Supreme Court

New South Wales

Amendment notes

Medium Neutral Citation:	**Steve Karamihos and Aristea Karamihos v Bendigo and Adelaide Bank Limited, Bendigo and Adelaide Bank Limited v Steve Karamihos and Aristea Karamihos [2013] NSWSC 172**
Hearing dates:	25 and 26 February 2013
Decision date:	08 March 2013
Before:	Pembroke J
Decision:	See paragraph 49
Catchwords:	'Unjust contract' - elderly borrowers - necessity for exit strategy given age and term of loan - failure by bank to make reasonable enquiry of value of collateral property on which exit strategy depended
Legislation Cited:	Contracts Review Act 1980 National Consumer Credit Protection Act 2009 (Cth)
Cases Cited:	Antonovic v Volker (1986) 7 NSWLR 151 Beneficial Finance Corporation Limited v Karavas (1991) 23 NSWLR 256 Knowles v Victorian Mortgage Investments Ltd [2011] VSC 611 Perpetual Trustee Company Limited v Khoshaba [2006] NSWCA 41 Riz v Perpetual Trustee Australia Limited [2007] NSWSC 1153
Category:	Principal judgment
Parties:	Steve Karamihos - first plaintiff Aristea Karamihos - second plaintiff Bendigo and Adelaide Bank Limited - defendant
Representation:	Margiotta Solicitors & Attorneys â€“ for the plaintiff Gadens Lawyers â€“ for the defendant JF Merkel â€“ for the plaintiffs RI Bellamy â€“ for the defendant
File Number(s):	2012/00334829, 2009/14393

JUDGMENT

INTRODUCTION

1 Mr and Mrs Karamihos are the borrowers pursuant to a loan from a Bendigo and Adelaide Bank Limited (BAB). They have defaulted. They contend that their loan and mortgage transaction was, in the circumstances that prevailed at the time that it was entered into, 'unjust' within the meaning of section 76(1) of the National Credit Code and section 7(1) of the Contracts Review Act. For the reasons that follow, I have reached the view that their contract was unjust in the statutory sense and that they are entitled to relief.

THE BOQ LOAN

2 At an objective level, even putting to one side the personal circumstances of Mr and Mrs Karamihos, to which I will return, there are a number of curious features of the transaction. The loan from BAB was entered into in May 2007 and replaced a loan from the Bank of Queensland (BOQ) that was entered into in as recently as January 2006. But the evidence did not satisfactorily reveal any sound reason why it was thought necessary to obtain the new loan and pay out the BOQ loan.

3 The BOQ loan was for a term of thirty (30) years. It was a 'Low Doc Investment Fixed Rate Home Loan'. The loan amount was $966,000. The interest rate was fixed for the first three years at 6.59%. After the fixed rate period, the annual percentage interest rate became the BOQ's standard variable investment housing rate. In January 2006, that rate was 7.32% pa. The variable rate was not payable until January 2009. The repayments pursuant to the BOQ loan were repayments of principal and interest and were payable monthly in arrears. Mr and Mrs Karamihos paid fees and charges totalling $12,260.26 for the privilege of obtaining the BOQ loan. These included $6,712.12 for mortgage insurance, $3,864.00 for mortgage duty and $450.00 for a valuation fee. The loan was secured by a mortgage over their residential home at Maroubra. When the loan commenced, and until January 2009, the monthly repayment required to be paid by Mr and Mrs Karamihos was $6,171.00. They paid this amount in full and on time until May 2007 when they chose to pay out the BOQ loan and obtain a fresh loan from BAB.

BAB LOAN

4 The BAB Loan was entered into on 21 May 2007. The amount of the loan was $1.2 million. The term of the loan was 25 years. The interest rate was the bank's balanced variable interest rate. In May 2007 that rate was 7.56% and the indicative monthly repayment amount was $7,560.00. However within days of the loan commencing, the interest rate became 8.41% and the monthly repayment amount increased. The first 120 repayments represented interest only. The remaining 180 payments were for principal and interest. Mr and Mrs Karamihos paid the usual fees and charges for the establishment of the loan. However, unlike with the previous year's loan from the BOQ, there was no charge for mortgage insurance. They nevertheless paid $6,358, of which $4,741 represented mortgage duty. The loan was secured by a mortgage over their residential home at Maroubra and an additional fee was incurred for the discharge of the BOQ mortgage.

