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The Banks and Small Business Borrowers: case studies of adversity

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The Banks and Small Business Borrowers: case studies of adversity

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ABSTRACT

Recent surveys of banking products for small business imply a sector in excellent working order. The presumption is of a qualitative advance since financial deregulation, with more diverse and cheaper facilities. Competition to retain and attract customers has intensified. Information from other sources highlight that the story is more complex and troublesome. An undesirably large number of small businesses have had unfortunate experiences with their lenders. At face value, their experience does not appear to be the result purely of their own ineptitude. This paper examines eight case studies, all involving the National Australia Bank, although comparable cases could be elicited involving other major banks. Most of the cases are of recent vintage, although some are of long standing and retain their salience. The borrowers' experience merits recounting as an apparent reflection of the unequal relationship that small businesses experience with the major banks. The capacity of the legal system to appropriately process small business complaints is also at issue. The accounts are based on representations of the NAB's customers. These will inevitably be prejudiced. Nevertheless, the representations highlight issues that deserve exposure and generate questions that deserve answers.

Keywords: *financial deregulation; small business; lender-borrower relations; receivership; bankruptcy; bank litigation*

JEL codes: *G21; G28; G33; K41; K42; M13; M14*

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1. Introduction and background

The mission statement of the Australian Bankers' Association reads "Improve the economic wellbeing of Australians by fostering a banking system recognised as one of the safest, dynamic and most efficient in the world".

In February 2002 KPMG Consulting produced a report for the Australian Bankers' Association on small business banking. The general tenor of the report was of a sector in excellent working order, with the claim of 57 institutions offering 720 debt financial products. The tenor of the 2003 KPMG report is comparable. The ABA's CEO, David Bell, summarised the essence of the 2003 report, painting a glowing picture of the banking sector's catering to small business needs (Bell, 2004). Bell claimed a qualitative advance since financial deregulation, based on the thrust to user pays pricing by which the imposition of fees for services have facilitated downwards pressure on interest margins. Competition was reputed to be intense: "...business bankers are working hard to retain and attract customers" says Bell.

Academic opinion has generally painted a rosy picture of the after-effects of deregulation. Ackland and Harper claim that "popular resentment directed at the banks in recent times has much less to do with deregulation than with the current restrictive stance of monetary policy". They also claim that calls for "the reintroduction of regulations on banks and non-banks on the grounds that deregulation has failed to deliver its promised benefits or unleashed evil spirits of one sort or another" is "either misguided or naïve" (Ackland & Harper, 1992: p.69).

In a recent book, *Straw Polls, Paper Money*, the economist David Love claims that the Australian finance sector has created a 'web of economic

rationality' that has underpinned Australia as a top-ranking modern economy by global standards (Love, 2001: p.27).¹

These claims are representative of the 'official' banking community and the representation in the respectable media of the sector's positive contribution to the economy.

KPMG surveyed the financial providers, not small business customers. Telstra's subsidiary Sensis does survey small business regularly, albeit the financial dimension is not included in its regular surveys. Sensis' 1999 *Yellow Pages Survey*², though not ideal, provides rare information on (non-rural) small business attitude to their financial providers. The myriad and growing number of providers touted in the KPMG summary and press release distorts the skewed character of small business providers. The four major banks comprised the major financial institution for approximately 80% of the Sensis sample (the percentage varied across States), with the Commonwealth Bank and the National Australia Bank being the major institution each for approximately one quarter of all sample businesses.

Of significance is that there has been a recent gradual move away from the four majors to other providers. Respondents report dissatisfaction with inflexibility, lack of general support and poor value for money. However, the extent of the movement appears to be linked to the availability of the second-tier banks (hence the variability of the 'major four' share across States). Without alternatives, the movement from the four majors is less.³

¹ Love was a principal in the thoroughly orthodox and influential consultancy, Syntec Economic Services, from 1972 to 1998.

² There has been no survey as comprehensive since the 1999 survey. This survey has now been removed from the Sensis website.

³ This phenomenon highlights the importance of a viable second-tier in Australia, and the adverse implications of the regulatory authorities' toleration of the gobbling up of some second-tier institutions by the four majors.

However, the four majors have retained their extraordinary dominance, though it is not from total satisfaction from customers. KPMG speculates on the reason for this continued dominance. Full service provision would probably be a factor, but KPMG also suggests that the majors offer better facilities in risk management and that 'brand status' matters in customer perceptions (KPMG, 2003: p.38). On the latter criterion, NAB was the most prestigious, with 'the 4th most valuable brand in Australia'.

With respect, we would suggest that brand status counts for little amongst small business customers, and that the superiority of the majors on risk management is not only not transparent but dubious (as is clear from the case studies cited below). We would suggest that a key reason for the 'major four' dominance is 'the devil you know' caution amongst customers; moreover, the costs of shifting all financial facilities are substantial. In short, the 'major four' dominance tells us little about the relative performance of the various institutions, in particular the four majors, in serving the financial needs of small business.

The 2003 KPMG report notes that "the information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity". This is an astute qualifier.

Information from other sources highlight that the story is more complex and troublesome. An undesirably large number of small businesses have had unfortunate experiences with their lenders. Some go through the court system, and their experience is (partly) exposed publicly in the material of the judicial process. Much information is passed by word of mouth. At face value, their experience does not appear to be the result purely of their own ineptitude. For predictable reasons, the media is not partial to the recounting of such small business hardship.

Dissonance between small business borrowers and their lenders arose most dramatically in the cases of an estimated 3600-4000 borrowers in foreign currencies during the mid-1980s. The offering by major institutions

(particularly Westpac, the CBA and ANZ) of an intrinsically flawed credit instrument produced a catastrophe for many borrowers. The providers denied responsibility, fought litigants in the courts or made secret settlements with troublesome borrowers, to the general indifference of the regulatory authorities and of Parliament. The Martin Committee, conducting an inquiry into the banks, heard considerable evidence from all parties on the foreign currency matter, but ultimately whitewashed the issue.⁴ The desire of the official financial community to paint a benign picture of the post-deregulation period necessitated the obliteration of the foreign currency debacle from the official account. In the process, however, the vulnerability of the small business community to its large corporate lenders became institutionalised.

A rare publicly accessible window into alleged bank lender continued maltreatment of small business borrowers can be found in the Parliamentary report of the Reid Committee (1997: Ch.5). Submissions noted problems related to information disclosure, access to account information and breach of client confidentiality. More significant was evidence of various forms of unconscionable conduct, and alleged 'harsh and oppressive' conduct with respect to repossession and sales of mortgaged property. Many submissions were confidential, for fear of reprisal. Nothing came of the evidence presented to the Committee on this matter. A handful of substantive changes to the Trade Practices Act and its administration were effected following the Reid report but none of these have been pertinent to the bank-borrower relationship. Most notable has been the 1998 enactment of S.51AC of the Act, which formally covers potential bank-borrower unconscionable conduct, but the Section has lain relatively dormant in practice.

⁴ The chapter of the Inquiry report covering foreign currency loans is a superficial product with the character of an undergraduate essay (Martin Committee, 1991: Ch.17). Edwards and Valentine claim that "the Report of the Committee failed to substantiate the criticisms of the banks. ... The detailed allegations were dismissed". Tom Valentine was an expert witness for the banks on the status of foreign currency knowledge during the 1980s, but the judgement here is clearly inexpert. The Committee did not dismiss the allegations; it merely let them 'go through to the keeper'.

