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Ms Jan McClelland
Code of Banking Practice Review
GPO Box 3419
Sydney NSW

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Email: info@reviewbankcode2.com.au

Dear Ms McClelland,

Re: Review of Banking Code of Practice

Our department is involved in the delivery of banking law courses at both undergraduate and postgraduate levels.

Issues relating to principal and agent

The problem of a Code regulated creditor making a loan through a non regulated reseller, where the agreement does not identify the Code regulated creditor arises often. This raises the obvious point that the Code regulated creditor should deal strictly with brokers who are members of acceptable industry bodies who have adequate internal dispute resolution procedures.

The problem of the undisclosed principal can extend to guarantees, with a non Code regulated reseller (the agent) using their own guarantee documents. Under general principles of principal to agent, the agent's documents must also comply with the Code. The fact that this is often not the case represents a potential problem but one that should behove the agent to ensure the documentation is properly altered to reflect the true position.

The Australian Bankers Association considers there should not be any provision in the Code that forces the subscribing principal to become disclosed on the agent's documents. They suggest one option is to "exclude from the Code products or services offered by banks on an undisclosed basis."¹ An alternative proposition suggested in the same source (see footnote 1) is for individual clauses of the Code to be considered separately to determine whether it is appropriate to require disclosure after taking into account the legitimate issues of customer protection and competition between subscribing and non subscribing creditors. This latter proposition is acknowledged as cumbersome and potentially resulting in a number of exceptions in

¹ See p.41 of the Review of the Code of Banking Practice, Issues Paper, Sydney May 2008

the Code that may result in added complexity and internal inconsistency within the Code itself.

How then should the matter of the undisclosed principal be dealt with?

It would seem readily apparent that the existence of a principal and agent relationship should require the principal to be disclosed in these situations. This should be the case from the predominant aspect of customer protection but also from basic principles of law. The argument presented by the ABA seems to centre on the cost of compliance by the complying bank to arrange for the agent to change relevant documentation and the fact that an agent may, as a result, feel more inclined to deal with a non complying principal. Such cost and competition issues should not, in our view, be placed ahead of consumer protection requirements.

There should not be any encouragement to the apparent acceptance of the agent as the “principal” by the customer. It is incumbent on the prospective principal to acknowledge the agency relationship or else ensure that there is no agency relationship. To acknowledge the agency relationship would then require the principal to ensure the agent makes clear that the terms of the Code apply. The issue should not be determined by the relative inconvenience of the agent having to change its documentation to reflect the application of the Code. Broader issues are at stake that relate to the nature of the relationship entered into by the subscribing “principal”. It would seem incumbent on that party to determine at the outset the ambit of the relationship. Should there be an agency relationship and the principal is undisclosed the law² says that the following applies:

1. The undisclosed principal may sue or be sued provided the agent has acted within the scope of his or her actual authority,
2. The agent of the undisclosed principal may sue or be sued on the contract (this being in the alternative to 1),
3. The agent, of course, must intend to act on the principal’s behalf,
4. A defence available against the agent is also available against the principal.

Of course it is always open for the terms of the contract to make clear that the agent is the actual principal.

In light of the above the issue seems to be more about the nature of the relationship that the subscribing bank has with their reseller rather than about costs of altering documentation to reflect the application of the Code. If the principal or the agent want to limit the amount of further work required to reflect the application of the Code this should be determined from the outset by the nature of the relationship entered into by the parties.

The issues the Code should reflect relate more to whether the principal either expressly or impliedly authorised the agent to act for it. It should also reflect the possibility for the principal to expressly exclude the operation of undisclosed principal applying. The question becomes more about the intention the parties have in

²See *Siu Yin Kwan v Eastern Insurance Co Ltd* [1994] 2 AC 199.

entering into the particular commercial transaction with the customer. It would seem to follow that the relevant intention (for an agency) should be shared by the principal and the agent that the latter is so acting on behalf of the other. If there is no intention it seems incumbent for that to be made clear in writing and therefore the terms of the Code should reflect an obligation on the subscriber to determine that question.

