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Client Alert

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Australia: The Arrium Series #3

Do you owe a lender a duty of care?

In brief

The Arrium Series

Welcome to issue #3 of our **Arrium Series**, where senior members of the Baker McKenzie team involved in the successful defence of proceedings against the former CFO, Treasurer and other employees of the Arrium Group consider key issues arising in those and related insolvent trading proceedings and from the judgment handed down on 17 August 2021[1].

A summary of the relevant background, some key terms and the key issues to be considered in this Arrium Series can be found in issue #1 here. Issue #2, which considers solvency in the context of large debts due in the relatively distant future, can be found here.

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Today's issue - do you owe a lender a duty of care?

As discussed in issue #1, the Anchorage plaintiffs' claims included that:

- Arrium's Treasurer and/or Treasury or Finance employee(s) negligently completed and signed drawdown and rollover notices containing personal misrepresentations in breach of a **duty of care** they **personally** owed to lenders.
- the CFO had breached a **personal duty of care** allegedly owed to lenders by directing that all available monies under the various facilities be drawn down or by failing to ensure representations contained in the drawdown and rollover notices were accurate.
- if, in the alternative, the representations in the drawdown and rollover notices were made by the Arrium borrowers (rather than by the employees personally) then those Arrium entities negligently made misrepresentations in breach of a duty of care they owed to lenders which was "procured" by the CFO because he had directed the monies be drawn down and/or by both the CFO and Treasurer because they had failed to prevent that occurring.
- the Treasurer had also separately made negligent misstatements in the course of a telephone discussion with one lender concerning the accuracy of representations made in a particular drawdown notice and the progress of the sale of Arrium's Mining Consumables business.

Ultimately, for the many reasons discussed below, the Court found that **no** duty of care was owed to lenders by either the Arrium entities, the CFO, the Treasurer or the other Arrium employees save for that single telephone discussion between the Treasurer and that one lender, where the Court held that there was **no** breach of that duty.

[1] *Anchorage Capital Master Offshore Ltd v Sparkes (No 3); Bank of Communications Co Ltd v Sparkes (No 2)* [2021] NSWSC 1025

Relevant legal principles

The Court identified the following relevant legal principles before going on to consider the particular facts before it:

- where a court is considering whether to recognise a novel duty of care it is necessary "to undertake a close analysis of the facts by reference to the 'salient features' … affecting the appropriateness of imputing a legal duty to take reasonable care to avoid harm or injury"[2], which include of particular relevance to the Anchorage proceedings (without being a mechanical checklist):
    - the foreseeability of harm.
    - the nature of the harm alleged.
    - any assumption of responsibility by the defendant.
    - the degree of vulnerability to harm, including the capacity and reasonable expectation of a plaintiff to take steps to protect itself.
    - the degree of reliance by the plaintiff upon the defendant.
    - the proximity or nearness of the plaintiff to the defendant in a physical, temporal or relational sense.
    - the nature and consequences of any action that can be taken to avoid the harm to the plaintiff.
    - the existence of conflicting duties arising from other principles of law or statute.
- a person giving information or advice on a serious or business matter intending to induce the recipient to act on it (a representor) **will** owe the recipient a duty of care if:
    - the representor realises, or ought realise, the recipient will trust in their special competence to give that information or advice.
    - it would be reasonable for the recipient to accept and rely on that information or advice.
    - it is reasonably foreseeable that the recipient is likely to suffer loss should the information turn out to be incorrect or the advice unsound.[3]
- it is **not** necessary that the representor be personally responsible for the communication if the representation is contained in a document prepared by the representor who knew or ought to have known that:
    - the information or advice would be distributed to the recipient (either individually or as a member of an identified class) for a purpose which would very likely lead the recipient to enter into a transaction of the kind they do enter into.
    - it was very likely the recipient would enter into such a transaction in reliance upon that information and advice so as to risk economic loss if the information was incorrect or the advice unsound.[4]
- the **vulnerability o**f a recipient is an important factor in determining whether it is appropriate to impose a duty of care to avoid pure economic loss, where "vulnerability" refers to a plaintiff's inability to protect itself against a defendant's want of reasonable care rather than only that the plaintiff was likely to suffer loss if reasonable care was not taken.[5]
- it is not for the common law to alter any contractual allocations of risk by supplementing or supplanting the terms of any contract by a tortious duty of care.[6]

