FORGED PAYMENT DIRECTIONS
CUT LENDERS (AND THEIR SOLICITORS) AS DEEP AS A FORGED MORTGAGE

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The Court of Appeal has unanimously rejected a lender's attempts to enforce its mortgage in circumstances where a faxed payment direction sent to the lender's solicitors was found to be unauthorised.

In *Perpetual Trustees Victoria Ltd v Cox* [2014] NSWCA 328 the evidence, although inconclusive, strongly suggested that the broker forged a drawdown request sent to the lender's solicitor. The money was transferred, as per the direction, to a bank account under the broker's control.

The decision is a clear warning to solicitors acting for lenders, not only on prudent conveyancing practice, but also on the need to properly draft their mortgages.

While the profession has apparently received the message regarding the nullification of indefeasibility by reliance on "all monies" clauses, this case shows that the courts give no points for ineffectual attempts to address the issue with poor drafting.

Arguments on appeal

On appeal, Perpetual made three independent arguments. Firstly, that notwithstanding the fraudulent direction, the debt was, on the proper construction of the mortgages, secured (an indefeasibility argument). Secondly, the mortgagors had, by their subsequent conduct, ratified the drawdown. Thirdly, that the primary judge erred in failing to find that the direction had been signed by the husband. The way the Court of Appeal disposed of all three arguments is of particular relevance to solicitors acting for lenders.

The judgment

Leeming JA, with whom Macfarlan JA and Emmett JA agreed, gave the primary judgment. Leeming JA dealt first with the construction/indefeasibility argument. His Honour noted (at [35]-[36]) that the registered mortgage was replete with grammatical errors, had two paragraphs that were both numbered '1' and that it was missing one of the securities from the schedule. There was an attempt to address the "all monies" issue and the case turned on the interpretation of that clause (the second paragraph numbered '1'). This consisted of an acknowledgement of the receipt of the enumerated full facility amount (including that part fraudulently misdirected) and the mortgagors' covenant to "repay" that amount. Perpetual argued that in these circumstances indefeasibility applied as it would to any forged mortgage not reliant upon an "all monies" clause.

Snapshot

- The Court of Appeal has unanimously rejected a lender's attempts to enforce its mortgage in circumstances where a faxed payment direction sent to the lender's solicitors was found to be unauthorised
- The decision is a clear warning to solicitors acting for lenders, not only on prudent conveyancing practice, but also on the need to properly draft their mortgages in accordance with the *Real Property Act*

"Indefeasibility for what?"

In considering this argument, His Honour went back to first principles of the recent chain of "all monies" clause cases, being the classic reflection *"indefeasibility for what?"* by Campbell J (as his Honour then was) in *Small v Tomasetti* [2001] NSWSC 1112 at [9]. Accordingly, His Honour noted (at [72]) that the mere inclusion of the full facility amount in the schedule to the registered mortgage was insufficient alone to trigger indefeasibility for that amount.

Instead, it was necessary to examine the drafting of the mortgage as a whole to see exactly to what extent the estate of the mortgagor was being delimited.

On this basis, His Honour reasoned:

1. There was no free standing obligation to repay the full facility amount. Rather, there were repeated references to the memorandum which contained a regular "all monies" structure incorporating a separate facility agreement (at [75]-[77]).
2. The use of the word "repay" limited the reach of the covenant to repaying what the mortgagor had actually borrowed, not to paying that which the lender had been duped into advancing to the fraudster (at [78]). His Honour held that the more natural construction, 'which does no such violence to the language' is that "repay" extends to repaying only that which has been received in accordance with the contract (at [81]).
3. The loan provided a 30-year term for the mortgagors to repay the monies that they actually received. Therefore, it would be 'commercial nonsense' to accept an interpretation that made them liable to pay, on demand, monies they had never actually received (at [79]).
4. *Reductio ad absurdum* that supposing Perpetual or its solicitors mistakenly (rather than as a result of the broker's fraud) advanced the monies to another party. In those circumstances it would impossibly strain the wording of the covenant to oblige the mortgagors to repay that amount, and there is no valid reason why a different construction would apply in the circumstances of the broker's fraud (at [80]).

As an adjunct to the construction argument, Perpetual contended that the acknowledgement of receipt of the entire facility amount could be relied upon. However, His Honour noted (at [86]) that 'one element of the maxim

that "fraud unravels everything" is that the common law estoppel deriving from the fact that the mortgage covenant is to be treated as if it were a deed does not apply to prevent the Borrowers from contending, contrary to their acknowledgement, that in fact they received nothing by reason of the fraud'.

Ratification

His Honour next addressed the ratification argument. His Honour noted that for this ratification to be established there had to be full knowledge of all the material facts by the mortgagors. Although it was established that the mortgagors were appraised of the fact the facility was drawn down, it was not proven they realised that the broker had transferred the money to an account she controlled using a forged direction. His Honour held (at [90]) that full knowledge required the borrowers to know that the document was a forgery at the material time.

The third argument involving the attack on the trial judge's findings as to fact was rejected.

Conclusion

This is the second case in recent memory in which the lender's solicitor has relied upon a fraudulent direction to pay sent by the broker and directing the funds to an account controlled by the broker. The same material facts occurred in *Perpetual Limited v Rocco Costa and Santina Costa* [2007] NSWSC 1093 with the same outcome.

When one considers the steps that are taken, or should be taken, by lenders and/or their solicitors to ensure that the mortgagor genuinely signed the mortgage (see s 56C of the *Real Property Act*), it seems incongruous that lenders and/or their solicitors are relying on directions sent to them by finance brokers.

Solicitors should consider that, in the light of these cases and in light of s 56C, such an approach is no longer appropriate (if it ever was). **LSJ**

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