5 There were other costs built into the BAB loan that do not appear to have been present in the BOQ Loan. The BAB Home Loan Contract revealed the payment of a number of commissions by BAB to Mortgage Portfolio Management Pty Ltd (Mortgageport). These included an application fee of $660.00, a subsidy and a monthly fee. The amount of the subsidy and the monthly fee were not disclosed in the Home Loan Contract and were said to be 'not ascertainable'. Although I do not discount the possibility, there was no suggestion in the evidence that BOQ paid similar commissions to any person or entity for the introduction of the business of Mr and Mrs Karamihos.

LOAN ORIGINATION

6 Mortgageport was one of two entities involved in the procuration of the business of Mr and Mrs Karamihos and the introduction of that business to BAB. Mortgageport was a party to a 'Mortgage Origination and Management Deed' with BAB which provided for the payment of fees to Mortgageport in return for the provision of services. Among other things, Mortgageport was obliged to:

> *provide in writing to the lender all information reasonably relevant to considering an application for Approval and to enable necessary loan documentation to be prepared and to permit the loan to settle and the manager must use its best endeavours to ensure that such information is accurate and complete.*
>
> (emphasis added)

7 The Mortgage Origination and Management Deed provided more information about the commissions to which Mortgageport was entitled. Among other things, an 'origination subsidy' was payable in an amount agreed from time to time and a monthly 'Managers Fee' was calculated on a daily basis on the principal balance outstanding of the loan.

8 In addition to Mortgageport, another entity was involved in the loan. This was a business known as South Western Financial Services. It was carried on by a company under the sole control of George Koovousis. This was a finance broking business whose relationship with Mr and Mrs Karamihos was governed by a finance broking contract dated 23 April 2007. That contract described South Western Financial Services as 'an authorised mortgage consultant of Mortgageport Management Pty Ltd and Mortgageport Origination Pty Ltd.' No fees were payable by Mr and Mrs Karamihos pursuant to the finance broking contract but it was stated that 'Mortgageport pays [South Western Financial Services] a set salary/ wage and commissions, based on loans I successfully introduce (sales)'.

9 The finance broking contract went on to explain that in relation to Mortgageport's mortgage wholesalers, the broker may earn an upfront payment of between 0% and 0.66% of the amount borrowed. It continued, stating that if Mr and Mrs Karamihos are not suitable to or eligible for a loan product offered by Mortgageport's mortgage wholesalers, credit may be available through a panel lender. BAB was one of the panel lenders. In the event of a loan from a panel lender, the contract stated that 'Mortgageport may earn an upfront payment of between 0.44% and 1.43% of the amount borrowed by you and an ongoing fee of between 0% and 0.55% of the balance owing by you from time to time'. It added that South Western Financial Services 'may earn between 0% and 11% of the upfront income received by Mortgageport'.

10 On 23 April 2007, George Koovousis completed a loan application form on behalf of Mr and Mrs Karamihos, who added their signatures. He submitted the application to Mortgageport together with, or followed by, a number of documents obtained from Mr and Mrs Karamihos' accountant. There included financial statements of their family company Karamakis Pty Ltd and individual and company tax returns, all of which were unsigned. I will return later to these documents.

PERSONAL CIRCUMSTANCES

11 In May 2007, Mr and Mrs Karamihos were already elderly. Mr Karamihos was 72 years old and his wife was 73 years. They were both born in Greece. Mr Karamihos in the north, in the region of Salonika; Mrs Karamihos in the south, in the Peloponnese. Both migrated to Australia at a young age, met and married in this country and initially worked in factories. In the 1950s, they purchased a fruit shop. Some time later, they owned and managed a corner store. In due course they became the owners of land in Marrickville where they conducted the business of a café and take-away eating outlet. They appear to have worked hard and long during their adult lives until the recent

failure of their health.

