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The Foreign Currency Loan Experience in 1980s Australia
with particular reference to the Commonwealth Bank of Australia :
bank documents, bank culture, and foreign currency loan litigation

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ABSTRACT

The 'foreign currency loans' saga was a significant feature of the 1980s, following financial deregulation in Australia. It involved significant financial losses and personal suffering for many borrowers. Perspective on the origins and character of the foreign currency loan facility may be gleaned from internal bank documents and contemporary legal commentary. This paper reproduces selective excerpts from Commonwealth Bank documents (the 'G' documents). The documents highlight the early ambitions to create a foreign currency loan clientele in the face of official monetary policy restraint. They also highlight the erratic state of expertise within the Bank regarding both the foreign currency market itself and the management of borrowers. The juxtaposition of bank document content with judicial treatment of litigants provides a vehicle to discuss fundamental issues of principle – the nature of the foreign currency facility and the nature of the bank-borrower relationship. One important lesson is that regarding the character of legal culture itself. One finds a clash between the context that gave rise to the foreign currency facility and the general legal culture that prevailed over the ensuing litigation. The passage of foreign currency litigation through the courts provides an exemplary study in the conventions and tensions of the law. The tension between judgments provides an exemplary case study in banking law in Australia.

Key words: financial deregulation; foreign currency loans, small business; bank-borrower relations; bank litigation; judicial culture

JEL codes: G21; G28; K41; K42; M14; N27

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1. Introduction and Background

The ‘foreign currency loans’ saga was a significant feature of the decade following the deregulation of the finance sector in Australia in the 1980s. In a companion paper to the current paper, I briefly describe the rise of this phenomenon (Jones, 2005b: 1):

Beginning in 1982, and with impending deregulation of the Australian financial sector, three major banks (and some lesser players) fashioned loan products denominated in foreign currencies for small business borrowers. Australian interest rates were high; interest rates in some other countries (notably Switzerland) were significantly lower (roughly 7% compared to 13%). The number of such loans was never established with any accuracy, but it is estimated that between 3000 and 5000 such loans were made, mostly in the 1982-1985 period. The Australian dollar plummeted in 1985, and the principal owing blew out dramatically. A million dollar loan in Australian dollars (a not unrepresentative sum) blew out to over two million dollars as the Swiss franc appreciated against the Australian dollar.

Disbelief on the part of borrowers led to meetings seeking clarification and reassurance or instructions to cope with intolerable debt burdens. Disputation between borrower and lender escalated in the late 1980s and, in many instances, ended up in the courts. A small handful of borrowers were successful litigants, especially against Westpac, but the typical litigating borrower was unsuccessful, especially against the Commonwealth Bank of Australia. ...

With superior resources, the banks were successful in many court cases in centring and limiting judicial wisdom to the issue of information and knowledge – what did the borrowers know about the nature of the product they had signed up for. The nature of the

facility itself was removed from consideration. By contrast, at the centre of court litigation over foreign currency loans was whether the borrowers went into the contract with ‘eyes wide open’, the nature and extent of information imparted by bank personnel, and whether bank lenders had a fiduciary duty to their borrowers regarding the viability of the foreign currency loan in the hands of the borrowers.

Perspective on the origins and character of the foreign currency loan facility may be gleaned from internal bank documents and contemporary legal commentary. Remarkably, bank documents played a minor role in many court cases. For example, they were not available in *David Securities and Rahme v Commonwealth Bank of Australia* (1989), and they made only a cameo appearance in *Ralik v Commonwealth Bank of Australia* (1990) and *Dwyer v Commonwealth Bank of Australia* (1991a; 1991b).

This paper reproduces selective excerpts from documents of the Commonwealth Bank (the ‘G’ documents). The paper is intended to complement a companion paper specifically on the Dwyer litigation proceedings (Jones, 2005b), and to provide insight into the lacunae in those proceedings that allowed the straightforward success of the Commonwealth Bank in that instance.

Section 2 highlights the early ambitions to create a foreign currency loan market and clientele in the face of official monetary policy restraint. It also highlights staff’s vision of the prospective market as an exceptional profit-earner. Section 3 highlights the erratic state of expertise within the Commonwealth Bank both regarding the foreign currency market itself and regarding the management of foreign currency loan borrowers. The excerpts expose the unpreparedness, rising frustration, indecision and fear for the Bank’s security position during 1985-1989, following the fall of the Australian dollar as borrowers clamoured for assistance, before many turned to litigation.

Sections 4 and 5 outline the critical perspective, arising from examination of Bank documents, taken by Justices Rogers, and Burchett andinfeld after their Honours’ experience in presiding over *Mehta* and the *Quade* appeal in particular.

The juxtaposition of the content of bank documents with the judicial treatment of borrower litigants provides a vehicle to discuss fundamental issues of principle – the nature of the foreign currency facility (Section 6) and the nature of the bank-borrower relationship (Section 7). This paper takes a jaundiced view towards the conventional judicial treatment of these issues. Section 8 offers a damning summary of the Commonwealth Bank’s role in the foreign currency loan affair, courtesy of a 1998 affidavit of a sometime experienced Commonwealth Bank officer.

2. The initial context and the decision to introduce and market the facility

The report of the Campbell Committee inquiry into the Australian Financial System had been published in September 1981 (an interim report appeared in May 1980), promoting financial deregulation and the dismantling of the old rules ([Campbell] Committee of Inquiry into the Australian Financial System, 1981).

Deregulation offered the promise of new opportunities and the threat of new competitors. There was the felt necessity to plough new ground. One might label the ascendant mentality hubris or desperation, but the attendant risks appear to have been subsumed as unavoidable.¹

¹ Westpac was subject to a radical organisational transformation (including a change of name) under Bob White the new Chief Executive Officer (since 1977), while simultaneously merging multiple cultures after the takeover of the Commercial Bank of Australia and its subsidiaries in 1982. According to Westpac’s biographer, White quickly introduced a policy of ‘judicious but vigorous lending’ (Carew, 1997: 17).

There was a certain irony to the occasion in that the opportunities from deregulation were met with new constraints on lending.

Contemporaneously the Reserve Bank had implemented a credit squeeze in late 1981 (a byproduct of the 'resources boom'). The early CBA G documents are preoccupied with official restrictions on its profit-making ambitions.

Thus Clark to NSW State Manager Gerathy in early May 1982 (Clark, 1982):

You are also aware that the CTB [Commonwealth Trading Bank] has found it necessary in recent times, in its endeavour to adhere to Reserve Bank of Australia guidelines, to request clients to refinance cash funded advances by the execution of bill options at the CTB's cost. Under the present difficult lending conditions it is necessary to explore alternative means of meeting the requirements of CTB clients and enabling the expansion of corporate lending business.

You will recall that at our recent conference attention was drawn to the scope for the CTB to make greater use of foreign currency lending for both trade financing and proposals of a capital nature. Indeed this medium may be the only way in which some customers will be able to be assisted in the foreseeable future.

The present high level of domestic interest rates is creating an awareness of the availability of foreign currency loans, which is being exploited by merchant banks and foreign banks. It is important that the CTB fully exploits this area of business, particularly at a time when lending in traditional areas is being contained. (p.1)

In the space of two weeks, the urgency has increased. Thus Clark to State Managers (O'Brien, 1982):

Wherever possible applications for Item 8 type facilities [i.e. overdraft, farm development loan and term loan] should only be approved on a foreign currency basis unless exceptional circumstances exist. In the latter cases, a foreign currency option should attach to the domestic facility with, wherever practicable, activation being at the CTB's discretion and costs for customers' accounts. ... (2)

Although customers may resist such action I would expect waiver (sic) of the foreign currency option to be an exception rather than the norm. You may be assured that in many instances the CTB would not be placed at a competitive disadvantage as other Australian banks have been vigorously directing their clients to borrow offshore in recent months. ...

I am sure you would have declined many attractive proposals in recent times on the grounds of either quantitative or qualitative lending restrictions. No such restrictions apply with foreign currency loans and I would see great scope for providing foreign currency loans for proposals for specific projects which can stand alone. In most of these latter cases, the borrower will generally not wish to hedge his foreign exchange exposure and we should take a more relaxed attitude in this regard provided the CTB is adequately secured (ie on approved lending margins) and the risks have been fully explained to the client. ... (3)

Unfortunately the number of staff available to me with the required expertise is not large and for this reason it is proposed to initially concentrate on NSW and Victorian clients. ... (4)

Initially marketing efforts should be concentrated on the small to medium sized customer with needs/facilities ranging between \$250,000 and \$5m ... I would like you to prepare a list of accounts which you consider could be diverted into foreign currency loans together with a list of possible prospective clients so that necessary plans can be made to implement a calling programme. ... (5)

I know I can rely on you to encourage use of this facility in your State and I look forward to seeing a significant escalation in foreign currency accommodation to our clients. (6)

Head Office had already been promoting the facility in mid-April. From a Hulme (1982) memorandum:

Act to ensure that all appropriate new applications are approved subject to an offshore option ... Identify existing customer targets ... We will want to avoid large prime companies and concentrate in small/medium company range. (1)

In early May, the Head Office international currency team (of two) had summarised the evolving strategy initiated in March² and cemented at two meetings chaired by Hulme (O'Brien & Knezevic, 1982). Quoting selectively:

Rather than delay promotion of the facilities until all procedures etc were in place, a letter be immediately forwarded to State Managers under the General Manager's signature [resulting in Clark, 1982]. ...

It would be necessary for the marketing team to have access to all NSW clients for the promotional drive to be a success ... (1)

² with the memorandum of G C Johnson (1982).

One aspect that should be emphasised is that it is highly unlikely clients [for new facilities] would readily accept foreign currency loans in lieu of item 8 type facilities unless they and the CTB are prepared to allow the facility to proceed on an unhedged basis. The statement is regularly made that the cost of hedged foreign currency loans is approximately equal to the cost of borrowing funds in Australia. ... (2)

While the CTB does not have a published policy on hedging when providing foreign currency facilities to customers, it would be safe to say that the majority of management consider hedging to be an essential ingredient to any foreign currency proposal. There are obviously moral considerations at issue as well as the safety of the CTB's security position.

On the moral issue, it is felt that the CTB would protect its banker/customer relationship by fully explaining the inherent risks in borrowing in a foreign currency on an unhedged basis. If after hearing of the risks involved a client wishes to borrow on an unhedged basis then it is not necessarily the CTB's right to dictate otherwise. ...

This leaves the CTB's security question. Foreign exchange rates can move sharply at little notice and therefore regardless of the level of allowances made for this risk, the allowance may be insufficient. One argument is that an allowance similar to hedge exposure guidelines should be made for possible adverse affect (sic) on security (hedge exposure guidelines – 10% allowance for up to 12 months, 15% allowances for 12 months to 24 months and 20% allowance for over two years). ... (3)

As a further protection, the CTB could include a 'claw back' clause in the loan agreements covering foreign currency borrowings. ... It of course follows that this could create liquidity

problems for the borrower. However, it would protect the CTB's security position, assuming of course the CTB was prepared to realise on security if need be. ... (4)

It is felt that there is no real prospect of clients readily accepting a foreign currency loan option where they have item 8 type facilities unless they are prepared to carry the foreign exchange risk (the interest rate differentials between item 8 facilities and hedged/covered offshore borrowings are too great). It would seem that the decision is therefore to reduce/cancel item 8 facilities and offer bill/foreign currency options instead. ... (8)

[Under the sub-heading 'Preparation of Submissions/After-Care (a) Existing Clients] ... The role of the account officer at point of control is seen as the after-care centre which would respond to Head Office directives concerning lending policy. In many respects the account officer should have indicative interest rates for both domestic and offshore markets at 11am each morning. The account officer should have contact with the client at least twice weekly to give a rundown on rate movements and find out if there are any transactions coming up which the Bank could/should become involved in. [A senior manager has made annotations on the margin, partly indecipherable, to the effect that this proposal is not workable 'on a cost/benefit basis', and that approaches by customers to staff can not be encouraged at this stage.] (9)

[The following are hand-written comments by an unknown senior manager]

I am in general agreement with the whole thrust of this paper. ... the one area requiring a basic policy decision now seems to me to be the question of security in any unhedged situation. ... As a general guide, I would prefer to look for security on margins, plus some added allowance – say 10% – for reasons similar to those applicable to hedging limits approvals. ...

