

Doctrine of agency found to apply to brokers

Lenders beware

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A sobering wake-up call to wholesale lenders who rely on originator-managers to distribute their products and originator-managers who entangle themselves with finance brokers, the decision of Justice Price in *Permanent Trustee Company Limited v Gillian; O'Donnell Permanent Trustee Company Limited v Di Benedetto; Tonto Home Loans Australia Pty Ltd v Tavares* [2009] NSWSC 902 was handed down on 4 September 2009.

Until now the courts have been quite rigid in finding that brokers are agents of the borrower and that misrepresentations and fraud by the brokers cannot harm the lender.

In this case Justice Price found that the fraudulent broker was an agent of the lender and set aside the mortgages pursuant to the *Contracts Review Act*.

ASIC, which intervened in the case on behalf of the borrowers, issued a warning that lenders may be engaging in "unconscionable conduct" if they try to recoup loans fraudulently arranged by external brokers.¹

The decision encompassed three related cases, heard together. All involved a company known as Streetwise Property, which as well as purportedly being a property developer, traded as a finance broker.

In each case Streetwise went to Tonto Home Loans Australia Pty Ltd for funds. Tonto acted as a mortgage manager for Permanent Trustee Company Limited, and in two of the three cases Permanent loaned the funds through the agency of Tonto. In the third case, Tonto loaned its own funds. When

the mortgagees sued for possession, the mortgagors cross-claimed, seeking to set aside the mortgages pursuant to the *Contracts Review Act*.

His Honour also found that there were oral terms to the agreement between Streetwise and Tonto, including terms to the effect that:

□ Tonto would not contact borrowers until after the loan had settled;

□ prior to settlement all loan application forms and other documentation to be given to borrowers would be branded with Streetwise's name, even if they in fact came from Tonto (Streetwise gave Tonto a JPEG file with its logo to aid in this masquerade); and

□ Streetwise would have "absolute administrative control" of the loan applications.

The court found that in all three cases Streetwise not only defrauded the borrowers by having them borrow money and give it to Streetwise on false pretences, but also made fraudulent misrepresentations to Tonto by fabricating the borrowers' financial particulars to satisfy Tonto's lending requirements.

The key factual finding was that Streetwise was Tonto's agent in dealing with the borrowers. In making this finding, Price J first acknowledged that "a finance broker is ... prima facie the agent of the borrower",² but that the position "depends upon the individual circumstances of each case".³ His Honour then found that the circumstances of the present case justified departure from the general rule.

In particular, under its agreement with Streetwise, Tonto completely entrusted to the broker all pre-settlement dealings with the borrower, which was of particular importance given the fact that this was lo doc lending in which particular reliance would be placed upon statements made by the borrower.

Streetwise thus owed a duty in these dealings to Tonto and hence was acting as Tonto's agent. As Tonto was Permanent's agent, Streetwise was found also to be the agent of Permanent.

With the conclusion that the mortgagees knew (through the knowledge of Streetwise as agent) that none of the borrowers could repay the loans, it was a small leap to find that each of the loans constituted "asset lending", that the asset lending was unconscionable, that the contracts were unjust, and that relief should be granted under the *Contracts Review Act* by setting aside the mortgages in each matter in their entirety – save that one mortgagor had to repay \$50,872.60 and interest at 6.95 per cent due to a prior mortgage being paid out by the mortgagor.

This represented the only benefit that flowed to any of the mortgagors.

Price J noted a definition of lo doc loans in an expert report before him as being "loans where the savings history and/or income of the borrower is not fully verified by the lender when [assessing] the borrower's capacity to pay".⁴ In the cases before him, there were lending guidelines provided to Tonto in relation to entering into loans that provided for some limited degree of checking by Tonto of the borrower's financial circumstances, even with lo doc loans, but Tonto did not comply with these guidelines.

The judge was not especially critical of lo doc loans per se, but was critical of Tonto's arrangement with Streetwise, whereby Tonto was not to contact customers at all until after settlement and could therefore not itself verify information being provided to it, and where Streetwise as both a broker and property developer would have a conflict of interest in pursuing those due roles.⁵ The judge noted the particular

importance of proper preparation of the loan application and determination of the eligibility of borrowers in relation to lo doc loans where full financial documentation was not required.⁶

The main implication of this decision is that lenders should ensure that neither they nor their originators enter into agreements with brokers in the nature of that between Tonto and Streetwise without complete confidence in the broker in question. The agreement put the mortgagees in a position where it was next to impossible to verify the financial circumstances of the borrowers due to an agreement not to contact the borrowers.

The lo doc nature of the loans were such that there would be no documentary confirmation of the financial circumstances, yet the consequence of the arrangement was that the broker was effectively being appointed the mortgagee's agent; hence the mortgagee would be fixed with the knowledge of the broker.

Effectively, Tonto and Permanent put themselves at the mercy of Streetwise's honesty (and suffered the consequences). □

ENDNOTES

1. The Herald Sun, 11 May 2009.
2. At [339].
3. At [341].
4. At [5].
5. See [320].
6. At [350]. □

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