12 Neither Mr Karamihos nor Mrs Karamihos had any understanding of the English language when they arrived in Australia. And neither had received any significant education in Greece. Mr Karamihos attended primary school but went no further. Mrs Karamihos attended only the first year of primary school before her parents removed her. Over the years Mr Karamihos has acquired passable spoken English and is able to communicate effectively at a reasonably simple level. He would have preferred an interpreter to assist him in the witness box but I would not permit it and he managed quite well alone. Mrs Karamihos clearly needed an interpreter and her comprehension of spoken English was limited.

13 I am quite satisfied that the ability of Mr and Mrs Karamihos to read and understand written English was feeble. Their ability to do so in relation to detailed documents relating to the respective legal obligations of borrowers, lenders and intermediaries was virtually non-existent. Nonetheless, Mr Karamihos understood in a rudimentary way the essential elements of a loan and mortgage transaction. As did Mrs Karamihos. Both well understood the need to maintain their monthly repayments and the consequences of default. They had obtained numerous loans over the years - probably far too many - but they were unsophisticated (albeit frequent) borrowers with limited financial acumen, who operated at a relatively simple, homespun level.

MR AND MRS KARAMIHOS

14 By 2007, Mr and Mrs Karamihos had owned and successfully operated their café and take away food business at Marrickville continuously for 27 years. The modest business was operated through a family company of which the only shareholders were Mr and Mrs Karamihos and their daughter. The unsigned financial statements of the company for the year ended 30 June 2006 revealed a successful business. The total trading income for that year was $613,667; cost of sales was $183,251; and gross trading profit was $430,416. The figures were similar for the year ended 30 June 2005. The total trading income in that year was $610, 474 and the gross trading profit was $423,901.

15 Mr and Mrs Karamihos were however, highly geared. They had substantial borrowings secured over both their home at Maroubra and the business property at Marrickville. The amount of these borrowings is troubling especially given the ages of Mr and Mrs Karamihos at the time, and the fact that in 2007, it must have been obvious that they were approaching the end of their useful working lives. I have already mentioned the BOQ loan that was secured over the residential property at Maroubra. It was for an amount of $966,000 and would not expire, unless paid out earlier, until 2036. There was

also another loan, secured over the Marrickville land, in the amount of $750,000. The lender was Australian Unity Ltd. The evidence did not reveal the term of this loan.

16 Also troubling was the prior loan history of Mr and Mrs Karamihos. It reveals multiple loans and numerous mortgages. The evidence did not explore the commercial justification for each new loan, but the number of transactions does not appear to reflect prudent and responsible financial management. Mr and Mrs Karamihos gave mortgages over the Maroubra land to secure loans in 1992, 1993, 1995, 1998, 2000 and 2004. The lenders were a diverse group including Citibank Savings Limited, Westpac, Perpetual Trustees, Commonwealth Bank of Australia, ANZ Banking Group and ING Bank. Over the same period, they gave mortgages over the Marrickville land to secure loans in 1993, 1996, 1997, 1999, 2000, 2003, 2004 and 2006. Those lenders included ERMA Pty Ltd, One Call Building Maintenance Pty Ltd, ANZ Banking Group, ING Bank, Permanent Trustee Australia Ltd and Perpetual Nominees Ltd.

17 The frequency of these loan transactions and the waste, duplication and additional costs and charges that must necessarily have been incurred, at least raise a question as to whether Mr and Mrs Karamihos really knew what was in their best interests. BAB made credit reference enquiries and was aware of some or all of this loan history.

18 Mr and Mrs Karamihos also took out multiple loans through their company, Karamakis Pty Ltd. These followed the same pattern. The company was apparently the owner of another property in Marrickville, over which it gave mortgages to secure loans in 1992, 1995, 1998 and 2000. The lenders to the company included Mercantile Mutual Finance Corporation, Westpac, ANZ Banking group and ING Bank. It is not clear whether BAB also knew of the company's loans. The evidence did not explore that issue or the circumstances in which the loans came into existence.

19 I will return generally to these matters when dealing with the question of whether the BAB loan transaction meets the statutory criteria for an 'unjust' contract. But to my mind, the multiple loans and overall loan history of Mr and Mrs Karamihos suggest financial immaturity rather than the reverse. It no doubt also reflects the ready availability of credit in the period before 2008. I should add that Mr and Mrs Karamihos appeared to have no savings and little in the way of superannuation.

