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Guarantors and the Code of Banking Practice

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Two cases decided in the final 2 months of 2015 — *George 218 Pty Ltd v Bank of Queensland Ltd*[1] (*George 218*) and *Doggett v Commonwealth Bank of Australia*[2] (*Doggett*) have provided the courts with an opportunity to consider the interaction between the 2013 Code of Banking Practice (Code) and guarantors.

In *George 218*, the Western Australian Supreme Court confirmed unequivocally that the Code has no operation in respect of corporate guarantors. This is in contrast to the position of corporate borrowers. There is scope for the Code to operate in a loan agreement between a bank and a "small business" corporate borrower. A "small business" as defined by the Code could include a special purpose vehicle borrower with fewer than 20 employees, thereby extending the protective regime of the Code to larger enterprises.[3]

In *Doggett,* the Victorian Court of Appeal considered the incorporation and interpretation of certain Code obligations into individual guarantees, finding that while a Code obligation had been incorporated and breached, the appellants were not entitled to relief because they had entered into a letter of compromise releasing the bank from such a claim.

Taken together, *George 218* and *Doggett* are further reminders that care needs to be taken by borrowers and lenders alike when considering the applicability of the Code to arrangements with guarantors.

The Code of Banking Practice

The Code is published by the Australian Bankers' Association Inc (ABA), the national organisation of licensed banks in Australia. The ABA describes the Code as "the banking industry's customer charter on best banking practice standards".[4] The Code applies to consumer and small business customers, and their guarantors,[5] and contains general principles as well as detailed rules.

The Code was first published in 1993, and again in 2004, and each of those iterations was considered a significant advance in consumer protection at the time.[6] Following a review conducted by Jan McClelland in 2007–8,[7] the Code was revised and the most recent version was published in 2013, commencing on 1 February 2014.[8]

The Code is voluntary[9] and its adoption has been widespread.[10] If the Code is incorporated contractually into an agreement between banker and customer, compliance with Code obligations is reviewable by the courts. As has been observed, claims brought against banks for breaches of the Code (including claims brought defensively) are becoming increasingly frequent.[11]

Individual guarantors and the Code: Doggett v Commonwealth Bank of Australia

The appellants, Steven Doggett and Kevin Sullivan, incorporated Dogvan 007 Pty Ltd (Dogvan) for the purpose of purchasing property and management rights in an apartment complex. Dogvan obtained a loan from the Commonwealth Bank (Bank) to be provided by a bill facility, which was guaranteed by the appellants in their individual capacities. Each of the bill facility and the guarantees contained a clause stating "relevant provisions of the Code of Banking Practice apply".[12] The Bank argued (among other things) that cl 25.1 of the 2004 Code of Banking Practice (2004 Code) was not a "relevant" provision of the guarantees.

The court first considered cl 25.1 in the context of the bill facility. McLeish JA (Whelan JA and Garde AJA agreeing as to the analysis of the application of the Code)[13] acknowledged that a bank would naturally consider the financial position of a guarantor in carrying out its credit assessment of a borrower, but considered that that did not mean that the question to be asked in fulfilment of the obligation owed under cl 25.1 is whether the combined resources of borrower and any guarantors will be sufficient to service the loan. The Bank undertook to exercise the care and skill of a diligent and prudent banker in forming its opinion about Dogvan's ability to repay (noting that regard could properly be had to the availability to Dogvan of financial assistance from other sources).[14]

The court then turned to the guarantees. Determining whether cl 25.1 was "relevant" to the guarantees was a two step process: first, the clause incorporating the relevant provisions must be construed to determine the width of the incorporation; second, the incorporated words must be read into the guarantees to see whether any incorporated wording was inconsistent, insensible or in any way in conflict with the expressly agreed terms when placed in that context.

In the case of a guarantee, the likelihood that a borrower will fail to meet its obligations is a matter of

critical importance to parties to a guarantee. The court held that a promise by a bank as to the level of care it will take in conducting its assessment of that likelihood is properly "relevant" to the guarantee, and in the present case, therefore within the scope of the interpretation clause.