[There follows hand-written comments by another senior manager] After discussion with Mr. Hulme – we will agree to a 10% margin (extra) for time being subject to Capitals being initially informed as to its application, and the need to keep movements in exchange rates under periodical review. (unnumbered attachment)

There were opportunities to not merely transcend lending restrictions but to enhance profit margins as well. From Johnson in March 1982 (1982):

This lending could be directed to the small and medium size business area for development, investment and other financing requirements as distinct from loans to State Governments and prime corporate names which is a highly competitive area offering a comparatively lower rate of return. I would see this lending attracting fees and margins a good deal higher than those for existing borrowers ... and without being specific, it is felt that fees and margins could be pitched at levels to match or better those applying for domestic bill facilities. (3)

And from O'Brien & Knezevic (1982):

The prospect of writing offshore loans for clients creates an opportunity for the CTB to earn income in our overseas branches at considerably better after tax margins ... (7)

Thus by October (Moran, 1982):

The CTB in recent months has actively promoted foreign currency lending facilities. (1)

In the September 1984 issue of *Rydge's* magazine there appeared a bold 2-page advertisement by the CBA with wide-angle photographs of

multiple dealers hard at work, and the following text, under the title ‘A bid for world supremacy’:

This is the most advanced foreign exchange dealing room in the southern hemisphere.

In fact it’s equal to anything in the world.

It’s been built to help give our forex dealers superior information and communication when dealing in world currency transactions.

This means more competitive quoting and superior efficient service. Without loss of reliability or safety.

How can you utilise such a sophisticated operation?

Just pick up the phone and ask for a quote.

When Geoff Dwyer, with solicitor Baird, went to the Commonwealth Bank for the decisive meeting with Messrs Savell and Fuller on 1 August 1984 to discuss their loan, they were subsequently taken to the dealing room. In the trial Court proceedings, Dwyer noted (*Dwyer & Anor v Commonwealth Bank of Australia*, 1991a: 321):

I was told by Mr Savell it was the best dealing room in the Southern Hemisphere and I was quite taken with the fact that you could call up [interrupted] ...

Dwyer recalls that he and Baird were mightily impressed by the seeming sophistication of the edifice and it gave him confidence that he was in good hands. Here was an institution seemingly in command of its operations, albeit the dealing room’s activities were in practice of no relevance to Dwyer’s prospective loan. In cutting off Dwyer’s account of the visit to the dealing room, the Bank’s counsel evidently attempted to minimise attention to the propaganda significance of the room and that particular visit.

What was the outcome of this early ambition to actively market a new product (indeed foist it on customers)? Two years later, from Edwards (1984):

In 1982, Combank set out to achieve an increase in the smaller/higher yielding F/C/L’s to Australian customers. ...

Despite the increase in outstandings since 1982, it would be fair to say F/C Loan marketing has been only moderately successful ... it would be fair to say that the concept of F/C Loans was never totally embraced by senior loans staff.

The F/C/L concept seems to attract large numbers of fringe type borrowers (entrepreneurs, developers, etc). My assessment would be that a considerable number of potential borrowers would not meet CBA standards. Nevertheless, there is an element of sound business available. It seems imperative that CBA has the expertise available to service inquiries. ... (1)

F/C Loans and simulated loans should not be aggressively marketed. (2)

In comments on Edwards’ memo, Long (1984) concurred as basis for a revitalised roll-out of foreign currency loans:

F/C/Ls may be marketed to those clients who it is considered may utilise them and who would have the capacity to manage their exposures or meet exchange losses which may occur. F/C/Ls are not a facility for weaker clients. (1)

As background to his recommendation, Long noted:

Some of the confusion which currently exists is due to discussions held at credit committee some weeks ago. The Chairman raised a few doubts about the desirability of lending to the small end of the

market and in the discussion which ensured it was agreed that care needs to be taken to ensure that the inexperienced are not assisted or encouraged into a situation they cannot handle. However my understanding of the discussion is such that we were not instructed to hold back from F/C/Ls but merely to lend judiciously. (1)

Long emphasised that the education of staff remained a daunting task. These comments were written precisely at the time that the Dwyer loan was established in July/August 1984.

3. The foreign currency markets and the state of Commonwealth Bank expertise

1985 saw the free fall of the Australian dollar against the Swiss franc in which the bulk of the CBA's foreign currency loans were written. What was the state of expertise in the Bank? The Bank's Investment and Economic Research Department wrote a substantial report in June 1983 (Investment and Economic Research Department, 1983):

Over the period from 1983 to 1986 the Deutschmark (sic) is forecast to appreciate by more than 10% against the US dollar. ... (1)

Over the period to 1986 [the Australian dollar] is expected to appreciate noticeably against a declining US dollar and pound sterling, but to fall substantially against the yen and Deutschmark. Exchange rates are expected to continue to exhibit a high degree of volatility. (2)

This from the International Division (1984) in June 1984:

Strong economic fundamentals, a CHF6 billion current account surplus in 1984, and investor confidence in the Swiss central

bank's anti-inflation stances augers well for appreciation of CHF against the US Dollar. ... The Swiss Franc traditionally tends to track movements in the Deutschmark/US Dollar exchange rate and is expected to strengthen in the second half of 1984 in tandem with the mark. (1-2)

The Australian dollar has weakened since April due to the rising trends in US interest rates, an easing in local bill rates and resurgence of the US Dollar. ... However, we expect the AUD to recover from current low levels in the second half of 1984 ... (2)

Relative movements of AUD and CHF against the USD is expected to result in an overall moderate strengthening of the Swiss franc against the Australian dollar over the next 12 months.

Historical and forecast trading levels of Swiss Franc against the Australian Dollar are as follows: June 1983 1.8434 ... June 1984 2.0100 ... June 1985 1.93-1.95 [i.e. an estimate of 3-4% depreciation of the Dollar against the Franc in twelve months to June 1985].

In summary, therefore, exchange rate movements are likely to offset, to some extent, the interest rate benefit of borrowing in Swiss Francs. However, an overall lower cost of funds should still be provided by borrowing in Swiss Francs which also offers the advantage of lower withholding tax cost than other foreign currency alternatives. (3)

February 1985 witnesses the unexpected. This from Edwards (1985), of Head Office International, to State offices:

The recent substantial depreciation of the Australian dollar against overseas currencies, especially the US dollar, raises the question of the increased AUD exposure that each F/C/L borrower could have

to CBA. ... in view of the extent of the AUD depreciation which has occurred – around 26% over 12 months for the USD and 6% over 12 months for SFR – it is prudent that the position of each client be reviewed and, if considered warranted, the client put “on notice” that the parity adjustment will be sought at the time of next rollover if the AUD exchange rate remains at its depreciative level or depreciates further. (1)

A hand-written annotation from a senior manager notes that as ‘most if not all of our F/C/Ls are in CHFs’, then CBA borrowers are ‘not too affected’.

Edwards’ memo was paralleled by a circular from Treasury (Hulme, 1985a), the essential ambition of which was to hose down concern:

The attached memoranda prepared for internal use are circulated as a matter of information in view of the confusing, conflicting and misleading commentary on this matter over the past couple of weeks. (cover sheet)

All that can be said about attempts to apply neat economic theories to rationalise the extraordinary decline in the AUD over the past couple of weeks, is that they have been entertaining. Most have also been ill-informed and misleading. ... There was not science in, or economic rationalisation for what followed over the next couple of weeks ... The level of uncertainty in the market was such that it became a game of pass-the-parcel. No-one wanted to be caught holding AUD when the music stopped. AUD had become a hot potato. Seeing this strong downward trend in the AUD, a very interesting array of pure speculators entered the arena looking for capital gain. Contrary to economic theory, the speculators served only to exacerbate the situation. ... (2)

Finally, it is worth reiterating just two points made by the bank during the height of the highly charged (and mostly emotive) debate on FX licences in 1983:

(a) Because of the relatively small volume of genuine commercial business and the uneven, often very lumpy, trade flows in Australia, speculators would tend to be all on one side or all on the other. Speculation would thus be inherently destabilising in the AUD market. ...

(b) Increasing the number of FX licencees may bring artificial depth to the market but would add little, if any, real depth. ... Market behaviour has attested to the validity of these points. Much of the recent volatility has been the result of dealers playing banks amongst themselves. ... When the market does settle down, at whatever price level, then this will provide the time necessary (or rather essential) for rational assessment to be made so that the price can move smoothly to a level determined on the basis of fundamental economic factors such as balance of payments, internal economic performance and relative inflation rates. ... (2/3)

For the longer term outlook, it should be noted that fundamental economic factors have changed little in the midst of the events of the past three weeks. ... By mid-1985 the domestic currency market is expected to have readjusted to recent events and the Australian dollar should trade with increased steadiness. However, it is difficult to assess what will be the longer term damage on confidence in the AUD as a result of the destabilising events of the recent weeks. Overall, fundamental factors suggest the underlying trend of the AUD will remain relatively weak over the remainder of 1985, unless the upward course of the US dollar reverses. (second section, 2)

The Bank’s chief economist, R. H. Dixon, conceded that what was needed to be known was perhaps in the realm of the unknowable:

There is no simple answer to the reason behind the fall in the value of the Australian dollar and behind movements in foreign exchange values generally. ... Because of the complexity of the issues involved it is virtually impossible to forecast exchange rates. It is fair to say though that the Australian dollar will remain volatile over the next few months with a possibility that it may fall further. (13)

I think the lesson learnt over recent times is not to dabble in foreign exchange speculation unless you have the resources to back up a bad punt. Rather, every effort should be made to insure risks which can be arranged through facilities such as forward cover and hedging. (14)

Dixon then highlighted his detachment from the peculiar state of his employer's 'dabbling' in foreign exchange speculation by concluding:

I conclude with the thoughts that deregulation has been of benefit to all parties and we can look forward to a shake-up in the finance industry. And in line with life in general, life in the financial world, which has become more complex, will continue to do so. (14)

F J Hulme, Group Treasury head, was not in a position to join Dixon in his detachment. Hulme wrote to the Chief General Manager of Corporate & International in October 1985 (Hulme, 1985b). Hulme noted the recent creation of a Risk Management Advisory Service within Treasury. 'Because of the significant paper losses incurred over the past year by borrowers of foreign currency ... it was decided that RMAS would extend its services from the outset to incorporate clients with borrowings in foreign currency for purposes other than trade'.