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[2] per Allsop P (with whom Simpson J agreed) in *Caltex Refineries (Qld) Pty Limited v Stavar* (2009) 75 NSWLR 649; [2009] NSWCA 258
[3] *Sebastian Pty Ltd v The Minister Administering the Environmental Planning and Assessment Act 1979* (1986) 162 CLR 340 at 372, referring to the judgment of Barwick CJ in *Mutual Life & Citizens' Assurance Co Ltd v Evatt* (1968) 122 CLR 556 at 571 (which itself was approved by Mason J (with whom Aitkin J agreed) in *Shaddock & Associates Pty Ltd v Parramatta City Council (No 1)* (1981) 150 CLR 225 at 251 and by Gleeson CJ, Gummow and Hayne JJ in *Tepko Pty Ltd v Water Board* (2001) 206 CLR 1; [2001] HCA 19 at [47])
[4] *Esanda Finance Corporation Ltd v Peat Marwick Hungerfords* (1997) 188 CLR 241 at 252
[5] *Woolcock Street Investments Pty Ltd v CDG Pty Ltd* (2004) 216 CLR 515 at [23]-[24] and *Brookfield Multiplex Ltd v Owners Strata Plan No 61288* (2014) 254 CLR 185 at [128]
[6] *Brookfield Multiplex Ltd v Owners Strata Plan No 61288* (2014) 254 CLR 185 at [132]

- the fact that an individual was acting in their course of their employment does not necessarily mean they are not personally liable for their conduct[7] and one recognised exception is where the employee was merely acting in a "purely ministerial" function as a corporate organ.[8]

Did the signatories to the notices owe a duty of care to lenders?

In finding that the employee signatories did **not** owe lenders a duty of care, the Court concluded that:

- the representations in the drawdown and rollover notices were **only** given by the **Arrium borrowers** (rather than by, or also by, the employee signatories personally), including where:
    - contrary to the Anchorage plaintiffs' submission, it was "apparent", as a matter of construction, that the reference to "we" in the drawdown and rollover notices was only a reference to the Arrium borrower and "cannot be a reference to the signatories".
    - if the Anchorage plaintiffs were correct, "the signatories were either forced to incur potential personal liability by signing the notices or risk breaching their duties as employees by refusing to sign notices that they had been requested to sign in accordance with the terms on which they were employed".
- the signatures were required as part of a contractual mechanism between Arrium entities and the lenders whereby Arrium borrowers (rather than individual signatories) were required to make representations and give warranties and the representations and warranties made by the notices were plainly intended to be "absolute" whereby lenders were entitled to their **contractual remedies against the Arrium entities** if the representations or warranties were breached.
- it could **not** be said that the signatories realised, or ought to have realised, that the lenders would be relying on the signatories' **personal** knowledge or expertise.[9]
- it was also **not** reasonable for the lenders to have relied on the representations as having been made by the signatories personally where:
    - lenders understood the representations were being made as part of the contractual process by which Arrium could drawdown or rollover loans.
    - "there was nothing about the signatories which would have caused the lenders to rely on what they said other than the fact that they were authorised to bind Arrium."
- the lenders were also **not** vulnerable, in a relevant sense, to a failure by the signatories to take reasonable care (even though they may be worse off if the signatories were not liable to them in negligence), in circumstances where:
    - it was, at least in theory, open to lenders to have negotiated guarantees from eligible signatories at the time they negotiated the facility agreements but they did not do so.
    - it was unlikely, in practice, that they would have been successful in doing so.
    - (to quote): "Why it might be asked, should the Lenders through a claim in negligence be entitled to obtain what was open to them to obtain, but which they were unlikely to have obtained, through contractual negotiations?"

