'Special disadvantage': the role of conscience in asset-based lending

Przemek Kucharski reports on *Stubbings v Jams 2 Pty Ltd (ACN 600 173 117)* [2022] HCA 6

The High Court has held unanimously that it is unconscionable in equity for a lender to enforce a guarantee and mortgages against a guarantor in circumstances where the lender's agent deliberately turns a blind eye to the guarantor's vulnerability and financial circumstances. The decision serves as yet a further reminder to financiers of the importance to investigate and have regard to the personal and financial circumstances of borrowers.

The facts

The three respondents before the High Court were in the business of asset-based lending or pure asset lending – that is, making loans exclusively based on the value of assets securing the loan, without regard to the borrower's ability to repay interest or principal. Such loans may allow borrowers who would be ineligible for credit from traditional banks to obtain finance, but usually at the cost of higher interest rates and greater risk. There was no suggestion that asset-based lending in and of itself is inherently unconscionable.

Loans would on occasion be facilitated by the respondents' solicitor, a Mr Jeruzalski of Ajzensztat Jeruzalski & Co (AJ Lawyers), who acted as the respondents' agent. Mr Jeruzalski had a system by which he would place the loans. The system involved a number of components designed to immunise loans and security instigated by Mr Jeruzalski from the reach of equitable remedies.

First, loans would only be made to companies and were stipulated not to be used for personal, domestic or household purposes. This was designed to avoid the national credit code applying to the loans. Secondly, the loans were always secured with personal guarantees and mortgages over real estate. Thirdly, Mr Jeruzalski would never deal directly with borrowers, but always through an intermediary. This was done with the intention that Mr Jeruzalski and (through him) the respondents could not be fixed with knowledge of the borrower or guarantor's financial circumstances or

any representations or inducements offered by the intermediary. Fourthly, to obtain the loan, the borrower had to provide a 'certificate of independent legal advice' and a 'certificate of independent financial advice'. The form of both certificates had been drafted by Mr Jeruzalski.

The appellant before the High Court was a Mr Stubbings, who had no meaningful income at any relevant time. He was the sole director and shareholder of Victorian Boat Clinic Pty Ltd (VBC), a shell company that had no assets and had never traded. Via Mr Jeruzalski and a Mr Zourkas, the intermediary who dealt directly with Mr Stubbings, VBC obtained two loans from the respondents – the first for $1,059,000 (at an interest rate of 10 per cent per annum and a default rate of 17 per cent per annum) and the second for $133,500 (at an interest rate of 18 per cent per annum and a default rate of 25 per cent). The loans were for a minimum of six months and a maximum of 12 months. Mr Stubbings guaranteed the loans and gave mortgages over two properties in which he held equity totalling about $530,000.

In entering into the loans, Mr Stubbings caused VBC to obtain a legal advice certificate and a financial advice certificate in Mr Jeruzalski's standard form. Mr Zourkas facilitated procurement of the legal certificate from a Mr Kiatos (a solicitor) and the financial certificate from a Mr Topalides (an accountant). Mr Topalides completed the financial certificate with Mr Stubbings, stating the purpose of the loan was to 'set up & expand the business'. In reality, the purpose of the loans was to enable Mr Stubbings to purchase a home in his own name, which is what occurred. The monthly interest-only instalment payable on the loans was $10,377.50.

Mr Jeruzalski accepted that he assumed Mr Stubbings had no income, he knew that Mr Stubbings had paid only a nominal deposit to acquire the property the subject of the loans and he was aware that, after all outgoings, any surplus from the loans would be very small compared with the amount borrowed.