From the types of questions being asked of RMAS personnel by either existing borrowers or prospective borrowers with approved

but undrawn loans, it would appear that there could have been deterioration in the quality of advice/information provided by CBA staff generally regarding the risks associated with such loans and other related matters. [A hand-written marginal annotation notes: 'At grass roots levels the quality of advice has probably never been sound!'] (3)

If an overall review of foreign currency loan policy etc is to be undertaken, we strongly believe that the first issue to be decided should be the degree of advice/information, etc, you desire to be given to borrowers. ...

Should [your leaning be to the view] to provide advice and let clients deal through the Bank to manage exposure, it would be necessary to set down some guidelines for our dealers ... Obviously the resources of RMAS would need to be increased substantially to handle the business and may necessitate the recruitment of additional expertise from the market. As we see the situation, the big danger with this development would be that probably 80% of the clients with foreign currency loans would not really understand what they were doing. While this would not represent a problem if the client won, it is not difficult to envisage the complaints if losses occurred. To proceed on this course, the Bank would need to undertake a massive client education programme and obtain water-tight and wide-ranging indemnities. (4/5)

The remaining course of action is to provide professional management for a fee. ... We have taken a policy decision within Group Treasury not to pursue this course for the present.

As an aside, but very much related issue, RMAS is in the process of establishing a computer-based profile on foreign currency borrowers. ... We would also stress that this RMAS programme is

a stop-gap rather than a final solution to existing reporting deficiencies relating to foreign currency loan usage. ... (7)

For what it is worth the Group Treasury view is that the CBA should not be actively encouraging borrowers to take open foreign exchange risks in situations where we know now that these borrowers have no foreign exchange cash flows and are instead wholly speculative in motive. There is a widespread lack of understanding of the magnitude of risk, and the short-sighted attraction of lower foreign currency interest rates has proven disastrous to many of our clients.

We would recommend that any revised policy on foreign currency lending take particular account of the term of the proposed advance. Also, you may wish to consider a system wherein a client's foreign currency borrowing ceiling would be established by discounting his aggregate Australian dollar borrowing capacity ... [A marginal annotation notes: 'We would surely only need to consider such system if we waive parity adjustment requirements'.] (8)

L. G. Watson (1985), *Corporate Administration*, summed up the state of play in October:

It is probably not putting it too strongly to say that [point of controls] are approving F/C/L's, S/L's etc far too freely in the present climate, particularly having regard to the outlook for the Australian dollar. It seems reasonable to assume that there is not a full appreciation of the risks involved. In the circumstances a complete overhaul of the policy guidelines is seen to be necessary. (1)

Corporate Head Office (1985) sent out a document outlining the revised more stringent guidelines for potential FCL borrowers. The

motivation was the fear that 'borrowers with very limited capacity to absorb exchange losses, may expose the Bank to an unacceptable level of risk in the event of any further devaluation in the Australian dollar'. The document continues:

It should be borne in mind that because of the impossibility of accurately forecasting exchange rates and the inherent dangers associated therewith, the views expressed by Group Treasury will be more of a general nature. ... (4)

While it is acknowledged that there is a need to provide some exposure management advice on request to F/C/L borrowers during the course of a loan, we would not at present wish to advertise the availability of such a service.^[3] Further, it should be emphasised that the CBA does not wish to provide a comprehensive foreign exchange exposure service which could involve the assumption of responsibility for currency management and this needs to be kept prominently in mind when discussing exchange rate movements with clients.

Because of the above mentioned limitations on the involvement of RMAS and the general complexities of F/C/L's, we would see considerable merit in each point of control identifying one/two officers as the initial referral point for branches/clients with respect to all aspects of F/C/L's. In this manner the required level of expertise could be quickly built-up and, if considered appropriate, passed on to other lending staff. It would of course be a pre-requisite for such officers to have a reasonably sound understanding of basic foreign exchange transactions (eg forward cover/hedging principles, switching currencies, exchange rate withholding tax, interest rates, etc. (5)

³ This position followed instructions from R G Weaver (1985).

P. R. Hamilton (1986), Corporate Head Office, evaluated the failings of previous lending practices:

Our review has indicated that although the standard of creditworthiness under which approvals were given was generally satisfactory given the guidelines under which branches and points of control were operating, a very large percentage of borrowers were ill equipped to accept the exchange risks involved. It is now apparent that many of our own staff do not have an adequate understanding of the risks involved and were not well placed to advise potential FCL borrowers. The problems experienced have, in some instances been compounded by the introduction of borrowers through brokers who have insulated our staff from direct dealings. ... (2)

Administrative management responsibility for CBA's FCL exposure to domestic borrowers is currently divided on an ill defined basis between Corporate, International and Group Treasury. This division of control has been a contributing factor towards delay in consideration of many matters now being addressed in the current review ... (4)

As part of the data attached to Hamilton's review, it was noted (without comment) that 'NSW and ACT account for 64% of the total number of F/C/L's and 69% of the total amount of F/C/L's outstanding'. This statistic does not sit comfortably with the notion that the extent of FCL loans outstanding was the product of customer demand; nor does it sit comfortably with the presumption that Sydney was the fulcrum of expert advice on and administration of the facility.

By mid 1986, CBA memoranda reflected the extent of the calamity. Corporate & International produced an extensive report in July

(Lawrence, 1986).⁴ A certain displacement of responsibility, without evidence, for the dilemma pervades the report, but acknowledgement of the failure of the Bank's procedures is transparent.

... the effluxion of time and a relatively stable AUD during 1982/1983 and 1984 lulled many borrowers and staff into a false sense of security, particularly as the AUD had been floated in December 1983. Consequently, many FCL's were provided to clients who perhaps should not have borrowed in that manner; albeit in most instances, the CBA actively tried to discourage such loans. However, competition and the threat of the loss of connections to other financial institutions/banks ... saw a rapid escalation in the Bank's FCL portfolio during 1984/early 1985 from a level of around AUD100m in late 1983 to current position of around AUD 770m (excluding major corporates/semi-governments/NBFIs).⁵ Unfortunately, growth outstripped any previously established general monitoring/control mechanisms and as a consequence many loans were allowed to continue unchecked (parity adjustments were waived) in the belief/hope that the exchange rate would improve. ... (1)

Under current monitoring/control systems it is very difficult to readily obtain/gauge the state of the portfolio. ... (3)

[Under the heading 'Customers' Expectations/Reactions] Almost all customers believe they have a commitment from the CBA to provide and continue their FCL for the agreed term. ... in many instances the Bank was aware at the outset that cash flows were insufficient to meet domestic interest rates and therefore must have

⁴ The discovered copy of this document excludes tabular detail on 'the magnitude of the problem'.

⁵ The estimated total portfolio of \$770 million appears to have been a figure left in the document by accident. All other numerical estimates have been censored from the document.

encouraged customers on the basis of “riding the exchange rate out on the back of security” in the event of any adverse movement in the exchange rate. ... (7)

There is no doubt that borrowers hold the attitude that should the CBA force them into domestic finance we could be denying them the opportunity to take advantage of any upturn in AUD over the full term of the loan and crystallising capital losses which, for other than new loans (after 2/86), are non tax deductible. ...

There are instances of threatened litigation ... The level of complaints from customers has escalated dramatically recently since the extent of the problem has been recognised by points of control/branch managers and the attempted adoption of a more rigorous application of the loan terms and conditions. Given the scenario outlined above regarding customers’ criticisms on provision of information and after care generally, there must be some uncertainty as to the Bank’s ability to successfully defend litigation. There is a need for extreme care as an adverse legal decision against the Bank (or any other lender for that matter) would have far reaching implications for all FCL borrowers. ... (7/8)

[Under the sub-heading ‘Immediate Internal Action Required’] While the deterioration of the AUD has been the major cause of the CBA’s current predicament, the CBA has contributed to the problem by not having its “house-in-order”. Internal influences on the problem are seen to be:

a) The facility has been neglected for the last two/three years with no single area within Head Office formally responsible for the product. As a consequence, no firm action was taken to monitor the situation Australia-wide and there has been a distinct lack of directions/instructions to points of control up until December 1985 when new lending guidelines were issued. ...

b) Many FCL’s were approved mainly on security margin criteria. While, at the time, this criteria may have seem adequate in that currency depreciation of over 30% was difficult to contemplate, the security buffer available has proved insufficient and highlights the high level of liquidity/cash flow necessary for the smooth functioning of FCL’s under the CBA’s existing guidelines. Our system of providing FCL’s has been on a completely uncovered risk basis compared with facilities provided by merchant banks etc which include risk management as an integral part of the facility. ... (9/10)

In regard to CBA’s obligations to its customers, it is considered imperative that we move quickly to establish some form of foreign exchange management fund and, in the interim, that the Risk management Advisory Service of Group Treasury be upgraded and given the necessary discretion to switch customers’ exposure in an effort to minimise exposures and potential losses. (18)

Fast forward three years to May 1989. Management of the FCL portfolio has been centralised in Corporate & International, and a NSW senior manager, Max Dodd, finds the experience less than satisfactory. At the time of the letter from Dodd to Barry Poulter, head of Corporate & International, Dodd was committed to the FCL as a viable facility, in the right hands. However, Dodd (1989) provides an overall view of the impasse whose elements are discernible in the excerpts quoted above.

Thank you for your offer to reconsider the decision directing us to withdraw from the arrangements we have in place with the Bank of Singapore Australia Ltd ... the F/C/L area in Head Office has developed a tainted view of the total portfolio; and in some respects has lost touch with the facility itself. That such an environment should exist is not surprising having regard to the

lack of “coal-face” exposure in the Head Office group, and to their almost total pre-occupation with litigant files. (1)...

Dodd categorises the degree of resilience/vulnerability of the FCL borrowers, and notes that there is a ‘tragic group’ in the portfolio which is already lost and faces either self-liquidation or foreclosure. Dodd’s concern is to ensure that the FCL facility is managed appropriately to save the potentially viable FCL borrowers. In doing so, Dodd casts a jaundiced eye on the CBA’s relationship with the facility.

... a need exists to rewrite the policy in the interests of business retention and acquisition. In carrying out this task we should keep in mind our litigation experience but acknowledge privately that all of the problems we are experiencing are essentially of our own making. Broadly speaking they stem from:

- * Inadequacies in the criteria adopted for approval of F/C/L’s;
- * Inadequacies in documentation, especially the absence of Stop Loss/Market watch and Automatic Hedging mechanisms;
- * A less than effective response when parity payments were not made;
- * Inadequate briefing of Managers etc who were charged with the responsibilities of marketing the product; and
- * Inadequate knowledge at the Administration level. ...

In short Barry, there is nothing wrong with the facility – only the way we packaged and promoted it is deficient. (6)

4. Rogers J. and the G documents

The Bank’s internal documents did not figure prominently in foreign currency litigation. An exception to this rule occurs via the medium of Justice Andrew Rogers. Rogers presided over the 1989 trial proceedings of *Mehta* (Mehta v Commonwealth Bank of Australia,

1990). Sixteen transcript pages of preamble to the Mehta judgment are devoted to a selective examination of Bank documents, paralleling the information elicited above. From this examination, Rogers notes:

It is important to note that ... the writer recognised the importance of maintaining the provision of information to customers after the loan had been effected. It recommended that the account officer should make contact with the client at least twice weekly to give a run down on rate movements. However it would seem that attention was more on the interests of the bank in acquiring further business opportunities than in ensuring that the customer was protected against unforeseen movements in the exchange rate [re O’Brien & Knezevic (1982)]. (transcript, p.4)

At the hearing, it appeared to be contended that the plaintiffs should have relied on their accountant to give them advice on the risk element of the transaction. As can be seen, in fact, that was never the contemplation of those who were responsible for designing the scheme ...