LOAN APPROVAL

20 Despite this unpromising background, BAB approved a 25 year loan of $1.2 million to Mr and Mrs Karamihos. The finance broker Mr Koovousis, said that, given the circumstances of Mr and Mrs Karamihos, BAB was effectively a lender of last resort and that no other lender would have been likely to approve such a loan to them. The sequence of events relating to BAB's approval was as follows: On 23 April 2007, the loan application was signed, completed with the assistance of George Koovousis and submitted to Mortgageport. On 1 May, Mortgageport obtained a credit reference report and wrote to BAB seeking approval to the loan application. On 2 May, Mr Schrapel, a senior credit officer with BAB, reviewed and considered the financial position of Mr and Mrs Karamihos, decided to grant conditional approval and so informed Mortgageport. On 3 May, Mortgageport wrote to Mr and Mrs Karamihos informing them that their loan application had been conditionally approved. Between 3 and 21 May, BAB and Mortgageport attended to a number of checks and verifications of an administrative nature. On 21 May, Mr Schrapel prepared a loan serviceability worksheet and an internal document known as an 'Exit Fasttrack' Summary. He then formally approved the application, following which Trish Fisher, another senior credit officer, reviewed and confirmed its approval. Mortgageport was then informed.

21 On 22 May, the bank's solicitors wrote directly to Mr and Mrs Karamihos enclosing the loan documents for their execution and return. A number of other documents were also included for their execution. One of those documents was headed 'Representations by Mortgagors'. It contained a representation and warranty by Mr and Mrs Karamihos that they 'had been advised to take independent legal advice before signing the mortgage and [that] we have had an opportunity to do so'. In fact, Mr and Mrs Karamihos received no independent legal or financial advice and were not told by anyone that they should do so. They signed the loan documents and the related papers at home in the presence of their daughter. Neither the finance broker, Mr Koovousis, nor any other person assisted them.

22 I doubt very much whether Mr and Mrs Karamihos read, understood or even noticed this representation in the document, which they signed. And I am quite certain that their daughter did not draw it to their attention or discuss it with them. The approach of Mr and Mrs Karamihos to the BAB loan was, I think, marked by naiveté and simple mindedness. They saw BAB as yet another financial institution that was all too ready to extend credit to them. Their constant re-financings and increased borrowings in the past had given them false confidence. It should have been reasonably obvious that they were now reaching the end of the line. Neither they nor BAB could assume that things would continue as they had always done before. Their age, the prospect of ill health and the natural onset of an inability or disinclination to continue working, were significant factors that should have shaped the

approach to this one final loan - by them, by their finance broker George Koovousis, by Mortgageport and by BAB.

BASIS OF APPROVAL

23 BAB is the statutory successor to Adelaide Bank. In December 2006, Adelaide Bank introduced a new credit policy. The policy addressed the significance of the age of individual borrowers. Residential loan applications where the applicants are over 60 years were not to be accepted unless approved by a senior credit officer having a specified level of delegated lending authority (DLA). Clause 6.1.1 of the policy stated:

> *An applicant's age must be considered to ensure they can repay the total debt within the agreed term. Therefore proof of future incomes, such as superannuation or income from family investments must be substantiated at the time of the application, for those applicants who rely on this income to repay the loan once they retire from existing employment.*
>
> (emphasis added)

24 In this case, Mr Schrapel had the required DLA level and decided to override' Mr and Mrs Karamihos' age restriction. He said that:

> *'Bank policy required me to consider whether Mr and Mrs Karamihos had the capacity to exit the loan in the event that Mr or Mrs Karamihos were unable to continue to service the loan before the end of its 25 year term.'*
>
> (emphasis added)

25 In the circumstances, and especially given their ages, it seems somewhat surreal to speak of Mr and Mrs Karamihos being 'unable to continue to service the loan before the end of its 25 year term', as if it were only a possibility. In truth, it was a certainty. Mr Schrapel must have recognised this. He therefore did not base his decision on substantiation of the future income that would be available to Mr and Mrs Karamihos once they retired in order to ensure that they could repay the total debt within the agreed term. Instead he based his approval on an 'exit strategy' that depended on the sale of the Marrickville property.

