Finance Law

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- Finance Law:
  - A sub-specialty of commercial law and goes by different names
- Gregory Burton identified three important characteristics:
  - Specialized application of legal concepts in contracts, torts, equity, property and restitution;
  - Intensely practical and often developed by business people outside the formal law; and
  - Subject matter not defined
- Two aspects of finance law:
  - That related to transactions in trade and finance
  - That relating to the institutions that conduct the transactions
  - Both aspects are interwoven and this unit covers both, but with greater emphasis on the former

Taking Security

- A major concern of any financier is whether the customer has the power to borrow and to give security (an interest in property to secure repayment of a loan)
  - This in turn depends on the capacity of the customer and the authority (authority to bind person/company to agreement) of the person acting on behalf of the customer
    - On the issue of capacity, see Hazell v Hammersmith & Fulham London Borough Council
    - And on the issue of authority, see AWA Ltd v Daniels- whether foreign exchange dealer had authority to borrow money on behalf of employer.
  - What are the implications of lack of capacity and authority?

Individuals

- At common law, individuals have the capacity to contract and deal with property subject to *two restrictions*:
  - *Age* – loan contracts with minors not binding unless ratified in writing ('after full age')
  - *Mental disability*
- In some states, like NSW, the common law has been altered by statute

Partnerships

- Capacity to contract depends on the capacity of the partners, as a partnership is not a separate legal entity
- Major issue is the authority of a partner to bind other partners (i.e., the firm)

    - Under partnership legislation, a partner is an agent of the firm and thus binds other partners, unless authority is negated/qualified by agreement
    - But even if no actual authority, the partner may bind the firm if she had ostensible authority (an 'act necessary for or usually done in carrying on business of teh kind carried on by the firm')
- When a borrows money, there are *two kinds of property* that may be *offered as security:*
    - *Partner's interest in the partnership* (share in profits & surplus) may be assigned
    - *Partner's interest in partnership property* (may be partner's or the firm's (partners hold it jointly or a few partners hold in trust for all partners)

Corporations

- Corporations have a separate legal personality and fall into 2 categories:
    - *Companies (governed by CA)*
        - They have the capacity of an individual (can contract even if in breach of objects clause)
        - Person signing the contract on behalf of the company must have authority (usually the BOD/delegate) – the CA provides protection for anyone contracting with a company
    - *Statutory corporations* (capacity determined primarily by statute under which they were constituted)

Trust

1) Trust, like a partnership, has *no separate legal entity* and contracts are entered with the *trustee who is personally liable* – risky if the trust is a '$2 company'
2) The trustee (which can be an individual or a company) must have legal capacity to contract and deal with the trust property – usually not an issue
3) The authority to contract and to hold trust property depends on whether the trust was properly constituted (formed) and trustee properly appointed
4) Trusts in Australia evolved from a vehicle for holding interests to one for trading in interests, hence the rise of the commercial trust
5) Although the trustee is personally liable for debts incurred on behalf of the trust, the trustee has a *right of indemnity*
    a. Which may be excluded by the trust instrument, or lost where the trustee acts outside its powers as laid down in the trust instrument
    b. But where the trustee is a company*, section 197* of the CA makes the *directors personally liable* in limited circumstances

Security

- Traditionally, the term 'security' was used to refer to a right over, or an interest in, property of the debtor (or a third party) to secure repayment of a debt or performance of an obligation
- Security can be taken over real or personal property (tangible and intangible personal property); it can arise by agreement or by operation of law

- Under the general law, security took a number of different forms:
    - The four main forms were mortgage, charge, pledge and liens
    - The rules governing the security depended on its form, e.g. separate set of rules for mortgages, charges, etc.
    - Security can either be legal or equitable (the reasons for this division are historical, but it is particularly important for purposes of determining priority). Legal interest normally takes priority even if it was created later.

Charge- create an interest, no transfer of ownership.
Pledge- possessory security. Actually give property until loan is repaid.
Lien- arises by operation of law. E.g. mechanic can retain car if bill not paid.

1) Security is usually taken when money is lent
    a. A common example is when you borrow money from a bank to buy a residential property, the bank will take a charge over the house as security
    b. If you default on the loan, the bank can sell the property and recovers its debt from the proceeds of sale, i.e. the bank can look to the property to satisfy its debt
    c. Even though the bank can sue you to recover the outstanding loan, the bank will prefer to rely on its security for several reasons:
    d. First, legal action is slow, expensive and you may have insufficient assets to satisfy any judgment awarded

Secured creditors have 3 legal rights/ advantages over unsecured and lower ranking creditors:

1) have right to be paid ahead of others if you have the highest ranking priority.
2) Can follow assets into hands of a 3rd party transferee.
3) It is entitled to keep the asset out of the bankruptcy or liquidation of the debtor

In summary we can say that:

a. Security gives the creditor a prior right over, or an interest in, the collateral (i.e. the asset subject to a security interest)
b. As such, security is primarily a protection against the debtor's insolvency. If the debtor remains solvent, the creditor has no need for the prior right or interest

Some arguments for security:

a. Protection against systemic risk
    i. 'Domino effect' of insolvency of debtor
b. Encourages availability of credit
    i. Reduces credit risk , making lenders more willing to lend
c. Requires less monitoring of debtors
d. All of which results in lower costs
    i. Secured credit generally cheaper than and unsecured credit costs

Some arguments against security:

e. Appearance of false wealth
    i. Mitigated by registration requirements

f. Violates bankruptcy equality
    i. Prefers secured creditors over unsecured creditors
g. Encourages careless lending
    i. Focus on availability of collateral rather than repayment ability
h. Threatens safety of commercial transactions
    i. Purchasers placed at risk that goods subject to prior interests

Title Finance (aka vendor financing/quasi security)

Person who is financing property retains title until person has paid. There is no security interest created.

- There are a number of transactions mainly in the form of a sale or lease which are in substance financing transactions, e.g., the 'sale' of an asset on condition that title does not pass to the debtor until the asset has been paid for
- Transactions of this nature are variously described as 'title finance', 'asset-based finance' or 'quasi-security', as in each case the financier retains title of the asset as protection
- Traditionally, a debtor can only grant security over an asset in which the debtor has title. As such any arrangement where the financier retained title was not regarded as security under English law
- Often the reason for structuring such transactions were to circumvent the laws restricting the freedom of transactions. For example, hire purchase was developed in response to the need to avoid the provisions of the Sale of Goods Act
    - **Title retention/reservation of title**
        - A.k.a. conditional sale. Sale on terms that title to goods remain with seller until buyer pays for goods. Seller transfers possession to enable buyer to resell goods and use sale proceeds to pay purchase price. The retention of title clause may extend seller's title to products in which the goods are incorporated ('Romalpa clause')
    - **Finance Leasing (hire arrangement)**
        - The seller (hires) the goods to the buyer for a fixed period (usually the economic life) on terms that title remains with seller but the buyer is to have possession. The lease rentals are calculated to include the cost of the goods and finance charges.
    - **Hire purchase**
        - A lease coupled with the option to purchase the goods at the end of the lease period which is usually the last rental payment, or a nominal sum
        - The Personal Property Securities Act 2009 (Cth) has recharacterised title finance arrangements as security interests on the basis that they serve the same functions as traditional security
    - Now all forms of security including quasi-securities are subject to essentially the same rules

- There were many reasons for adopting a functional approach to personal property securities law. Essentially, the prior law was complicated, confusing, and lacked uniformity (see the article on LMS about the reasons behind the adoption of PPSA)