Rogers refers to an instructional booklet distributed in July 1982 containing the phrase ‘to avoid misunderstandings it is essential that customers be formally advised of the potential exchange risk at the time of approval and the disclaimer to this effect is to be embodied in the approval letter’.

I hope I am not being unfair in lending emphasis to the unfortunate choice of words by the writer. In my view, it highlights what has created the difficulty in these cases. The bank’s attention seemed to focus on protecting its own position as to the security held and on ensuring that a disclaimer was in place. Notwithstanding the recognition of the dangers inherent in borrowing in a foreign currency, bringing the danger to the customer’s attention may have been regarded as a formality. (5-6)

Coming from a senior member of the legal profession, this subtlety is of some moment. Bank officers sought to cover the bank purely in terms of the letter of the law but to neglect their substantive responsibilities. Conventional judicial culture (the signatories to a contract are parties to its content) would ensure that the language in the contract covered the bank. Bank counsel played on this culture at every opportunity, generally to great effect. However, the gap between formality and substance was not lost on Rogers.

Referring to a May 1985 document that highlighted the unknowability of future exchange rate movements, but with likely continuing weakness of the Australian Dollar (not available to this author, but comparable to Hulme, 1985a), Rogers noted:

As will be seen nothing that was said to the plaintiffs conveyed either the historical facts noted by the bank's economist or his apprehensions for at least the immediate future.

In May and June a number of documents were circulated within the bank concerning foreign currency loans. The theme of these documents was universally one of concern to ensure that the bank's position was safe guarded. No attention appears to have been devoted in these documents towards taking any steps to ensure that customers were warned of the volatility of the market, the recent sharp depreciation in the value of the Australian dollar, the apprehensions of further depreciation, the increased need for explaining the safe guards provided by selective hedging, or any other measures, calculated to safeguard the position of the client. (9-10)

Referring to Hulme (1985b) that referred to the continuing 'lack of experience in foreign exchange markets of the vast majority of our staff ...', Rogers noted:

Once again the point needs to be made (sic) that not only was the bank's staff untutored in the problems arising from borrowing in a foreign currency but that the bank's management was well aware of that fact. It is clear from the bank's own material that at the time it made the loan to the plaintiffs the management of the bank was aware of first, the high risk, second, of the need to warn customers of it and third, of the inability of the vast majority of the bank's staff to satisfy this need. (12)

Referring to the Corporate Head Office memo (1985), Rogers noted that the bank was now defining speculative foreign currency borrowing as 'any borrowing where the borrower did not have a foreign currency income which would serve as a natural hedge against the borrowing' (15). Yet this 'speculative' borrower was the characteristic borrower targeted by the Bank in the marketing of the generic product. Rogers continues:

I am bound to point that, in the course of evidence, nothing emerged which suggested that the writer's [i.e. the author of the bank memo] hopes of the bank's staff acquiring a higher level of expertise then (sic) before was realised. ...

There was no effort made by the bank to explain the reason for the differences between what was considered desirable and what occurred in actual practice. The decision of counsel for the defendant not to call evidence from any senior officer of the bank to meet the inferences to be drawn from the bank's own documents exposed a dangerous gap in the bank's defence. In my view the bank's case, suffered from a large evidentiary deficit. No officer of the bank braved the witness box with the exception of the two officers who actually participated in the transaction. In all the circumstances I accept the plaintiffs' submission that the defendant's marketing of offshore loans either outpaced, or

disregarded, the prudent procedures proposed in its own documents as necessary in the case of small and medium sized borrowers.

Recognition of the existence of the risk and of lack of training of staff did not deter the bank from publishing advertisements such as the following, in the Australian Financial Review, 11 September 1984 ... :-

So we're extremely well qualified to help you in areas such as multi-currency loans, leveraged leasing, sale/lease backs, currency/interest rate swaps and supplier credit facilities. ...

This then is part of the backdrop against which the actions of the bank's staff in relation to the loan to the plaintiffs need to be assessed. (15-17)

Rogers summed up his evaluation of Mehta's experience thus:

Had the bank told Dr. Mehta the full facts the borrowing would not have been undertaken. I have no hesitation in accepting that proposition. Nobody in his right mind, after being told that the possible loss was unlimited, that the necessary implementation of safeguards would be limited in their effect and would require continuous attention which the bank refused to provide, would contemplate making the borrowing. Attractive as the borrowing may have been, the attraction could not survive a full and complete explanation. (57)

Rogers heard the Mehta proceedings in September and October 1989, and delivered his judgment in favour of the borrower in June 1990. Mehta was undoubtedly foremost in Rogers' mind when he delivered a paper to a Banking Law Association Conference in May 1990 on foreign currency loan litigation (Rogers, 1990). Two appeal judgments had been handed down in the previous two months upholding divergent judgments by Trial courts (Westpac Banking Corporation &

Spice, 1990; David Securities & Rahme v Commonwealth Bank of Australia, 1990).

Rogers canvassed the ambiguity of legal precedent regarding this complex arena, but juxtaposing learned discourse and decision with his evidentiary experience of bank documents, as he would shortly elaborate in his Mehta judgment. Rogers mused on the problematic related areas of the nature of the bank-borrower relationship, the possible existence of a 'duty of care', and the character of the foreign currency 'product' itself.

The distinguishing feature of the Rogers position, both in the paper and the Mehta judgment, is the importance of context:

Primarily, the duty of a bank to a customer lies in contract. However, in some circumstances a duty of care may arise otherwise than in contract. Quite apart from a duty in tort, an obvious case is where the parties are in an unequal bargaining situation. ...

The setting in which the nature and extent of the duty has to be determined is of crucial importance and relevance. Thus, a bank may hold itself out by its advertisements as providing financial advice. In *Woods v. Martins Bank Ltd* ([1959] 1 Q.B. 55) Salmon J. said:

It is at any rate remarkable that the defendant bank, who seem to be keen competitors with other banks to obtain custom, and who, in order to do so, apparently spend large sums of money in advertising that one of the advantages that they offer is expert advice in all financial matters without obligation, are taking the point in this court that they are under no duty to use any care or skill in giving such advice. ...

The hypothetical situation which I posited earlier in this article of a customer who simply requests a loan in a foreign currency but makes no other inquiry and is given no information is one that seldom actually arises in a litigious context. ... In the more usual situation where, in response to inquiry, or voluntarily, the bank gives information as to a foreign currency borrowing, what is its duty? The question needs to be examined in context. (203)

In more recent cases the defendant banks have produced, on discovery, a great deal of internal bank documentation which has attracted considerable attention in judgments at first instance. The documents, which were not tendered before Hill J. in *David Securities*, were tendered before the Full Court but appeared to make no particular impact. ...

... the difficulties confronting the banks in marketing [foreign currency] loans were forbidding. Internal bank documents make clear that these difficulties were recognised at the higher levels of bank management. In my opinion the recognition of the difficulties and problems involved reflect on the duty of care owed by the banks to borrowers. ...

It is only fair to say that the memoranda recognised both the need to make customers aware of the risks and the inability of the bank staff to satisfy the need. The question has to be posed, whether in those particular circumstances there arose any particular obligation on the part of banks. The point I am making is that it is one thing to go ahead with transactions permeated by the risk element where there is a fully-informed client. Is it permissible to go ahead where it is known that those who should be making the risk known to the customer and therefore obtaining the customer's consent are insufficiently equipped to do so? (204)

A picture has emerged, at least in some cases, of customers engaged in discussions concerning borrowing in a foreign currency, in the following setting:

- (1) The bank knew that such a borrowing was pregnant with the danger of large capital loss unless precautions were taken.
- (2) The bank knew that its staff was ill-equipped to explain the risk to the borrower.
- (3) The bank knew that its staff was ill-equipped to explain the nature of the available precautions to be taken.
- (4) The bank was unwilling to accept the task of management, even at a fee, and thereby to undertake the task of implementing appropriate safety precautions as and when required.
- (5) The customer was unaware of the extent of the possible risk and of the available precautions which could be taken and the techniques for implementing such precautions.
- (6) The bank was aware of this lack of knowledge on the part of the customer.
- (7) The customer relied on the fact that the bank gave no warning of any of the foregoing matters. By reason of the omission to warn of the extent of the risk the customer relied on the belief that any risk was limited or slight.

The knowledge of the bank of the matters I have attempted to summarise played an important role in the reasoning process of Foster J., at first instance, in *Spice* and of Sheppard J. on appeal. (204-205)

5. Quade and the G documents

The *Quade* litigation complements closely the reflections of Rogers after his experience in several foreign currency cases culminating in *Mehta*. Thomas Quade and family lost their foreign currency litigation

in the New South Wales registry of the Federal Court (Quade v Commonwealth Bank of Australia, 1989). A full Court overturned that judgment (Quade v Commonwealth Bank of Australia, 1991), producing (in this author's understanding), the only litigated success achieved by a foreign currency borrower against the Commonwealth Bank.

The appeal by Quade was granted on the grounds of non-discovery of documents. The full Court took a very dim view of the Bank's reluctance. A select but extended quotation of excerpts from early documents is provided in the judgment by Burchett J, and thus publicly available, for those not familiar with the originals (*Australian Law Reports*, 1991: 571-575). The judgment itself is dominated by an exegesis of the G documents. Burchett and Einfeld JJ were not impressed with their content. Selective commentary from Burchett J follows:

But it now appears that there is evidence to suggest the bank was, at the time, actively promoting foreign currency loans as a matter of policy, so that its officers would in fact have had strong conscious and subconscious motivation to put the best complexion on the exchange situation. Furthermore, the bank seems to have been promoting such loans to customers who were inadequately informed on the subject, so that its own senior management had expressed a number of concerns, including concern about the level of understanding of the complex issues involved shown by loans officers and bank managers. In particular, it is plain that the appellants did not nearly meet the criteria set by the bank itself for borrowers who could safely venture into the foreign exchange market. Only extreme optimism could have thought otherwise. Even assuming the appellants had met those criteria, the bank's own expert assessment was that it would have been necessary for them to have had the loan constantly monitored, so that at any time it could have been promptly "hedged" in order to anticipate or

contain any adverse movement of the exchange rate. ... (ALR: 570)

The conclusion of ['The Economic and Financial Outlook – 1983 to 1986' (Investment and Economic Research Department, 1983)] provokes the comment that it is one thing for bank officers to warn a customer of a risk that exchange rates may move adversely; it is quite another to say that they are expected to do so. An expectation of volatility involves an expectation that at unpredictable times in the future the rates will be adverse. The loan might fall due for repayment at such a time. It was not suggested in the bank's evidence in this case that Mr Quade was warned in these terms. Nor was he told, when considering a loan in Swiss francs, that the Australian dollar was expected to fall substantially against the neighbouring West German mark. Indeed, when Mr Quade, on the occasion of the first roll-over of the loan, "requested that [the bank] arrange forward exchange cover for the loan", which would in fact have avoided a great part of the loss, Mr Knezevic "advised", as the branch manager noted, "that such a move would be madness", and Mr Quade was persuaded against his own better judgment to leave the loan off-shore and unhedged. In the light of the new documents, Mr Knezevic's emphatic advice is intelligible, and only intelligible, on the footing he really thought ... that the exchange rate "moves back" after a fluctuation. ... (ALR, 573)