In reading cl 25.1 as incorporated into the guarantees, the central issue was the meaning of "you" and "your" as used in cl 25.1. The Bank submitted that except in the three clauses specified in the definition clause (cl 42 of the 2013 Code[15]), "you" and "your" referred only to persons being offered or granted a credit facility — in the present case, Dogvan, which was not a party to the guarantee — so it followed that clause 25.1 could have no sensible operation if incorporated into the guarantees.

The court accepted that the reference to "you" in cl 25.1 as incorporated into the guarantees referred to Dogvan, but held that it did not follow that cl 25.1 could have no sensible operation. What followed was that in discharging its obligations to the appellants under the guarantees, the Bank had a duty to exercise the care and skill of a diligent and prudent banker in assessing Dogvan's ability to repay.

The court was not dissuaded from this view by cl 28.4(d) of the 2004 Code (cl 31.4(d) of the 2013 Code), which requires a bank to provide a guarantor with information regarding the borrower's finances, which indicates that a guarantor makes his/her own inquiries as to a borrower's ability to repay. In fact, the court held that an expectation that both parties would make such inquiries sat comfortably with an obligation on the bank to do so exercising a level of care and skill to be expected from an entity of its expertise. In the court's view, it would be hard to explain, if not perverse, for the bank to owe such an obligation to the borrower — who is more able to accurately assess its ability to repay than its guarantor — and deny that such an obligation was owed to the guarantor.

The court proceeded to confirm the first instance result — although breach of the Code obligation was established,[16] the court held unanimously that the letter of compromise was sufficient to release the Bank from any claim alleging breach of cl 25.1 of the 2004 Code. On the question of whether the breach caused loss (which was not dispositive of the appeal), Whelan JA (Garde AJA agreeing)[17] also upheld the first instance finding that the breach of cl 25.1 caused the appellants loss, while McLeish JA found that the appellants failed to discharge their onus of proving that had cl 25.1 not been breached, the Dogvan bill facility would not have been advanced.[18]

This result illustrates that even where a Code obligation is incorporated, and breach is established, a claimant may not be entitled to relief.[19]

Corporate guarantors and the Code: George 218 Pty Ltd v Bank of Queensland

Success Assets Pty Ltd (Success), a company controlled by Tina Bazzo, borrowed money from Statewest Credit Society Ltd (Statewest). Ms Bazzo and three other companies she controlled (the plaintiffs) executed guarantees in favour of Statewest which secured the loan and all future loans from Statewest to Success. The loan to Statewest was then repaid, using funds borrowed from Home Building Society Ltd (Home). Statewest's rights under the guarantees (in respect of any future loans) as well as Home's rights under its loan agreement were transferred to the Bank of Queensland (BOQ).

BOQ granted Success a loan to pay out its existing facilities secured by mortgages, and the plaintiffs executed a deed in which they agreed that the guarantees originally provided to Statewest operated in respect of this loan. Success defaulted on this loan and, after the sale of the mortgaged property, there remained a shortfall owing to BOQ of $2,274,516. The plaintiffs commenced proceedings, claiming (among other things) that the guarantees did not apply to secure the BOQ loan to Success.

The claim raised a number of issues, including whether any liability of the plaintiffs under the guarantees was discharged by reason of alleged breaches of the Code by BOQ — it was argued that, contrary to cl 28.3 of the 2004 Code (cl 31.3 of the 2013 Code) the guarantees did not state that the Code applied; and the guarantees were for an unlimited amount (cl 28.2 of the 2004 Code (cl 31.2 of the 2013 Code) required that the bank only accept a guarantee limited to either a specific amount, or to the value of a specified security).

The court (Mitchell J) had no difficulty in rejecting the aspect of the plaintiffs' claim that relied on the Code.[20] First, the court held that the Code by its terms only applies to guarantees by individuals. Clause 28.1 (cl 31.1 of the 2013 Code) provides that the clause of the Code governing guarantees:

> … applies to every guarantee and indemnity obtained from **you** (where **you** are an individual at the time the guarantee and indemnity is taken) for the purpose of securing any financial accommodation or facility provided by **us** to another individual or a **small business** … [Bold in original and indicates defined terms].

