Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry

Commonwealth Bank of Australia and its associated Australian entities (Group)

Round 3 Hearing – Loans to small and medium enterprises

RESPONSE TO SUBMISSIONS FILED BY MICHAEL DOHERTY AND DOHERTY HOTELS GROUP (DHG) DATED 19 JUNE 2018

Introduction

1. The submissions filed by Mr Doherty and DHG (**Doherty Submissions**) contend that Bankwest acted unconscionably in connection with its funding of the Hadleys Hotel and the adjacent Inner Collins development. Although the Doherty Submissions are unclear as to whether they contend that the Commissioner should *make a finding* that the bank acted unconscionably,[1] to the extent that such a finding is sought, CBA and Bankwest submits that no such finding is open either:

   (a) on the facts as stated in the Doherty Submissions (which mischaracterised the evidence before the Commission in several material respects); or

   (b) on the evidence before the Commission, properly characterised.

The facts relied on by Mr Doherty and DHG do not establish unconscionable conduct

2. The ‘specific conduct’ said to amount to unconscionable conduct by Bankwest is identified in the Doherty Submissions as comprising:[2]

   (a) a decision by Bankwest in about 2010 and 2011 that it wanted to be free of its exposure to the loans to DHG (**first conduct element**);

   (b) taking, in pursuit of that decision, a particular approach to valuing the properties between March and July 2011, and refusing to provide to Mr Doherty and DHG a copy of the valuation prepared by JLL in July 2011 (**2011 Valuation)** (**second conduct element**);

   (c) using the result yielded by the particular valuation approach adopted ($55 million) to ‘drive’ DHG to have to re-finance the whole exposure instead of

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[1] The relief that Mr Doherty and DHG apparently seek, in terms, is that identified in paragraph 85 of the Doherty Submissions, viz: (a) referral of the claim to be determined by an Arbitrator, whose decision is binding on both parties; alternatively, (b) the Royal Commission recommend a statutory compensation fund for victims be established, against which Mr Doherty may claim.

[2] See Doherty Submissions at [2].

supporting DHG with a term loan for the construction debt, which was what DHG 'expected' when it entered into the loans in August 2009 (**third conduct element**); and

(d) applying an LVR breach resulting from the 2011 Valuation to 'justify' the appointment of receivers and managers in January 2012 (**fourth conduct element**).

3. None of this conduct, either in isolation or in combination, rises to the level necessary to ground a cause of action in unconscionable conduct, either pursuant to ss 12CB or 12CC of the *Australian Securities and Investments Commission Act 2001* (Cth) (**ASIC Act**) or at general law.

4. To establish that Bankwest acted unconscionably at general law DHG must have been at a special disadvantage vis a vis Bankwest.[3] The purported source of the special disadvantage relied on in the Doherty Submissions is the 'information asymmetry' that resulted from Bankwest obtaining the 2011 Valuation and not providing a copy of it to Mr Doherty. While Bankwest accepts that the failure to provide a copy of the 2011 Valuation reflected a lack of transparency, and CBA's policy with respect to providing customers with copies of valuations has since changed,[4] the obtaining of the 2011 Valuation and failure to provide Mr Doherty with a copy falls well short of creating the requisite special disadvantage.

5. At paragraphs 71 and 72 of the Doherty Submissions, the core submission on special disadvantage is revealed as follows:

> *"[71]. … The bank was aware that possessed of the information, especially the actual JLL valuation report, Mr Doherty was in a stronger position to negotiate with it, or complain to it, which it did not want*.
>
> *[72]*. *The bank was clearly aware then of the 'special disadvantage' or 'disability' Mr Doherty would labour* [sic] *if it did not provide him with the JLL valuation or knowledge of its intention of only supporting the borrower until its own security position was maximized."*

6. Thus stated, the disadvantage or disability of which Mr Doherty and DHG complain is exposed as being placed in an inferior bargaining or negotiating position relative to the bank. It is well-established that a special disadvantage will not exist merely because there is a difference in bargaining power between the parties.[5] Moreover,

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[3] *Blomley v Ryan* (1956) 99 CLR 362 and *Commercial Bank of Australia v Amadio* (1983) 151 CLR 447 (***Amadio***).

[4] See CBA Closing submissions on Business Lending, Part A, [41]; CBA Closing Submissions on Business Lending, Part B, [37] – [39].