On 27 February 1985 a memorandum from the assistant manager international of the bank [(Edwards, 1985)], written some three weeks after the loan was drawn down, refers to "the extent of the AUD depreciation which has occurred - ... 6 per cent over 12 months for SFR". It seems remarkable there is no suggestion, in the present case, that depreciation of this extent was drawn to the attention of the appellants, who were borrowing in Swiss francs, at about the end of that very period of 12 months. ... (ALR, 575)

[The bank documentary] material cuts away the foundation of a major part of the trial judge's reasoning in rejecting the evidence of Mr Quade and his neighbours.⁶ (ALR, 575)

Burchett's evaluation was complemented by that of Einfeld J. Einfeld also commented (as had Rogers) on the disjuncture between the Bank's strictures in its letter of offer and its behind the scenes practice:

Again the bank's apparent lack of knowledge of the appellants' capacity to meet periodic currency losses and their ability and arrangements to cover adverse exchange exposure, matters which it emphasised in its offer, is instructive and of concern. Moreover, the very first paragraph under the heading "Exchange Risk" reveals a significant flaw in the bank's approach to the loan. How could the bank for its part have the "understanding" that the appellants "fully recognised" the exchange risks if the bank did not know, as was apparently the case, that the appellants had read and comprehended the advice and other documents shown to them and understood the discussions they had held with the bank's officers, and what actions and decisions they had taken on them? ... (ALR, 583)

In commenting on the contents of the G documents, Einfeld noted a conundrum for the Bank. The documents highlight that hedging was desirable (necessary?) but counter-productive in eradicating the interest-differential advantage.

... the risks in not hedging, especially in the case of commercially unsophisticated borrowers, did not deflect the bank from its aggressive marketing intentions for this type of loan with such persons amongst others. ... to me the inescapable inference of the

⁶ Quade's neighbours had accompanied Quade in his discussion with bank officials on the nature of foreign currency loans.

"G" documents is that the loans were to be marketed primarily for the bank's benefit, not the client's advantage, at least wherever these two interests were or may be in competition. ...

... the strong if not overwhelming flavour of the documents was in firmly advantaging the bank through charging fees, and in fully protecting it by ensuring that adequate security, at whatever risk to the clients, was in place. The obvious clash of interests between the bank and its clients was strongly skewed towards the bank. There was no suggestion in any of the documents that this major conflict should itself be declared and explained to clients as a most important reason for the bank to decline to give any advice at all and to recommend and encourage them to seek and obtain competent independent advice. ... (ALR: 585)

The documents also seem clearly to demonstrate a realisation that not only did many of its customers not appreciate the risks involved in unhedged loans, but the bank's own officers were ill equipped to advise potential borrowers about these risks. ... (ALR: 586)

Referring to Hamilton's February 1986 memo (Hamilton, 1986), in which Hamilton claims 'it is now apparent that many of our staff do not have an adequate understanding of the risks involved ...'⁷, Einfeld claimed:

The use of the word "now" signifies or infers that throughout or for the majority of its 1982-86 campaign to sell foreign currency loans, the bank had apparently been content to allow its clients to encumber or put at serious risk their assets, perhaps their life savings, as security for the bank without the slightest sense of urgency about remedying this most unsatisfactory approach to its

⁷ Supra, p.11.

obligations under the Trade Practices Act and the general law. In terms of risk, the emphasis was heavily on the bank's exposure and profits rather than the clients'. The clients' capacities to fund the consequences of adverse currency movements other than by the sale of basic assets were not even mentioned. ... (ALR: 586)

Regarding an October 1984 memo that stated: 'It is also planned to conduct as soon as practical (subject to resources) short term seminars on foreign currency related lending techniques' (Dawkins, 1984), Einfeld claimed:

The words in parentheses are instructive. They convey a disturbing tendency to prefer administrative economies to statutory and legal obligations to provide competent advice and information to clients. ...

In summary, then, the "G" documents appear to me to give a radically different underpinning and content to the evidence at the trial concerning the state of knowledge of this area of borrowing both at West Wyalong and in Sydney, and the respondent's responsibilities under s 52 and under the general law. ... [The absence of these documents] also deprived the appellants of what would have been a powerful criticism of the bank's reluctance to admit its failures in this regard and to call evidence on these subjects at the trial. It is difficult to overstate the forensic and evidentiary effects of this change of atmosphere ... (ALR: 587)

The Bank made various submissions to the Quade appeal to the effect that the G documents were of no additional consequence to the issues already raised in the trial court. Einfeld found the Bank's submissions variously 'bland if simplistic', correct in isolation but trivial, 'semantic', 'logically flawed', or 'unacceptable' (the latter with respect to the Bank's claim that its duty to the respondent had been discharged

with the information it had supplied). Einfeld's summary of the significance of the G documents was otherwise.

The "G" documents lend support to the bank's understanding of what was required, and the consequences for unsophisticated borrowers if certain fundamental precautions were not taken. In other words, the risk not being explained and the means of its minimisation by stated precautions not having been identified, the "G" documents permit a finding, not open at the trial because the documents were not available then, that the appellants were put in the completely deceived and false position of being effectively required to accept the risk of loss. They may be used to show that the bank embarked on and undertook a presentation which was manifestly incomplete, with the consequence for the appellants that they entered the loan agreement under a false sense of security of direction. If, as the respondent suggests here, there was no call for further explanation, it may be found that the incomplete information proffered may well have been worse than no information at all. In the absence of full and complete information and advice of this kind, the conclusion is manifestly open that what was imparted significantly failed to fulfill the obligation to advise which the respondent had willingly undertaken and volunteered to perform. ...

In my opinion, the evidence at the trial, if supplemented by the unsullied or unqualified "G" documents, manifests a clear case of misleading and deceptive conduct inducing the appellants to accept and enter the loan. (ALR: 598-599)

6. The foreign currency loan as dangerous product?

Should the foreign currency loan have been developed and marketed to the constituents that took it up? For this author, the answer is no. The facility was a 'dangerous product'.

A Westpac memo provides the quintessential statement on the character of the product. In early 1986, Westpac appointed one, L. G. Riley, an account manager for a disgruntled borrower, as chair of an ad hoc task force. On the 17 January, Riley's group reported in a 6 page memo, 'Offshore Commercial Loans (OCL)', for the Executive Committee. In a same day minute regarding the report, F. A. Ward, General Manager Credit Policy and Control, noted: 'Neither the Bank nor the borrower has control of liabilities'.

The Ward document was one of many Westpac documents examined and their implications summarised by John McLennan, sometime Westpac employee and then consultant to a borrower in litigation with Westpac (McLennan, 1989).⁸ During McLennan's appearance before the Martin Committee in its public hearings, McLennan commented on the implications of Ward's summation (McLennan, 1991: 1090):

I will attempt in the time available to provide further evidence about a defective banking product which has left many bank borrowers financially destroyed. No other lending product in banking history has contained the basic flaw of the offshore loan. ... [McLennan paraphrases Ward] that neither the bank nor the borrower had control of the liabilities. In other words, the principal was open ended, and management of the exposure was almost impossible ...

McLennan notes, *inter alia*, that myriad Westpac documents disclosed significant internal dissent within the Bank regarding the particular facility, not least from Frank Cass, then Chief Manager Retail Lending (McLennan, 1991: 1109-1116). McLennan concludes (p.1119):

⁸ Westpac ultimately settled with the borrower on favourable (albeit confidential) terms.

Let us face it – nobody in their right mind, if they had done a proper analysis of what could happen, would have gone ahead with it.

Some members of the bench who presided over foreign currency cases thought otherwise. Seminal in this approach was the appeal court in the Rahme case (David Securities & Rahme v Commonwealth Bank of Australia, 1990). The learned judges ruled against the appellants in their 'faulty product' claim, a ruling that has been much quoted in other cases and by bank representatives facing criticism, not least in the Martin Committee hearings.

For all the significance of David Securities, the judgment devotes only brief attention to the issue (pars. 69-73); it was tangential to that judgment's concern with the question of reliance. It was argued for the appellants that:

... foreign currency loans involve unusual dangers when compared with traditional forms of bank lending; and that they should never be "supplied" to unsophisticated small businessmen without comprehensive warnings (extending beyond the mere fact of risk) to encompass the inappropriateness of a facility of this kind for this type of customer.

The cautious bankers within Westpac and the CBA would have had no problem with this argument, but the bench found that 'We have difficulty in accepting any of these arguments'.

Counsel for the appellants had also referred to parallels with dangerous physical products: 'that the manufacturer or distributor of a product is under a duty to warn of any unusual dangers ... and that insufficient warning is the same as no warning at all'. The bench could readily find no useful precedent in physical products. This inference is understandable. However, the bench goes on to declare:

But it is clear that the rule as to things dangerous in themselves can have no direct application here. Nor, in our view, can the rule as to things inherently dangerous provide an appropriate analogy in the case of a borrowing in a foreign currency. It may be accepted that there will always be a risk of an adverse movement in the rate of exchange. But it does not follow that a foreign loan transaction is something “dangerous”, let alone “dangerous in itself”, or anything analogous to such a special thing. Speaking generally, all that can be said is that it is possible that such a transaction may result in some economic gain in certain events or in some economic loss if other contingencies occur. A foreign borrowing is not itself dangerous merely because opportunities for profit, or loss, may exist. (par.73)

Precedent had failed to deliver a sensible analogy, so the bench is excused from examining the specifics before it. This reasoning fails to deal with the circumstances, indeed with the product itself. More significant – this paragraph constitutes the basis for the dogmatic claim that reverberates through foreign currency loan litigation. That precedent can take hold with a succession of learned judges on such flimsy grounds as is contained in this paragraph does not speak well for the principles on which Australian justice is founded.

In the Commonwealth Bank appeal against an adverse judgment by Rogers J on Mehta, Meagher J contributed a brief annexure to the extended judgment overturning the trial court by Waddell J (Mehta v Commonwealth Bank of Australia, 1991). Meagher saw in Rogers’ ‘Nobody in his right mind’ summation⁹ a ‘particularly censorious view of foreign currency loans in general. Meagher begged to differ (p.4 of Meagher judgment):

⁹ Supra, p.16.

A foreign currency loan is largely a gamble; consequently, it would be unattractive to the timid and the prudent. Nonetheless, there are perfectly rational people who are prepared to gamble; and it is notorious that many borrowers did enter into such transactions at the time without suffering any damage, some of whom actually made a profit. All the experts agreed that it was reasonable for an informed borrower to enter into such transactions.

To this author, this flourish is injudicious; indeed, it verges on the scandalous. ‘It is notorious ...’? ‘All the experts agreed ...’? Who is an ‘informed borrower’? The statement does not do credit to the bench.¹⁰

It is appropriate to return to the May 1990 Conference address by Andrew Rogers. Rogers quotes the decisive paragraph 73 (supra) from *David Securities*, and continues:

With great respect, I would suggest that the foregoing statement may be susceptible to criticism for two reasons. First, it may not sufficiently recognise the vagaries of the foreign exchange market. As I ventured to say in *Lloyd v. Citicorp Aust. Ltd* (1987) ...

In determining the extent of the duty, it is essential to have regard to the nature of the market to which the plaintiff committed his financial future. There is no scientific basis upon which accurate forecasts can be made of movements in currency. ...

