

## Article Information

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# Ignorance Is Not Always Bliss: The High Court Decision of *Stubbings v Jams 2 Pty Ltd* [2022] HCA 6

The case of *Stubbings v Jams 2 Pty Ltd* [2022] HCA 6 has had a tumultuous history in court with a final conclusion to the saga being handed down in the High Court. The High Court provided important insights into unconscionable conduct and the use of independent legal and financial advice certificates (Certificates) in the context of asset-based lending. The decision has provided a timely reminder to lenders that thorough due diligence must be conducted prior to engaging in loans with borrowers, as these Certificates will not necessarily 'protect' lenders from unconscionable conduct if concerns surrounding a borrower's vulnerability arises.

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## Facts

Mr Stubbings, the appellant, owned two properties in Narre Warren and wanted to purchase a third property in Fingal. At the time he was unemployed and had no regular income. Mr Stubbings used his company, the Victorian Boat Clinic Pty Ltd (**Borrower**), to enter into an asset-based loan with the respondents, Jams 2 Pty Ltd, Conterra Pty Ltd and Janaco Pty Ltd (**Lenders**). The loan was obtained via Mr Jeruzalski a partner of Ajzensztat Jeruzalski & Co (**Agent**). Mr Stubbings provided a personal guarantee which was secured by the mortgages of both the Narre Warren and Fingal properties. Mr Stubbings also saw an independent lawyer and accountant who signed the independent legal and financial advice certificates. Shortly following financial close, the Borrower defaulted on the loans and two of the properties were sold.

## First Instance and Court of Appeal

At first instance, the primary judge found that the loans were procured by unconscionable conduct. It was found that Mr Stubbings was under a 'special disadvantage', due to his unemployment, absence of income to service the loans and poor financial literacy. The primary judge also found that the Agent knowingly and deliberately failed to make inquiries about Mr Stubbings' personal or financial circumstances, even though the Agent knew that the loan was 'a risky and dangerous undertaking' for the Borrower.<sup>[1]</sup> The primary judge ordered the mortgages to be discharged and loan agreement was declared unenforceable.

The Victorian Court of Appeal reversed the first instance decision, and held that the transaction was enforceable based on two main reasons:

1. Asset-based lending is not inherently unconscionable; and
2. the Lenders and its agents were entitled to rely on Certificates as evidence that Mr Stubbings had consulted an independent solicitor and accountant for advice and as to the truth of the matters stated in those Certificates, without making any further enquiries.<sup>[2]</sup>

## Decision of the High Court

The High Court unanimously overturned the Victorian Court of Appeal decision. The Court held that the Agent's conduct on behalf of the Lenders amounted to the unconscientious exploitation of Mr Stubbings' special disadvantage, and the Certificates were not sufficient to overturn this ruling. The loan and mortgage were ruled unenforceable.

*Was Mr Stubbings under a 'special disadvantage'?*

The High Court held that Mr Stubbings was under a 'special disadvantage'. The entry into the improvident transaction by Mr Stubbings, an unemployed man with no income who used his only other assets to secure the Fingal property, demonstrated his inability to make a realistic assessment of the consequences of the transaction and therefore shows his vulnerability.<sup>[3]</sup>

*Did the Lenders via an agent have knowledge?*

The majority held that while there was no finding of actual knowledge of the Agent, he had a 'lively appreciation' of the likelihood that the loss of Stubbings' equity in his Narre Warren properties would be due to his financial naivety and absence of income.<sup>[4]</sup> This was sufficient in establishing equitable unconscionability. In a separate judgment, Justice Gordon noted that she would have also found statutory unconscionability under section 12CB of the ASIC Act, in respect of the 'system of conduct' constructed by the Agent.

Following the doctrine in *R v Crabbe*,<sup>[5]</sup> wilful blindness was used to establish actual knowledge.<sup>[6]</sup> It was found that the Agent deliberately using a 'system of conduct' which involved asset-based lending to only companies, using an intermediary to deal exclusively with Mr Stubbings and then obtaining legal and financial advice certificates to enhance the enforceability of the loan did not dispel with the need to make further enquiries. Rather, the Agent's reliance on this system and failure to make further enquiries amounted to 'wilful blindness'.

The High Court held that the Agent (acting on behalf of the Lenders) had sufficient knowledge, exploited Mr Stubbings' special disadvantage and therefore the Lenders also acted unconscionably.

*Can Lenders rely on independent legal and financial advice certificates?*

The High Court considered the question of whether the independent legal and financial advice certificates could protect the Lenders from a finding of unconscionable conduct. It was held in this case, that the Certificates could not be solely relied upon to negate the risky nature of the transaction and Mr Stubbings' vulnerability.

The High Court found that while on its face the Certificates confirmed that Mr Stubbings understood the effect of the finance documents, it did not contain anything which inferred that Mr Stubbings turned his attention to how he could service the loan. The standardised language of the Certificates suggests that they were merely 'window dressing'.<sup>[7]</sup> The Certificates were a 'precautionary artifice' designed to prevent an inference that the Lenders were wilfully blind to the obvious risk to Mr Stubbings.<sup>[8]</sup> Therefore, the mere existence of Certificates, may not be sufficient to protect Lenders from an argument of unconscionable conduct, if there are suspicions of the borrowers' vulnerability.

### **What is the minimum standard of due diligence that a lender must achieve?**

At a minimum, a prudent lender will obtain the independent advice certificates and make the following enquiries in respect of an individual obligor including, among others:

1. their ability to repay the loan and possible exit strategies of the loan;
2. their current financial circumstances prior to entering the loan, including the nature of their income streams and current assets; and
3. their fitness to be a guarantor, including their financial literacy, education, any financial hardship and business experience.

In these circumstances, the Court ruled that lenders and their agents have a moral duty to satisfy themselves that the individual obligor is not unreasonably exposing themselves to a significant financial risk.

### **Key Takeaways**

- While it is important for borrowers to obtain independent legal and financial advice certificates, it is also imperative to conduct due diligence prior to lending to borrowers.
- If there are suspicions of a borrower's vulnerability, you should make further enquiries into their personal and financial circumstances.
- Reliance on the independent financial and legal advice certificates on their own are not adequate protection from a finding of unconscionability and unenforceability of the loan in court.

<sup>[1]</sup> *Jams 2 Pty Ltd v Stubbings* [No 3] [2019] VSC 150 [308].

<sup>[2]</sup> *Jams 2 Pty Ltd v Stubbings* [2020] VSCA 200 [132].

<sup>[3]</sup> *Stubbings v Jams 2 Pty Ltd* [2022] HCA 6 [90].

[\[4\]](#) Ibid [47].

[\[5\]](#) (1985) 156 CLR 464.

[\[6\]](#) Ibid [162]-[167].

[\[7\]](#) Ibid [49]

[\[8\]](#) Ibid [49]