Let us examine a number of case studies, all involving the National Australia Bank.⁵

One could readily construct an alternate list of case studies involving the Commonwealth Bank of Australia. Anne Lampe, the experienced *Sydney Morning Herald* financial journalist, has recently reported on several cases that deserve attention. There is the case of the Timms family, who bought a furniture business in 1991 with funds borrowed from the CBA, reputedly on the strength of positive claims from bank staff regarding viability, only to discover that the business was a lemon (Lampe, 2003a, 2003b, 2003c, 2004a). The Timms case bears a remarkable similarity to the Kabwand case outlined below. There is the case of Bernie Madigan whose attempt to close out a mortgage involved demands for further unwarranted and substantial payments, with Madigan's costs escalating with battles through the court system (Lampe, 2004b). There is a Queensland case pending since 1996 of a Dr Robert Cooke, proprietor of three medical emergency centres whose modernisation was being funded by the CBA under agreement, with the bank subsequently reneging on that agreement and foreclosing on the centres. Other cases that deserve exposure arose when the Commonwealth Bank (following full privatisation) closed its small business subsidiary, the Commonwealth Development Bank in 1996 (Jones, 2001), with some CDB

⁵ The recent report by the Australian Prudential Regulation Authority on the NAB's currency desk may or not be relevant to the matters under discussion here. The Executive Summary notes: "'Profit is king' was an expression frequently heard in our interviews with Corporate and Institutional Banking (CIB) staff." (APRA, 2004: p.6). That the NAB would be focused on profit is a truism; the issue presumably is the means by which profit is achieved. APRA's comments on corporate culture perhaps offer resonance beyond the specific focus of the report. One of two cultural themes emphasised by APRA concerned "a close management of information flows that discourages the escalation of issues of concern to the Board or to relevant external parties (such as APRA). ... Managing the message was frequently given equal, or greater, priority than dealing with the underlying issue. NAB's tendency to closely control information flows can be seen in the lack of escalation of issues outside the immediate operational environment" (ibid.: Ch.6).

borrowers getting rough treatment. Case studies involving the Commonwealth Bank deserve attention on another occasion.

The NAB borrowers' experience merits recounting as an apparent reflection of the unequal relationship that small businesses experience with the major banks. It needs to be emphasised that the accounts below are based on the representations of the NAB's customers. These will inevitably be prejudiced. Nevertheless, the representations highlight issues that deserve exposure and generate questions that deserve answers. Analytical commentary is warranted but, with some exceptions, has generally not been pursued in the stories.

2. The Goonans [2001 New South Wales]

Tony and Lorise Goonan had run a successful hardware store in Singleton, New South Wales, since 1993. Tony has an accounting background, and they plucked the hardware business out of the moribund local Cooperative, and built the business up from scratch. They had a good relationship with local builders. In early 2000, they purchased a reputable hardware business in Forster on the New South Wales north coast. The funds were obtained from the Singleton branch of the National Australia Bank, with whom the Goonans had long had a productive relationship.

In late 2000, the stores were hit with declining sales. The implementation of the Goods and Services Tax was clearly a factor, and spending in Forster (a holiday and retirement town) was down due to the Olympic Games. Forster was also hit with heavy rains (knocking local building) and an unconscionable Council road closure lasting six weeks. In early 2001, Tony Goonan sought an extension of his Forster overdraft to assist with what was interpreted as short-term cash flow problems.

In July, the Singleton Manager discussed the business, claimed the application to be reasonable and promised to forward the application to

Sydney for 'rubber stamping'. After five weeks' silence, Goonan rang the NAB to be told by the Manager's assistant that the application had been unsuccessful. No reasons were given.

In October, the Singleton manager and his assistant called in unannounced at the Forster store (also secretly checking out the Goonan's residence at Old Bar), claiming 'only a social visit as we happened to be in the area'. Two weeks later, Goonan received a call from the Sydney office of Deloitte advising that the NAB had foreclosed on the facilities and that Deloitte was now managing the accounts.

Tony Goonan rang his branch to inquire what was going on, and was told that they knew nothing about it and would call him back to arrange a conference call with relevant parties. The branch did not call him back.

Given the conditions, the Goonans placed their company in voluntary administration in late November with Knights Insolvency of Sydney. The Goonans' original ambition was to get through the immediate difficulty period and then revive their businesses. Knights led them to believe that they would continue trading for three months (over the important Christmas/Summer period), during which time both shops would be advertised as going concerns. Knights ordered new stock for this period. Yet, at a meeting of creditors on 19 December, the NAB and Knights placed the company into liquidation.

Being unable to pay trade creditors, the Goonans placed themselves into bankruptcy in February 2002. The keys to their residences, for lack of alternatives, were handed over to the NAB in March and June.

The Goonans had overdrafts totalling \$365,000 on Singleton and Forster, a fixed term loan of \$417,500 (for the Forster purchase) and five vehicle leases (two of which were almost paid off). The loan was being repaid at \$6000 per month, and payments were several thousand dollars ahead of schedule. Total

payments were roughly \$12,000 per month on a previously long-term turnover of \$200,000 per month.

The Goonans were not in default, and their payment history was sound. None of the various definitions of default in the loan documents are applicable to the Goonans. No written advice was received from Deloitte. No written advice was received from the NAB advising default in spite of requirement to that effect in the loan documents.

The Goonans' accountant contacted a sometime NAB branch manager known to him. The accountant was informed that, following the introduction of the GST, small hardware stores and small transport companies were being generally targeted by the NAB, and that the Goonans' files would be marked 'red'.

A January 2002 letter from the NAB Asset Structuring Unit claimed that 'as you are aware, the company is in default by virtue of the appointment of an Administrator (or Liquidator) to it'. This claim bears no relation to bank loan documentation.

The Goonan's Singleton residence was sold in November 2002 for \$235,000. The Goonans estimate that its proper value was about \$260-270,000, but the NAB had left the property vacant for 8 months before its sale. The Old Bar property had been valued at \$175,000 and was left vacant for seven months before its auction in January 2003 (the Goonans had requested that their children be permitted to purchase Old Bar at market valuation, but the bank refused). Serendipitously, the NAB benefited from the beginning of a local life-style boom, the property selling for \$287,000. Blocks in Old Bar now sell for over \$200,000, and the Goonan house, 100 yards from the water, would be now worth about \$400,000.

The two hardware properties were leased. All the stock, fixtures, fittings and vehicles were auctioned at Singleton in early January for \$125,000 –

estimated by the liquidator to be less than 20% of total value while trading. A vehicle sold for \$31,000, \$20,000 less than its market value.

Approximately \$1m. of assets has disappeared – some redistributed through lower prices to purchasers of stock, vehicles and residences; substantial goodwill was destroyed, and the rest frittered away in costs of liquidation.

The Forster stock was re-located to Singleton over Christmas at a cost of \$41,000. Contemplate the rationality of moving the contents of a hardware store across country for a fire sale, especially in early January. By the liquidator's estimate, the NAB would only have received about \$10-15,000 of the auction proceeds, the bulk going to the liquidator and auctioneer.

The NAB's net proceeds after foreclosure appear to be negative, with the proceeds of sale of the two residences and the paltry returns from the stock/vehicles sale less than total debt. Interest continued to be charged on the Goonan's debt, at penalty rates, between the time of bankruptcy and the sale of Old Bar, summing to \$60,000, presumably with no expectation of recoupment.

In mid-August 2002, the NAB was reported in the *Australian Financial Review* as shedding 'non-performing and marginal borrowers from its \$65 billion business loan book to preserve credit quality' (Lekakis, 2002). In the previous ten months, the NAB had shed \$1.3bn worth of business borrowers 'because those customers either wouldn't work with us or failed our tests'. The Goonans had over eight years of passing the usual tests of successful businesses for their bank lenders.

The Goonans previously employed up to 16 people. They are now penniless and in receipt of the pension.

3. Paul Buckman and Basstech [1999 Victoria]

Buckman and his partners ran a small business, Basstech Pty. Ltd., in regional Victoria servicing the refining and manufacturing sectors across Australia and internationally with electronic repair, calibration and National Association of Testing Authorities' (NATA) certification services.

In May 1999, the directors uncovered an incidence of theft from their company perpetrated by Brian Harman, their financial controller. His principal method of theft was to forge signatures on cheques. He also forged signatures on cheques to pay legitimate creditors, to help him hide his activities. This theft took the form of processing legitimate creditor payments through the accounting system, then writing the cheques payable to either himself and depositing into his bank account, or payable as 'Cash' cheques. This process effectively wrote the creditor invoice as a liability out of the accounting system, and provided the illusion that Basstech debt to creditors had been discharged when it hadn't.

On 9th October 2001, Harman was sentenced to 2 years 9 months in prison for theft, making and using false documents. Harman pleaded guilty to all 413 charges covering 184 cheques. Of these 184 cheques some, bearing forged signatures, were used to pay legitimate creditors so convictions for 'making false documents' were only recorded. The breakdown was: Theft: total value \$231,400; Making False documents (forging signatures on 152 cheques): \$238,750. A value of around \$7,300 went to legitimate creditors – not theft but still bearing forged signatures, a criminal offence.