¹⁰ Meagher concluded his brief adjunct judgment with the note ‘Finally, I should like to acknowledge that I have derived considerable assistance from the judgment of Cole J in *Ralik Pty Limited v. Commonwealth Bank of Australia* (14 August 1990, unreported)’. The *Ralik* judgment is not one that stands scrutiny as capable of ‘delivering considerable assistance’. Cole made no definitive statement on the ‘dangerous product’ issue, but was discursive on the bank-borrower relationship; mention of *Ralik* will be deferred to the ensuing section.

I am afraid that, in my ignorance, I cannot understand how “informed judgments” can be made in the context of unpredictable factors. ... At the risk of being branded an economic ignoramus I remain unrepentant in my description of borrowing in a foreign currency without constant and instant access to information and the market.

Secondly, the statement of the Court in *David Securities* does not acknowledge the importance and relevance of the Bank’s positive refusal to accept responsibility for advising borrowers on the management, insofar as that was possible, of the risk. Everybody who has ever spoken on the topic has acknowledged the importance of managing the risk. ...

Finally, there is the lack of sophistication in this field of the majority of the small borrowers. In the circumstances the exposure of the unsophisticated small borrower was truly immense and it is no exaggeration to say the loans were dangerous. One may look at the figures to which borrowings were shown to have blown out in the contested cases to question the basis for the rejection of the submission. (205-206)

Rogers’ evaluation of the product is incisive. However, I disagree with one part of Rogers’ characterisation. The quote under his first point above continues (quoting himself in *Lloyd v. Citicorp*):

Although some operators in the market are better equipped to give advice than others, ultimately it is a gamble. It is a gamble because unpredictable factors may have immediate and violent repercussion. A rumour of the death of the United States President, the MX missile crisis, dismissal of an oil minister cannot be predicted or guarded against. Yet they may have immense impact on the foreign currency market. De-regulation has brought in its

train volatility of proportions previously unknown. As in every true gamble, returns can be very high but so can losses. (205-206)

Strictly, Rogers’ first point refers to foreign currency dealing *per se*, to which the label ‘a gamble’ may be appropriate. However, there is an implicit slide to apply the label to loans denominated in foreign currencies. Rogers draws comfort from Foster J in *Spice*, in turn quoting a senior Citibank executive, of the view that ‘foreign exchange borrowing was *basically* a gamble’ (206). This characterisation also puts Rogers in the same camp as Meagher conceptually, albeit diverging inferentially.

This author takes the view that the said characterisation is misjudged. The recipients of foreign currency loans were not gamblers. It is the essence of a gamble that it is taken consciously. Moreover, a gamble is intrinsically and solely a speculative activity.

It is important to state the obvious – necessary because of the pervasive denial and neglect in official opinion. First, expertise in currency dealing *per se* is a high art. Such expertise was extremely thin on the ground even in financial circles – a dearth entirely predictable in that the country was only just emerging from a long-time regime of fixed exchange rates and of exchange controls. Expertise in currency dealing remains thin on the ground.¹¹

Second, the borrowers’ competence was not as currency dealers but in the field of their business. The competencies are of a dramatically different kind.

The borrower businesspeople were risk-takers in the substance of their occupations. They daily took risks in the conditions surrounding

¹¹ Currency dealing expertise remains problematic, evidenced by the recent adverse experience of major corporates (Pasminco, National Australia Bank) and of the federal Treasury itself.

property development, retailing or rural commodities, but these were risks commensurate with their specific business skills. The borrowers would have had the expectation of reliable credit instruments that would allow them to concentrate on the risks associated with their particular stock in trade.

Claims have been made by the banks and in the courts that the borrowers, by virtue of their business activity, were generally sophisticated and, of necessity, risk-takers. This vision pervades the opinion of Cole J. in *Ralik*. That is, both business skill and risk-taking are assumed to be generic phenomena – transparently a wild claim. That skills are not generalisable has been obscured in the important cases of *Ralik* and *Mehta*. Both Richard Caratti (the more active of the Caratti brothers, principals of Ralik) and Vipal Mehta appear to have been possessed of a self-estimation of their own talents that was wholly unwarranted. Caratti was a property developer and Mehta was a doctor. Respectable legal opinion has re-fashioned their hubris (probably also possessed by their provincial advisors) to constitute generically competent businessmen in command of their faculties.¹²

Finally, a foreign currency loan demanded constant monitoring. Implicitly the borrower (or their ‘advisor’) was handed this responsibility although the banks as lenders declined to assume the role because of its onerous nature. Foster J in *Spice* (quoted by Rogers, 1990: 206) derided the presumption of borrower capacity, regarding both expertise and time:

[It was very difficult for off-shore borrowers to take a necessary long term view] because they are not sitting in the market to manage and monitor a short-term position. They do not have

¹² The unfortunate implication is that Caratti and Mehta were natural passengers for the foreign currency loan bandwagon. The Caratti/Ralik case is symptomatic of the flawed character of the entire affair – the Carattis were West Australians, but their loan was arranged in Sydney through finance brokers.

access to information showing second movements on the exchange rate from minute to minute and they do not have access to go into the market to execute.

Gregory Burton, barrister and legal scholar, couched a lengthy objection to Rogers’ analysis, soon after it was articulated at the May 1990 Conference (Burton, 1992). Burton’s views represent a cogent statement of legal orthodoxy. Burton does not discuss systematically the ‘dangerous product’ argument, dismissing it (in Rogers’ hands) as ‘exotic’. Burton preferred to interpret foreign currency loans not as ‘hazardous gambling-type products’ but rather as ‘commercial transactions with a novel element of what is found in all commercial transactions: risk’ (32).

Burton’s view is that Rogers’ trial judgment on *Mehta* diverged from what was emerging as a ‘reasonably coherent approach to formulating the duty of obligation’. Burton continues:

Courts acknowledged that the financial products in question showed intense risk from sudden small movements in volatile and unpredictable markets over which neither party to the transaction had very much control. There were prospects of large gains or large losses. The markets in which some of the products were traded were impersonal. The scope for remedies based on opinions given about market movements was restricted, *so long as market risk was properly described*. ...

Prior to *Mehta*, courts emphasised that the esoteric nature of forex markets meant that their operation and risks were understood by very few, including among experienced business people. Even a reasonably experienced business person might be unlikely to be able to make an informed judgment because he or she might not understand enough to appreciate the presence, nature or degree of the risk and the need to inquire into it further. (28)

This author has to confess to finding in this text neither intelligibility nor close correspondence to the foreign currency loan litigation to that date. The essence of the argument appears to be that noone was culpable for the ensuing disaster because all the participants were equally ignorant – an ersatz equality of opportunity in the free market closely monitored by the rule of law. The fact that bank staff were manifestly incompetent lessens their liability to duty of care!

Of significance is that Burton found the Rogers' position to be dramatically divergent from a central tendency in appropriate legal opinion. For Burton, appropriate opinion was affirmed in the appeal Court's overturning of Rogers' errors in *Mehta*, and affirmed by Cole J in *Ralik*. According to Burton, the treatment of the duty of care in *Ralik* is seen as 'particularly comprehensive'. (39)

Much argument on the concept of a dangerous product and on duty of care depends upon the underlying nature of the bank-borrower relationship, to which we turn.

7. The bank-borrower relationship

What is the relationship between bank lender and borrower? This brief treatment cannot properly explore an extensive judicial practice and accompanying scholarly literature. However, there are anomalies in the foreign currency litigation and literature that demand scrutiny.

According to Rogers (1990: 202):

The law recognises that the relationship of banker and customer does not in itself give rise to any duty of care. ... Generally speaking, a customer wanting a loan goes to a bank to ask for it, not to seek advice.

Rogers had previously stated (ibid.):

At the outset, it should be recognised that for some time now the banker/customer relationship in Australia has been basically that of a vendor and purchaser of a commodity – money. For any number of reasons the personal relationship that used to subsist has substantially disappeared. It is fair to say that the erosion of the relationship has been replicated in the decreasing reliance placed by customers on their bank other than simply a supplier of credit facilities.

There is much deserving of critical commentary in these brief statements.

First, a businessperson seeking a loan will presume that professional advice is embodied in the particular facility which is ultimately negotiated. Consider an extreme case in which a loan supplicant already has strong opinions as to the preferred facility. By analogy, if a person goes to his GP doctor and says that he feels strongly that his well-being will be enhanced if he were to have a leg amputated¹³, does the GP write out a referral to the surgeon, first having the 'patient' sign a document absolving the GP of any responsibility for the implications of the referral, and then hand him a bill for the 'consultation'?¹⁴ Or does the GP, drawing on the full resources of his training, on the basis of which he is now a party to a medical relationship, inform the would-be amputee that his preferred course of action would be seriously injurious to his well-being?

Let us conceive of a more plausible case, and an appropriate medical analogy for the circumstances under discussion – that of a GP who

¹³ Self-amputee fixation is apparently called apotemnophilia.

¹⁴ Note that the language itself embodies a relationship dependent upon professional authority and responsibility, with its accompanying 'information asymmetry'.

recommends a course of medication to a patient which is untried and potentially harmful, fostered by a relationship with pharmaceutical suppliers that is (whether explicit or tacit) mercenary in essence. In this instance, professional authority has been abused, and it would be a nit-picking didact that sought to argue otherwise.

The point is that professionalism is intrinsic to both medical and banking practice, and (what modern day economists are wont to call) 'information asymmetry' is intrinsic to its character.

Second, there is no doubt that financial deregulation in Australia induced a changed mentality in some sections of Australia's major trading banks.¹⁵ This is precisely the environment that underpinned the incautious assertiveness in expanding foreign currency loans that pervades the internal documents of the Commonwealth Bank and of Westpac. However, the banks neglected to tell their customers of the attempted internal cultural transformation. As Rogers notes, qualifying his statements replicated above (201):

On the other hand, the judgment of Foster J. in *Chiarabaglio v. Westpac Banking Corporation* ... gives an interesting portrait of a customer of the old school who "regarded Westpac as a friendly and conservative guide".

The 'old school'? Domenico Chiarabaglio was of course not atypical but representative of his generation. You don't wipe out a long-standing structure of embedded cultural beliefs, practices and relationships by the rollover of senior management and the bringing on board of McKinsey and their ilk. When James Gerathy, ex-Chief NSW Manager of the Commonwealth Bank, paved the way for a Commonwealth Bank loan in 1984 for Geoffrey and Gloria Dwyer

with whom he was on good terms (Jones, 2005b), the Dwyers were exhilarated that here was the prospect of a relationship with an institution that embodied trustworthiness. When Dwyer and his solicitor were taken to the Commonwealth Bank's dealing room by officials after discussion of the Bank's loan facilities, a presumption of institutional competence was added to the extant presumption of trustworthiness.

Third, a proper judgment on the relationship depends not on what bank management may think or would like to construct but on technical considerations. A credit facility is not a commodity. A lender and borrower are not a 'vendor and purchaser of a commodity'. A bank lender is not a broker.