[5] It is accepted that the respective positions of a banker and borrower give rise to an inequality of bargaining power, but that does not of itself create a special disadvantage for the purposes of unconscionable conduct: *Bank of Queensland Ltd v Edwards & Anor* [2017] QSC 191.

the lack of access to the 2011 Valuation did not affect Mr Doherty or DHG's *"ability to make a judgment as to his best interest*", or place him in an inferior bargaining position.[6] The evidence establishes that Mr Doherty was well aware that the 2011 Valuation was being conducted on an "in one line" basis; his complaint is that he "could not understand" why Bankwest was taking that approach.[7] It is not explained in the Doherty Submissions why the bank's failure to communicate its rationale for adopting an "in one line" approach left Mr Doherty at a disadvantage, or impaired his ability to make a judgment as to his best interests. Nor would receipt of the 2011 Valuation have placed Mr Doherty in a better position to 'judge' what was in his best interest.

7. Analysis of the Doherty Submissions reveal the essence of Mr Doherty's grievance to be that he was unable to dictate to Bankwest the terms on which the valuation should be conducted. That is not a special disadvantage, nor has Mr Doherty established that use of a different valuation methodology would have yielded a different result. The Doherty Submissions fail to articulate how the so-called special disadvantage affected Mr Doherty's ability to engage with the bank in a manner that would have enabled him to better protect or advance his own interest, or have otherwise affected the outcome.

8. Even if the threshold criterion of special disadvantage could be satisfied on the facts relied on by Mr Doherty and DHG (which, for the reasons outlined, it cannot) Bankwest must have then acted to exploit[8] or take an unconscientious advantage of[9] DHG's position of disadvantage. The Doherty Submissions appear to confuse and conflate the circumstances which created the special disadvantage with the act purportedly taken in exploitation of it. Not only does Mr Doherty assert that the special disadvantage was *created* by the bank's failure to provide him with a copy of the valuation[10] but he also asserts that not providing the valuation and not discussing alternate methods of valuation with him was the *exploitative* conduct.[11] The Doherty Submissions fail to identify any conduct by the bank that could be characterised as exploitative of the purported advantage it possessed by reason of having access to information not available to Mr Doherty or DHG.

9. While ss 12CB or 12CC of the ASIC Act do not require the existence of a special disadvantage, the provisions require at least some degree of moral tainting in the

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[6] Doherty Submissions, [61]. Referring to *Australian Securities and Investments Commission v Westpac Banking Corporation (No 2)* [2018] FCA 751 (***ASIC v Westpac***) at [2223].

[7] Doherty submissions at [68]-[69].

[8] *Amadio* at 489 per Dawson J, applying *Blomley v Ryan* (1956) 99 CLR 362.

[9] *Kakavas v Crown Melbourne Ltd* [2013 HCA 25; (2013) 250 CLR 392 at [118], applying *Amadio*.

[10] Doherty Submissions, [23] and [71].

[11] Doherty Submissions, [73].

transaction of a kind that permits the opprobrium of unconscionability to characterise the conduct.[12] As Beach J recently said in *Get Qualified Australia Pty Ltd (in Liquidation) (No 2)*[13] and then adopted in *ASIC v Westpac*[14] in the context of ss 12CB or 12CC of the ASIC Act:

> "*Unconscionability" means something not done in good conscience or conduct against conscience by reference to the norms of society. But that is to be undertaken and applied in the context of trade or commerce, but including consumer protection objectives directed at the requirements of honest and fair conduct free of deception*."

10. None of the conduct alleged against Bankwest in the Doherty Submissions (much of which mischaracterised the evidence, as discussed further below) exhibits a want of honesty by the bank or is conduct that is deceptive or is otherwise against good conscience. A failure to act with complete transparency by not providing a copy of a valuation to a customer, whilst may be characterised as unfair in some circumstances, it does not carry with it the moral tainting or conduct against good conscience required to engage the statutory prohibition on unconscionability provided for in ss 12CB or 12CC of the ASIC Act. For these reasons, even if the conduct relied on by Mr Doherty and DHG is accepted as accurately reflecting the evidence before the Commission, there is no basis for a finding that Bankwest acted unconscionably.

Mr Doherty and DHG's mischaracterisation of the evidence before the Commission

11. The conclusion that a finding of unconscionability is not open on the Doherty case study is *a fortiori* when close regard is had to the evidence before the Commission. As is well-established, in order to determine whether conduct is unconscionable, it is necessary to look at all the conduct, by "[s]tanding back and looking at the whole episode".[15] Taking each of the elements of conduct relied on in the Doherty Submissions (summarised in paragraph 2 above) in turn, the following features of the evidence may be noted.

12. The <u>*first and second conduct elements*</u> relied on by Mr Doherty and DHG proceed from the premise that as a consequence of Project Magellan and the decision to 'exit certain classes of higher-risk exposures',[16] Bankwest formed a view in 2010 that it wished to 'excising the [DHG] exposure from its portfolio',[17] and then procured the

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[12] *Tonto Home Loans Australia Pty Ltd v Tavares* [2011] NSWCA 389 at [293] per Allsop P (with whom Bathurst CJ and Campbell JA agreed).