Did the Arrium entities owe a duty of care to lenders?

In finding that the Arrium entities also did **not** owe lenders a duty of care, the Court relevantly concluded that:

[7] *Houghton v Arms* (2006) 225 CLR 553, [2006] HCA 59 at [40]
[8] *Australian Securities and Investments Commission v Narain* (2008) 169 FCR 211, [2008] FCAFC 120 at [96]
[9] Applying *San Sebastian Pty Ltd v The Minister Administering the Environmental Planning and Assessment Act 1979* (1986) 162 CLR 340 at 372 per Brennan J

- the terms of the facility agreements (including the required representations and warranties), and the consequences if representations and/or warranties were false or misleading, were negotiated between **sophisticated parties** who were "quite capable of protecting their own interests."
- the law of contract has "primacy" in the "protection afforded by the common law against unintended harm to economic interests where the particular harm consists of disappointed consequences under a contract"[10] and there was **no** reason to overlay a different set of obligations and consequences on those already set out in the facility agreements.
- it could **not** be said that the lenders were vulnerable to any negligence on the part of the Arrium borrowers in making the relevant representations.
- it was "difficult to see how such a duty could be owed", including in circumstances where "there is no duty in tort to take reasonable care to perform a contract".[11]
- there was no greater reason to recognise a duty of care owed by the Arrium borrowers any more than the individuals who signed the notices.

Did the CFO owe a duty of care to lenders?

In finding that the CFO did **not** owe lenders a duty of care in respect of any direction that was made to draw down monies, the Court concluded that:

- any direction constituted an **internal instruction** given as part of the **internal operations** of Arrium.
- it "cannot possibly be said" that a director or employee owes a duty of care to a third party every time that individual makes, and communicates, a decision to another employee which affects that third party (even if any loss is reasonably foreseeable).
- the imposition of such a duty of care would involve a "**radical change**" in the law and would be **inconsistent** with established and binding authority,[12] while imposing such a duty would:
    - place the CFO in an "**impossible**" position, in circumstances where the direction appeared to have been given on the basis of external advice and/or on the wishes of the board.
    - be "perverse" where, on that premise, employees would owe a duty to creditors to take reasonable care to avoid economic loss arising from actions they took that were internal to the operations of the company while directors did not owe a direct duty to creditors (cf their company) where the company was at risk of becoming insolvent.[13]
- it was open to the lenders to negotiate other representations and warranties (or different consequences) and the lenders were not vulnerable in a relevant sense to a want of care by the CFO.

In also finding that the CFO was not liable for directing or procuring any negligent misstatements or breach of contract by the Arrium borrowers' conduct, the Court concluded that:

- the Arrium entities had not breached the terms of the facility agreements, including because the MAE Representations were true and, even if they were not, there had not been any Event of Default (including because that required the lenders to give a "remedy" notice).
- the Arrium entities also did not owe the lenders a duty of care (see above).
- apart from the CFO's direction to draw down monies, there was no evidence the CFO had induced or procured the notices which made the representations, including where:
    - they were issued "as part of the normal functions of Arrium's Treasury Group".

[10] citing *Brookfield Multiplex Ltd v Owners Strata Plan No 61288* (2014) 254 CLR 185; [2014] HCA 36 at [132]
[11] citing *Rolls-Royce New Zealand Ltd v Carter Holt Harvey Ltd* [2005] 1 NZLR 324 at [66].
[12] citing *Spies v The Queen* (2000) 201 CLR 603; [2000] HCA 43 at [95] per Gaudron, McHugh, Gummow and Hayne JJ
[13] *Kinsela v Russell Kinsela Pty Ltd (in liq)* (1986) 4 NSWLR 722

- it was not suggested that the CFO had "any particular involvement" in the decision to serve the notices (such as the selection of facilities which should be drawn down).
- there was also "no evidence" the CFO knew that the representations amounted to a breach of the facility agreements, even if it was assumed they were.