There is a hint of the complexity of the lender-borrower relationship (giving rise to an 'intimacy'?) in the judgment by Legoe J. favouring the borrower in the 1989 foreign currency case *Foti v. Banque Nationale de Paris* (cited in Rogers, 1990: 203):

I am of the opinion that the defendant Bank had involved itself far more closely with the plaintiffs than a mere arm's length agreement to lend a sum of money. Furthermore, the relationship was not just that of acting as a banker on behalf of its customer. There was both the professional banking element in the transaction and the personal rights and duties of a bank lending money to a group of people in the particular way in which this transaction was set up. The proximity of the parties to each other in their respective rights and duties arising from the negotiations, letters, respective executed mortgages, guarantees, deed and verbal agreements, was as to the actual performance of the several transactions, clearly giving rise to a duty of care in the circumstances.

¹⁵ Edna Carew describes at some length the top-down attempt at cultural transformation at the old Bank of New South Wales in the early 1980s (Carew, 1997: Ch.1). See n.1.

Yet this statement is still only half way there, aware of the surface byproducts but grasping for a conceptualisation of the character of the relationship.

A lender-borrower relationship is distinguished by its on-going character. The relationship has this dimension in common with the employer-employee relationship and the franchisor-franchisee relationship. The 'contract' has always been an imperfect instrument to encompass the terms of an ongoing relationship. For this reason, labour law has developed as a legal specialisation and separate labour tribunals or regulators have been established to mediate the relationship.¹⁶

An ongoing relationship also enhances the prospect of an unequal relationship. Indeed, there are grounds for arguing that an ongoing relationship will house an intrinsically unequal relationship, rooted in an inequality of power.¹⁷ A bank's credit to a borrower is typically secured on the borrower's real property. In the case of small businesses, a bank's credit is typically secured on the borrower's family home. A bank lender, perennially an incorporated enterprise resting on a substantial capital base, has a relationship with a small business borrower that entrenches structural subordination.¹⁸

¹⁶ Not by accident, disputes between franchisors and franchisees are now brought before the NSW Industrial Commission because of the Commission's legal and cultural inheritance in confronting the character of ongoing (and potentially 'unfair') relationships.

¹⁷ There are conceivably instances in which a lender-borrower relationship is on countervailing terms. This situation would be reflected, for example, in a major bank acting as a substantial creditor to a major corporate (a current embodiment of perhaps a long-term relationship). Each party exercises leverage over the other. But these countervailing relationships are, in this author's opinion, exceptions to the rule in ongoing relationships.

¹⁸ The pervasive structural subordination of small business to corporate business in the contemporary Australian economy is explored in Jones (2005a).

The contractual relationship itself exemplifies the structural subordination. For example, the standard Terms and Conditions of the National Australia Bank Business Secured Overdraft includes the phrase in section 5: 'Despite 6 below, the Bank may cancel the facility at any time whether or not you are in breach of this agreement.'

For all but the largest business with syndicated borrowings and considerable market clout, the relation between the lender and borrower is intrinsically asymmetric. The lender holds the power of life or death over the borrower's business. The borrower also necessarily depends on the lender for the functionality of the lender's credit facilities. In particular, for trading banks as principal institutions in the finance sector hierarchy, the bank-customer relation is steeped in paternalism. It is a relationship that the banks have always been reluctant to expose to public scrutiny. It is a relationship that the private banks have been keen to dictate on their own terms. It is also a relationship that has been systematically abused (c/f Jones, 2004).

It is therefore surprising to read that legal discourse exists in which the discovery of unequal power is something of a surprise, like the archeological discovery of a long extinct species. Thus from Rogers (1990: 203):

Primarily, the duty of a bank to a customer lies in contract. However, in some circumstances a duty of care may arise otherwise than in contract. Quite apart from a duty in tort, an obvious case is where the parties are in an unequal bargaining situation. Indeed, it has been argued that in some circumstances fiduciary duties may be imposed upon a bank ... The setting in which the nature and extent of the duty has to be determined is of crucial importance and relevance.

Just what conditions might be constitutive of an 'unequal bargaining situation' are not pursued in the legal banking literature, and the

conditions on which a duty of care might arise are determined on grounds other than the fundamental structural character of the relationship.

Rogers has seemingly endeavoured to draw on legal precedent for his considered view that a substantial injustice has arisen at the core of the foreign currency loan affair. Yet the endeavour appears to be a case of creating a silk purse out of a sow's ear. The raw material is not up to the task. The purist position highlights what a demanding task is involved, and Cole J. in *Ralik* is Exhibit A for the prosecution.

The general statements of Cole J. pertaining to the bank-borrower relationship derive from his response to a series of claims by Ralik that point to 'foreseeable, reasonable reliance' upon the bank (the Commonwealth Bank) and the company's finance brokers (Belor). The particular matter is reproduced, to highlight the claim to which Cole responds (*Ralik v Commonwealth Bank of Australia*, 1990).

Claim 4. The Banks and Belors should have recognised, as providers or advisors of or regarding foreign currency loans, that few understood the magnitude of foreign currency loan exchange risks, and should have investigated the capacity of Ralik both to understand the risk and bear any loss.

[Cole:] I regard this as unrealistic. I see no reason why a bank or a finance broker, each with its own commercial interests, should be obliged to nursemaid a company, the principals of which had successfully engaged over an extensive period in farming, property development and other business activities, and which was independently and apparently competently advised by experienced accountants and solicitors, unless there was some contractual or statutory obligation to do so. In commercial transactions of significant dimension or amount between parties of apparent substance and competence, there is not in my view, a common law

obligation in one to care for the interest of the other, or to satisfy itself as to the understanding held by the other commercial party of risks associated with the proposed transaction. ... In my view, if a company engaged in property development approaches a bank or a finance broker seeking a loan of \$1.6m by means of a foreign currency loan, the recipient of that approach is entitled to assume that the applicant knows what it is doing, and knows or will obtain advice upon and will consider risks associated with such a loan, in determining whether it is in the applicant's commercial interest to proceed.

These circumstances do not give rise to any position of such inequality between the parties as to bestow upon one the duty to have regard to the interests of the other; or put another way, to confer upon one the right to require the other to protect the former from entering into an inappropriate transaction in other than a fully informed state.

The commercial interest of the bank so approached is to ensure that the prospective borrower will be able in all foreseeable circumstances to meet its obligations to the Bank' to 'bear the loss', put in the words of Professor Valentine ..., should it occur. It is not, in my view, the Bank's obligation to satisfy itself that the applicant has made a correct or wise commercial decision based upon a full understanding of all risks. ...

Claim 5. The defendants should have known that borrowers such as the plaintiff were unlikely, or at least considerably less likely than themselves, to have knowledge or means of knowledge of the longer term history of exchange rate fluctuations.

[Cole:] ... the mere circumstance that one commercial party, here a bank or a finance broker, may be better informed regarding history and may thus be in a better position to speculate regarding the

future, does not create in the other commercial party, here a property developer, a right to rely upon the other to warn of either risks of loss or of profit from currency movement. ... In a significant commercial transaction, imbalance of knowledge or means of knowledge does not create reliance interests, or duties between the parties at common law.

Claim 9. The [bank] gave express, detailed consideration to the necessity to fully inform foreign currency borrowers, including the plaintiff.

[Cole:] ... In a commercial transaction, information regarding risk is thus not given by a bank because of any protective duty to the client: it is given to protect the interest of the bank. Any duty to inform protective of the client imposed upon a bank is to be derived from circumstances additional to the relationship of banker and client (whether they be additional circumstances creating a duty, contract or statute). ...

It must be remembered that all of the matters pointed to by Ralik in the internal memoranda from the bank were quite unknown to Ralik at the time of the transactions. (97-100; 104, 106)

It is noteworthy that this last paragraph is Cole J's sole contribution on the significance of the G documents – his judgment is that they are of no significance, and apparently because their content was unknown to the other party to the transaction (the litigant in this case).

Alternatively, Ralik argued that the Bank assumed responsibility by “undertaking a ... wholly inadequate course of enquiry concerning Ralik's understanding of and ability to manage risks”.

...

To enquire whether a borrower is capable of managing a foreign currency loan or of coping with risk attendant upon one, is not to adopt or assume protective responsibility to warn or perceived incapacity or of measures ameliorating loss. It is no more than a step a prudent bank would take towards satisfying itself that its loan is safe. (115, 117)

A similar sentiment is expressed by Hill J. in *Rahme* a year earlier. In denying a duty of care under contract, Hill made the comment (David Securities & Rahme v Commonwealth Bank of Australia, 1989: 60):

It was submitted for the applicants that in the case of a contract between banker and customer there can be implied a term that the bank will give advice or pass on information in circumstances that include the case where the bank knows or should know that the customer is relying upon the bank to give advice and where the bank knows or should know that its customer may act in reliance on that advice and in circumstances where the bank is possessed of special skills or sources of knowledge (as here with the Bank's resources in foreign exchange markets) so that it is reasonable for the customer to expect the bank's experience and skill to be made available to the customer. In my view that submission finds no support at all in his Honour's judgment [referring to Deane J. in *Hawkins v Clayton*]. *To accept it would impose an intolerable burden on the Bank.* [my italics]

The alarm expressed by Hill J. above is analysed more systematically when Burton confronts the appalling possibility that the path of Rogers' reasoning might pry ajar the strongly-bound container that is 'duty of care'.

Justice Rogers argued for a fuller duty of disclosure on the part of the bank than in normal commercial transactions on the basis of the unequal bargaining position of the parties, in the process citing

academic writing which dealt with Canadian law imposing fiduciary duties on banks ...

It should be noted that fiduciary duties have developed more elastically in Canada than in Australia. It seems likely that a fiduciary duty (or a duty of good faith with more flexible but similar content) in Australia would be limited to long-term relationships of adviser/manager in respect of the loan or marked instances of dependence or trust and confidence in the bank as sole adviser/manager, a role which the bank accepts by active assumption of such responsibility or acquiescence in the customer's degree of reliance where the customer fairly sees that to a significant extent his or her interest is consistent or congruent with that of the bank ... Even if such a relationship arose, the availability of proprietary remedies might be restricted by the chancy, volatile trading context ... Transactional disadvantage – unequal bargaining power alone – does not qualify. (30-31)

The vigour of the debate following his Honour's paper was not because of the factors to which his Honour drew attention. ... The departure advocated by Rogers J. appears to have been twofold. First it required foreign currency loans to be treated as hazardous gambling-type products rather than as commercial transactions with a novel element of what is found in all commercial transactions: risk.

Secondly, because of the hazardous nature of the product, the purveyor of that product was required to take detailed precautions against the product causing injury. ... Rogers J.'s departure emphasised a different liability regime for forex loans and similar products, although some commentators at the Conference saw scope for its extension *to other categories of lender liability* particularly in connection with inexperienced borrowers. The approach of Rogers J. appears to have parallels with the perceived

philosophy behind "remedial" legislation such as the Contracts Review Act 1980 (N.S.W.) ...

In practical evidentiary terms, the normal onus on the existence and content of a duty or obligation under the approach advocated by Rogers J. appeared to shift in important respects. Even if strict liability was not expressly imposed, the effect of characterizing forex loans as akin to hazardous substances was, not only to put the existence of a duty of care under the general law beyond doubt, but also to raise the standard of care as well as to enlarge the content of the duty.

Rogers J.'s approach also potentially made easier the application of s.52 of the *Trade Practices Act* 1974 (Cth) and corresponding State and Territory provisions such as s.42 of the *Fair Trading Act* 1987 (N.S.W.). Under those provisions, mere silence can constitute misleading or deceptive conduct in a context where the customer can reasonably have the impression, assumption or expectation that an explanation or warning will be forthcoming if there are risks or dangers, a fortiori if there is a duty to speak under the general law ...