[13] [2017] FCA 709 at [60].

[14] At [2177].

[15] *Australian Competition and Consumer Commission v Lux Distributors Pty Ltd* [2013] FCAFC 90 at [44].

[16] Doherty Submissions, [3].

[17] Doherty Submissions, [3].

2011 Valuation as the 'perfect excuse'[18] to realise that objective. This contention seeks to re-enliven a theory surrounding Project Magellan that was carefully considered and rejected by Counsel Assisting on the basis that the available evidence, across several case studies examined, did not support it. As Counsel Assisting submitted, and CBA agrees, Project Magellan was: (a) primarily concerned with impairment and provisioning; (b) necessary to address the risks that CBA and Bankwest had identified in the Bankwest business loan book following the acquisition of Bankwest; (c) a prudent and responsible response to the identified need to review that part of the Bankwest loan book that had not, at that stage, been recognised as troublesome or impaired in order to consider whether further provisioning needed to be made for accurate reporting of the Group's end of financial year accounts.[19]

13. It is true that, in 2011, Bankwest instructed JLL to value Inner Collins "in one line",[20] a different valuation approach to that which the bank had adopted when it decided to offer the Construction Facility.[21] However, there is no basis for connecting the valuation approach adopted between March and July 2011 with some anterior decision by Bankwest, as part of Project Magellan, to 'exit' the DHG facilities. Nor do the Doherty Submissions attempt to explain why it was inappropriate for Bankwest to adopt the "in one line" methodology in the 2011 Valuation (the mere assertion that a "mixed use approach" would have resulted in a higher valuation does not establish that the "in-one-line methodology" was inappropriate). As a result, the premise underpinning the first and second conduct elements relied on in the Doherty Submissions is false. [22]

14. The *third conduct element* relied on in the Doherty Submissions – that the 2011 Valuation was used by Bankwest to 'drive' DHG to re-finance its facilities and to justify a decision not to rollover the Construction Facility– is unsupported by, and inconsistent with, the evidence before the Commission. First, as Mr Doherty accepts, the Construction Facility expired in July 2011.[23] Secondly, Mr Doherty had been actively pursuing refinancing options for some five months *before* the 2011 Valuation, in anticipation of the expiration of the Construction Facility: he put a refinancing proposal to 333 Real Estate in February 2011.[24] Thirdly, although the 2011 Valuation triggered a breach of DHG's LVR covenants, no formal breach notice was issued by

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[18] Doherty Submissions, [24].

[19] T3046.23 - 35.

[20] Exhibit 3.102.23 (CBA.4000.0078.1880) at .1993 - Exhibit PNC-22 to Clark 3-25 Statement.

[21] T2687.4-10; T2688.14-15.

[22] See Doherty Submissions at [2](b), viz: *"In pursuit of that decision…"*

[23] Doherty Statement at [81]; see also CBA Closing submissions on Business Lending, Part A, [56].

[24] T2659.4-15; see also Exhibit 3.102.19 (CBA.0001.0319.2870) at .2878-79 - Exhibit PNC-18 to the Clark 3-25 Statement.

Bankwest.[25] Fourthly, Bankwest continued to support DHG, and refrained from taking any enforcement action, for six months following the 2011 Valuation. Fifthly, Mr Clark's evidence was that the 2011 Valuation was not the reason why Bankwest ultimately decided not to renew or extend the Construction Facility.

15. The *fourth conduct element* – that Bankwest applied the LVR breach to 'justify' the appointment of receivers and managers in January 2012 – is simply not borne out on the evidence, and is inconsistent with the evidence referred to above in paragraph 14. The LVR breach occurred in July 2011, some seven months before Bankwest appointed receivers. The position of DHG deteriorated over that seven month period.[26] The trigger for the appointment of receivers was DHG foreshadowing an intention to appoint a voluntary administrator.[27]

Conclusion

16. Counsel Assisting submitted that it is not open to the Commissioner to find that CBA engaged in misconduct (which would include any finding of unconscionable conduct) in relation to Mr Doherty, nor any of the other case studies connected with Bankwest's business lending practices.[28] There is nothing in the Doherty Submissions that should lead the Commission to doubt the correctness of that conclusion.

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[25] T2693.39 – T2694.12.

[26] See CBA Closing submissions on Business Lending, Part A, [57].

[27] Exhibit 3.102.34 (CBA.0001.0319.5891) - Exhibit PNC-34 to Clark 3-25 Statement; Exhibit 3.102.35 (CBA.0001.0319.6542) - Exhibit PNC-35 to Clark 3-25 Statement;

[28] T3052.28 - 30.