast for GIO Re in the GIO profit forecast at a time when, on ASIC's case, the Appellant knew or ought to have known of facts that should have led him to advise it was improbable that the company would achieve that forecast.

### Standard of negligence

The Appellant submitted that the degree of negligence that must be established to constitute a contravention of s 232(4) is higher than that which would support a claim of negligence at common law. In support of this contention he pointed to the consequences of a finding of a breach of the statutory provision which include a declaration of contravention, penalties in the form of monetary fines, disqualification from office and compensation orders. These consequences are wider than the damages that could be awarded in a claim of negligence at common law.

The Appellant contended that in this statutory scheme the failure to act with care and diligence must be 'gross enough to become a matter of public concern, to interest the State by reason of its gravity'.

In a meticulously considered judgment, Spigelman CJ concluded that the degree of negligence is no higher than would support a claim of negligence at common law.

### Is the duty owed solely to the corporation?

The court held that the duty set out in s 232(4) of the law is owed to the corporation. Spigelman CJ indicated that further development of the law may identify a duty owed to creditors or shareholders or employees but that it did not arise in this case.

Santow JA said that while the duty is owed to the company, it must be accommodated to the overarching related duty to act honestly and in the interests of the company as a whole — that is, for the benefit of both present and future shareholders.

## SAFFRON SUN PTY LTD v PERMA-FIT FINANCE PTY LTD (IN LIQ)

***(2006) 65 NSWLR 603; [2005] NSWSC 1317; BC200511131***

### Main point

- A director of a trustee company may be personally liable for debts incurred by that company under s 197(1) of the *Corporations Act 2001* (Cth) if the trust deed does not provide that the company has a right of indemnity against trust assets for that liability.

In this case, the purchaser of land brought a claim against the directors of Perma-Fit Finance Pty Ltd (in liq) (the company), a trustee company. That claim was for the difference between the purchase price contracted for and the amount required by the mortgagee of the company to provide a discharge of its security to enable the sale to complete. The purchaser claimed to be subrogated to the rights of the mortgagee and brought its claim in both contract (that is, under the provisions of the mortgage) and under s 197(1) of the *Corporations Act 2001* (Cth) (the Act).

The contract claim was dismissed. It is the claim under s 197(1) of the Act which is of greater consequence.

In this case, the court considered the proper construction of s 197(1) of the Act as it existed prior to its amendment, which took effect on 18 November 2005.

In its unamended form, s 197(1) of the Act provided at the relevant time:

> Section 197: Directors liable for debts and other obligations incurred by corporation as trustee
>
> (1) A person who is a director of a corporation when it incurs a liability while acting, or purporting to act, as trustee, is liable to discharge the whole or a part of the liability if the corporation:
>
> (a) has not, and cannot, discharge the liability or that part of it; and
>
> (b) is not entitled to be fully indemnified against the liability out of trust assets.
>
> This is so even if the trust does not have enough assets to indemnify the trustee. The person is liable both individually and jointly with the corporation and anyone else who is liable under this subsection.

The relevant trust deed contained a full right of indemnity to the trustee.

### Section 197(1) of the Act

As will be apparent from the terms of s 197(1) of the Act, there are several conditions that must be met before a director may be liable under s 197. These conditions are:

(1) a corporation must have incurred a liability while acting, or purporting to act, as trustee;
(2) the corporation has failed to, and cannot discharge the liability or that part of it; and
(3) the corporation is not entitled to be fully indemnified against liability out of trust assets.

When considering the former s 229A of the *Companies Act 1981* (Cth) the appeals division of the Victorian Supreme Court in *Young v Murphy*[1] held that it was limited to assisting external creditors to recover their debts and that it did not extend to liabilities incurred by the trustee to beneficiaries for a breach of trust.

#### *Condition 1: Liability*

The Act does not define 'liability' for the purposes of s 197 of the Act. Liability may arise by a party entering a contract or through tortious or statutory obligation wholly unknown to the party at the material time.[2]

Section 197 of the Act also does not define the term 'incurring a liability.' The phrase 'incurring a debt', which, of course, is a form of liability is used in s 588G of the Act. In the context of the consideration of s 588G of the Act which, for present purposes, is arguably analogous to s 197, the courts have construed the phrase 'incurring a debt' to mean '… when, in substance and in commercial reality, the company is exposed to the relevant liability'.[3]

#### *Condition 2: The corporation has failed to and cannot discharge the liability*

A corporation, acting in its capacity as trustee, must have failed to and cannot discharge the liability or that part of it in issue.

#### *Condition 3: The trustee corporation is not entitled to be fully indemnified against liability out of trust assets*

One of the conditions to be met before

one can recover against a director is that the corporate trustee must not be entitled to be fully indemnified against the liability out of the trust assets. Lack of entitlement may arise, for example, where the liability incurred by the corporation purporting to act as trustee was incurred in breach of trust.[4]

But s 197(1) also provides that: 'This is so even if the trust does not have enough assets to indemnify the trustee.'

