‘Unconscionable conduct’ : what is so far outside norms of acceptable commercial behaviour as to warrant being unconscionable?

Australian Securities & Investments Commission v Lindsay Kobelt [2019] HCA 18

A case note by Nicholas Green QC, Svenson Barristers

Introduction

1. Any court who does equity in identifying conduct as unconscionable provides relief against a stronger party to a transaction exploiting some special disadvantage which works to impair the ability of a weaker party to form a judgment bearing on his or her interests.

2. On 12 June 2019 by majority, the High Court dismissed an appeal from the Full Federal Court. The majority held that the respondent’s provision of ‘book-up’ credit did not contravene the prohibition on unconscionable conduct in s 12CB(1) of the *Australian Securities & Investments Commission Act 2001* (Cth).

The statutory provision

3. Section 12CB(1) is:
   ‘(1) A person must not, in trade or commerce, in connection with:
   (a) the supply or possible supply of financial services to a person (other than a listed public company); or
   (b) the acquisition or possible acquisition of financial services from a person (other than a listed public company);
   engage in conduct that is, in all the circumstances, unconscionable.’

The evidence

4. In *ASIC v Kobelt* the respondent ran a general store in Mintabie, South Australia, 1,100 km north of Adelaide. He sold food, groceries, fuel and second-hand cars. Nearly all of his customers were Anangu people who lived predominantly in two communities. The Anangu customers were vulnerable due to the remoteness of their communities, their impoverishment and the limitations on their education and financial literacy. Kobelt supplied credit to his Anangu customers using a “book-up” system of credit under which payment for goods was deferred wholly or in part subject to his retaining the customer’s debit card and PIN linked to the customer’s account into which wages or Centrelink payments were credited. Kobelt would then use the debit card and PIN to withdraw the whole or almost the whole of the wages or Centrelink payments soon after they were credited, preventing the customer from having any practical opportunity to get access to the money in other ways. At least half of the withdrawn funds were applied to reduce the customer’s indebtedness to the general store, and the rest was held in Kobelt’s account and informally made available to the customer for future goods and services. The customers, who understood the elements of the book-up system, authorised the withdrawal of funds.

5. There was anthropological evidence that Anangu customers entrusted Kobelt with their debit cards to let them exercise choice of what was in their own interests. Several customers reported that they supported the book-up system and Kobelt's business. Book-up for many was the only way to buy a car or access credit. His retention of the whole of the money credited to his customers' accounts could protect them from 'humbugging' or 'demand sharing', which required them to share resources with certain categories of kin. 'Book-up' credit took out the sting of the 'boom and bust' cycle of expenditure, allowing the Anangu customers to buy food between pay days. All but two witnesses considered that Kobelt had treated them well.

The proceedings

6. The primary judge, White J, found that Kobelt's conduct was unconscionable, in contravention of s 12CB(1), for he had chosen to maintain a system which, although it provided some benefits to Anangu customers, took advantage of their vulnerability to tie them to his store. On appeal to the Full Federal Court, allowing the appeal from White J, the court concluded that Kobelt's conduct was **not** unconscionable. Besanko & Gilmour gave a joint judgment, Wigney J delivering a separate one.

7. On 17 August 2018 Gageler, Nettle & Edelman JJ granted ASIC leave to appeal from that part of the Full Court's judgment respecting the claimed contravention of s 12CB(1).

8. A 4-3 majority of the High Court dismissed the appeal from the Full Court, holding that while Mr Kobelt's book-up credit system was open to abuse, he did not abuse it.

9. Kiefel CJ & Bell J (who formed part of the majority) said at [14]: "The term 'unconscionable' [in the ASCIC Act] …is to be understood as bearing its ordinary meaning. The proscription in s 12CB(1) is of conduct in connection with the supply of financial services that objectively answers the description of being against conscience. The values that inform the standard of conscience fixed by s 12CB(1) include…certainty in commercial transactions, honesty, the absence of trickery or sharp practice, fairness when dealing with customers, the faithful performance of bargains and promises freely made, and 'the protection of those whose vulnerability as to the protection of their own interests places them in a position that calls for a just legal system to respond for their protection, especially from those who would victimise, predate or take advantage."

10. It was the application of the last-mentioned value with which the appeal was concerned: [15].

11. ASIC's case relied upon White J's assessment that Kobelt's conduct in withdrawing all of the funds in book-up customers' accounts involved the imposition of a condition not reasonably necessary for the protection of his legitimate interests: [70].

12. Contrary to ASIC's submission, Kiefel CJ & Bell J considered that the Full Court correctly took into account all of the circumstances, including the evidence of the

cultural norms and practices of the Anangu residents. "Acceptance of this evidence is against the premise of ASIC's central submission, that the supply of book-up credit was objectively contrary to the interests of Mr Kobelt's Anangu customers." [77]

What did the Anangu customers think appropriate?