26 This was the fulcrum on which Mr Schrapel's approval turned. Unless Mr and Mrs Karamihos could sell the commercial property for an amount that would satisfy the principal outstanding on the BAB loan and Australian Unity loan, they would be compelled to sell their residential home at Maroubra. Quite properly, Mr Schrapel would not countenance this. His approval depended on the proposition that the 'commercial real estate could be sold to clear all debts if required'.

27 The application submitted by Mortgageport to BAB on 1 May 2007 depended on the same analysis. It recognised that the existing loan that was secured over the Marrickville property would remain in place. It stated:

> *In view of clients' age, clients will have the option to sell their commercial property at Marrickville and the sale proceeds will be sufficient to clear all debts.*
>
> (emphasis added)

28 The loan application signed by Mr and Mrs Karamihos revealed that before taking out the proposed loan from BAB, their liabilities were approximately $1.7 million. This was made up of $954,000 outstanding to BOQ and $750,000 due to Australian Unity. Mr Schrapel adopted the figure of $1,714,097 in his 'Exit Fasttrack Summary' on 21 May 2007. However, once the BOQ loan was paid out and replaced by the proposed BAB loan of $1.2 million, the liabilities of Mr and Mrs Karamihos under both loans would become a little less than $2 million. This was the amount which, it must have been assumed, could be cleared from the sale of the Marrickville property.

29 The only indication of the value of the Marrickville property that was available to Mr Schrapel was the bare assertion of its value by Mr Karamihos in his signed loan application. His piteously optimistic and unsupportable estimate was $2 million. Mr Schrapel accepted that figure at face value and made no attempt to verify it. It matters not that the Marrickville land was not the property over which BAB was taking security and that the bank's policy was only to obtain a valuation over the secured property. In the unique circumstances of this loan, Mr Schrapel's approval depended on a satisfactory exit strategy. That in turn depended on the sale proceeds of the Marrickville property being 'sufficient to clear all debts.' That in turn depended on reasonable inquiry as to the value of the Marrickville property.

30 Even if the fair market value of the Marrickville property was $2 million, there was no margin for error. In fact, its fair market value was far less. The property had few redeeming features. It was a nondescript two-storey retail/residential property on a major traffic artery with no on-site parking. It was in fair condition for its age but was situated directly under the flight path for aircraft landing and taking off at Kingsford-Smith Airport. Although there was no direct evidence of its value in May 2007, there was a valuation at November 2010. The fair market value at that date was $750,000. To arrive at its forced sale value, the valuer suggested that a 15% discount should be applied. I think that it is reasonable to infer that in 2007 the fair market value of the Marrickville property was of a broadly similar order to its value in 2010. Any decline that may have occurred because of the onset of the global financial crisis in 2008, or any subsequent difficulties with a tenant, is not likely, in my view, to have affected its value so substantially as to detract from

this reasoning.

31 Mr Schrapel said that he would not have approved the loan if he had been told that the figure for the Marrickville property was $800,000. In truth, given the necessity for the amount of the proceeds of sale of the Marrickville property to be sufficient to clear all the debts of Mr and Mrs Karamihos, it is difficult to see how he could have rationally approved the loan on the basis of any figure less than $2 million. He said that he would normally have made some attempt to verify the figure of $2 million by reference to comparable sales. On this occasion, however, nothing was done and the owner's own inaccurate estimation was adopted without question or query.

DEFAULT

32 The trouble with old age is that it magnifies the risks associated with borrowing. The larger the loan and the older the borrowers, the greater the risk. The revenue stream on which the maintenance of the loan depends is inevitably more likely to be disrupted by ill health or retirement. The statistical probability of the occurrence of unforeseen events that may affect the viability of the loan necessarily increases. All of this came home to roost for Mr and Mrs Karamihos and for BAB.