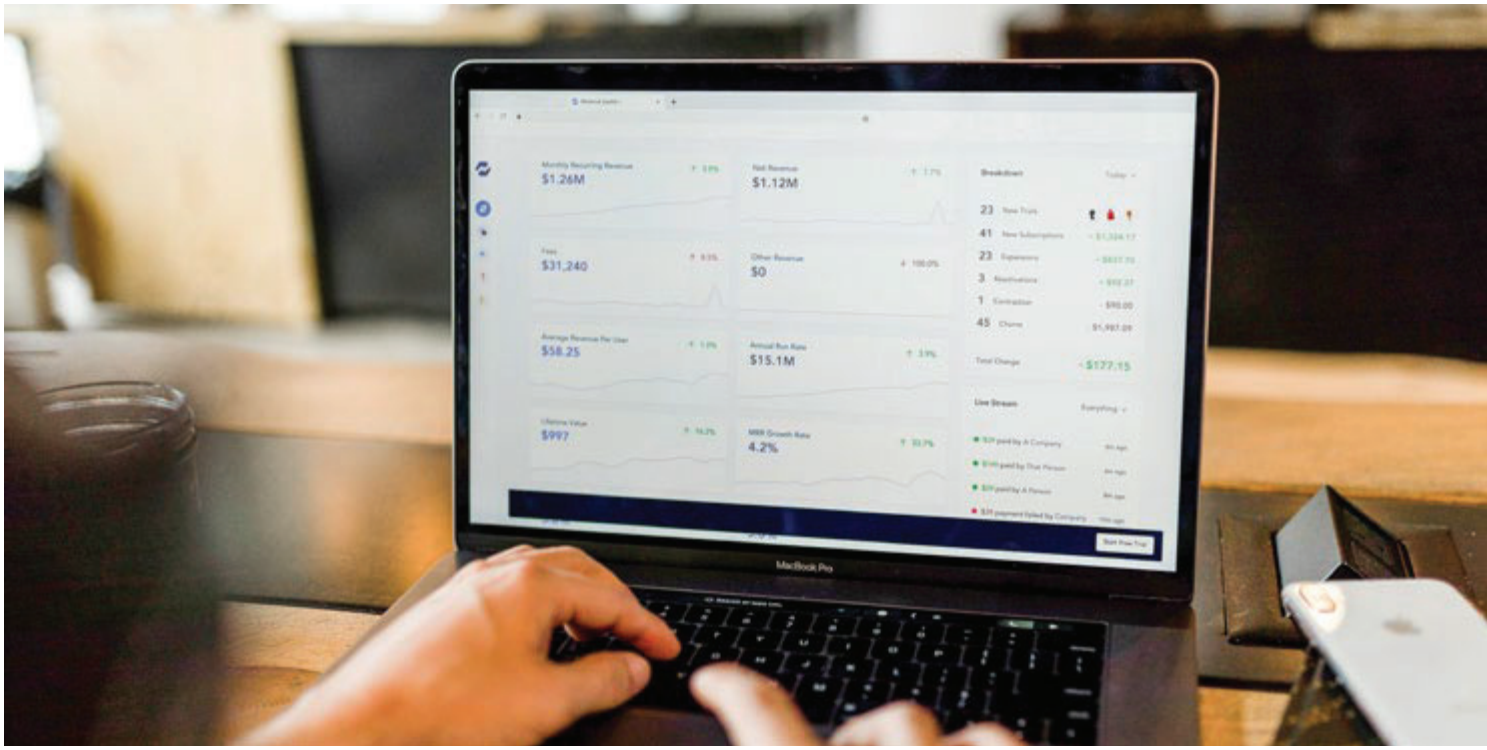
After entry into the loans, Mr Stubbings expected to have a surplus of some $53,000, which he intended to use to renovate and sell his pre-existing properties. However, the surplus was used largely to pay a 'procuration' fee to AJ Lawyers ($31,000), a consultancy fee to Mr Zourkas ($27,000) and the fees of Mr Kiatos and Mr Topalides, as well as to pre-pay the first month's instalment on the loans. Mr Stubbings was able to pay the second month's instalment by selling some other assets. By the third month he was in default.

The respondents commenced enforcement proceedings against Mr Stubbings under the guarantee and mortgages.

Supreme Court of Victoria

Before the Supreme Court (*Jams 2 Pty Ltd v Stubbings (No 3)* [2019] VSC 150), Mr Stubbings, who was self-represented, argued that: (i) the loans and security were procured in circumstances that made enforcement of the respondents' rights unconscionable; and (ii) the respondents had, in trade or commerce, engaged in conduct that was unconscionable in connection with the supply of financial services – in contravention of s 12CB of the *Australian Securities and Investments Commission Act 2001* (Cth) ('ASIC Act').

The primary judge (Robson J) found that Mr Stubbings' financial circumstances were 'bleak', he was 'unsophisticated, naïve and had little financial nous', and the manner in which he represented himself indicated he was 'completely lost, totally unsophisticated,



incompetent and vulnerable'. The very fact that Mr Stubbings entered into the loans, given his circumstances, was evidence of his vulnerability. These matters put Mr Stubbings under special disadvantage.