13. At the heart of the conclusion of Kiefel CJ & Bell J was their Honours' characterisation of the evidence before the primary judge: "[78] The basic elements of Mr Kobelt's book-up system were understood by [his] Anangu customers, and those who chose to enter into book-up credit contracts with him appear to have done so because it enabled them to purchase goods which they valued and which otherwise they may not have been able to acquire. The terms on which book-up credit was supplied were perceived by the Anangu customers to be appropriate. This perception was not the product of the Anangu customers' lack of financial literacy: it reflected aspects of Anangu culture that are not found in mainstream Australian society."

The characterisation of the book-up system of credit

14. Gageler J dismissed the appeal too. His Honour did not consider that the evidence provided a sufficient basis for him to be satisfied that the Federal Court or the High Court was in a position to question the choice made by Kobelt's Anangu customers, much less to question the ability of those customers to make it. "[111]…The result is that I cannot characterise Mr Kobelt's provision of the book-up system to his Anangu customers as involving exploitation of those customers' vulnerability and that I cannot, on that basis or any other basis that has been argued, conclude that [his] provision of that system was conduct so offensive to the norms of wider Australian society as to warrant its condemnation as unconscionable."

"I recant."

15. One interesting aspect of Gageler J's judgment was his show of humility as to his earlier use of language in elucidating the meaning of unconscionable conduct under s 12CB.

16. Recanting and then clarifying, his Honour said: "[91] In *Pacioco v ANZ Banking Group Ltd* (2016) 258 CLR 525 at 587 [188], I referred to unconscionable conduct within the meaning of s 12CB as requiring a 'high level of moral obloquy' on the part of the person said to have acted unconscionably. 'Moral obloquy' is arcane terminology. …using that arcane terminology does nothing to elucidate the normative standard embedded in the section. The terminology also has the potential to be misleading to the extent that it might be taken to suggest a requirement for conscious wrongdoing. My adoption of it has been criticised judicially and academically. The criticism is justified. I regret having mentioned it.

[92] What I meant to convey by the reference was that conduct proscribed by the section as unconscionable conduct is conduct that is so far outside societal norms of acceptable commercial behaviour as to warrant condemnation as

conduct that is offensive to conscience. To that view of the statutory standard I adhere."

17. Having so purged himself, his Honour decided that the Full Federal Court's conclusion that the book-up system had not been demonstrated on ASIC's case presented at trial to have been unconscionable was correct.

18. Keane J was the final member of the majority. In a short judgment, his Honour agreed with Kiefel CJ & Bell J that the appeal be dismissed. It had not been established that, upon "a scrutiny of the exact relations established between the parties", Kobelt engaged in conduct which could properly be characterised as unconscionable. 'In particular, [ASIC's] case did not establish that [Kobelt] exploited his customers' socio-economic vulnerability in order to extract financial advantage from them.' [115]

Voluntariness

19. Nettle & Gordon JJ formed a part of the minority. Let it be said. Theirs is a powerful dissent. Their Honours laid emphasis on the importance of considering voluntariness in the context of the system of conduct in issue.

20. "Conduct can be unconscionable even where the innocent party is a willing participant; the question is *how that willingness or intention was produced*." [157] (The italics appear in the original.) So it was that their Honours thought it necessary to go further and deeper than the majority.

21. I summarise their Honours' reasoning thus. An innocent party may make an independent or rational judgment about an advantage in an otherwise bad bargain. But an advantage and the innocent party's capacity to identify it and make a rational choice cannot transmute what is, in all the circumstances, an exploitative arrangement. The existence of that advantage does not resolve from liability the stronger party who unconscientiously takes advantage of the weaker. See [157].

22. In spite of some customers' expressing positive views about the services Kobelt provided, Nettle & Gordon JJ stated not without passion, "…it is not paternalistic to assess the vulnerability of [his] customers and whether that vulnerability was exploited. It is not paternalistic to take into account that the view of a vulnerable party of a transaction will be shaped by context and circumstance. Equally, it is not paternalistic to look at the transaction and the position of the parties objectively. It is to do no more than engage with the criteria of unconscionability." [160] This was not just a rejection of the view Wigney J adopted as a member of the Full Court. It is, with respect, a rejection of and an answer to the view expressed by Kiefel CJ & Bell J in [78] as set out in par 13 above.

