THE CONTRACTUAL EFFECT OF THE CODE OF BANKING PRACTICE NATIONAL AUSTRALIA BANK LTD V ROSE [2016] VSCA 169 (21 July 2016)

Snapshot

- Controversy has raged in the banking industry as to whether the Code of Banking Practice, a voluntary code of conduct to which most banks adhere, has any legal and, in particular, contractual force between a bank and a customer.

- It has been the subject of at least two Victorian Court of Appeal decisions, the most recent of which has confirmed that the Code does have contractual effect.

- The decision has obvious ramifications for the manner in which banks will be required to deal with guarantors and other persons to whom provisions of the Code of Banking Practice may apply.

Introduction

On 21 July 2016, the Victorian Court of Appeal delivered judgment in National Australia Bank Ltd (**Bank)** v Rose. Although the Bank submitted in opening at trial that the Code of Banking Practice (**Code**) was of no legal effect, in closing submissions it accepted for the purposes of the proceedings that the Code had the status of contractual terms of each of the guarantees in question.

Accordingly, the application of the Code was not in issue in the Court of Appeal where the primary issue was whether the Bank had, in fact, complied with the terms of the Code.

Background facts

In 2007, Mr Rose entered a joint venture arrangement with a Mr Timothy Rice (the first defendant at trial), to acquire investment properties on the Gold Coast via companies which they jointly controlled. The acquisitions were funded by a combination of funds contributed by Mr Rose (in the sum of $4.8 million) and financing from NAB (amounting to over $8 million) which was arranged by Mr Rice.

On 18 June 2007, John D'Angelo (a bank manager) attended Mr Rose's home with loan documentation to be signed, and provided him with an oral summary of some of those documents. Mr Rose signed the documents on behalf of the relevant subsidiary company as the borrowing entity, and executed a guarantee in respect of each loan, numbering five in total. Unbeknownst to him however, having neither read the documents nor having sought legal or financial advice, each of the documents stipulated that he was to personally guarantee the entirety of each of the loans to the purchasing companies.

Each of the guarantees executed by Mr Rose also included a warranty by the Bank that it would comply with the relevant provisions of the Code, including clause 28.4(a) (now clause 31.4(a)) which relevantly provided:

> We will do the following things before we take a Guarantee from you:
>
> (a) we will give you a prominent notice (emphasis added) that:
>
> (i) you should seek independent legal and financial advice on the effect of the Guarantee;
>
> (ii) you can refuse to enter into the Guarantee;
>
> (iii) there are financial risks involved;
>
> (iv) you have a right to limit your liability in accordance with this Code and as allowed by law;
>
> (v) you can request information about the transaction or facility to be guaranteed ("Facility") (including any facility with us to be refinanced by the Facility)…

Clause 28.5 (now clause 31.5) provided that the Bank "*will not ask you to sign a guarantee, or accept it, unless the bank has provided the proposed guarantor with the information described in clause 28.4 to the extent that the Code requires that information to be given and allowed the proposed guarantor until the next day to consider that information.*"

Warnings of the matters set out in clause 28.4 appeared on the cover page of each of the guarantees signed by Mr Rose as well as in other parts of the documentation.

Following defaults on the loans in 2010, the properties were repossessed and sold. The Bank then issued demands against the guarantors seeking the outstanding balance of the loans. By way of counter-claim, Mr Rose sought damages for a purported breach of the Code by the Bank consisting of an alleged failure to provide a prominent notice in accordance with the requirements clause 28.4.

The primary judgment

The Bank's claim at first instance was dismissed.

The Court found that Mr D'Angelo was unclear as to the precise explanations and warnings that he had given Mr Rose when the guarantees were signed, did not discuss any page of the guarantee in any detail and relied on his standard practice as to what he did and what he said to Mr Rose at the time of the execution of the guarantees.

The primary judge preferred the evidence of Mr Rose who said that he did not have any of the guarantees properly explained to him and that he simply signed where he was told to sign by Mr D'Angelo, that Mr D'Angelo did not advise him to obtain independent legal advice and that had he been so told, he would have obtained that advice.

The trial judge held that whilst Mr Rose was not in a position of special disability or disadvantage and was "*perfectly capable of protecting his own interests and obtaining his own advice if he wanted to do so*", he had nevertheless incurred loss as a result of the Bank's breaches of the Code (which conduct amounted to a breach of a contractual warranty).

The Court of Appeal

A majority of the Court of Appeal (Warren CJ, McLeish JA; Ferguson JA dissenting) affirmed the trial judge's conclusion that the Bank had failed to provide Mr Rose with the requisite prominent notice under clause 28.4(a).

In reaching their conclusion, the majority examined the circumstances in which the guarantees were signed, including the brevity of the meeting (having only occupied approximately 30 minutes), the length and number of documents, Mr D'Angelo's incomplete summaries of those documents and knowledge that Mr Rose had not read them, and the fact that the documents were not left with Mr Rose to be reviewed.

The Court concluded that it could not be said that the Bank had given Mr Rose a 'prominent notice' of the relevant matters. Whilst the Bank had no obligation to orally recite or explain the nature and effect of the guarantees under the Code, it did however, have an obligation to give Mr Rose notice of those matters which, in the context in which they were presented, was likely to be conspicuous.

The Court, in obiter, confirmed the primary judge's conclusion that clause 28.4 of the Code had contractual force, that is, as a contractual warranty under the guarantees:

"*It must be thought that cl 28.4, which is framed as an express promise to a guarantor that the bank will do certain things before taking a guarantee, is …plainly relevant to the transactions and obligations under the guarantees in the present case. The same can be said of cl 28.5. Accordingly, we would respectfully agree with the trial judge's conclusion that those clauses of the Banking Code had contractual force as terms of the guarantees at issue in this proceeding*." [40]

This finding is consistent with the earlier Victorian Court of Appeal decision in *Doggett v Commonwealth Bank of Australia* [2015] VSCA 351 in respect of which the High Court refused an application for special leave to appeal on 15 June 2016: [2016] HCASL 114.

Accordingly, the Court concluded that the breach of the Code entitled Mr Rose to damages equivalent to his liability under the respective guarantees with the consequence that the Bank could not enforce its loan guarantees of approximately $8 million against Mr Rose.

Conclusion

Both this decision and *Doggett* which preceded it confirm that the provisions of the Code can and do have contractual effect as between a bank and its customers. It demonstrates the importance of strict adherence to the Code and the consequences which can follow if those requirements are not observed.

5 August 2016

Anthony Lo Surdo SC

www.greenlist.com.au; www.silkmediator.com.au