His Honour also found that Mr Jeruzalski knew the loans were risky and dangerous for Mr Stubbings. Despite this, Mr Jeruzalski deliberately failed to inquire about Mr Stubbings' vulnerability, understanding of the loans or ability to service the loans.

His Honour was not satisfied that Mr Kiatos and Mr Topalides, who provided the certificates, were truly independent as they would only be paid if the loans proceeded.

His Honour concluded that Mr Jeruzalski's conduct amounted to wilful blindness of Mr Stubbings' financial and personal circumstances. Accordingly, Mr Jeruzalski and (through him) the respondents should be fixed with knowledge that Mr Stubbings was unable to service the loans. In the circumstances, the lending was unconscionable.

His Honour also found that the respondents had breached s 12CB of the ASIC Act.

Court of Appeal

The Court of Appeal (*Jams 2 Pty Ltd v Stubbings* [2020] VSCA 200) unanimously overturned the primary judge's findings.

In essence, the court (Beach, Kyrou and Hargrave JJA) was of the view that Mr Jeruzalski was entitled to rely on the certificates of independent advice and, as such, it was reasonable for him to refrain from further inquiry into Mr Stubbings' circumstances. The court concluded there was insufficient evidence for the primary judge's finding that the certificates did not reflect truly independent advice.

High Court

The High Court unanimously overturned the decision of the Court of Appeal and reinstated the primary judge's decision. Three judgments were delivered – by Kiefel CJ, Keane and Gleeson JJ, by Gordon J and by Steward J. All judges agreed that the respondents' conduct was unconscionable in equity, but with differing emphasis.

For Kiefel CJ, Keane and Gleeson JJ, the central question was whether Mr Jeruzalski's appreciation of Mr Stubbing's special disadvantage was such as to amount to an exploitation of that disadvantage: at [44]. Their Honours held that, however one views the certificates, they could not negate Mr Jeruzalski's actual appreciation of the dangerous nature of the loans and Mr Stubbings' vulnerability: at [49]. This was in a context where Mr Jeruzalski appreciated that taking Mr Stubbings' equity by way of interest payments would be good business for the respondents: at [51]. In the circumstances, Mr Jeruzalski's conduct on behalf of the respondents amounted to unconscientious exploitation of Mr Stubbings' special disadvantage: at [52]. Equitable intervention was justified not merely to relieve Mr Stubbings from the consequences of his own foolishness but to prevent his victimisation: at [5].

In agreeing that the respondents' conduct was unconscionable in equity, Gordon J focussed on the lack of assistance proffered to Mr Stubbings as an aspect of his vulnerability. The circumstance gave rise to an immediate need for the respondents, through Mr Jeruzalski, to warn Mr Stubbings that the loan was risky and dangerous. Not only did this not happen, but Mr Jeruzalski deliberately avoided making inquiries in an attempt not to enliven the court's equitable jurisdiction: at [91]. There was a lack of assistance where assistance was necessary. The respondents were thereby fixed with the knowledge their agent sought to avoid: at [94].

For Steward J, the narrow issue on which the appeal turned was whether the Court of Appeal was correct in concluding that the legal and financial certificates precluded a finding of wilful blindness against Mr Jeruzalski and thereby the respondents: at [154]. In his Honour's view, Mr Jeruzalski knew enough to at least give rise to a possibility that Mr Stubbings was in a position of special disadvantage: at [162]. The certificates were insufficient to undo that conclusion because they did not disclose any advice given to Mr Stubbings personally as guarantor (as opposed to VBC) and did not address ability to service the loans. Indeed, the certificates were part of the conduct designed to inhibit the grant of equitable relief arising from Mr Jeruzalski's unconscionability: at [171]–[172].

With the exception of Gordon J, the court did not find it necessary to address the claims relying on s 12CB of the ASIC Act. Her Honour concluded that the respondent's conduct also amounted to a breach of that provision. In doing so, her Honour noted that the statutory conception of unconscionability is more broad-ranging than the equitable principles, and that the provision can apply to a system of conduct or pattern of behaviour, irrespective of whether any particular individual is identified as having been disadvantaged: at [55]–[56]. The system put in place by Mr Jeruzalski as apparent from this case was a system of conduct that was unconscionable and contrary to s 12CB of the ASIC Act: at [84]. BN