33 From January 2008, Mr and Mrs Karamihos began to miss monthly payments. What followed was a nightmare of adversity, misfortune and travail. Within two years of taking out the loan, they were unable to continue to operate the business. The health of Mrs Karamihos was rapidly failing. And Mr Karamihos was unable to continue working. In April 2010, they felt compelled to retire from the business. Their daughter approached a real estate agent who recommended a tenant. The tenant commenced occupation but Perpetual Nominees Ltd refused to provide its consent to the grant of the lease. Mr Karamihos says that the tenant 'may have unlawfully removed all fixtures and fittings' and that the damage sustained by the removal of the fixtures and fittings was in excess of $300,000. In September 2010, Perpetual Nominees obtained judgment for possession of the Marrickville property. In November, it entered into possession. In December, it sold the property by public auction.

34 As for the BAB loan, Mr and Mrs Karamihos made sporadic lump sum payments but remained in default. Their health deteriorated. Mrs Karamihos suffered from depression. In 2012 she lost 17 kilograms in 2 months. They took tenants into their home at Maroubra, letting out three rooms. Each tenant paid three hundred dollars per week, the whole of which ($3,600 per month) was, for a time, passed onto BAB in reduction of the loan. In February 2011, BAB took possession of the Maroubra property but in April it returned possession pursuant to a 'Re-entry Agreement'. In July 2012, BAB informed Mr and Mrs

Karamihos that the arrears of the loan were $42,359 and that the penalty interest incurred in the previous month was $2,084. Since 29 August 2012, no payments have been made to BAB. As at 13 February 2013, the account balance owing to BAB by Mr and Mrs Karamihos was $1,332,997. Interest at the penalty rate continues to accrue. The total of all payments made by Mr and Mrs Karamihos since the inception of the loan is approximately $488,000. I was informed that if there had not been default, and if penalty interest had not been incurred, the amount required to be paid to BAB to date would only have been approximately $360,000.

THE STATUTORY SCHEME

35 The National Credit Code (NCC) commenced on 1 July 2010. It applies to this contract even though the loan and mortgage were entered into in May 2007. I will not repeat the reasoning that leads to this conclusion but it was explained in *Knowles v Victorian Mortgage Investments Ltd* [2011] VSC 611 at [16] - [24]. I adopt that analysis. It applies equally to this case. No submission was made that I should not follow it.

36 The critical factual question on which the application of the NCC depends in this case is whether the BAB loan was 'provided wholly or predominantly for personal, domestic or household purposes." The predominant purpose for which credit is provided is 'the purpose for which more than half of the credit is intended to be used'. I am satisfied that the statutory criterion is met. The proceeds of the BAB loan were used to pay out the BOQ loan, which was secured over the residential home. The balance was $237,000. The evidence was unclear as to the disbursement of that sum. Mr and Mrs Karamihos gave at least $100,000 of that sum to their daughter. A smaller amount may have gone into working capital for the business. Undoubtedly, however, more than half of the credit was used to maintain Mr and Mrs Karamihos' personal domestic living arrangements; to enable them to continue to live in their residential home at Maroubra. I am satisfied that the predominant purpose was personal, domestic or household and that the NCC applies.

PUBLIC INTEREST

37 Section 76(1) of the NCC permits the court to reopen a transaction if satisfied that it was 'unjust' in the circumstances relating to it at the time it was entered into. Section 76(2) prescribes certain mandatory matters to which the court must have regard in determining whether a contract is 'unjust'. The primary mandatory consideration is the 'public interest'. It is not defined, no doubt deliberately so. There is however, in my view, an indubitable public interest in the protection of aged borrowers who do not know what is in their

best interests and are not able to look after themselves, where the security for the borrowing is their sole residence. In such cases, the economic and emotional consequences of the loss of the borrowers' residence may be far-reaching. In a given case, those consequences may represent a public cost that far exceeds the cost to the lender of being deprived of its contractual entitlements. The financial loss to the lender will always be measurable but the impost on the public health system, the public housing system and the various state and federal government programs for the provision of security benefits, may be incalculable.

38 The public interest is not all one way however. A balancing exercise must be undertaken and each case will turn on its own facts. There will always need to be a resolution of competing considerations - the public policy of enforcing contracts and holding people to their bargain and the public interest to giving effect to the underlying consumer protection purpose of the Code: *Knowles v Victorian Mortgage Investments Ltd* at [64] and [68] and *Sharman and Anor v Kunert* [1985] 1NSWLR 225 at 231.