Rogers J.'s approach could even have made easier the finding of a breach of fiduciary duty, because the type of self-denying full disclosure required to fulfil the duty had similarities to the behaviour required of a fiduciary. ...

A consequence of the revised approach could have been the evidence from the bank's discovery, and subpoenaed material about the practice of banks, could have been likely to have become even stronger ammunition for the borrower. (31-33)

In this disquisition, Burton understood clearly that if the reasoning of Rogers was to be found illuminating, the protection by the institutions of

the law of powerful commercial interests would be severely at risk. Fortunately for Burton's concern, the Rogers line of reasoning has been successfully diverted into a cul de sac, at least with respect to banking litigation.

Fifteen years after the peak of foreign currency litigation has receded into history, the bank-borrower relationship remains legally quarantined. To quote a 2000 article (Weerasooria, 2000: 151-152):

Despite well established judicial decisions holding that the banker-customer relationship is basically a contractual relationship of debtor-creditor, legal counsel appearing for aggrieved customers are still heard to argue that bankers owe fiduciary or special duties to their customers. One such attempt – again an unsuccessful one – is found in the recent case of *Finding v Commonwealth Bank of Australia* (Court of Appeal, Supreme Court of Queensland ...) ...¹⁹

Queensland's Court of Appeal unanimously rejected the customers' claim that the bank owed them a fiduciary duty. They gave the following reasons:

1. The law does not recognise the relationship of banker and customer as one of the accepted categories of fiduciary relationship.
2. Of course, this does not mean that there could be special circumstances in a particular case where such a relationship will

¹⁹ The circumstances of *Finding* are not relevant here. However, it is pertinent that the details of the case were treated with indifference by the appeal judges – the bank had sold the property to the litigants as mortgagee in possession; the bank had a valuation substantially lower than that held by the litigants as purchasers; and the bank subsequently financed the sale of the foreclosed property to the purchaser. This set of circumstances in itself warrants forensic investigation; moreover, they are not unique to this instance of banking practice. Given these facts, one might reasonably inquire whether the mantra-like reiteration of the non-recognition within this domain of the 'accepted categories of fiduciary relationship' is overdue for reexamination.

arise ... Justice Hill in *Golby v Commonwealth Bank of Australia* ... stated the position correctly when he said:

It is not a critical feature of a banker/customer relationship that the banker undertakes or agrees to act for or on behalf of or in the interests of its customer in the exercise of some power or discretion affecting the interests of the customer in a legal or practical sense ... In the absence of some special feature such as the giving of advice, there is no reason to erect a fiduciary relationship between banker and customer when that relationship is essentially one founded in contract.

The article quoted is appropriately titled 'Banks owe no fiduciary or 'special duty' to customers: a reaffirmation'.

8. The definitive Dodd affidavit

It is appropriate to return to the considered wisdom of an insider. Max Dodd, Commonwealth Bank senior official on a foreign currency-related desk wrote the critical 1989 G170 memo, selectively quoted above.²⁰

Nine years later and retired from the Bank, Dodd was advising a CBA customer engaged in litigation with the CBA. Dodd's affidavit, dated March 1998, is the singular most important document with respect to the CBA's involvement in foreign currency loans (Dodd, 1998). The quotations are thus necessarily extended (paragraphs numbers are attached):

20. Now produced and shown to me ... is a copy of a letter dated 1989 (referred to as G170) that I wrote to Barry Poulter, Chief General Manager – Corporate & International, Head Office. I still

²⁰ *Supra*, p.13.

hold the views expressed in this letter and indeed my subsequent experience with case management has proved my views to be correct. (6)

1. I was employed by the Commonwealth Bank of Australia (the “Bank”) for approximately 40 years, prior to retirement from the Bank on 2nd July 1990. ... (1)

5/6. In about 1886-1987, I was appointed to the position of Assistant General Manager, New South Wales Branches Administration. My sole responsibility in that role was to exercise Administrative control, within the limits of my discretionary authority, over a portfolio of approximately 250 foreign currency loans in New South Wales. ... (2)

8/9. During my terms with New South Wales Branches Administration, I reviewed a large number of the Bank’s FCL files. These files covered the history of individual loans including:

- (a) The backgrounds on the borrowers.
- (b) The reasons influencing the Bank’s decision to approve the loans.
- (c) The financial position of the borrowers.
- (d) The security the Bank held in support of the loans.
- (e) Measures taken by the Bank to manage its exposure to individual borrowers.
- (f) Diary memoranda covering discussions with the borrowers and others.
- (g) Where applicable, details of action taken by the borrower to manage the exposure.

10. I personally interviewed or spoke on the telephone to many bank officers who had been involved in the establishment of FCL facilities ...

11. I found that a typical loan had the following broad characteristics:

- (a) It was a Swiss franc loan originally;
- (b) It was taken out before the devaluation of the AUD occurred in 1985;
- (c) It had at the outset no form of in built safety mechanism to protect the borrower and the bank against a dramatic fall in the AUD, such as a stop loss mechanism;
- (d) It was secured primarily by real estate.

12. I found that most borrowers typically:

- (a) were virtually completely inexperienced in foreign currency matters;
- (b) had a poor understanding of the contents of the letters of offer used by the bank for such loans, and instead relied on the explanations they had been given verbally by a bank officer.

13. I also found that few if any Branch Managers and Loans Officers had meaningful knowledge of the facility. Similar comments applied to many of the approving Control Officers in the State Administration. (2-4)

18. I spoke to many FCL borrowers all over the State of NSW and I heard again and again a consistent story about what they have been told by bank officers about FCLs before getting into their loans.

19. Typically, borrowers said that they had been told by a bank officer prior to taking up an FCL some or all of the following:

- (a) that the Swiss franc was stable
- (b) that Swiss interest rates were dramatically below the level of domestic rates.
- (c) that they would become onshore loans if the rate moved more than 5% against them; (6)

21. My review of the whole FCL problem for the Bank as headed (sic) the FCL Cell, led me to the following conclusions: ...

(c) When the bulk of FCLs had been entered into, in 1984 and up to say the first half of 1985, the Bank had no effective policies in place to ensure that the Loans Officers and Branch Managers who may have been explaining the ramifications of foreign borrowings had a proper understanding of the risks inherent in such currency loans to prospective borrowers. ...

(e) Borrowers typically were not advised fully enough to assess the risks of the foreign currency loan in the context of the borrower's individual position or at all.

(f) As a result of inadequate training of Managers and Loans Officers, advice which was in fact given by those Officers to prospective borrower although well intended, was almost invariably inadequate and insufficient to apprise those borrower (sic) of the degree of risk they faced if they were to take an unhedged foreign currency loan. ...

(h) The Bank did not have adequate procedures in place to control the foreign currency losses when the depreciation of the Australian dollar began in 1985. Although certain facilities were available within the Bank, and although there was a broad awareness that there was something available called "hedging", there was little appreciation amongst most Branch Managers and Loans Officers of the way in which hedging might best be used in particular circumstances, and the other ramifications of entering into hedge or forward exchange contracts, such as the necessity to fund in cash any losses that resulted on the maturity of the hedge on the next rollover date.

(i) Where borrower (sic) were advised that there was a risk in connection with the loan, they were frequently reassured that this risk was minimal by being shown graphs of the AUD/CHF relationship over recently relatively short periods which did indeed

show a relatively stable short term relationship between the currencies.

22. Based on my experience from many years with the Bank in lending, and my knowledge of foreign currency matters, I believe that in the interests of both the borrower and the Bank, a decision should have been made at the outset to embody an effective form of stop loss mechanism in the initial documentation. This would have focused the attention of the borrower on the risks and would have limited any losses to a figure with which the borrower could cope.

24. After the dramatic fall in the currency from February 1985 onwards, the Bank did take several steps to attempt to assist both itself and borrower in connection with the consequences of the depreciation. The main steps were:

(a) The setting up of the Risk Management Advisory Service in about October 1985. ...

(b) The setting up of the Foreign Currency Loan Cell, in about August/September 1986 ...

(c) The setting up of a Stop Loss mechanism ...

(d) Market Watch Arrangements ...

(e) Detailed information on hedging provided in the form of circular letter from the Bank to borrower of May 1987. ...

25. It is my view that these facilities and matters should have been attended to at the time that the product was first made available, bearing in mind that the Bank was fully aware of the exchange rate risk associated with borrowing in foreign currency and that it and the borrower were taking on board a grave risk of significant loss if loans were allowed to proceed on an unhedged basis. (6-10)

There is a marked disparity between the substance of the Dodd affidavit and the central tendency of court practice in foreign currency litigation.

9. Conclusion

The foreign currency loans affair of the 1980s is one of the most important byproducts of financial deregulation in Australia. The affair was essentially a disaster of hubris and incompetence, involving enormous financial losses and personal suffering. The phenomenon runs counter to the official wisdom on deregulation as wholly a desirable development, and it has been conveniently marginalised from the public record, to the detriment both of its casualties and its lessons.

One important lesson is that regarding the character of legal culture itself. The passage of foreign currency litigation through the courts provides an exemplary study in the conventions and tensions of the law. The tension between judgments, elaborated in scholarly commentary, provides an exemplary case study in banking law in Australia.²¹

In particular, one finds a clash between the context that gave rise to the foreign currency facility, an understanding of which the bank documents provide essential copy, and the general legal culture underpinning the ensuing litigation. On the one hand there were the specifics of the phenomenon; on the other hand there was legal procedure steeped in first principles moored on precedent. Rather than a meshing, we typically find polarisation. Of course, some crucial Commonwealth Bank judgments were decided on the issue of reliance – *David Securities*, *Ralik* and *Mehta* (and implicitly *Dwyer*). Findings

²¹ The potential, however, has not been fulfilled in the scholarly literature on the subject produced to date. In particular, the treatment of the foreign currency story in banking law texts is lamentable.

of non-reliance conveniently obviated any need for the examination of bank practices. Thus the evidentiary significance of bank documents was taken to be irrelevant in some cases and a revelation in others. Ultimately, the conscientious efforts of Rogers J. in his forensic search for understanding were of no avail, and the single beneficiary of such diligence (at least with respect to Commonwealth Bank borrowers) was Quade.

As a non-lawyer, this author confesses to substantial dissatisfaction at the quality of judicial oversight of justice throughout the proceedings on foreign currency loan litigation on cases involving the Commonwealth Bank of Australia. Evidently the sanctity of contract and the weight of precedent impose heavy constraints on the parameters confronting a bench in an individual case. However, that the adamant reiteration (indeed adaptation) of first principles and of precedent can perennially allow the deferral of the enlistment of both rational detachment and the full facts of the specific case is a source of bewilderment to this author. Bewilderment is further enhanced when legal scholarship, with the benefit of removal from the flesh and blood atmosphere of the courtroom and of hindsight, should continue to reinforce the transparent anomalies of the judgments emanating from high judicial office.

The foreign currency loans affair was a tragedy waiting to happen. A product of the vested interests and ideologues behind an incautious deregulatory process, of indifferent and cowardly officials in the regulatory agencies, and of self-interest and incompetence within the lending institutions behind doors that once commanded respect, the adverse consequences have been near universally attributed to those who bore the brunt of the disaster. In short, it is a disgraceful episode in Australia's banking history. This author looks forward to a *mea culpa* from those who participated in the construction of the edifice and who have to date been absolved from any responsibility for its adverse outcome.

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