- since the Anchorage plaintiffs had also **failed** to prove reliance by the lenders on the representations in the notices, it was not appropriate for the scope of the CFO's liability to extend to any consequences flowing from the fact that the lenders advanced funds in accordance with the notices.

Did the Treasurer owe a duty of care in discussion with a lender?

The Treasurer had a telephone conversation with employees of a single lender in late 2015 in response to a specific request by that lender seeking further information or reassurance in respect of representations and warranties in a particular drawdown notice.

In finding the Treasurer **did** owe **that lender** a duty of care in making any representations during the relevant telephone conversation, the Court had regard to the following matters specific to that event:

- the **conversation had been requested by the lender** so that it could better understand Arrium's financial position and the reasons behind the particular drawdown request.
- the Treasurer had accepted, under cross-examination at trial, that she regarded the conversation as "**a matter of importance**".
- the Treasurer "must have understood" that the lender wanted some **additional** information.
- it was reasonable for the lender to rely on what it was told by the Treasurer, including because she occupied a position of seniority and was responsible for the issue of the relevant drawdown notice (i.e. it was reasonable to expect that the Treasurer would **know or be in a position to find out the information sought** by the lender).
- the lender had **no other means** of finding out the particular information itself and, "in that sense", was vulnerable to a lack of reasonable care in the responses the Treasurer gave in that discussion in response to the lender's questioning.

Having concluded that the Treasurer owed that lender a duty of care in respect of **that** discussion, the Court found **no** breach of that duty had occurred where the Court was not satisfied that several of the alleged representations had been made or that what it was satisfied was said was inaccurate.

Ten key takeaways

In summation, the 10 key takeaways from the judgment on when a duty of care may be owed to lenders are as follows:

1. There is no fixed test to be "mechanically" applied in determining whether to impose a novel category of duty of care and a court will, instead, have regard to all relevant matters, including such of the "salient features" discussed in *Caltex Refineries v Stavar*[14] as may be relevant (see above).
2. Primacy will be given to any relevant contract, particularly where there are sophisticated commercial parties who are capable of negotiating and looking after their own interests, while courts will also be very hesitant to overlay existing obligations with new ones.
3. A duty of care is a personal duty and the court will need to be satisfied that the impugned conduct was sufficiently personal and, in the case of negligent misrepresentation, a court would also need to be satisfied that any representation that the plaintiff relied upon the defendant's **personal** knowledge or expertise.

[14] *Caltex Refineries (Qld) Pty Limited v Stavar* (2009) 75 NSWLR 649 at [103] per Allsop P, Simpson J agreeing

4. Courts will be hesitant to impose a duty of care where the impugned conduct involves purely internal decision making.
5. Courts will be very hesitant to impose a duty of care upon an officer or employee where that would place them in conflict with statutory, contractual or other duties owed to their employer.
6. A plaintiff's reliance (or lack thereof) may also be relevant to an assessment of whether a duty of care was owed.
7. A court would likely need to be satisfied that it was reasonable for the plaintiff to have relied upon the representation as being made by the defendant personally.
8. "Vulnerability" (in the sense of an inability to protect against a want of reasonable care rather than only a likelihood of loss if reasonable care was not taken) has emerged as a **key factor** in cases where a duty of care to avoid economic loss is alleged.
9. The more commercially sophisticated a plaintiff is, and the more power a plaintiff may have had to address risk through contractual arrangements (including guarantees), the less likely that plaintiff will be considered vulnerable to a want of care.
10. A lender may, nevertheless, be relevantly "vulnerable" where that lender proactively seeks information from a senior officer of a borrowing entity in a position to know or find out the information sought, and the lender has no other means of obtaining that information.

Arrium series authors

Mark Chapple
Partner
Sydney
mark.chapple
@bakermckenzie.com

Jayme-Lyn Hendriks
Senior Associate
Sydney
jayme-lyn.hendriks
@bakermckenzie.com

Kathleen Jeremy
Senior Associate
Sydney
kathleen.jeremy
@bakermckenzie.com

Charlotte Hendriks
Senior Associate
Sydney
charlotte.hendriks
@bakermckenzie.com