OTHER FACTORS

39 Section 76(2) also specifies a number of factors to which the court may have regard in determining whether a contract is unjust. A number of them have a particular relevance to the facts of this case. They include:

(a) The consequences of compliance, or non compliance, with all or any of the provisions of the contract, mortgage or guarantee;

(b) The relative bargaining power of the parties;

(c) Whether or not, at the time of the contract, mortgage or guarantee was entered into or changed, its provisions were the subject of negotiation;

(d) Whether or not, it was reasonably practicable for the applicant to negotiate for the alteration of, or to reject, any of the provisions of the contract, mortgage or guarantee or the change;

(e) Whether or not any of the provisions of the contract, mortgage or guarantee impose conditions that are unreasonably difficult to comply with, or not reasonably necessary for the protection of the legitimate interests of a party to the contract, mortgage or guarantee;

(f) Whether or not the debtor, mortgagor or guarantor, or a person who represented the debtor, mortgagor or guarantor, was reasonably able to protect the interests of the debtor, mortgagor or guarantor because of his or her age or physical or mental condition;

(g) The form of the contract, mortgage or guarantee and the intelligibility of the language in which it is expressed;

(h) Whether or not, and if so when, independent legal or other expert advice was obtained by the debtor, mortgagor or guarantor;

(i) The extent to which the provisions of the contract, mortgage or guarantee or change and their legal and practical effect were accurately explained to the debtor, mortgagor or guarantor and whether or not the debtor, mortgagor or guarantor understood those provisions and their effect;

(j) ...

(k) Whether the credit provider took measures to ensure that the debtor, mortgagor or guarantor understood the nature and implications of the transaction and, if so, the adequacy of those measures.

(l) Whether at the time the contract, mortgage or guarantee was entered into or changed, the credit provider knew, or could have ascertained by reasonable inquiry at the time, that the debtor could not pay in accordance with its terms or not without substantial hardship;

(emphasis added)

40 It has been said that 'section 76 and in particular section 76(2) in effect obliges the credit provider to find out about their customer and their circumstances': *Knowles v Victorian Mortgage Investments* at [67] citing Andrea Beatty and Andrew Smith, *Australian National Credit Code* Lexis Nexus, 4th ed., 2011, p 260. This is certainly true of the responsible lending provisions in chapter 3 of the National Credit Act, but those provisions did not take effect until 1 January 2011 and do not apply in this case. They impose a primary obligation on a lender to make an assessment that the loan is not unsuitable for the consumer.

41 Section 76 of the NCC does not impose such an obligation. It simply lists factors that may be relevant to whether a term of a particular contract is unjust. In effect, the considerations listed in section 76(2) represent a catalogue of prudence. And a lender who does not, for example, make 'reasonable enquiry' for the purposes of paragraph (l), or who does not take 'measures to ensure' for the purposes of paragraph (k), simply increases the risk that a court will find that the contract, or one of its terms, was unjust in the circumstances

that related to it when it was entered into.

APPLICATION TO THE FACTS

42 The findings of fact that I have made lead inexorably to the conclusion that the contract of loan and mortgage entered into between Mr and Mrs Karamihos and BAB in May 2007 was unjust for the purpose of section 76(1) of the NCC. I have reached that conclusion having regard to the consequence of non compliance by Mr and Mrs Karamihos, namely the loss of their sole residence; the relative bargaining power of the parties; the absence of any negotiation at the time the transaction was entered into, and absence of any practical opportunity for there to be any negotiation. I have also had regard to the fact that Mr and Mrs Karamihos were not reasonably able to protect their interests. They were too elderly and too foolish to know what was in their best interests. And they had no independent legal or financial advice. Their daughter apparently stood to receive $100,000 from the loan proceeds but she was, in any event, in no position to dissuade her father. The finance broker, George Koovousis, had no commercial incentive to advise Mr and Mrs Karamihos that the loan was unsuitable for them. His financial incentive was entirely the opposite.