This phrase was considered by the Full Court of the Supreme Court of South Australia in *Hanel v O'Neill*.[5] The majority[6] held that a director can be liable under s 197 of the Act because the trust has no assets to meet a trustee's indemnity, even though the trust instrument confers a right of indemnity.

In *Intagro Projects Pty Ltd v ANZ Banking Group Ltd*[7] McDougall J of the Supreme Court of NSW, in an interlocutory judgment, expressed reservations about the reasoning of the majority in *Hanel v O'Neill*. In the absence of that decision, McDougall J would have held that s 197(1) made no change to the existing law immediately prior to the enactment of s 197(1) of the Act. The immediate predecessor to s 197(1) was s 233(2) of the *Corporations Law*. The effect of that earlier provision was that the absence of entitlement to be indemnified is the relevant question and that any inquiry as to whether the trust has enough assets to provide indemnity is of no consequence.

McDougall J reluctantly followed *Hanel v O'Neill* consistently with the requirement that intermediate appellate courts and single judges should not depart from an interpretation placed on uniform legislation such as corporations' legislation by another Australian intermediate appellate court unless convinced that the interpretation is plainly wrong.[8]

## Decision

Windeyer J considered each of the relevant decisions, including *Hanel*, and determined that '… *Hanel* is wrong and should not be followed'.

His Honour found, consistent with the views expressed in obiter by McDougall J in *Intagro*, that the relevant consideration to give rise to liability was not whether the trust had sufficient assets to meet a trustee's indemnity but whether there was a right of indemnity. As the trust deed provided that right, his Honour held that no liability in the directors arose notwithstanding that the trust had an insufficiency of assets to meet a trustee's claim pursuant to that right of indemnity.

## Conclusion

Section 197 of the Act was amended with effect from 18 November 2005. The object of the amendment was to overrule *Hanel*. This decision is consistent with the amendment. It will continue to be of relevance to liabilities which may have arisen prior to the amendment to s 197 of the Act coming into effect. ●

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## Endnotes

1. [1996] 1 VR 279; (1994) 13 ACSR 722.
2. *McDowell v Baker* (1979) 144 CLR 413; 26 ALR 277; BC7900086.
3. *Australian Securities and Investments Commission v Plymin* (No 1) (2003) 175 FLR 124 at [516]–[517]; 46 ACSR 126; [2003] VSC 123; BC200302080 (Mandie J).
4. *Young v Murphy* [1996] 1 VR 279; (1994) 13 ACSR 722.
5. [2003] 48 ACSR 378; [2003] SASC 409; BC200307700.
6. Mullighan and Gray JJ (Debelle J disagreeing on this point).
7. (2004) 50 ACSR 224; [2004] NSWSC 618; BC200404761.
8. *Australian Securities Commission v Marlborough Goldmines Ltd* (1993) 177 CLR 485 at 492; 112 ALR 627; [1993] HCA 15; BC9303569.

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# newbooks

***Rush M***
**The Defence of Passing On**
***Hart Publishing***
***Oxford 2006***
***ISBN-13:978-1-84113-602-8***

This book is based upon the author's doctoral thesis undertaken at the University of Oxford under the supervision of Professor Burrows, the esteemed author of *The Law of Restitution*.

This work examines both the theoretical and practical applications of the loss-based defence of 'passing-on' or 'disimprovishment'. If accepted, disimprovishment provides a defence to a claim of unjust enrichment. It has as its purpose the determination of liability between two undeserving parties in dispute. If a claimant incurs a loss by transferring a benefit to the defendant but then makes good that loss by shifting it to a third party, if the defence operates, the claimant cannot recover against the defendant for unjust enrichment except to the extent, if any, that the claimant has not made good his loss from the third party.

The defence has received judicial recognition in at least Canada and some jurisdictions of the US and is considered in those jurisdictions to be part of the law of unjust enrichment. It has been rejected in England, Australia and some jurisdictions in the US, although the author argues that only one of the conflicting approaches to the defence can be correct and that there may be some room for the defence to emerge in those jurisdictions in which it does not currently find favour.

As to the state of the English authorities, the author argues that the leading cases rejected the defence of disimprovishment in obiter and therefore there is still some scope for an English court to revisit the defence without overruling binding authority. The position in Australia is unequivocal. Disimprovishment does not, on the current state of the authorities, provide any defence to a claim for unjust enrichment. The position in Canada and the US is also examined.

This book provides a thorough and well-reasoned exposition of the defence of disimprovishment and, as such, is a welcome companion to the works on unjust enrichment which have preceded it. ●

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