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NEWS

Important lesson for borrowers

Are funds under a loan agreement for an approved purpose held on trust for the lender and is their use for another purpose a breach of trust? Here, partner Selina Nutley discusses a recent Supreme Court of Victoria decision which is an important lesson for all borrowers under loan agreements for specific purposes in dealing with the funds advanced.

KEY TAKEAWAYS

- An advance under a loan agreement for a specified purpose may be considered to be made on trust and can only be applied for the approved purpose.
- If the purpose cannot be achieved, the funds should be returned to the lender unless there is a subsequent arrangement made.
- Transmission of those funds to third parties if there is found to be a trust will be a breach. Third parties who knowingly accept such funds may be liable to pay equitable compensation to the lender.
- When lending funds for a specific purpose, lenders should ensure the purpose is clear and limited in the relevant facility documents to ensure protection of the funds.

FACTS

The case centred around the proposed development of properties located in Toorak.

The lender, Jieyun International Investments (lender), advanced $8 million pursuant to a loan deed to Toorak Developments (borrower). Under the deed, the funds were advanced for the 'approved purpose' to—

- purchase the properties, and
- pay for development and construction expenses.

As a result of issues raised regarding delays to settlement and other matters surrounding the broader arrangements, the lender requested the final advance be returned pending settlement. They ultimately requested the entire funds advanced be repaid when the relationship broke down further.

When it became apparent the funds would not be immediately returned, the lender issued proceedings claiming the funds advanced were held on trust to be applied for the specified purpose and there had been a breach of trust.

Following the proceedings being issued, and despite a freezing order, large sums were transferred out of the borrower's account to related entities and individuals for supposedly outstanding invoices.

These invoices reflected events which the lender attended at the invitation of the borrower but were held by related entities to the borrower. In any event, they were not related to the approved purpose under the loan.

WHAT DID THE COURT SAY?

The Court said the advances made to the borrower were made on trust, only to be applied for the approved purpose under the loan deed, and to be returned if settlement of the Toorak properties did not proceed.

As a result, the failure to transfer the advanced funds back to the lender and the subsequent transfers to other parties for other than the approved purpose was a breach of trust.

The payments to the other entities were also found to be dishonest and fraudulent breaches of trust because the parties knew the invoices issued were not legitimate expenses. The director of the borrower was also found personally to have assisted in the dishonest and fraudulent breaches due to his knowledge of the essential facts.

The borrower was ordered to pay the loan funds back to the lender as a debt or equitable compensation. The other entities and individuals which also received payment from the funds advanced were ordered to repay the monies by way of equitable compensation.

IMPORTANT LESSON FOR BORROWERS

This is an important lesson for all borrowers under loan agreements for specific purposes in dealing with the funds advanced. Lenders should ensure when lending funds for a specific purpose that the purpose is clear and limited in the relevant facility documents to ensure protection of the funds.

Authors

SELINA NUTLEY

Partner