43 I am satisfied that Mr and Mrs Karamihos were not able to read and fully comprehend the typed written documents that they were required to sign. Nor did they, in my view, have any apprehension of the risks they faced in the event of unexpected illness, retirement and diminution of earnings. They were comforted by their apparent success with previous loans and were naively untroubled by the probability that all would not necessarily continue, without hitch or hurdle, in the future.

44 BAB knew that Mr and Mrs Karamihos did not have independent legal and financial advice. And it did not take any active steps to ensure that they understood the nature and implications of the transaction. I have not placed significant weight on the prior loan and mortgage transactions of Mr and Mrs Karamihos or those of their company. They were not explored in the evidence and their circumstances were unexplained. In any event, as I suggested in paragraphs [17]-[19] above, their number and frequency, and the accompanying duplication and additional expense, do not suggest financial sophistication.

45 Most importantly, BAB did not make reasonable enquiry as to whether Mr and Mrs Karamihos could meet their obligations under the loan. I have already explained in paragraphs [23] - [31] above, the false basis on which the supposed exit strategy was constructed. In the particular circumstances of this case, where approval of the loan depended on the satisfaction that there was

a viable exit strategy, Mr Schrapel's reliance on the customer's estimate of $2 million for the value of the Marrickville property, was unreasonable, to put it at its lowest.

46 If Mr Schrapel had made reasonable enquiries of the value of the Marrickville property, there would have been no loan approval and no loan. This litigation would not have occurred. Mr and Mrs Karamihos should not have been put in the position in which they now find themselves. The BAB loan was a bridge too far, at too late a stage of their fast-fading lives. Its unsuitability was compounded by the bank's incompetence. This is not a case like *Riz v Perpetual Trustee Australia Ltd* [2007] NSWSC 1153 where it was said 'a lender is not required, in the interests of the borrower, to have a high index of suspicion for fraud by the borrower': at [78].

47 In this case, there was no fraud by the borrower, just misplaced enthusiasm and an absence of reality. There was no evidentiary foundation for a finding that Mr Karamihos intended to deceive BAB. The bank simply did not make reasonable enquiry; when it knew that enquiry was called for; when it knew that the value of the Marrickville land was an essential element (indeed a *sine qua non*) of its approval.

48 For those reasons, I have concluded that the BAB Home Loan Contract was unjust for the purposes of the NCC. It was also unjust for the purpose of the Contracts Review Act. This is a conclusion of ultimate fact involving a broadly based value judgment, having regard to both the public interest and the particular matters set out in section 76 (2) of the NCC and section 9(2) of the Contracts Review Act: *Antonovic v Volker* (1986) 7 NSWLR 151 at 154-155 (Samuels JA, Kirby P agreeing); *Beneficial Finance v Karavas* (1991) 23 NSWLR 256 at 270E (Samuels JA); *Perpetual Trustee Company v Khoshaba* [2006] NSWCA 41 at [34]-[40] (Spigelman CJ) and [106] - [111] (Basten JA); *Riz v Perpetual Trustee Australia* [2007] NSWSC 1153 at [51]. I am amply satisfied that my factual conclusion is justified having regard to the evidence that was adduced.

RELIEF AND ORDERS

49 The transaction should therefore be re-opened. Mr and Mrs Karamihos should be put in the same position that they would have been in if they had not taken on increased borrowings on different terms. The BOQ loan should be treated notionally as if it had continued and there had been no refinancing with BAB. The parties should agree on calculations that demonstrate the true (hypothetical) indebtedness of Mr and Mrs Karamihos to BAB on this revised

basis, having regard to the payments already made by them. I referred to those payments in paragraph [34]. I will reserve costs for the time being, until the final outcome is known. The proceedings will be listed before me on 5 April 2013 for final orders, which the parties should endeavour to agree in advance.

Amendments

10 April 2013 - Correction of typographical error
Amended paragraphs: 14

DISCLAIMER - Every effort has been made to comply with suppression orders or statutory provisions prohibiting publication that may apply to this judgment or decision. The onus remains on any person using material in the judgment or decision to ensure that the intended use of that material does not breach any such order or provision. Further enquiries may be directed to the Registry of the Court or Tribunal in which it was generated.

Decision last updated: 10 April 2013