The doctrine of the undisclosed principal makes clear that the principal can be excluded from intervening in the contract where the contract between the agent and the customer expressly or impliedly exclude the principal. This places the onus on the subscribing bank to establish the terms of the contract arranged by its “agent”. If this party is not an agent or is an agent is at the behest of the subscriber to the Code to determine within their contractual arrangement. This means the Code should reflect the obligation of the subscriber to determine this position in writing. In short the law should place a positive obligation on the subscriber to reveal their identity in these situations where it is principal and agent.

In sum the suggested position is to go back to source and place a positive obligation on the subscriber to determine the nature of the relationship between it and the reseller. If it is one of agency then the position should require the principal to be disclosed in the contract. The Code should reflect a positive obligation on the subscriber to determine the nature of the relationship from the outset.

Guarantees

Clause 28.4 sets out what a lender will do in respect to a guarantor prior to the guarantee being signed. In our view it does not provide sufficiently for the explanation thereof, to the guarantor, of a continuing guarantee where the guarantor will be required to secure the performance of the principal debtor’s obligations to a series of future transactions. The terms of clause 28.13 do not sufficiently protect the guarantor since it places no positive obligation on the creditor to explain a “future credit contract” and the mere provision of such a contract, which will include a notice relating to the provision of future credit and the guarantor’s obligation thereto, will discharge the lenders obligation. Similarly any provision that seeks to be an “all moneys” clause should also place a positive obligation on the creditor to explain in detail the nature of the guarantor’s obligation in respect to such a term. The recommendation is place a positive obligation on subscribers to explain the nature of a continuing guarantee and an “all moneys” clause.

Where a guarantee is a continuing one and the consideration provided by the creditor is divisible in relation to the obligation of the principal debtor, the guarantor has the right to revoke the guarantee in respect to future liability. In our view this should be clearly stated in any continuing guarantee contract with an associated positive obligation on the creditor to explain this right. We consider the effect of clause 28.9 is of concern in that it expressly allows the creditor to not accept such limitation on the obligation of the guarantor where the credit contract stipulates future advances to the principal debtor. It seems incumbent on the creditor to make clear at the outset that future advances should be contingent on the existence of a guarantor and that a guarantor has the right to limit their obligation in respect to future obligations where consideration provided by the creditor is divisible.

We feel the combined effect of clause 28.2 and 28.13 in requiring the written consent of the guarantor as to the future credit obligations is substantial but not sufficient protection. The guarantor's consent may have occurred in terms that satisfy the provision of the Code (thereby making it enforceable) yet still allowing for the guarantor to remain ignorant of the terms of the continuing obligation. The matter is more effectively dealt with by providing for a positive obligation on the creditor (as per 1 and 2 above) prior to the signing of the guarantee.

The comments made by the Australian Bankers Association that resist more prescriptive measures that require more "processes" be placed on banks but are not placed on non Code subscribers, should not be allowed to obscure the need for more positive obligations on creditors in relation to guarantee contracts.

Other matters

Clause 3 "Compliance with Laws" does not alter the position of subscribers to the Code by its inclusion. However suggestions that it be deleted provide no positive improvement to the Code either. It has the effect of highlighting to consumers of financial products from Code subscribers that the law operates alongside of Code obligations and further that the law must take precedence where there may be a conflict with the Code. Therefore it is recommended it remain in the Code.

The terms of the Code provide for adequate provisions relating to notification of fees and charges and any changes to them. However there seems to be a significant failure to provide adequate protocols addressing the "how and why" new fees are instituted and the manner in which they are calculated. Fees, for example, that do not adequately address cost of time and labour and appear to be disproportionate to such inputs represent an unfair burden to customers. The failure to address these issues in the Code suggests a presumed adverse response from banks is of greater weight than commercial fairness.

Sincerely

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Submission contributors: