

PART V – UNDUE INFLUENCE

I INTRODUCTION

A Definition

Undue influence is an equitable doctrine that operates where a party is induced to enter into a contract because of abuse by another of their position of dominance. When a party acts as a result of being unduly influenced, it cannot be said that they have acted freely in choosing to contract with the other.

Undue influence consists of the donee's will being subjected to that of the dominant party; it is

the improper exercise of an ascendancy or domination ... affecting the will or freedom of judgment [of the donee] (Dixon CJ in *Johnson v Buttress*).

The doctrine is purely defensive; no damages are available, though the influenced party will be excused from performance. Though 'pecuniary rescission' may also be possible in some cases, the right to rescind is the primary remedy granted by a court of equity to an unduly influenced party.

Undue influence may be distinguished from duress and unconscionable dealing by the degree of volition with which the weaker party acts in entering into the contract:

- Duress: party does not want to enter into the contract, but is coerced into doing so by the application of illegitimate pressure (lowest degree of volition);
- Undue influence: party wants to enter into the contract, but such want is the product of their will being overborne and unduly influenced by the other party; and
- Unconscionable dealing: party acts with impaired judgment in choosing to enter into the contract (highest degree of volition)

B Elements

In order for a party to successfully create a right to rescind for undue influence, they must establish the presence of the following elements:

- 1 *Abuse of a dominant position* (by the other party)
- 2 *Overborne will* (by that party)
 - (a) May be presumed where there is an *antecedent relation* between the parties
- 3 *Causation* (of entry into the contract by that party's overborne will)

II CREATION OF THE RIGHT TO RESCIND

A Categories of Case

There exist two principle classes of undue influence: that actually proved in fact, and those presumed on the basis of either a recognised relationship or the existence of an antecedent relationship of special trust and confidence (per Dixon J in *Johnson v Buttress*):

1 *Actual undue influence*

- Here, the party (usually the promisee) was actually unduly influenced by the 'improper exercise of an ascendancy or domination' over the other party so as to be acting without independent will or freedom of judgment (Dixon J in *Johnson v Buttress*)
- Onus of proof is on the party asserting undue influence
- An antecedent relationship is unnecessary

2 *Presumed undue influence*

- 2A) Recognised categories of relationship
- 2B) Antecedent relationship of special trust and confidence

B *Actual Undue Influence*

In determining whether a person stands in a position of undue influence over a donee, courts will examine factors including (but not limited to): the intelligence and literacy of the donee, their previous business experience, and their 'equipment and character' (*Johnson v Buttress*).

If a presumption of special influence is capable of being drawn from the facts, the party seeking to uphold the transaction must then prove that the donee was not induced to authorise the transfer by the other party's abuse of their position. The transaction must have been 'the result of the free exercise of the donor's independent will' (*Johnson v Buttress*).

Johnson v Buttress:

Facts

- Buttress sought to set aside an agreement reached between his late father and Johnson to transfer land as a gift
- Buttress' father and Mrs Johnson, the daughter of one of his sisters, had known one another for more than 20 years; Johnson assisted Buttress Snr during his wife's illness
- Buttress Snr maintained a relationship with her
- After the death of Mrs Buttress, Mr Buttress became quite dependent upon Mrs Johnson, who acted as a kind of 'substitute wife'
- Before his death, Buttress Snr made a new will in her favour, to whom property is presently transferred
- Buttress Snr was of low intelligence, had little business experience, and believed the title transfer was not irrevocable
- Trial judge: transfer could not stand and must be set aside

Issue

- Was Buttress subject to an undue influence by Johnson when executing the transfer?

Reasoning

- Dixon CJ:
 - From the evidence, it does not follow that Buttress Snr did not understand the consequences of the transfer
 - If a presumption of undue influence does not exist, the plaintiff has not established proof to the required degree that 'the transfer was procured by the improper exercise or an *actual* ascendancy or domination gained over the donee' (emphasis added)
 - The justification for the doctrine of undue influence is prevention of 'an unconscientious use of any special capacity or opportunity' by the alienator
 - The alienor (person who parts with property) must show that the transaction was so affected by the actual authority or influence of the other party as to render their actions unfree (class 1)
 - Certain defined circumstances are recognised as giving rise to an obligation in the influential party not to take advantage of a donor to procure a substantial benefit (class 2A)
 - The class of relationships capable of giving rise to an undue influence is open
 - Where there is a presumption of a relationship of influence, the influential party must show that any transaction entitling him to a substantial benefit 'cannot be ascribed to the inequality between them'
 - An inference is drawn that the influential party has 'peculiar knowledge' of the circumstances giving rise to a potential undue influence, and that he is aware that the benefit may be induced by an abuse of his authority
 - Policy considerations justify a presumption against undue influence in such circumstances
 - Factors that legitimise a transaction for purchase are 'somewhat different' to those that apply to gifts (135-6) – adequacy of consideration is considered

Decision

- On the facts, to raise a presumption of undue influence, P needs to establish that Mrs Johnson stood in a special relation of influence over Buttress
- The doctrine stands upon a general principle and should not be too narrowly confined by exact specification of circumstances and factual features
- The standard of intelligence, the illiteracy, the equipment and character of Buttress are relevant factors in determining whether Mrs Johnson was in a special position; they are not separate elements, but factual evidence in support of a presumption of influence
- An antecedent relation of influence existed (class 2B)
- A presumption of undue influence thus exists, such as to reverse the onus of proof to Mrs Johnson
 - Mrs Johnson bears the burden of justifying the transfer
 - She needed to show that the transaction 'was the result of the free exercise of the donor's independent will'
 - Without this presumption, B could not have established *actual* undue influence
- Because Mrs Johnson failed to adduce evidence on this point, the presumption is validated and the appeal dismissed

B *Recognised Relationships of Influence*

Undue influence may be presumed to have caused the party's entry into the contract in certain circumstances. One such circumstance is where the parties stand in a recognised relationship of influence.

- Certain classes of relationship are recognised relationships of influence

- Examples:
 - Professional: solicitor-client, doctor/patient, guardian/ward
 - Legal: parent/child, *in loco parentis*/child, trustee/beneficiary
 - Religious: guru/disciple, fiancé/fiancée
- The following categories are specifically not (prima facie, without a special relationship of trust and confidence under 2B) recognised:
 - Professional: principal/agent
 - Financial: adviser/client, banker/customer
 - Familial: husband/wife

If it is established that the relationship falls into one of the recognised classes, the onus shifts to the dominant party to show that the transaction was entered into freely. The dominant party must prove that the transaction 'was the result of the free exercise of the donor's independent will' (*Johnson v Buttress* per Dixon J).

C Sui Generis Antecedent Relationships

Even though the relationship may not be of a recognised kind, it is still possible that an inference of undue influence may be drawn. Where a relationship is *sui generis*, meaning that it is 'of its own kind' (unique), such a novel category of relationship may still import a presumption of undue influence.

- The relationship must have existed from a point prior to the formation of the contract
- Such a relationship is said to arise when the party alleged to have been unduly influenced reposes special trust and confidence in the dominant party
- If the party asserting undue influence can prove that the relationship is one of 'special trust and confidence', the onus of proof is reversed
 - The dominant party must now show adduce evidence to disprove the presumption that their undue influence was operative

If this is established by the party asserting undue influence, an inference thereof will be drawn.

- Eg, in *Johnson v Buttress*, Buttress placed special trust and confidence in Mrs Johnson, who cared for him extensively and upon whom he was reliant; Mrs Johnson failed to adduce evidence rebutting the presumption of undue influence to be drawn from these circumstances

In order for a dominant party to disprove the assumption that they unduly influenced the other party, they must show that the transaction 'was the result of the free exercise of the donor's independent will' (*Johnson v Buttress* per Dixon J).

Typically, this will be achieved by reference to the following factors:

- The other party was not acting on the basis of the dominant party's influence, but rather on the basis of independent advice; or
- The other party at any rate acted freely and voluntarily; or
 - Eg, because the dominant party fully disclosed all the relevant circumstances and interests before transacting with the other party; and
 - The other party fully comprehended the significance of their conduct and still deliberately entered into the contract
- The transaction was not caused by undue influence; or
- The consideration provided was fair and there was no substantive unfairness to the other party as a result of the transaction

If this presumption of undue influence is drawn, the dominant party *must* adduce evidence rebutting it. It is not enough to simply point to a lack of evidence that undue influence was *actually* present (*Johnson v Buttress*).

III THIRD PARTY IMPROPRIETY

A Definition

Third party impropriety is the result of a dominant party exerting undue influence upon another, who subsequently enters into a transaction with a third party.

The prototypical situation involves a guarantor (typically a spouse) who claims to have been induced to give a surety over her husband's business activities due to the undue influence of her husband. The guarantor will attempt to assert undue influence against the bank to avoid forgoing the security provided in respect of the guarantee.

Issue: when will the other party (ie, the spouse) be excused (ie, granted a right to rescind) from a contract of guarantee with the bank when they have been unduly influenced by a third party (ie, the husband)?

B Prima Facie Position

If the undue influence is caused by a third party to the transaction (such as a husband or brother-in-law) then it is not *normally* possible to resile on the transaction with the third party bank or investor.

However, there are several exceptions to this initial position:

- *Notice*
If the bank has actual notice of the undue influence (or likelihood thereof), then it would be unconscionable to enforce the agreement against the spouse;
- *Agency*
If the husband acts as agent for the bank (very rare), then the transaction may be set aside;
- *Direct undue influence*
If the bank itself unduly influences the spouse to enter into the guarantee, then a right to rescind for undue influence may arise under a recognised relationship of influence;
- *Special disability*
If the bank has taken advantage of the spouse's special disability in accepting the benefit of the guarantee, the transaction may be set aside on the basis of unconscionable dealing (*Amadio*)

If the spouse (guarantor) is able to establish the applicability of one of these exceptions, it will be possible to rescind the agreement of guarantee with the bank on the basis of the undue influence.

1 The English approach

In England, actual notice of undue influence has been expanded to include constructive notice. Constructive notice is said to have been given to a creditor by their mere awareness that the guarantor is a non-commercial party.

A creditor also has notice of the possibility of undue influence if:

- The transaction is not to the 'wife's' financial advantage; and
- There is a substantial risk that the husband has committed a legal or equitable wrong.

Where the creditor (eg, a bank) knows of these factors, they will be taken to have constructive notice of any impropriety by the borrower and a subsequent right by the wife to set aside the transaction.

Constructive notice can be overcome by the creditor if they take steps to ensure that the wife's guarantee is freely provided (*Barclay's Bank plc v O'Brien*). Usually, this will involve ensuring that the wife obtains independent legal advice.

If no steps are taken by the creditor, the wife can rescind the guarantee if her husband has engaged in a legal or equitable wrong (ie, a presumed undue influence, taking into account the reversal of the onus of proof).

UK courts have rejected the 'special equity' principle of *Yerke v Jones*. However, their conception of 'notice' is considerably broader: unlike the Australian approach, UK courts do not confine constructive notice to married women. Other forms of 'emotional relationships' between cohabiters are recognised, providing an alternative basis for the protection of potentially vulnerable groups (*Barclay's Bank* per Lord Brown-Wilkinson).

C Special Equity

Australian courts adopt a narrower approach to the determination of notice given to the bank. There are a number of bases on which a guarantee can be set aside, the broadest of which is recognition of a wife's equity (*Yerke v Jones*).

If a wife is subjected to actual undue influence, then any surety she provides will be set aside if there is actual coercion by the husband (even if the wife understood the transaction). If there is no undue influence, but the wife does not comprehend the transaction, her surety will be set aside where it was procured by the husband (*Yerke v Jones*).

Yerke v Jones:

Facts

- The Yerkes sold their pottery farm to Mr Jones
- Payment was secured by a guarantee given by Mrs Jones

Issue

- Is Mrs Jones able to void the guarantee on the basis of undue influence by Mr Jones which induced her to secure payment?

Reasoning

- Dixon J: a 'special equity' exists for wives who sign guarantees to prevent their enforcement by the bank in circumstances of undue influence
- *Actual undue influence*
 - Where the husband exerts 'undue influence, affirmatively established' the guarantee may only be enforced if the wife receives, either:
 - 'independent advice; or
 - relief from the ascendancy of her husband over her judgment'
 - If independent advice or relief is not given, the contract is voidable
 - However, it is difficult to establish *actual* undue influence, so it will be rare that this is a successful basis on which to void the contract of guarantee
- *Misapprehension caused by impropriety*
 - Where the wife 'does not understand the effect of the document or nature of the transaction' the guarantee may only be enforced if the creditor:
 - takes steps to inform her; and
 - reasonably supposes that she has an adequate comprehension of her obligations and the effect of the transaction
 - Even if there is no actual undue influence, the contract may still be voidable unless the lender takes steps to ensure the wife's understanding
 - Thus, where the guarantee is signed under a misapprehension caused by 'some impropriety', it will be voidable

Decision

- Mrs Jones had had the transaction explained to her by an independent third party and there was no actual undue influence, so the contract of guarantee is not voidable

The *Yerke v Jones* 'special equity' is still a valid basis on which to grant rescission of the guarantee. *Garcia*, noting that *Yerke* is merely an application of broader equitable principles, extends the ambit of the wives' equity from husband/wife to relationships of long-term and publicly declared relationships of trust and confidence short of marriage.

As a result, a creditor (such as a bank) will be prevented from enforcing guarantees induced by third party impropriety – even in the absence of actual undue influence – in circumstances where:

- *Misunderstanding*
The guarantor did not understand the 'purport and effect of the transaction'; and
- *Volunteer*
The transaction was voluntary; or
The guarantor 'obtained no gain' from the loan; and
- *Notice*
The creditor has actual notice that the guarantor reposed trust and confidence in the borrower in matters of business; and
- *No reasonable steps*
Despite this knowledge, the bank made no effort to explain the agreement to the guarantor or ensure that a stranger had done so

(*Garcia*).

Garcia v National Australia Bank Ltd (1998) HCA:Facts

- Mrs G, a physiotherapist, and her husband executed a mortgage over their jointly-owned home in favour of NAB
- The mortgage was given in security of a business loan made to a company controlled by G's husband, which was subsequently repaid, along with another personal loan
- However, the mortgage was not discharged
- Mr G pressured his wife to sign the guarantee; the trial judge, Young J, found that:
 - Her signature appeared to be induced by Mr G's criticism of her commercial inexperience and as an attempt to save their failing marriage
 - Mrs G was told that the loan was 'risk proof' because it would enable more substantial dealings in gold by his company
 - Mrs G understood her signature to be a mere guarantee of Citizen Gold's overdraft, even though she was listed as a director of the company (which was actually wholly controlled by Mr G)
 - Mrs G did not realise that the guarantee was secured by the original mortgage
 - The guarantee was signed in the presence of the bank manager
- In 1989, Mrs G and her husband separated, of which she informed NAB, requesting that Citizens Gold's bank account be kept within certain limits
- Subsequently, Mr G's company was wound up; the Family court ordered the husband to transfer his interest in their property to Mrs G
- In June 1990, Mrs G commenced proceedings, alleging the mortgage and the guarantees she had given in respect of Citizens Gold were invalid on the bases of *Amadio*, *Yerkey*, and undue influence
- In August 1990 the bank demanded payment; they cross-claimed in the action commenced by Mrs G for possession of the mortgaged property

Issue

- Did Mrs G sign the guarantee under undue influence by her husband?

Reasoning

- There was no actual undue influence; the impropriety consists in Mr G telling his wife that there was no risk and inducing her to enter into the guarantee agreement by telling her she was a 'fool' in financial matters, leading Mrs G to misunderstand the nature and extent of the guarantee
- Mrs G, the appellant, argues that *Yerke* applies:
 - Mrs G is a volunteer (only a nominal director of the company)
 - The lender took no steps to explain the transaction
 - The lender knows that Mrs G is the borrower's wife
 - Mrs G was, in fact, mistaken about the meaning of the loan
- Approach of the majority:
 - *Yerke* still good law; a special equity does exist for wives
 - The *Yerke* principle may *also* be applied to quasi-marriages
 - Dicta: it may apply 'to long term and publicly declared relationships short of marriage between members of the same or of opposite sex'
 - *Yerke* is only an application of wider equitable principles; relationships of trust and confidence, such as marriage, indicate that undue influence may be actionable
 - Therefore, all relationships of trust and confidence (ie, relationships presumed to import influence) may fall within the ambit of *Yerke* – the

- same criteria apply [???
 - Special equity forms the basis of the majority's reasoning
 - If there is actual undue influence, explaining the effect of the document to the surety will not protect the creditor:
 - 'Nothing but independent advice or relief from the ascendancy of her husband over her judgment and will would suffice' (*Yerke v Jones* per Dixon J)
 - The bank cannot enforce the debt where:
 - In fact the surety did not understand the 'purport and effect of the transaction';
 - The transaction was voluntary (the guarantor 'obtained no gain' from the loan);
 - The lender 'is to be taken to have understood that' the woman is a wife and therefore should assume that she reposes trust and confidence in her husband in matters of business (so she may not be fully aware of the effect of the transaction); and
 - Despite this knowledge, the bank does not take steps to explain the transaction to the wife or ensure that a stranger does
 - In such cases, it would be unconscionable for the bank to enforce the guarantee
 - In the absence of actual undue influence, '[i]f the creditor takes adequate steps to inform [the wife] and reasonably supposes that she has an adequate comprehension of [the transaction]' then the fact that she does fail to understand the transaction will not be enough to set aside the guarantee
- Kirby J: rejects *Yerkey v Jones*
 - The principle is based on a historical anachronism, and embodies underlying stereotypes which are discriminatory and inaccurate
 - The principle is also economically unsound
 - Where a person has entered into an obligation to stand as surety and the credit provider knows, or ought to know, that there is a relationship involving emotional dependence on the part of the surety towards the debtor:
 - The surety obligation will be valid and enforceable unless the suretyship was procured by the undue influence, misrepresentation or some other legal wrong of the principal debtor;
 - If there has been some form of legal wrong by the principal debtor, unless the credit provider has taken reasonable steps to satisfy itself that the surety entered into the obligation freely and with knowledge of the true facts of the guarantee, the credit provider will be unable to enforce the surety obligation because it will be fixed with notice of the surety's right to set aside the transaction;
 - Unless there are special exceptional circumstances or the risks are large, a credit provider will have taken such reasonable steps to avoid being fixed with constructive notice if it warns the surety (at a meeting not attended by the principal debtor):
 - Of the amount of the surety's potential liability;
 - Of the risks involved to the surety's own interests; and
 - To obtain independent legal advice
 - '[I]f the "innocent" party knew or ought to have known of the impropriety or had reason to believe it might occur, then it will be bound by an equity

raised by the acts of the third party.'

- Kirby J sees this approach as preferable to that of the majority
 - It is cast in non-discriminatory terms
 - Emotional dependence is the real cause of vulnerability and unconscionability
 - Recognises the greater powers and resources of credit providers

Decision

- Like *Yerke*, there was no actual undue influence here
- Even so, Mrs Garcia was: mistaken about the purport of the transaction, a volunteer (even though a shareholder in the business, she had no financial interest in the fortunes of the company), known to the bank to be the wife of the borrower, and the transaction was not explained to her by the bank
 - Cf Kirby J (dissenting): Mrs Garcia obtained a benefit from the loan
- The guarantee is thus void for undue influence

Since *Garcia's* expansion of the classes of relationships to which *Yerke's* 'special equity' principle may apply, there has been some suggestion that the requisite extent of trust and confidence is still relatively high (*Kranz*). If the relationship is not one from which it may readily be presumed that trust and confidence have been reposed in the borrower (ie, a recognised category of presumed undue influence), the bank must have actual knowledge that this was in fact reposed (as in the case of husband/wife; *Garcia* majority).

Note that the ambit of *Garcia* is still narrower than the 'constructive notice' adopted in the UK.

Kranz:

Facts

- Here, the relationship between the guarantor and the borrower is familial
 - The guarantor is the brother-in-law of the borrower
- The borrower misleads the guarantor in respect of the risk of the loan
- The guarantor argues that a relationship of trust and confidence existed between them, so *Garcia* should apply to void the guarantee

Issue

- Can the guarantor rescind the agreement on the basis of the widening of *Yerke* to all relationships of trust and confidence in *Garcia*?

Reasoning

- No, brothers-in-law is not a relationship of the requisite degree of trust and confidence
- Such relationships are indeed no longer confined to husbands and wives – only 'intimate relationships' (trial judge) – but on appeal, no: no presumption of trust and confidence may here be drawn
- Even if the relationship was of the requisite degree of trust and confidence, does the bank *actually* know of this aspect of the relationship? (This is the important question)
 - No, the bank does not know
 - The bank only knows the familial status
 - There is nothing that would indicate actual knowledge the guarantor reposing trust and confidence in the borrower

Decision

- No relationship of trust and confidence exists, and at any rate the bank had no knowledge of any factors which would support drawing this inference, so *Garcia* does not apply and the guarantor is bound to secure the loan to the bank

This decision may be contrasted to the English approach: as long as the bank knows that the relationship between guarantor and borrow is not of a commercial nature, they will bear the cost of any impropriety. If English law had been applied here, Mr Kranz would have been able to rescind the contract because constructive notice would be held to have been given.

Note that leave to appeal *Kranz* was denied equivocally: future application of the English approach may not have been entirely ruled out. The basis for rejecting the leave to appeal was that Mr Kranz, the guarantor, had experience in business; this was said to make the case 'not a good vehicle' for exploring (and possibly reconciling) the discrepancy between the English and Australian positions.

D *The Extent of 'Trust and Confidence'*

Several pronouncements have been made of the classes of relationships to which the label 'reposing a special trust and confidence' will apply:

- *Yerke*
 - Applies only to the wife of the (male) borrower
- *Garcia*
 - Majority (*obiter dicta*):
 - *Yerke* is only an instance of wider equitable principles; relationships of trust and confidence generally, such as marriage, indicate that the guarantor may not have had the transaction fully explained to them, since they repose trust and confidence in the borrower in matters of business
 - Therefore, the *Yerke* principle also applies 'to long term and publicly declared relationships short of marriage between members of the same or of opposite sex'
 - Kirby J (dissenting):
 - Should not be limited to married women (discriminatory and outdated)
 - 'Emotional dependence' is the relevant criteria by reference to which the relevant classes of relationships should be determined
- *Kranz*
 - Brothers-in-law does not involve sufficient 'trust and confidence'
 - 'Trust and confidence' extends beyond matrimonial relationships
 - It even extends beyond 'intimate relationships'

It thus appears that, where the relationship between guarantor and borrower is 'long term and publicly declared' such as to embody a significant degree of 'trust and confidence' (as, perhaps, evidenced by 'emotional dependence'), and in the absence of actual undue influence, the creditor will be unable to enforce a guarantee against a guarantor who is mistaken about 'the purport and effect of the transaction' if they fail to take steps to ensure that the guarantor has had the transaction explained by an independent third party and the guarantor obtains no benefit from the transaction (*Garcia; Kranz*).