Of the 184 cheques, 71 were made payable as 'Cash' & converted to cash by NAB staff totaling \$133,757. Of those, 35 were referred to the NAB bank manager for explicit signature verification and clearance, including one to the value of \$10,173 with teller's comments on the reverse of that cheque stating, 'Chq faxed – signature not on system'. Regardless of forged signatures, \$10,173 was paid across the counter – no questions asked. The first of these

cheques bearing forged signatures was referred to Basstech's bank manager, for explicit clearance by another banker, on the 1st of May 1998, two months after the fraud commenced.

Basstech directors uncovered the fraud in mid May 1999. The bulk of the fraud occurred over a seven month period - November 1998 (\$40,000), December 1998 (\$29,000), January 1999 (\$18,000), February 1999 (\$36,500), March 1999 (\$16,000) April 1999 (\$14,000) and May 1999 (\$54,400). The amounts converted to cash by the NAB across the counter for November and December 1998 and May 1999 were \$37,200, \$23,500 and \$25,900 respectively.

Details of the case were outlined in evidence to the County Court Melbourne on October 1 2001, re The Queen v Brian Harman P00980076, and in the transcript of two recorded interviews between Harman and the Victoria Police investigating officer. Both the County Court and the defendant accepted Buckman's evidence. Harman pleaded guilty on all charges.

The issue now is the National Australia Bank's responsibility and culpability in these events, their duty of care, their application of due diligence as befits the concept of a 'Diligent and Prudent' banker. Buckman's understanding of the Cheques Act 1986, and of regulatory responsibility, is that it is incumbent upon banks and financial institutions to perform the clearance process to validate that a cheque presented for payment is a legal document. In settled law, it appears that "Fraud vitiates everything, even judgments and orders of the court" (McDonnell & Monroe, 1952: p.3).⁶

⁶ Master Harrison, of the New South Wales Supreme Court, applied this reasoning in a recent case with similarities to the Buckman case. The bank customer and defendant Roman Voloshin had defaulted on his mortgage payments because of cheque fraud by a third party. Master Harrison commented: "It is my view that it is at least arguable that the plaintiff's [the NAB] conduct in seeking to enforce the mortgage is unconscionable with the consequence that the court will decline to permit the National Bank to enforce its legal rights." (National Australia Bank v Voloshin, 2000, par.21)

According to Buckman's reading of the law of cheques, in view of the meaning of 'Non Negotiable' and the effect that a crossing (printed upon cheques) has on ownership and as direction by the cheque signer to his/her bank, this direction by the signer is the act that gives the bank its sole mandate to conduct business upon the signer's behalf. Without this mandate the bank has no legitimate authority to remove funds from the customer's bank account. The bank has no legitimate title to those moneys that are the subject of fraud. The NAB has removed and continues to hold those moneys illegally.

The NAB, as custodian and trustee of Basstech's account, cleared 152 cheques bearing forged signatures, to the value of \$238,750 from the business account, representing 25% of the company's annual receipts, forcing the company into insolvency. NAB staff had physically sighted 35 of 71 'Cash' cheques and still converted them to cash despite forged signatures, cheques totaling \$133,757. In addition, over the relevant period the NAB charged Basstech \$21,348 in interest, fees and charges on those moneys that had been stolen with the bank's acquiescence.

The NAB then used that insolvent condition as a trigger to enact provisions of their debentures held over Basstech's assets. The bank then appointed a receiver and manager, Scott Partners, in late August 1999 to strip and sell the business and assets. Subsequently the bank repossessed further assets from Buckman's partners and disposed of them at a mortgagee's auction.

The company's operational assets were sold by the bank in late September on knock-down terms. Assets included laboratory equipment (\$50-60,000 of test equipment for certification), vehicles, office furniture, repair workshop, lathes, PC network and five vehicles. The receiver apparently took tenders, and got two offers – \$30,000 and \$60,000. The higher offer also demanded a proviso that all staff entitlements were paid out.

The business, including goodwill (names, logos), went down the drain. A dozen people in a regional area lost their jobs. The business had been

growing rapidly. Gross receipts prior to the closure totaled \$600,000 (1995-96), \$800,000 (1996-97) and \$1.04m. (1997-98). Receipts in 1998-99 were on track for \$1.6m. Trade was prevented in May and June 1999, but receipts reached \$1.45m, with \$100,000 of signed purchase orders which couldn't be filled.

Buckman and his partners were then forced into bankruptcy, the partners in March and Buckman in June 2000.

In summary, Buckman and his partners detected the forged signatures in September 1999, not the NAB through their encashment cheque clearing process. Moreover, many of the 152 cheques bearing forged signatures were faxed to the bank's account manager in Bairnsdale, for explicit signature verification, yet they were still cleared.

4. The Walter family and Palatinat [1998 Victoria]

Fritz and Ingrid Walter ran a successful business in Germany, had acquired a reasonable nest egg and lived a comfortable life. Several holidays in Australia generated an interest in migrating permanently to this country. In the late 1980s, the Walters attended a seminar at Frankfurt sponsored by Australian government officials on the attractions of business migration to Australia. They met Victorian government officials who promoted the Albury/Wodonga area, reinforced by local officials when the Walters visited the area in 1994. In particular, local officials were promoting the 'Gateway Island' project (adjacent to Sydney/Melbourne traffic) as a tourist attraction.

The website of the Victorian government's Frankfurt office has promoted Victoria as possessing a large number of fundamental ingredients for doing business. These ingredients include 'a cost efficient place to do business'; 'secure and familiar legal and financial infrastructure and services'; and

‘strong safeguards for your intellectual property’. The language has to be seen as hyperbole in the light of the Walter family experience.⁷

By 1997 the Walters bought land in the ‘Gateway Island’ domain, planning a brewery and restaurant. They hired as consultant an Australian-based compatriot with a track record in boutiques breweries. Funds for the purchase and development of the property came predominantly from the disposal of existing family assets, generating \$712,000 in capital. Later, sale of another asset added \$202,000, totaling \$914,000 in family capital. Additional funds were made available from sale of the Walter family business in Germany for \$2.2m.

The Walters moved to Wodonga in February 1998. Construction had begun in July 1997 and the brewery was officially opened by the then Victorian Premier. Jeff Kennett, in May 1998.

The Walters began banking with the National Australia Bank, and developed a good relationship with the Wodonga branch manager. The Walters obtained a short-term overdraft, a housing loan and equipment leasing facilities from the bank.

By October, it was clear that business turnover was not up to expectations. There was cost overruns due to the high quality of construction and outfitting. Some locals claim that the restaurant did not cater to local tastes. The Walters claim that they were let down by the Council which had not proceeded with the precinct project. Moreover, the Council had failed to install traffic lights on the main thoroughfare that would make the business accessible to traffic passing in the opposite direction.

The Walters approached their manager via their accountant and asked for a restructuring of their loan facilities to reduce monthly repayments. The then

⁷ Correspondence with the Premier’s office has not elicited any concern for the integrity of the website’s offerings.

manager claimed that the request would probably be acceptable to his superiors. At about this time, the Walters’ manager resigned, and was replaced.

It was not until two months later, in December, that the branch organised a response to the Walters’ request. The Walters’ accountant had requested a single bills facility. The Walters were offered \$1.38m. (their existing total indebtedness), comprising a principal and interest combination loan of \$380,000 and a fixed interest one-year bank-funded loan of \$1m. This mix of debt seemed bizarre to the Walters.⁸ According to the Walters (albeit denied by the manager at trial), the new manager declined to explain the loan’s quantum or character, and offered it on a ‘take it or leave it’ basis. The new manager’s general response to questioning was that ‘it is best for your business’. In particular, the Walters presumed that the fixed interest component would be turned over (subject to interest rate movements), and they were not disabused of this belief (see below). The discussion generally focused on the interest rate payable; there was no discussion regarding repayment of principal.

In May 1999, Carmen Walter wrote to the bank querying the account fees. After a delay of almost four weeks, the bank replied that their accounts had been reviewed and demanded a reduction in the debt of \$100,000 through other asset sales. In the meantime, the second Wodonga manager had left to be replaced by an interim manager, and by September a fourth person was in the position. One of the first actions of this new manager was to turn up unexpectedly at the business and try to sell the Walters life insurance.

⁸ The Walters would not have known that the first set of facilities offered to them were not necessarily functional either. An October 1998 internal credit memorandum stated that ‘lending to this connection has in the past been based on security held’ (National Australia Bank v Walter, 2004: par.101). That is, the Walters’ business relationship with the NAB had been founded not on business needs and prospects but on the value of the Walters’ existing assets.

Although the fixed interest facility was due for reconsideration in late December, no correspondence was forthcoming. However, in late February 2000, advice was received that interest rates had increased to 12.25%, up from 7.9%. The Walters' accountant complained, and was met with an April response from Asset Structuring expressing concern regarding the company's profit and loss position. The Walters would not have known, nor were they advised, that their account's location in Asset Structuring meant that they had been downgraded to an impaired status (this had occurred in October 1999), and were now attracting a penalty interest rate.

The Walters explained that they were applying a depreciation regime to the brewing equipment as advised by their accountant, which was generating the paper loss. On their terms, they were just breaking even. In response the bank replied on 12 April, demanding sale of the business and the home by 30 June. Visits to senior management were met with the response "we don't want you". This is in spite of the fact that the Walters had never been in default with their monthly payments under either of their loan facilities. Moreover, business prospects were improving, with their brewing products increasingly attracting adherents.

On 30 November, the bank withdrew almost \$15,000 from the company account (consistent with regular payments on the two loans). On the next day a bank-appointed receiver (D'Aloia Handberg) arrived and took possession of the brewery and subsequently froze the account. The Walters were denied access to the balance of the account, estimated at \$30,000. A receiver appointed Melbourne-based valuer valued the property in the range of \$800,000 to \$1m.⁹ This valuation contrasted with a May 1999 appraisal by a local valuer at between \$3-3.5m., with a 'fire sale' valuation of \$2m. The receiver closed down the business in mid February 2001. The property was

⁹ In the major court case involving the Walters and the NAB (VSC36), Judge Dodds-Streton found that this lower valuation was more realistic, and thus the sale price not under-value (National Australia Bank v Walter, 2004: pars.286-314).

auctioned on 2 March 2001, the sale price being \$1.03m, inclusive of all chattels.

Carmen Walter has naturally sought discovery of documents from the bank. In this endeavour, the bank has responded belatedly with drabs and drabs, on each occasion insisting that all relevant documents have been discovered.

Service of court documents by the bank has eschewed formalities. On one occasion, a process server handed the Walters loose documents not in an envelope as they were going to church on Sunday morning. On another occasion, loose documents not in an envelope were dropped on the front doormat.

Fragments of bank statements obtained by the Walters (belatedly through discovery) are instructive. After informal demand was issued by the bank in May 2000 (formal demand was issued in November), the 'address' for the statements for the \$1m. interest only account was changed from the Walters' home address to 'Do not mail, refer to manager'. This practice of withholding statements of account from customers defaulted by the bank was examined and condemned by a parliamentary committee shortly after the Walters experience commenced (Chapman Committee, 2000).¹⁰ The Walters thus had no idea that their account was being loaded with legal costs and their extent, or that the account was subject to a partial bad debt write-off.

Carmen Walter has gone to the Victorian courts persistently. Without legal representation (for lack of resources) or training, her representations have floundered. The Walter residence, quarantined during litigation, shortly faces foreclosure.

¹⁰ In VSC36, Judge Dodds-Streton found that the bank practices described as standard "are explicable by legitimate internal record-keeping and accounting requirements of the NAB" (National Australia Bank v Walter, 2004: pars.254-264). Her Honour was surprisingly unaware that Parliament had changed the ethical goalposts regarding these practices.

Initial Walter representations in court centred on the illegality of seizure, due to ownership of property through a family trust. But the courts kept returning to the fundamental fact that the bank possessed registered mortgages and a debenture against the Walter assets, guaranteed by the Walters. For the law, a contract is a contract. The divergence between legal formalities and substance was captured neatly by Justice Beach:

“I feel a deal of sympathy for the Walter family. From the material before the court it is clear that their life’s dream of establishing the brewery and restaurant at Wodonga has been shattered. However ... I am required to administer the law as I find it to be and I can simply find no basis upon which the first-named defendant can lodge any caveat in relation to the property in question”. (Handberg v Walter & Anor, 2001, p.2)

The broad spectrum of the bank-Walter relationship was covered (albeit selectively) in recent litigation (National Australia Bank v Walter, 2004).¹¹ Several generalisations are warranted.¹² That the Walters’ brewery and

¹¹ Selectivity of coverage is reflected, for example, in two representations. First, the business’ financial status is reported from the bank’s perspective (par.182), without acknowledgement that there was disputation over the significance of the figures regarding viability. Second, Her Honour states that the Walters were “in default under the interest-only loan ... [which] constituted a default under the home loan” (par.185). One cannot tell from the judgment transcript that the default refers to the loan status *after* the bank had issued demand.

¹² A side issue that nevertheless excites some commentators is that of potential ‘apprehended bias’ of the bench. Judge Dodds-Streeton disclosed, belatedly in par.198, that she was the beneficiary of 8,000 shares in the NAB. Her Honour did preface the opening of the court case with the acknowledgment of share ownership, but had to correct the details on the second day, from a total of 3,000 shares to 8,000. At \$30 a share, that holding would be worth a not inconsiderable quarter of a million dollars. Nevertheless, Her Honour declined to disqualify herself on the grounds that “a fair-minded observer with knowledge of the material facts would not reasonably

restaurant business was in trouble is clear. What is also clear, however, is that conventional litigation involving banks and small business customers, well represented by this 2004 Walter judgment, does not get to the nub of the relationship or the key sources of the ensuing crisis.

Much of the time of learned judges is devoted to exploring the intricacies of what or was not said at crucial meetings, with the necessity for the judge to make up with inference for the paucity of information and for conflicting accounts (not least because of the prevalence of verbal exchanges rather than documentary records). In the Walter case, it appears that extant documents might have been handled more productively. At the 16 December 1998 meeting at which the new facilities were offered to the Walters, including the ‘time bomb’ 12-month interest-only loan, Carmen Walter had the letter of offer in front of her, and on it she wrote the words she heard from the new manager at time of hearing, “it will be renewed year by year”. This document, with annotations, was submitted to the court, without effect. The bench sees only the terms of the letter of offer: “ ... The Balance Owing shall be repaid in full on the Maturity Date”.

Perennially, bank staff claim that they do not remember the substance of particular meetings, but that ‘it was their normal practice to ...’, etc. Perennially also does His/Her Honour conclude that bank staff were ‘disinterested and honest witnesses’ (ibid.: par.361), and that the borrower(s) was ‘evasive and unco-operative’ (par.173), or words to that effect. Partly, the latter judgment is leveraged on apparent borrower resort to claims of duress or incapacity.

The courts will not or cannot dig beneath such ephemera to confront an underlying structural asymmetry embodied in the nature of facilities dictated to the borrower and in the potential draconian clauses contained therein. The terms on which borrowers go into the relationship and are subsequently

apprehend that I might not bring an impartial mind to the resolution of the questions to be decided in the proceedings”.

forced out of the relationship are generally hidden in the black box called ‘commercial discretion’.

Somewhere in the interstices of a judgment, convention dictates a learned disquisition on legal precedent. On the matter of fiduciary duty, pleaded by the Walters, Judge Dodds-Streeton expounded (without explicit summation) that the law is entirely contradictory in this domain (pars.277-285). As is customary with her peers, Her Honour then moved on to make a very human evaluation of the case at hand under the constraints just outlined.

5. The McMinns [1997 Queensland]

The McMinns had for decades run a successful motor vehicle dealership in rural Victoria. In 1995, in semi-retirement on the Gold Coast, they decided to invest in a childcare business.

In 1995, the McMinns were introduced to a local NAB commercial manager by a mutual friend. After discussions with the manager, the McMinns liked his proposals for their business and his promotion of the NAB’s services and financial expertise. They consequently switched banks and became clients of the NAB.

The McMinns came to the NAB with a ‘triple A’ rating, a label given to them by their previous ANZ bank manager. They negotiated new business loans that were well within the NAB’s lending ratio and, with the manager’s help, they put together a business plan and began implementing this business plan in October 1995. They purchased a childcare centre catered to children but not babies. The plan was to erect an adjacent childcare centre for babies, complementary to the existing centre and the vehicle for building a stable and loyal client base.

Throughout 1996, the business was enhancing its profitability, product of expansion from 85% to 100% of capacity, and was ready to expand with the construction of the second, adjoining childcare centre.

This period of pending expansion coincided with the commencement of major NAB internal restructuring, resulting in a sustained period of downsizing with the closing of branches and retrenchment of staff. The McMinn’s trusted commercial manager was a casualty in this downsizing. They were never assured that his original business advice would be followed through with the new manager.

The McMinns had four different managers in quick succession handling their account. In August 1996, a fifth manager re-endorsed the soundness of the original business plan (jointly developed by the NAB and Alan McMinn) and agreed that the business expansion should proceed as planned.

At the critical point when the expansion had to commence to be ready for the commencement of the school year in 1997, in September 1996 the new manager reported to Mr McMinn that “head office was in a mess due to ongoing restructuring and staff changes, but the loan would be OK so go ahead with planning while he prepared and completed NAB paperwork”. On this basis, the McMinns believed him to be speaking on behalf of the NAB, and they proceeded with preparing to build. Timing was critical for the building to commence by November 1996 and be ready for trading by end January 1997, as this is when parents make childcare decisions for the year.

Suddenly in December 1996, at some senior level of the NAB it was ordered that building work stopped on-site, and a senior officer was sent to appraise the project. Despite McMinn’s efforts to ascertain the reason for the bank’s delay and to organise its immediate resolution, no reasons were given by the bank, and the delay continued. Approval to restart building was not granted by the NAB until March 1997. This unnecessary delay dramatically undermined the business plan, and caused irreparable damage to the previously strong company. Trading during 1997 was below business plan projections because the new development missed the start of the school year. Families in need of the baby centre (some had even planned their babies in expectation of the centre’s availability) moved their children from the existing centre, and capacity declined.

McMinn believes that, during 1997-2000, the NAB was culpable both because of mismanagement of his account as well as mismanagement resulting from NAB's own internal restructuring. As a reflection of the dysfunctionality associated with bank restructuring, in the 3 ½ year period to mid-2000, eleven people filled in for the manager with whom the McMinn had re-established a viable relationship with in late 1996.

As a consequence of the delayed completion, debt repayments ran into difficulty and the McMinn sought a restructuring of their loan commitments. The bank declined and moved the McMinn from bills to an overdraft and a penalty interest rate of 13%, up from 7%. The bank soon foreclosed on the business.

The bank sold the McMinn business property at a significantly undervalued price. The property was purchased in October 1995 for \$1,200,000. There was a valuation in 1996 by Herron Todd White of the expected value of the two businesses (with the expected completion of the baby care centre) of \$2,050,000.

With the McMinn under pressure to sell the property following foreclosure, they obtained a contract for \$1,700,000, the same day that the bank appointed Arthur Anderson as receiver. The offerers heard about the receivership, and made a reduced offer of \$1.51m. The receiver claimed that the offer was not genuine, although no contact was made with the offerer. However, the offerer subsequently purchased three child-care centres for \$3m., giving substance to the McMinn offer.

The bank sold the property for \$1,180,000, in July 2000 with settlement in September. The property was sold rapidly and by tender, not by auction.

The McMinn have now lost all their assets, including the family home.

6. Lynton Freeman [1997 Queensland]

Lynton Freeman was a grazier, with a 10,000 hectare property out of Gladstone, Queensland. In 1992, Freeman borrowed \$540,000 from the NAB on a property that the bank valued at \$2m, consolidating debt previously owed to other lenders. Freeman had been improving the property for ten years and had recently managed a divorce settlement. Over the next few years he borrowed another \$400,000 to finance improvements and herd expansion, especially breeders, all with the Bank's support.

A long drought had him successfully gain a subsidy from the Queensland Rural Adjustment Authority annually from 1994 to 1996 (applicable to early 1997). To get this subsidy, the client has to undergo a review that satisfies the Authority that the client is long-term viable. Freeman passed this test. The program had a five year orientation.

In July 1996, Freeman's NAB branch acquired a new manager, Mr. 'Birch'. In his first credit report in August, Birch upped Freeman's interest rate another .75% above the base rate and demanded that Freeman reduce his overdraft by \$30,000 by November 1996, to claw back previous extensions of his overdraft limit.

Freeman pointed out that, if Birch would do the bank's contribution to the annual review for the QRAA subsidy, the subsidy would reduce his overdraft for 1997 significantly below the reduction desired.

Birch's October 1996 budget was cavalier on cattle sales, and didn't include the potential subsidy, or the additional expected income from mining rights and timber sales. This inaccurate budget became the fulcrum for Freeman's later treatment.

Freeman put together a QRAA application in early 1997 with assistance from a Department of Primary Industry consultant. There were delays with the

bank signing and returning the application. The QRAA belatedly approved the subsidy (worth \$54,550) in April, pending the bank's formal review.

Birch then reported to superiors as if the QRAA approval had not taken place (NAB document D1-57, 10 June 1997). In essence, the bank demanded a reduction of debt by \$30,000 and, at the same time, refused to accept \$54,550 from the QRAA. Birch never completed the review and Freeman never received his subsidy. In a letter of July 1998 to Liz Cunningham, the State Member (Independent) for Gladstone, the bank denied knowledge of the favourable QRAA report.

Freeman's accounts were moved to the Asset Structuring Unit in June 1997. In November his facilities were not renewed and he was forced into mediation.

Bank-farmer mediation was established with Queensland Farmer's Federation assistance in 1996, with the presumption of enhancing the rights of the borrower. In practice, mediation has acted to enhance the substantial asymmetry of the bank-customer relationship.

Freeman's four facilities were consolidated into one commercial accommodation bill. This amalgamation of accounts facilitated the bankruptcy process in due course. Freeman never received closing statements for these facilities. Freeman was instructed that he had until early April to refinance or suffer foreclosure. As no other institution will offer finance under these circumstances, the pain is merely prolonged.

There appears to have been internal differences in the bank hierarchy over Freeman's treatment. In early March 1998 he was made a verbal offer by the Brisbane Asset Structuring Unit that the bank would accept repayment of half of the debt.

To satisfy this new arrangement, Freeman paid in \$2205 as partial interest payment. However, Freeman was defaulted anyway. The \$2205 was put into

a suspense account and not credited to Freeman for another 36 days. The diversion of the payment facilitated demand, which was issued on April 20th.

The bank then devalued Freeman's securities. In 1992 Freeman's property had a market value in the NAB's books of \$2m. In 1996, it was down to \$1.75m, but no documents have been discovered to explain the downgrading. Security schedule documents were not discovered by the bank during litigation, including schedules for Freeman's stock. Freeman's bank file documentation recorded the market value of his mixed herd of livestock at \$578,000 as at 17 March 1995.

On 14 April 1998, market value was put at \$1.4m., and another \$600,000 arbitrarily knocked off for the 'effects of mining involvement and Freeman's possible effect on price' (NAB document, D1-48). Market value of stock was not included. Freeman's 1996 Statement of Position, accepted by the bank, estimated his net surplus at \$2.067m. (D1-80, 9 May 1996). With receivership expenses, Freeman's net worth had been reduced from an approximate \$2m. surplus to a deficiency of \$250,000 at several strokes of the pen.

The NAB took Freeman to the Queensland Supreme Court for possession of the property, gaining assent in October 2000 (QSC 295). The judgment relied upon a draconian caveat in the mediation deed that released the Bank from any claims against it to that date. Judge Ambrose inconsistently touched casually on Freeman's claims, only to conclude that one could hardly countenance claims against 'bank officers of their experience and holding the offices that they did' (National Australia Bank v Freeman, 2000: par.94).

Freeman would not win prizes for social graces, antithetical to sympathy from an impatient loans officer or a status-conscious judiciary. But bank lending is not supposed to be determined on personality and refinement.

Freeman had made losses but was financing his interest bill and bank charges. His debt at worst was marginally outside 'Category A', the Bank's own

classification for low risk. If the QRAA subsidy had been received by the bank and reduced indebtedness as proposed, liabilities would have then attracted a 'Category A' classification. The Bank's documents had recorded the property sound and Freeman competent, and the QRAA had judged him long-term viable.

The property, inaccurately advertised, was sold in May 2001 for \$770,000 (net of selling costs).

Freeman appealed the Supreme Court judgment but the Court of Appeal rejected Freeman's appeal in December 2001 (QCA 473). Judge White declined (as per the trial court proceedings) to consider Freeman's substantive complaints. Affidavits incorporating relevant evidence were not admitted into the hearing.

The Bank filed for bankruptcy in January 2001, based on the spurious asset deficiency. The bankruptcy petition was granted on 12 March 2002 (FCA 244). The judgment is not particularly coherent. Judge Spender deliberated on whether to look behind the Supreme Court decision, citing precedents that legitimise this option, and then declined to take this route. The matter of the existence of a debt is integrally tied up with the nature of the valuation of the property and the sale by the receiver. The Judge cited precedents that the law treats the receiver as the agent of the mortgagor (the borrower), but declined to follow the logic of the argument to infer that the Bank had interfered with this agency.

The thrust of Freeman's judicial experience is that, after myriad Court hearings, his complaints against the Bank have never been given a proper airing. The caveat in the Mediation deed facilitated this neglect, but possible avenues for examining the full nature of the relationship were not pursued by the presiding Judges.

Several days after the bankruptcy judgment, Freeman was pursued by the Queensland Stock Squad and arraigned in the Gladstone District Court with

stealing cattle from his property. Freeman's documentation proved that the relevant cattle were not encumbered to Bank mortgages, and a jury found in his favour.

Freeman's application to annul his bankruptcy was recently heard in the Federal Court in Brisbane and dismissed. He is appealing that decision.

7. Ross Delahunty [1993 Victoria]

Ross Delahunty is a suburban solicitor. He and his wife were having a house built in Brighton in 1989. They ran foul of the builder who didn't construct the house as they expected him to do. The builder held a significant position in the Housing Industry Association (HIA).

Delahunty became involved in arbitration with the builder and the outcome was far from satisfactory. He contacted the Department of Consumer Affairs and, through examination of comparable arbitrations, was able to show that the arbitration process was biased. The builder typically came out on top. Moreover, Delahunty claims that he was able to show how the bias was established.

Delahunty subsequently made application to the Housing Guarantee Fund (HGF) Ltd for restitution for faulty workmanship. This was a novel situation for the building industry and Delahunty found that he was not only fighting the HGF but also fighting the HIA. The builder was a director of both the HIA and of the HGF. Both the HIA and the HGF banked with the NAB.

Delahunty's photo appeared on the front page of the Melbourne Herald Sun Property Guide in early March 1993 with quotation from Alan Fels condemning shoddy builders.

The following Tuesday the NAB initiated the calling up of his loan. Delahunty suspected that any or all of the builder, the HIA or the HGF had

instigated such action by using their influence with NAB, given the millions of dollars held by the NAB on behalf of both organisations.

Delahunty endeavoured to get another loan through seven other financial institutions. None of those attempts succeeded. None rang back as Delahunty had to declare that the NAB had called up his mortgage. Delahunty subsequently obtained a loan privately but the NAB refused to negotiate the payout of the mortgage.

In a Supreme Court action (No.5831) the NAB got summary judgment against Ross Delahunty for possession of his half share of the family home. Such summary judgment was not obtained against his wife. The matter against Mrs Delahunty went to trial. At mediation there was a proposal for settlement. This fell through, as the Delahunty's were informed by processing staff, because of the intervention by a senior NAB officer, a Mr Copsy. There was a proposal in mediation that Mrs Delahunty might pay out her husband's share and keep her own. Mr Copsy apparently said no to the NAB solicitors on the grounds that the Delahunty's hadn't paid rent nor had they serviced the loan since it was called up.

Ultimately the bank obtained judgment for possession and sold the Delahunty's' home for \$505,000 in August 1997. The house subsequently resold in 2001 for \$821,000. Although the bank claimed that it was owed over \$900,000 it did not sue the Delahunty's to recover such monies. It only sought possession of their home.

The bank tried to bankrupt Mr Delahunty on three attempts but failed, due to procedural incompetence. It then took Mr Delahunty to court again and sued on the debt (No.6735). However the bank would never tell Delahunty what the residual debt was. No documentation was produced disclosing the presumed debt. Delahunty went back three times seeking further discovery in Supreme Court interlocutory proceedings. On two occasions the bank produced further affidavits showing extra material that hadn't been provided

previously in either of the court cases. After about six efforts at discovery, the bank had not produced the documents that Delahunty sought.

At about the seventh attempt, Delahunty requested certain specific documents that he knew that the bank had but still refused to provide, especially in relation to the quantum of debt. The bank then withdrew from the proceedings instead of providing such information.

The debt to the bank before the conflict escalated was about \$210,000. It was purely a business debt secured on investment assets which had subsequently been sold after request from the bank. However, the bank wrongly claimed that money (against which there was now no security) was still owing. There was also an overdraft of \$15,000 which had arbitrarily been reduced by the bank from \$30,000.

The only borrower was Mr Delahunty. However, the debt was secured against the house in the joint names of Mr & Mrs Delahunty which had earlier been valued at about \$600,000 by the bank. However, after that Tuesday when the proceedings were initiated, the bank sent out an agent who did a kerbside valuation and he valued the property at just over \$300,000. That was the trigger that gave the bank the credibility to take action and make demand.

Without servicing of the mortgage and with interest of 24% (6% higher than the normal rate) the total debt was approximately \$450,000 and the bank sold the house for \$505,000. The NAB wrote off the debt to \$1 (although how much debt was written off is unknown), whereas the 'red ink' statements showed the continuation of the debt and the accumulation of charges.¹³ Delahunty claims that there was no evidence that the bank wrote back the proceeds of sale against the tax write offs. Delahunty was advised that the NAB also claimed on its mortgage guarantee insurance. This case was never

¹³ The NAB 'red ink' statements are comparable to the 'shadow ledger' statements of the Commonwealth Bank.

going to involve a bad debt unless the arbitrary kerbside valuation of \$300,000 was taken as legitimate.

The NAB had no continuity of bank statements. There was no linking of separate accounts. Investment loans became home loans and some statements showed \$600,000 to \$700,000 debt while others showed \$300,000. Delahunty persuaded the Master in the Supreme Court of the necessity for the continuity of bank statements to be produced but at that stage the bank withdrew its legal proceedings and paid Delahunty's legal costs instead of providing its modus operandi in dealing with the Delahunty account.

The Delahuntys no longer owe the NAB any money. Whether the bank owes the Delahuntys any money has never been determined because no proper accounting of the proceeds of sale has ever taken place. A proper accounting would have only occurred if another mammoth court case had been instigated by the Delahuntys. After ten years of litigation, that did not seem to be a viable option.

8. Keith Smith¹⁴ [1984 Queensland]

William Keith Smith of Brisbane left school at the age of 13 and worked for the timber merchants Hancock and Gore as a labourer. He was apprenticed as a fitter and turner and joined the Royal Australian Air Force in 1942 at the age of 18. He was discharged in 1946. After 1957 he was mainly involved in the hotel industry, either through leasing or ownership.

In the latter part of 1983 Smith decided to venture into hotel brokering. Previously, Smith had dealings with National Australia Bank managers and had found them to be people of integrity. Smith paid his debts, but he was judged by friends as 'commercially illiterate'.

¹⁴ The first part of the Smith account draws substantially on Hardgrave (1998).

A customer interview record of an NAB branch manager (the Sunnybank Plaza Branch) records the circumstances of Smith's execution of a guarantee for \$15,000 as follows:

"22 April 1984 CGB International: The Company Secretary, Mr. McP, called together with Mr. S, the Managing Director, and Keith Smith, our customer, the hotel broker. The firm is buying a series of hotels and borrowing overseas. They left an extensive rundown in the form of a presentation. Mr. S and Keith signed a Guarantee for \$15,000 and they had to issue a cheque for \$10,000 to their agent to go to Hong Kong to negotiate their overseas loan."

At the time, NAB branch managers could not approve an unsecured loan in excess of \$1,000. Yet here was a case of approval for \$15,000. The manager took no statement of position to confirm whether Smith had the resources to act as guarantor for the \$15,000. Standard bank guidelines at the time were that, if a proposed guarantor's principal asset was the matrimonial home and it was in joint names, the bank's guarantee was to be executed by both. If this were not the case, it would need to be fully explained by way of customer review record.

In the period preceding February 1984, the NAB had dishonoured Smith's car lease monthly payment of \$396.68. The bank was not prepared to meet a payment of around \$397 per month when there was insufficient funds in the account, but the local bank manager was prepared to accept an unsupported guarantee from Smith for \$15,000. The co-guarantor, Mr. S, was later discovered to be a bankrupt and had a criminal record.

Smith accompanied S and McP to the bank. There was a statement by McP to the effect that bank manager, Mr. 'North', 'owes me a favour'. At the beginning of the interview, another manager, Mr. P, was also present. During the initial discussions in which Smith did not take part, there was no mention of a Bank Guarantee and Indemnity. The relieving manager, Mr. P, confirmed the exchange via an affidavit in a statement to the police.

In Mr. P's statement to the police he said: "McP and [North] did all the talking. The discussion was about the hotel purchase and lasted about 15 to 20 minutes. At that time I was called away for an interview. I did not see McP, S or Smith from then on that day. There was no discussion of the guarantee and indemnity while I was present."

After Mr. P left the manager's office, a typist brought in a document which North perused and verified as acceptable. The document was placed in front of S to sign, which he did. The document was then placed before Smith. The company secretary, McP, asked Smith to witness S's signature, which he did. Smith could not read the document, as he only had his driving glasses with him. Smith signed as requested by McP, with the word 'guarantor' above his signature obscured by McP's finger.

This process took place in front of North, the NAB manager. In normal banking procedures, the manager should have explained the importance of the document. The manager should have made Smith aware of the nature and extent of his liability under the guarantee. Smith must act under his own free will. Should there be suspicion that he was acting under duress or undue influence from the customer or anyone acting on the customer's behalf, and if the manager considered that Smith had failed to understand his responsibilities, then he should have told Smith to seek independent legal advice.

North disregarded normal banking procedures. A statement of position was not obtained from Smith. North did not query the fact that the company CGB International was in the process of buying hotels requiring about \$25 million in capital, and yet it could not raise \$15,000 set-up costs.

After Smith witnessed S's signature, he left the bank. The company accountant, McP, then drew a cheque for \$10,000 which he signed, and North then issued a bank cheque in replacement, despite the fact that the bank's own authority for CGB International required two authorised persons to sign. The company accountant was previously an NAB employee and was believed to

have reached the status of branch accountant. McP's personnel records have been expunged from the bank's resigned officers' files.

Shortly after North oversaw the transaction, he was transferred. It was left to his successor at the Sunnybank branch to inform Smith of his obligations under the guarantee. It is Smith's understanding that the bank has never attempted to claim any type of reimbursement from S, the company owner and manager. Smith was told verbally that the NAB was only interested in chasing him. The witnessing of S's signature would ultimately cost Smith \$35,880.

Smith was naturally dependent on professional legal advice. One of his solicitors permitted the bank to gain a judgment by default. The bank's documents were never called for in the discovery exercise. Moreover, affidavits of bank staff were transparently false, claiming that Smith was aware and acknowledged that he was signing a guarantee. Smith was advised to pay the judgment debt and pursue the matter later (either through appeal or through direct approach to the bank). Smith had to borrow to pay the debt. In the process, involving unsympathetic treatment by his solicitors, Smith had a massive heart attack. When it came to the appropriate proceedings he was advised that he should not have paid the judgment debt, namely \$20,700, in the first place. Smith's perception was that at times his counsel was working for 'the other side'; he continues to hold that view.

Smith sent a letter to the Banking Ombudsman, dated 27 July 1990. Smith also lodged a submission covering similar material (3 December 1990) to the then Martin inquiry into the banking sector. The Ombudsman claimed that the office could not investigate Smith's complaint because the legislation did not allow them to consider a complaint originating in 1984. The Martin inquiry referred the matter to the bank that was the source of Smith's distress. The NAB replied that, on investigation, there was no cause for complaint.

Since Keith Smith lost his Supreme Court of Queensland Appeal in October 1987 (No.447), he has brought his predicament to the notice of anyone who

he considers may help him. One politician told him “your case is too hot to handle, Keith; I’m afraid there is nothing I can do”.

In January 2002 Smith lodged three complaints with the Queensland Law Society against the three solicitors who represented him. The Society informed Smith that there was nothing positive they could do and suggested that he may wish to complain to the Legal Ombudsman. Smith made his three complaints known to the Legal Ombudsman in March 2002. In late 2003 he was advised that he, Smith, was not in a position to pursue any action at that stage. There was then pending legislation to facilitate victims of unethical practices by their solicitors to pursue action retrospectively. The Queensland State election has come and gone and the legislation is still pending.

Smith is now a war service and disability pension recipient.¹⁵

9. The Somersets and Kabwand¹⁶ [1984 Queensland]

Ned and Joy Somerset were successful farmers and graziers. In 1952 the Somersets commenced as soldier settlers who acquired balloted land in the first Brigalow land development scheme in Wandoan in Queensland. After

¹⁵ The following summary and crude judgment on the Smith case is transcribed *verbatim* from the House of Representatives Hansard, from the mouth of Representative Gary Hardgrave (Hardgrave, 2001): “I think of a constituent of mine, Keith Smith from Robertson, who 15 or 16 years ago was in the National Australia Bank branch at Sunnybank and was allowed to sign as guarantor on a loan document which he thought he was witnessing. In fact, the manager was in cahoots with the person who borrowed the money and allowed him to sign and go guarantor. There were only tens of thousands of dollars involved, for a company which last year made \$2.4 billion profit or whatever it was—not much money. But National Australia Bank, which has a hide thicker than the proverbial elephant’s, could not care less and never has.”

¹⁶ The first part of the Somerset/Kabwand account draws heavily on McLean (1990).

32 years on the land producing wheat, sheep and cattle, the Somersets sold their western rural holdings and retired to Toowoomba in Queensland. In the development of their properties, the Somersets had had numerous dealings with banks and bank officers, finding them to be institutions and people of integrity. This relationship of trust was to underpin the mentality that they brought to an engagement with the National Australia Bank, an engagement whose terms would be radically transformed.

In semi-retirement in Toowoomba, the Somersets became interested in a property called Gunnadoo, priced at \$625,000 and sited overlooking the city. Figures produced by the vendor showed the property returning above \$400,000 per annum. The Somersets did not believe the valuation and the vendor, in an endeavour to encourage a sale, introduced the Somersets to his own bank manager of the NAB in Toowoomba, Mr ‘Lancer’.

Mr Somerset discussed the property with Lancer on 30 October and 1 November 1984, as well as the financial investment and cash flow of the vendor, before signing a contract on 2 November.

The Somersets were denied access to the title deed at settlement of Gunnadoo. The title deed would have disclosed two NAB mortgages on the property worth \$260,000. Yet the property contract signed by the Somersets records encumbrances as ‘NIL’. It later transpired that the vendor paid the mortgages and eliminated the encumbrances out of the deposit paid to him by the Somersets immediately prior to settlement.

Mr and Mrs Somerset both met with Lancer and became NAB customers on 6th November. Further reassurances were given regarding the property’s cash flow and profitability.

Settlement of Gunnadoo was to be on 16 November. The Somersets informed Lancer that they had previously been interested in another property called Glenhaven, a run-down 100 acre property near Gunnadoo. However, with their investment in Gunnadoo they were not in a position to proceed.

Lancer told the Somersets that Gunnadoo had an excellent cash flow; he also complimented the vendor.

The Somersets were advised that the manager could assist with the Somerset's acquisition of Glenhaven but that the Somersets would have to transfer their business to the NAB. Lancer indicated that the Somersets would have no difficulty servicing a bill finance facility of \$300,000. An appointment was made for the Somersets on 8 November 1984, the day preceding the sale of Glenhaven by auction on 9 November 1984. On 8 November, Lancer advised the Somersets that the NAB had approved the sum of \$300,000 to assist in the purchase of Glenhaven, to be auctioned the next day by the NAB as mortgagees in possession.

At auction, the Somersets successfully bid \$320,000 and contracted the property Glenhaven. The contract required settlement within 30 days. However, settlement did not take place until 22 March 1985, due to a South East Queensland Electricity Board requisition order, in force since September. This was not advertised nor disclosed at the auction. Discovered documents highlight that NAB officers knew of the existence of this major charge on the property. The bank threatened to sue the Somersets if they tried to rescind the contract.

From 8 November 1984 to 1 February 1985 the Somersets met with Lancer on numerous occasions to complete the financial documents. However, the manager departed on leave, leaving everything in abeyance.