23. That this is so is reinforced by what Nettle & Gordon JJ added at [161]: "Moreover, so to conclude does not ignore that there are perceived to be cultural benefits of book-up generally, in that it can, in some circumstances, address 'boom and bust' expenditure and 'demand sharing' obligations. Because the focus of s 12CB(1) is on the conduct of the supplier of financial services, those cultural

benefits, even if they were being addressed by Mr Kobelt's system, do not relieve a finding of unconscionability with respect to his particular system. Instead, s 12CB(1) requires the supplier to set up a system, a book-up system, that is not unconscionable. The contention that [his] system is 'better than nothing' is not good enough. [His] system could, and should, have been better. There were alternative ways to access those benefits without exploitation. Voluntariness of entry into the arrangements, and the perceived advantages of the system, do not prevent Mr Kobelt's conduct from being unconscionable."

24. Their Honours' discussion of the evidence as to the book-up system, vulnerability, taking advantage, sale of second-hand cars, withdrawal conduct, book-down, record-keeping, fees and charges of the book-up system, the tying conduct and the availability of alternatives which could work and work well makes a compelling case for contravention. See [165]-[229].

25. In the relationship, Kobelt held all the power. His customers were vulnerable. They could not protect their own interests. Kobelt had a near-monopoly when it came to providing credit. The only terms on which he did so was book-up. And he was inflexible in relation to the customers' having to provide their key card and PIN. Unequal bargaining power does not on its own make out unconscionability. It supplies the context in which one assesses the factors. See [241]-[244].

26. So it was that Nettle & Gordon JJ concluded, "there can be no doubt that the Anangu were at a material, relevant disadvantage to Mr Kobelt and that [he] took advantage of them by stipulating for the conditions he did notwithstanding that other, less onerous requirements would have been adequate to protect his legitimate interests." [264] They held his system of conduct was unconscionable contrary to s 12CB(1).

The *manner* in which the credit system was offered

27. Edelman J agreed with the conclusions and orders of Nettle & Gordon JJ. [268] His Honour went to the evidence of a number of specific customers at [297]-[301] to make good the proposition that Kobelt's system was unconscionable. "What was unconscionable was not the mere fact that Book-up was offered, and voluntarily accepted, but the *manner* in which the system of credit was offered and administered. The manner of offer, and the process of administration, of the system of credit underlie many of the non-exhaustive factors enunciated in s 12CC(1)…": [302] (The italics appear in the original.)

28. In support, his Honour identified 7 factors [303]-[309] as being the most relevant. (1) The extreme difference in bargaining position between the customers and Kobelt (s 12CC(1)(a)). (2) The conditions imposed by Kobelt were not reasonably necessary for the protection of his business interests (s 12CC(1)(b)). (3) Basic understanding of the credit transaction was impossible because the interest rates were concealed within the price differential for cars purchased on credit as against cash, so that, even with high levels of literacy and numeracy, effective interest rates could not be calculated. Customers had no access to records of their debts to understand the ongoing system of credit, and even those records that were kept were rudimentary (s 12 CC(1)(c)). (4) The

effective rates of interest, potentially up to 43% for a car sold for $4,000 with repayments taken over 12 months were, as White J said, 'very expensive', far above market rates for unsecured lending (ss 12CC(1)(e), 12CC(1)(J)(ii)). (5) Mr Kobelt discriminated between his customers (s 12CC(1)(f)). The book-up system was the only form of credit offered to Aboriginal customers, although other forms of credit were offered to non-Aboriginal customers. No other form of credit could be negotiated by Aboriginal customers (s 12CC(1)(j)(i)). (6) The undisclosed risks of supplying Kobelt with the customer's bank card and PIN included the possibility of unauthorised withdrawals, including withdrawals with a lack of good faith such as the time when he withdrew $56,944 from his customers' accounts knowing he had no authority to make withdrawals of those amounts (ss 12CC(i)(i), 12CC(1)(j)(iv)). (7) To a significant degree the system of credit had the effect of tying Kobelt's customers to make purchases from him (s 12CC(1)(b)), which purchases were subject to his discretion. He restricted the goods which the customers could purchase and the amount of money they could withdraw from funds not used to discharge their debts to him.

29. Accepting an oral submission made by the Solicitor-General, appearing for ASIC, that 'the system of credit adopted by Mr Kobelt is one that would be unacceptable in mainstream Australian society', a submission that his Honour thought was understated, Edelman J concluded: "It is made less acceptable, not more acceptable, because it was the *only* form of credit offered, and thus accepted, in remote communities of highly vulnerable persons in need of credit." [313] (The italics appear in the original.)

Conclusion

30. Of the 11 judges who heard the matter, 7 decided that the system of credit was not unconscionable. Four of them decided that it was unconscionable. One of the 4 was the primary judge. The other 3 were High Court justices. In each judgment, in substance, the judge or judges approached the matter as though he, she or they were hearing and determining the matter as one of fact and law.

31. *ASIC v Kobelt* illustrates that so far as the outcome of a hearing is concerned, a thorough grasp of the evidence and the way in which the evidence is characterised are at least as important on appeal as they are at trial.

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