Further, there was no evidence that the terms of the Code were incorporated into the guarantees or the loan agreement. Mere adoption of the Code by a bank, without incorporation into a contract, is insufficient for the Code to be incorporated. In addition, there was no evidence that Statewest had adopted the Code at the time the guarantees were executed.

The court went on to observe that the loan agreement was expressly conditional upon the provision of an unlimited guarantee; and the guarantees made clear that

that the liability created was unlimited. Even if the Code was incorporated by reference, the clear and express provisions of the guarantees and the loan agreement would prevail.

While obiter, this observation is consistent with the second step of the two step process described by the court in *Doggett,* and indicates that courts would not be willing to construe as "relevant" provisions of the Code that are contrary to the express terms of a loan agreement or guarantee — again, highlighting the significance of the incorporating clause required by cl 12.3 of the Code.

The position of guarantors post — George 218 and Doggett

Doggett makes clear that Code obligations can be incorporated into banking facilities and guarantees given by individuals. This case demonstrates that where the Code is incorporated into a loan and guarantee (where the guarantor is an individual), the bank may owe both borrower and guarantor an obligation to take due care and skill in selecting and applying credit assessment methods and considering the borrower's ability to repay.

Conversely, *George 218* confirms that the Code does not operate in respect of corporate guarantors. However, those entering into corporate guarantees still need to be aware of the potential "long-arm reach" of the Code due to the definition of "small business" in the Code. It remains a live possibility that a borrower that is a small business or special purpose vehicle of less than 20 employees could still fall within the operation of the Code.

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Footnotes

1. *George 218 Pty Ltd v Bank of Queensland Ltd* [2015] WASC 434; BC201511125.
2. *Doggett v Commonwealth Bank of Australia* [2015] VSCA 351; BC201512471.
3. See Dr N D'Angelo and K Cibich "Beware the Code of Banking Practice — it's not just for retail and consumer banking" (2015) 31(7) *BLB* 141.
4. Australian Bankers' Association, *Code of Banking Practice*, www.bankers.asn.au.
5. Code, cl 1.
6. See, eg, N Howell "Revisiting the Australian Code of Banking Practice: Is self-regulation still relevant for improving consumer protection standards?" (2015) (38)(2) *UNSW Law Journal* 544 at 545.
7. Jan McClelland and Associates Pty Ltd *Review of the Code of Banking Practice Final Report* (December 2008) www.reviewbankcode2.com.au.
8. For an examination of the more significant changes made as a result of that review, see N Mirzai "The 2013 Code of Banking Practice: effect, effectiveness and comment" (2013) 28(8) *BLB* 139.

9. Code, cl 1. In 2012, the Banking Amendment (Banking Code of Conduct) Bill 2012 (Cth), which sought to make the Code mandatory, was introduced in the House of Representatives but did not proceed.
10. For a list of banks that have adopted the Code, see ABA, *Banks that have adopted versions of the Code of Banking Practice,* 31 January 2014, www.bankers.asn.au.
11. See, eg above n 3, at 141.
12. See Code, cll 12.3 and 31.3.
13. Above n 2, at [1] per Whelan JA and [218] per Garde AJA.
14. Above n 2, at [120] per McLeish JA.
15. Cl 42 provides: "**you** and **your** means a person who, at the time the **banking service** is provided, is an individual or a **small business** that is **our** customer … and includes, in clauses 31, 35 and 2, any individual from whom **we** have obtained or propose to obtain a **Guarantee** …".
16. See above n 2, at [148]–[162].
17. Above n 2, at [2] per Whelan JA and [219] per Garde AJA.
18. Above n 2, at [100(q)] and [188] per McLeish JA.
19. See also *Williams v Commonwealth Bank of Australia* [2013] NSWSC 335; BC201301853, which held that even if the Code obligations had been complied with, the customer would still have entered into the agreements, and commentary in R Dennings and E Hamman "Breach of Code of Banking Practice does not necessarily lead to relief" (2013) 29(3) *BLB* 41; and *National Australia Bank v Rice* [2015] VSC 10; BC201502030, cited in *National Australia Bank v McCarthy* [2015] NSWSC 1040; BC201507055 at [35], as authority for the principle that even if breach of the Code is established, it is not necessarily actionable.
20. Above n 1, at [226]–[237].