



High Court lays down the law on asset-based lending

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A recent case decided by the High Court found that the lender of an asset-based facility acted unconscionably in making a loan available to the borrower and ordered that the loan and mortgage be set aside.

Key Takeaways

- Lenders must carefully scrutinize the circumstances of prospective borrowers and their ability to repay a proposed loan.
- If a lender deliberately fails to find out information about a borrower's financial circumstances and capacity to repay a proposed loan, a Court may step in and intervene when the lender attempts to enforce its security after the borrower defaults on that loan.
- In some circumstances, the fact that a lender has received certificates of independent financial and legal advice will not prevent a finding of unconscionable conduct.

Background

Asset based lending is where a lender advances a loan to a borrower based solely on the lender's assessment of the value of assets, such as property, which the borrower provides as security for the loan.

In *Stubbings v Jams 2 Pty Ltd* [2022] HCA 6, Mr Stubbings was the director of a shell company that had never traded or held any assets. Whilst Mr Stubbings was an unsophisticated individual with a lack of business acumen, little financial resources and no regular income, he owned two properties in Narre Warren and wanted to purchase a third property using the equity in those two properties.

Mr Stubbings was introduced to Mr Zourkas, who in turn arranged for the shell company to obtain an asset-based loan from Jams 2 Pty Ltd, Janaco Pty Ltd and Conterra Pty Ltd (**the Lenders**). The loan was secured by mortgages granted by Mr Stubbings over the two Narre Warren properties and the third property he purchased from the proceeds of the loan.

Interestingly, Mr Stubbings had no contact with the Lenders as all communications were through Mr Zourkas and the solicitor for the Lenders, who essentially acted as agents for the Lenders. As a pre-condition of the loan, Mr Stubbings was required to:

- provide pro-forma certificates (prepared by the Lender) to the Lender stating that he had received independent legal and financial advice in relation to the loan; and
- attest that the loan was for business purposes (which all parties knew was false).

Very soon after the loan was advanced, Mr Stubbings defaulted on the loan by failing to make the required interest repayments. The Lenders sought to exercise their rights as mortgagees of the three properties.

Decision

The High Court set aside the loan and mortgages on the basis of unconscionable conduct by the Lenders. It was a foregone conclusion, given the circumstances, that Mr Stubbings would not be able to meet the interest repayments and ultimately default on the loan.

The Court looked at the extent to which Mr Stubbings suffered a special disadvantage and the extent of the Lender's knowledge and exploitation of that special disadvantage. The Court found that the solicitor for the Lender was aware of how detrimental the loan would be for Mr Stubbings, yet took the opportunity to exploit his poor financial literacy and lack of income.

The existence of the certificates of independent legal and financial advice was not enough to save the Lender. Whilst the certificates took on the standard form commonly used in loan matters, they did not demonstrate that the specific issues in relation to the loan (i.e. the matters that should have been the subject of the legal and financial advice) were explained to Mr Stubbings.

Conclusion

This decision does not signal the impending death of asset-based lending. It does however have important ramifications for lenders, particularly those operating in this space. Lenders must implement practices and procedures to properly investigate a borrower's capacity to repay a loan (and be able to substantiate those investigations). In addition, independent legal and financial advice is not merely a 'tick box' exercise – lenders should ensure that the particular risks specific to the loan are the subject of legal and financial advice given to borrowers.