On 13 November 1984 the Somersets transferred their banking business to the NAB branch in Toowoomba. The relieving manager, Mr 'Brittan', during his manager's absence, obtained approval for three loans totaling \$575,000. The loan documents were signed on 14 March 1985.

Gunnadoo proved to be immediately and dramatically less productive than the promises of vendor and bank manager. Gross income for the 13 ½ months of operation amounted to \$140,000; net income summed to \$9,000.

By contrast, Lancer had written to NAB State Administration in December 1984 claiming that cash flow was confirmed at \$50,000 per month "as is", although it had never exceeded \$15,000 per month. By July, the loans were in default. The Somersets walked off the property in December. Repayments which had been made were from the Somerset's savings.

In May 1985, the vendor's son informed the Somersets that they had been 'conned'. The vendor had a criminal record for fraud. The son estimated that his father's NAB overdraft had increased from \$50,000 to \$260,000 and, after being extended by a bridging loan, faced an ultimatum from the bank for the 31 October 1984. This information, consistent with the Somerset's experience of Gunnadoo's profitability, was contrary to what Lancer had led them to believe.

The Somersets instituted Supreme Court proceedings against the vendor for fraud and won the case. However, the vendor had disposed of all of his assets and the Somersets received nothing. The Somersets received legal advice that they should sue the National Australia Bank in the Federal Court for false and misleading conduct under section 52 of the Trade Practices Act.

The Somersets' solicitor engaged on their behalf a retired NAB manager. His examination of bank records revealed that the vendor's account with the NAB had a history of chronic irregularity. The vendor was unable to service the overdraft indebtedness in the twelve months prior to the contracted sale date. The overdraft had escalated from \$55,000 to \$240,000 in the previous three years. No other income was shown and none of this was disclosed by the bank.

Lancer increased the market value of the Gunnadoo property/business from \$260,000 to \$475,000 in November 1984. In September, some 10 weeks prior to this November revaluation, Lancer had increased the property's market value from \$210,000 to \$260,000 in bank records. On both occasions, the effect of the revaluation was to allow the terms to fall within the Regional Manager's delegated lending authority (avoiding the necessity to send details

‘upstairs’). The September revaluation facilitated localised approval of a bridging loan to the vendor; the November revaluation facilitated localised approval of the loan to the Somersets. Moreover, the property was correctly recorded in bank records as two hectares in the property vendors’ name; however, when comparable bank records are raised by Lancer in the Kabwand name, the area was recorded as four hectares.

Before taking annual leave and leaving the loan application in abeyance, Lancer increased the market value of Gunnadoo a third time, by \$100,000 to \$575,000, offering no evidence for the increase. The further revaluation assured the success of the application processed by the relieving manager.

Lancer stated in court (G65) that improvements by the Somersets had justified the increase. However, the ‘improvements’ were a demountable building, and the NAB held no security over it. There were no fixed improvements to Gunnadoo which would justify the revaluations.

The Somersets took the NAB to the Federal Court but the judgment, in September 1988, was against them (G65). The trial hearing had commenced without full discovery from the Bank. Moreover, some duplicate documents produced as evidence at the trial were different in content to those produced in discovery which had been produced and stated in interrogatories as the original documents. It is surmised that the ‘original’ documents were reconstructions.

Discounting the questionable documents and inadequate document discovery, Justice Neaves considered that bank staff were more reliable witnesses than the Somersets. Justice Neaves did not believe the Somersets’ claim that meetings took place between them and bank manager Lancer on 30 October and 1 November 1984 (the meetings at which the Somersets were given distorted representations of Gunnadoo’s prospects). Rather, said Neaves, the Somersets had already made up their mind to purchase Gunnadoo before first meeting Lancer.

An appeal was heard and dismissed in April 1989 (G355). Leave to amend the appeal pleadings to include fraud was denied because fraud had not been a component of the original pleading. The Somersets appealed to the High Court on twenty five grounds with five specific orders sought. The High Court appeal was dismissed on all counts.

The Somersets were declared bankrupt in November 1991.

In his adverse judgment in the Appeal Court, Justice Lockhart noted that Justice Neaves “found that no complaint of alleged misleading conduct by Mr. [Lancer] was made to any officer of the respondent before the commencement of the proceedings in this Court and that such complaints as were made related to other matters” (G355, par.36). This claim was not made during the trial but appears in Neaves’ judgment. Not merely is the claim made by Neaves and repeated by Lockhart, but it is repeated anew by the bench in the two hearings regarding bankruptcy proceedings against the Somersets and in the Somersets’ attempt to access the High Court. It transpires that, on all five occasions, the source of the judges’ information was the NAB’s counsel through their instructing solicitors.

Yet this claim, an integral element of adverse judgments against the Somersets, was seriously inaccurate. The Somersets had a bitter row with Lancer immediately following the disclosures to them by the vendor’s son. Given the refusal of Lancer to acknowledge their complaints, the Somersets initiated and participated in a lengthy meeting with senior bank officials in the offices of the NAB’s State Administration on the 23 August 1986. The bank’s external solicitors were also present.

The Somersets came to the National Australia Bank in 1984 with net assets in the order of \$700,000. The initial trial and the appeal cost approximately \$800,000, with the Somersets paying their solicitors approximately \$400,000, with the balance being met by Legal Aid. The Somersets are now penniless, are in receipt of a Department of Veterans Affairs pension, and are living in rented accommodation.

Kabwand is now regularly cited in court judgments and legal texts. However, the significance of the Kabwand case lies in domains other than those presumed in the citations.

10. Conclusion

As noted in the introduction, the representations summarised above highlight issues that deserve exposure and generate questions that deserve answers.

Several questions present themselves:

1. Is there a statutory requirement upon banking and financial institutions in Australia to provide for the safety and security of depositor funds?
2. Why do borrowers who have had a productive relationship with the bank but who may have experienced problems (possibly short-term) have their facilities withdrawn, as opposed to two alternatives: working with the customer to re-establish their viability with appropriate instruments and terms to the mutual benefit of both customer and lender; or working with the customer to facilitate an ending of the relationship on terms that minimise the costs to the borrower without substantially inconveniencing the lender?
3. Why do some borrowers who have never defaulted on loan payments have their facilities withdrawn and their assets subsequently commandeered?
4. Why do customers not have the most appropriate credit facilities for their needs, with the potential for inappropriate facilities contributing to their demise?
5. Is it possible that banks regularly determine facilities on the criterion of borrower assets rather than that of borrower business prospects?
6. Is the traditional use of security over the family home a morally legitimate practice? This issue was raised in *Finding a Balance* (Reid Committee, 1997: p.150), which in turn noted that the issue had also been raised in the House Industry Committee's previous report on small business (the Beddall report) in 1990.
7. What is the rationale of foreclosing on a borrower on terms that would have left the bank with better returns if the alternatives of either continued support or support until sale as going concerns had been pursued? Are there net gains to the bank from tax deductions arising from write-offs of the debt?
8. Following the bank's decision to place customer assets on an impaired status, are all customer bank statements (including both conventional and red ink/shadow ledger statements) distributed to customers, as per the recommendations of a Commonwealth Parliamentary Committee (Chapman, 2000)?
9. Why is bank discovery of relevant documents, following request from aggrieved customers, a belated and inadequate process?
10. To what extent is staff turnover at the point of contact with customers a contributory factor in a customer's demise? What principles have driven the substantial staff turnover at branch manager level in recent years, and has the functionality of such turnover been evaluated?
11. Why are customer assets sold under value?
12. Why are customer preferences for sale of assets refused?
13. Is there any statistical relationship between the phenomenon of assets sold under value and the pursuit of customers to bankruptcy?

14. In banking litigation, why do the courts persist with the farce that the 'receiver is the agent of the mortgagor' (the borrower) and that 'the mortgagor is solely responsible for the receiver's acts and defaults and for the payment of the receiver's remuneration' (c/f Walter, VSC36; Freeman, FCA244)? Is this fiction a perennial de facto vehicle for the mortgagee (the bank lender) to exercise discretion over the receiver's actions without incurring any legal responsibility?

15. On occasions when the apparent cause of customer problems is incompetence on the part of bank employees, why is the customer left (or pursued through the courts) as the ultimate victim?

16. On occasions when the apparent cause of customer problems is malfeasance on the part of bank employees, why is the customer left (or pursued through the courts) as the ultimate victim?

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